WORK AND WELFARE IN EUROPE

Labour Market Flexibility and Pension Reforms

Flexible Today, Secure Tomorrow?

Edited by Karl Hinrichs and Matteo Jessoula

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Work and Welfare in Europe

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Edited by

Karl Hinrichs
University of Bremen, Germany

and

Matteo Jessoula
University of Milan, Italy

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This volume is dedicated to Elena, Fil, Leo, Riccardo, Giulia and the young people of Europe, with the hope they will be secure and happy pensioners tomorrow.

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Series Preface

Since the late 1970s, both labour markets and welfare regimes have been under intense economic pressure and have been challenged by profound changes in social and demographic structures, as well as in social norms. The work–welfare relationship has always been key to the modern state but has undergone substantial change over recent decades. On the one hand, approaches to social provision have become more explicit in recognising the importance of the relationship to employment, such that it is possible to suggest that social policies have become 'employment-led'. On the other hand, it is possible to argue that there is a profound 'disconnect' between labour markets and welfare systems, and that this partly explains the socio-economic problems that some countries are facing, in terms of high unemployment and low activity rates in particular. Changes in labour markets, which have often tended to more 'flexibilization', often pose challenges to the protective goals of social policies. Thus, the financial and programmatic configurations of social policies are often held to have impeded job creation. These arguments over the nature and effects of the relationships between labour markets and welfare systems have been, and are, intense. They need to be further analysed.

These relationships between labour markets and welfare systems constitute the backdrop to this series, which takes as its starting point the tensions that now characterize this centrally important relationship between 'work and welfare'. Among these tensions, one could mention: the tension between firms' demands for more labour market flexibility and citizens' need for economic security; the tensions between increased participation in paid work and the importance of family life, the greater fluidity in family relationships and the greater flexibility in labour markets; the friction between the quantity and quality of the jobs to be created, between job creation and maintaining or improving the quality of employment; and finally, the conflicts raised by the need to adapt (industrial) social protection systems to new labour market structures.

This book series has been created within RECWOWE, a European network of excellence, created within the 6th Framework Programme of the European Commission (FP6). The full title of the network's activities is 'Reconciling Work and Welfare in Europe'. Such a reconciliation is an important political objective for most EU member states. In order to meet it, we need to improve our understanding of the relationship between work and welfare in very diverse national settings across member states. The RECWOWE series publishes books that analyse work and welfare, and which pay special attention to the tensions that now characterize this relationship. Beyond the four main tensions mentioned above, the series is open to any other analysis of the relationship between work and welfare. It is committed to publishing work that focuses on the gender dimension of this relationship, on the impact of the relationship on migrants, and, on its multi-level – European, national and local institutional – dimensions.

Denis Bouget, University of Nantes
Jochen Clasen, University of Edinburgh
Ana M. Guillén, University of Oviedo
Jane Lewis, London School of Economics, UK
Bruno Palier, Sciences-po Paris

Preface and Acknowledgements

This book is part of the research project, 'Flexible Today, Secure Tomorrow', which has been developed within the RECWOWE strand, focusing on 'Tensions between Flexibility and Security' and coordinated by Giuliano Bonoli and Jochen Clasen. After its launch at the RECWOWE General Conference in Warsaw in 2007, the project was developed through subsequent workshops – in Oslo 2008, then in Bremen and Milan in early 2010 – where preliminary versions of the country chapters were discussed thoroughly. The research is thus primarily the result of the commitment of the various contributors over a long time span. We extend our sincere thanks to them, especially to Silja Häusermann and Hanna Schwander for joining the research group at a later stage. A mid-term review of the volume chapters was carried out by Camila Arza, and we are extremely grateful for her comprehensive and very useful suggestions and remarks. We would also like to thank Denis Bouget and Bruno Palier, as well as Maurizio Ferrera, John Myles, Philippe Pochet, Anne Marie Guillemard, Zofia Czepulis Rutkowska and Sini Laitinen-Kuikka for their valuable advice. Finally, the book could have not been completed without the expert assistance of Furio Stamati and Igor Guardiancich in the final editing of the book, or without the careful language editing of Karen Anderson.

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Contributors

Karen M. Anderson is Associate Professor of Political Science and researcher at the Institute for Management Research at Radboud University, Nijmegen. She received her PhD in Political Science from the University of Washington. Her research focuses on the comparative political economy of the welfare state, particularly the role of unions and social democratic parties in welfare state restructuring processes. Her work has appeared in *Comparative Political Studies*, *Comparative Politics*, *West European Politics*, *Zeitschrift für Sozialreform*, *Canadian Journal of Sociology* and the *Journal of Public Policy*. She is the editor (with Ellen M. Immergut and Isabelle Schulze) of the *Handbook of West European Pension Politics*.

Igor Guardiancich is Research Assistant at the Academic Careers Observatory, Max Weber Programme at the European University Institute, Florence. His research interests are centred on welfare state policies and reforms. He has published several articles in international peer-reviewed journals such as *West European Politics*, *East European Politics and Societies* and *International Social Security Review*. His book, *Pension Reforms in Central, Eastern and Southeastern Europe: From Post-Socialist Transition to the Global Financial Crisis*, will be published in 2012. From January 2012, he will be a visiting fellow at the University of Michigan, Ann Arbor.

Silja Häusermann is Assistant Professor at the University of Konstanz. She is the author of *The Politics of Welfare Reform in Continental Europe: Modernization in Hard Times* (2010) and has published on welfare state politics, Europeanization and party system change in journals such as the *European Journal of Political Research*, *Journal of European Social Policy* and *Journal of European Public Policy* and *Socio-Economic Review*.

Karl Hinrichs is Senior Research Associate at Bremen University's Centre for Social Policy Research and Professor of Political Science at Humboldt University in Berlin. In 1989–1990 he was John F. Kennedy Fellow at Harvard University (Center for European Studies) and guest professor at the Norwegian University of Science and Technology in Trondheim in 2003. His research focus is on comparative welfare state analysis, the development of social policy in Germany and the study of old age security policies and politics in ageing societies.

Matteo Jessoula is Assistant Professor in the Department of Social and Political Studies at the University of Milan. His research focuses on policy developments and political dynamics in the fields of pensions, labour markets and social assistance. His recent publications include *Pension Policy* (in Italian, 2009); '"Selective Flexicurity" in Segmented Labour Markets: The Case of Italian "Mid-Siders"' (with P. Graziano and I. Madama) in *Journal of Social Policy* (2010); 'Italy: "From Bismarckian Pensions to Multi-pillarization under Adverse Conditions"', in B. Ebbinghaus (ed.), *The Varieties of Pension Governance: Pension Privatization in Europe* (2011); '"Eppur si muove(va)...". The Italian Trajectory of Recent Welfare Reforms: From "Rescued by Europe" to Euro-Skepticism' (with P. Graziano), in S. Jacquot, P. Graziano and B. Palier (eds), *The EU and the Domestic Politics of Welfare State Reforms: Europa, Europae* (2011); 'Italy: An Uncompleted Departure from Bismarck' (with T. Alti), in B. Palier (ed.), *A Long Good Bye to Bismarck, The Politics of Welfare Reforms in Continental Europe* (2010).

David Natali is Associate Professor in the Department of Political Science at the University of Bologna, Faculty of Political Science in Forli and Research Director of the European Social Observatory. His work deals with the comparative analysis of social protection reforms across Europe, and on the role of the European Union in the field. He is a member of the OECD Working Party on pension markets. In 2009, he received the SISP Young Researcher prize for the best Italian book of political science, for *Pensions in Europe, European Pensions* (2008). His recent publication is *Europe 2020: Towards a More Social EU*? (co-edited with E. Marlier and R. Van Dam, 2010).

Niels Ploug has been Director of Social Statistics at Statistics Denmark since 2008. For many years he worked at the Danish National Institute for Social Research (SFI); since 1995 as the research director. He has conducted research on the European and Nordic welfare states, and on Danish labour market policies and old age pensions. In the 1990s, he directed a major research programme comparing European welfare states. Between 2000 and 2005, he directed a major research programme on social mobility, social inheritance and the challenges to children with social disadvantages. He trained as an economist at the University of Copenhagen and has been a lecturer there at the Economics department for many years.

Hanna Schwander is a PhD candidate and research assistant at the Centre for Comparative and International Studies (CIS) and the Department for Political Science at the University of Zurich, Switzerland. Her research interests are social policy, labour markets, political parties, and the preferences of labour market insiders and outsiders. In her PhD research, she examines the implications of labour market dualization for party competition and the voting behaviour of insiders and outsiders. More specifically, she investigates the conditions under which parties either mobilize low-skilled insiders or low-skilled outsiders in Western European countries.

1
Labour Market Flexibility and Pension Reforms: What Prospects for Security in Old Age?

Karl Hinrichs and Matteo Jessoula

Introduction

Rarely has the incorporation of two words into an analytical as well as a political concept been as successful as the term *flexicurity*. The word developed as *the* catchword for an array of policies to increase labour market *flexibility* by imposing more risks on workers for the sake of expanded opportunities, while providing (social) *security* through a variety of instruments: robust income protection for the jobless; early activation of the unemployed; active labour market policies; and further measures that restore or maintain employability and prevent people from being trapped in poverty, low-wage jobs or other undesirable situations.[1] This is why *flexicurity* generally has a positive connotation in the public debate, in contrast to the negative associations of *stagflation,* another neologism which emerged during the 1970s.

A large body of research explores whether recent waves of employment policy reform aiming at both flexibility and income security have indeed facilitated and cushioned transitions within the labour market: transitions from part-time to full-time work; from unemployment or training to employment; from precarious to stable employment; or from dependent work to self-employment. This book investigates the *relationship between labour market flexibility and (social) security* by taking a perspective that is different from the one that has dominated the literature thus far, because it extends the focus beyond the working life. Hitherto, both policy reforms and research have mainly dealt with the (more or less) successful combination of flexibility and security arrangements for workers of employable age. The consequences of increased labour market flexibility on economic security after retirement have received much less attention. Therefore, in this book *flexicurity* is researched by acknowledging that two ongoing transformations have altered – and are still altering – the traditional relationship between employment and income security in old age. First, endogenous changes in the labour market, on both the demand and supply side (post-industrialism, entry of women with care obligations), and labour market reforms (de- and re-regulation) have led to more 'atypical' jobs and 'non-standard' employment careers. These employment relationships and life course trajectories deviate from once prevailing patterns of continuous full-time employment until reaching standard retirement age.

Secondly, the prospects for economic security after retirement have been changed substantially by (still ongoing) pension reforms in all EU countries, which will affect 'standard' as well as 'atypical' workers (see next section on 'Three strands of research'). Thus, in this book an explicit *life course perspective on flexicurity* is adopted in order to analyse the interaction between labour market developments, pension reforms and the consequences for income protection of current and, especially, future retirees.[2] The central question pursued in this book is, therefore, whether pension reforms will have disproportionately negative effects on the retirement income of workers with an atypical employment career; or whether pension reforms have been adjusted so as to extend the income security function of pensions systems to atypical workers as well. As labour market flexibility increases, will pension reforms lead to security in old age or not? As the chapters in this book demonstrate, there is growing interest in this issue in national debates as well as concern at the supranational level, as recent efforts to evaluate the impact of spells of non-employment or unemployment on future retirement income show (see Social Protection Committee, 2009; European Commission, 2010a).

Three strands of research

This book builds on the large corpus of literature that has accumulated over the last 15–20 years in political science and sociology concerning social protection and labour market developments. These studies – often comparative by design – have analysed developments and policy reforms in the spheres of social welfare and the labour market, focusing on the distributive effects and the outcomes in terms of individual entitlement, as well as the politics behind the reforms. In particular, three different perspectives for research can be distinguished, which have applied their respective analytical lenses to: (a) pension policy and the reform of old age protection systems; (b) *flexicurity,* which is the institutionalization of flexible and, at the same time, security-providing arrangements for employees; and (c) the emergence of so-called 'new social risks'. The research topic pursued in this book lies at the intersection of these three perspectives and explicitly takes a policy-oriented perspective.

Pension policy

The first strand of literature aims to identify both policy changes and political dynamics in the sphere of old age protection. This policy area is a central element in public debates on developed welfare states for two reasons. First, public spending on pensions makes up the largest item of social expenditure in all European countries (except for Ireland). Secondly, pension systems have been exposed to strong pressures for reform since the mid-1980s. These challenges predominantly stemmed from population ageing and slow economic growth, as well as from ideologically motivated economic and political debates concerning the desirability of shifting from public Pay-As-You-Go pension schemes to privately funded ones (Feldstein, 1986; World Bank, 1994). Early analyses focused on both retrenchment and restructuring of pensions systems in liberal welfare states, like the UK and the United States (Pierson and Weaver 1993; Pierson, 1994).

Comparative research in this area emphasized the varying institutional arrangements for economic protection in old age and stressed that problem pressure, opportunities for reform and the direction of change are strongly contingent on the institutional design of pension systems. In other words, it was argued that pension reform is path dependent (Immergut et al., 2007). In order to highlight the varying constraints on overcoming the institutional *status quo*, several analyses have updated the traditional classification of pension systems – based on the Bismarck-Beveridge dichotomy – and identified different pairs of old age protection systems. Scholars have labelled the contrasting models differently: *social insurance vs. latecomers* (Hinrichs, 2000); *mature vs. latecomers* (Myles and Pierson, 2001); *social insurance vs. multi-pillar* (Bonoli, 2003); or *single pillar vs. multi-pillar* (Jessoula and Ferrera, 2006). To a large extent, the features of the pension systems that are singled out for contrast are related to the varying role of PAYG and funded components within the public-private mix of retirement income.

Building upon modified classifications, several studies have analysed different reform opportunities and trajectories. In countries with multi-pillar systems (Denmark, the Netherlands, Switzerland, the UK and Ireland), reforms have combined retrenchment with expansionary interventions aimed at providing more comprehensive coverage of workers with supplementary pensions. By contrast, in most Continental, Nordic and South European countries – which have traditionally relied on single pillar systems and have been dominated by public earnings-related pension schemes – reforms were first limited to retrenchment and straightforward cost containment measures (Myles and Quadagno, 1997). However, more recent research has shown that institutional, economic and political barriers to reform could be overcome (Jessoula, 2011) and, as a preliminary endpoint to a sequential reform process, privately funded pillars have been strengthened or introduced (Palier and Bonoli, 2007; Hinrichs, 2009; Ebbinghaus, 2011) and they will play a stronger role in the composition of total retirement income. Additionally, in all EU countries, we observe efforts to increase actual retirement age either by positive and negative incentives, or by legal requirements.

Flexicurity and labour market policy

Since the end of the 1990s, a number of studies of labour market policies and social protection systems have contributed to the development of the concept of *flexicurity* (Wilthagen, 1998; Madsen, 1998, 2006; Wilthagen and Tros, 2003). Interestingly, in the beginning, the protagonists of the concept were either Dutch or Danish. The early research came from two countries which, independently of each other, had pursued similar strategies and now widely figure as prototypes of successfully implemented *flexicurity* – although there have been critical voices as well (see for instance van Oorschot and Abrahamson, 2003; Becker and Schwartz, 2005). Despite (or, perhaps, exactly because of) the ambiguity of the concept (Burroni and Keune, 2011), it has gradually gained prominence among a wider circle of scholars and collective actors. For example, the European Commission published in 2007 the Communication, *Towards Common Principles of Flexicurity: More and Better Jobs through Flexibility and Security*, and adopted *flexicurity* as part of the European Employment Strategy (EES) the same year. It is not presumptuous to state that *flexicurity* has now gained a pivotal role in public discourses and in political debates at both the supranational (EU) and the national level (Pirrone, 2008).

The conventional understanding of *flexicurity* points to the interplay between labour market policies and a wider array of policy measures to tackle the negative impact of unemployment. To be more precise, it refers to strategies aimed at combining labour market flexibility with workers' social security. *Flexicurity* thus denotes a set of actions based on three components. The first consists of increasing labour market flexibility through decreased job protection (that is less strict dismissal restrictions) on the one hand, and a greater reliance on non-standard ('atypical') jobs on the other. Fixed-term contracts and part-time jobs are exemplary characteristics of a labour market where standard employment relationships (SER – see below) lose relative or absolute importance. The second component, however, aims to compensate for less *job* security through high(er) levels of *income* security for the unemployed. The promotion of employment and re-employment – through strengthened active labour market policies (ALMP), life-long learning and training programmes to maintain employability – constitutes the third strategic component directed at sustaining employment security.

Related to *flexicurity* is also another concept. The notion of a 'transitional labour market' (Schmid, 2002, 2006) refers to the observation that the threshold between gainful employment and other productive activities is becoming blurred as people increasingly transit between different employment statuses and between gainful employment and labour market inactivity over the life cycle. Unemployment, education, training, unpaid family work and retirement characterize (temporary) positions outside the labour market, whereas gainful employment may be full- or part-time work or self-employment. Transitional labour markets may be defined as institutional arrangements that enable individuals to move freely between different employment relationships in a coordinated way, whilst retaining an adequate level of social protection, allowing them to combine paid and unpaid work.

New social risks

An innovative perspective on *new social risks* has emerged over the last ten years, which partly overlaps with research on flexible labour market arrangements. Works by Esping-Andersen (1999) and Pierson (2001) have partly triggered this development and it has been further elaborated in volumes edited by Armingeon and Bonoli (2006) and Taylor-Gooby (2004). In contrast to *old* social risks – broadly, being sick or disabled, unemployed or old – *new* social risks stem from socio-economic changes that either make traditional social security arrangements ineffective or create gaps in protection that need to be filled by new modes of welfare state intervention. Changes in the spheres of the family and the labour market are colliding with welfare state architectures that have been crafted during the 'Golden Age' (circa 1945–75) in accordance with the structures of industrial societies (see the next section). These arrangements are usually not well suited to reconciling work and family life, supporting single parenthood, enabling (older) workers with obsolete skills to stay on in employment, or protecting workers holding atypical jobs. In this respect, welfare states themselves may increase social risks when they do not adapt quickly or comprehensively enough to new risk structures.

Figure 1.1 summarizes the basic ideas behind the new social risk approach and classifies the emerging risks. We will not dwell further on the developments mentioned in the first column. More important are the *new* risk factors and the corresponding consequences (in the second column) because the focus of this book is on possible gaps in social security after retirement. Therefore, among the potential remedies (third column), only policy measures are relevant here which aim at a comprehensive consideration of 'critical life events' within the pension system.

The empirical background

Increased labour market flexibility

In general, all welfare states have been organized around a normative and empirical model of work and family life. Pre-World War II, social policy was based on the assumption that the standard family consisted

Socio-economic developments	New Risk factors	Potential remedies
Technological change; post-industrialism; globalization; de-standardization of employment	*Low/obsolete skills; atypical jobs* → unemployment → working poor → enforced early exit	Active labor market policies; institutions and policies that keep wage inequality in check
Demographic aging; single parenthood; women entering the labor market	*Having children/frail relatives* → women not (continuously) participating in the labor market	Subsidized child and elderly care → reconciliation of paid work and family tasks
Welfare state restructuring; too slow adjustment to new risk structures	*Insufficient coverage through social protection schemes* → pockets of poverty	Broad/universal security at high level ("flexicurity")

Figure 1.1 Classification of new social risks
Source: Adapted from Bonoli, 2006: 5–8.

of a male employed full-time and a female homemaker (and their children). During the period of welfare state expansion – from the end of the 1940s until the mid-1970s – this norm remained the unspoken or implicit point of reference. In particular, advanced welfare states on the European continent clung to this norm even longer although the term 'standard employment relationship' (*SER*), which defined a specific pattern of gainful employment, gained prominence only when it was empirically already on the decline. The *SER* became a kind of yardstick for exploring changes and concomitant risks in the labour market and in the social protection system (see also Kalleberg, 2000).

The *SER* developed through the interplay of state intervention into the working of the labour market, the achievements of collective bargaining and the rules of social custom when the labour contract was gradually enriched with individual and collective status rights regulating dependent labour and its exchange (see Chapter 2 on Germany). The *SER* implies continuity and stability of employment, and it is supposed to involve dependent work, performed from the end of education until retirement at a defined age and based on open-ended contracts. Involuntary interruptions of employment are infrequent and assumed to signify only short-term spells of unemployment for most workers. Moreover, the *SER* entails full coverage by all legal protection and participation rights, encompassing rights to the results of collective bargaining and full entitlement to occupational benefits (for instance corporate pensions) and procedures (for instance participation in qualification schemes). Therefore, 'normal' employment is expected to be full-time according to the prevailing working time standards and, even at the lowest wage rate, usually delivers a 'family wage', sufficient to maintain the needs of a nuclear family. It is obvious that the *SER* concept caters to the male breadwinner family. By specifying the criteria of 'normal' employment, the *SER* concept allows for an assessment of the empirical prevalence of this type of waged work and of the disadvantages those workers face who cannot (or, who prefer not to) meet the standards. Those disadvantages can be related to job stability, wage level, access to social benefits and the like.

Admittedly, factual deviations from gainful work according to the *SER* concept are not a completely new phenomenon. In the past, there have always been day labourers or seasonal workers in certain industries, and in many countries a sizeable number of workers in the informal economy were and still are excluded from any kind of job or social protection. From about the early 1980s (although the actual timing differed across various countries), the transition towards a post-industrial economy has been accompanied by slower economic growth and high unemployment rates, an increase in international competition and a shift to supply-side economic policies. These changes resulted in a radical transformation of long-established labour market arrangements. In most European countries, after some early responses aimed at containing unemployment mainly through labour shedding strategies,[3] policy makers turned to more innovative policy measures. Increased labour market flexibility was a major component. This has been pursued in two ways. In a few cases, the rules for dismissing employees with permanent jobs have been relaxed. More often, greater flexibility has been achieved by either easing or boosting various 'non-standard' contracts, resulting in a growth of atypical jobs or employment careers, especially for young entrants and women. Parallel to labour market 'flexibilization', increased female participation has represented the second major driver of the spread of atypical employment in most European countries. By 'atypical' we thus mean all employment career patterns that deviate from the 'standard employment relationship' (*SER*). 'Atypical jobs' comprise employment patterns resulting from a fixed-term contract, or on a (marginal) part-time basis, or one not, or not completely, covered by social protection schemes. Employment at temporary work agencies belongs to the atypical category as well, because this type of employment is often short-term and involves a higher risk of intermittent employment. The 'false self-employed' also fall into this category because they are usually dependent on a single client, who is very often the former employer saving on social protection expenses (see Eurofound, 2002; Muehlberger and Pasqua, 2009). Finally, 'wage flexibility' mainly means a larger spread of earnings at the lower end of the wage scale. Jobs paying extremely low wages are atypical insofar as they provide no family wage but, rather, transform employees into 'working poor', sometimes even where there are no family members to be supported.

Atypical employment careers are hence characterized by discontinuous labour market participation and recurrent spells of unemployment, as well as transitions between waged work and self-employment, successive labour contracts of different stability, or moves between full- and part-time work. Atypical careers may also be characterized by enforced early exit or delayed labour market entry. The (total) duration of atypical spells, and when they occur during the course of a life, determine whether non-*SER* careers will result in precarious income patterns before and after reaching normal retirement age. An individually precarious income situation, however, is not necessarily to be equated with

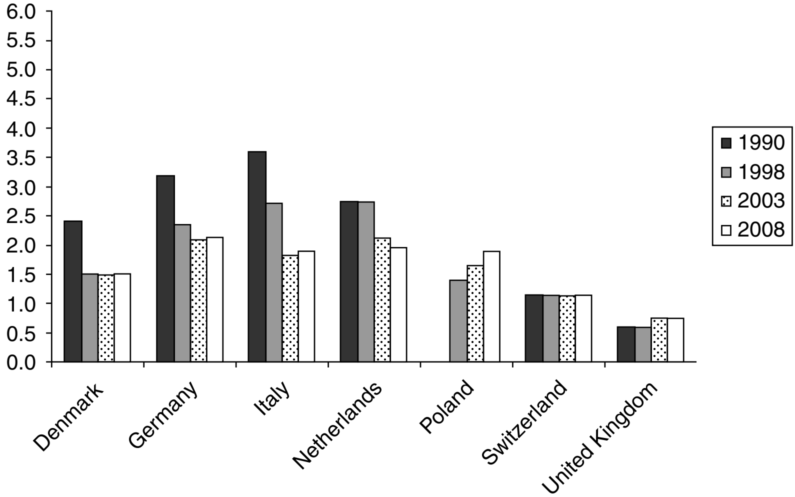

Figure 1.2 Overall employment protection legislation, selected years
Source: Online OECD Employment database.

poverty, which is really contingent upon the respective family or household context (see section on 'framing the analysis').

Employment Protection Legislation (EPL) indices, as developed by the OECD (2004), try to capture the constraints on employers dismissing workers.[4] Figure 1.2 shows that between 1990 and 2008, some convergence towards lower job security occurred, although national differences are clearly recognizable when looking at the levels of overall employment protection.[5] Job security is quite low in the UK, Switzerland and Denmark whilst it is higher in Germany, Italy and the Netherlands. In Poland, the index value even increased. The EPL index values for temporary workers (Figure 1.3), which measure the ease with which employers can make use of fixed-term contracts, declined considerably although they had been quite high previously. In Poland, it was made more difficult for employers to use fixed-term contracts.

Turning to labour market flexibility as measured by the spread of atypical jobs, Figure 1.4 shows the growth of part-time and fixed-term employment over the last 20 years in the OECD Europe area. Fixed-term employment has more than doubled as a percentage of total employment: from below 6 per cent in the early 1980s to over 14 per cent in the mid-2000s. The increase in part-time work has been less intense

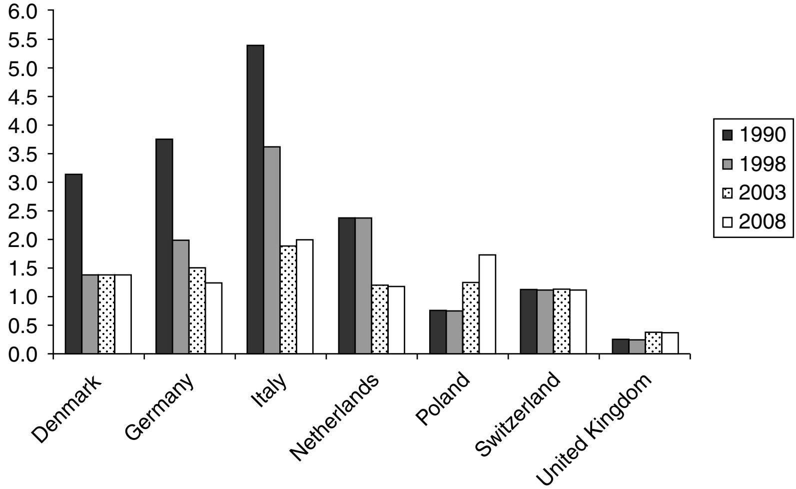

Figure 1.3 Employment protection legislation for temporary (fixed-term) workers, selected years

Source: Online OECD Employment database.

Figure 1.4 Share of part-time and fixed-term employment in OECD European countries, 1983–2009

Source: Online OECD Employment database.

Table 1.1 Incidence of part-time employment (% of total employment), 1983–2009

	1983	1987	1991	1995	1999	2003	2005	2007	2009
Denmark	20.6	19.9	18.7	16.9	15.3	15.7	17.6	17.7	18.9
Germany	13.4	11.0	11.8	14.2	17.1	19.6	21.8	22.2	21.9
Italy	8.0	8.5	9.0	10.5	11.8	12.0	14.6	15.1	15.8
Netherlands	18.5	26.4	28.6	29.4	30.4	34.6	35.7	36.1	36.7
Poland					14.0	11.5	11.7	10.1	8.7
Switzerland			22.1	22.9	24.8	25.1	25.1	25.4	26.2
United Kingdom	18.4	20.8	20.7	22.3	22.9	23.7	23.5	23.3	23.9
EU15	12.8	13.0	13.1	14.8	16.1	16.6	18.0	18.1	18.6
OECD Europe	12.8	13.0	13.2	13.4	14.6	14.8	15.8	16.1	16.6

Source: Online OECD Employment database.

Table 1.2 Incidence of fixed-term employment (% of dependent employment), 1983–2009

Time	1983	1987	1991	1995	1999	2003	2005	2007	2009
Denmark		11.1	11.9	12.1	10.2	9.6	9.9	9.1	8.9
Germany		11.6	10.1	10.4	13.1	12.2	13.7	14.2	14.5
Italy	6.6	5.4	5.4	7.2	9.8	9.5	12.4	13.4	12.5
Netherlands	5.8	9.4	7.7	10.9	12.0	14.5	15.2	18.0	18.3
Poland						19.4	25.7	28.2	26.5
Switzerland					11.7	12.1	12.8	12.9	13.2
UK	5.5	6.3	5.3	7.0	6.8	5.9	5.5	5.8	5.7
EU15	5.5	9.0	10.4	11.4	13.2	13.1	14.1	14.8	13.7
OECD Europe	5.5	9.0	10.8	11.8	13.3	13.3	14.3	15.0	14.0

Source: Online OECD Employment database.

although it reached about 17 per cent of total employment in 2009. These developments clearly indicate that the transformations addressed in this book are relevant and worthy of careful analysis.

Within these general trends, however, there are substantial national differences, as reported in Table 1.1 and 1.2. Part-time work has been on the increase, especially in the Netherlands where part-time employment has doubled between 1983 and 2009 but also in Italy and Germany over the last decades. In these countries, women with care obligations are likely to enter (or re-enter) the labour market as part-time workers. This is in many ways a positive development – one that is in line with what happened earlier on in countries like Denmark and other Nordic

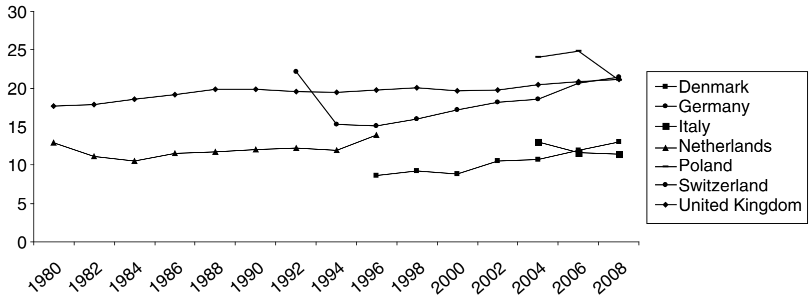

Figure 1.5 Incidence of low-pay jobs, 1980–2008
Source: Online OECD Employment database.

countries where, nowadays, the labour market participation of women is almost as high as that of men. However, inadequate social protection and even discriminatory rules for part-timers can be found in a number of countries where a significant growth of this and other types of atypical employment has occurred (see also Schulze Buschoff and Protsch, 2008). From our perspective it is more important that inferior social rights during working life may lead to low entitlements after employable age. This is a problem that disproportionately affects women.

As noted, the increase of fixed-term employment in recent decades is significant but, there are substantial national differences. Fixed-term employment grew most in the Netherlands and Italy – where the percentage of workers on fixed-term contracts has tripled and doubled respectively – but the highest share of this category of atypical work is found in Poland. By contrast, it plays a much less important role in the UK and Denmark. Against such a background, it is extremely important to analyse how pension rules interact with diverse labour market configurations.

Similarly, the extent to which the pension system offsets spells of low-paid employment is crucial because the percentage of 'working poor' is on the rise (Figure 1.5). The share of gainfully employed people earning less than two thirds of the median wage increased most dramatically in Germany and is now as high as in the UK and Poland.

All in all, we can maintain that the employment landscape in Europe has become more diversified as deviations from the *SER* have increased over the last three decades but the extent differs quite substantially between the countries covered in this book. The one problem emanating from the rise of *non-standard* employment patterns is that the employed persons' old age pension entitlement is non-existent or incomplete. Additionally, those patterns of work are often precarious because they imply an above average risk of becoming non-employed, (long-term) unemployed or being squeezed out of the labour market before reaching normal retirement age. One of the most important considerations is, thus, how spells of involuntary joblessness and early exit are taken into account in statutory and supplementary pension schemes. Further details on the development of atypical jobs and careers, and on whether holding a job not corresponding to the *SER* criteria is indeed always 'precarious', will be presented in the subsequent country studies.

Old age security and pension reforms

It is clear that countries that have reformed their pension systems, faced with similar imminent challenges (predominantly population ageing and slow economic growth), have followed different trajectories of reform, depending on the given institutional configuration of their own system (Hinrichs, 2009). It is possible, however, to distinguish three groups of countries that display a number of similarities in terms of their approach to reform: single pillar; multi-pillar; and so called 'transition' countries.

Countries relying mainly on a *single public pension pillar* have responded to immediate and imminent challenges to their Pay-As-You-Go (PAYG) schemes by launching a staged process of reform (Bonoli and Palier, 2007). During the first phase (circa 1975–1990), governments mostly filled the emerging gap between revenues and expenditures either by increasing contribution rates, or through transfers from the state budget. Politicians thus relied on existing institutional resources: they exploited the flexibility of PAYG schemes in order to 'fix' financial problems and to avoid politically risky cost containment measures. However, since the early 1990s, the increased internationalization and liberalization of economies, combined with the requirement of sound public budgets imposed by the Maastricht Treaty (Schludi, 2001), have obliged national policy makers to re-orient their pension policy. As continued increases to the contribution rates did not represent a viable strategy any longer, governments were pushed into retrenchment in order to adjust to the new economic and political environment. Consequently, they revised pension rules by adopting cost containment interventions, accompanying them with measures aimed at a wide-ranging restructuring of pension arrangements based on the development of supplementary funded pillars.

Strategies	**Challenges/Goals**
1) Inducing later retirement/active ageing	*Financial sustainability*
2) Reducing (or containing) costs	*Financial sustainability*
3) Tightening contributions-benefits link	*Elimination distributive distortions + Financial sustainability*
4) Regulatory harmonization	*Elimination distributive distortions*
5) Extending targeted (minimum) pensions	*Recalibration / adaptation*

Figure 1.6 Parametric reforms in single-pillar pension systems: goals and strategies

Source: Adapted from Jessoula (2009).

In fact, all countries with single pillar pension systems have adopted reform packages based on a combination of *parametric interventions* – which incrementally modify pension rules within the pre-existing institutional arrangements – and *structural reforms*, which are intended to modify the institutional architecture substantially. Parametric reforms have mostly pursued three major goals: (a) financial and economic sustainability; (b) the elimination of distributive distortions (especially in Bismarckian systems); and (c) regulatory recalibration in order to adapt to the changing social and labour environment. Five different strategies have been applied in order to attain these goals, as is shown in Figure 1.6. They aim to: (a) promote later retirement and enhancing active ageing; (b) contain (or reduce) costs, mainly through lower replacement rates and changes in indexation mechanisms; (c) tighten the contribution-benefits link for the sake of actuarial fairness; (d) harmonize rules for the different occupational groups; and (e) introduce (and reinforce) targeted and redistributive measures for retirees with very low entitlements.

By contrast, structural reforms imply a shift of the public-private mix of retirement income by giving private and funded schemes a larger weight. Supplementary pillars – second (occupational) and third (individual) pillar pension schemes – have been introduced or extended whilst the public ones will provide a declining portion of retirement income in future. In other words, structural reforms have prompted a transition from a single pillar to a multi-pillar pension system.

In *multi-pillar countries*, public schemes have traditionally not aimed to maintain status but, rather, provided basic security. Reforms since the 1980s have primarily been directed at the expansion of supplementary funded pensions. The objective was to cover the whole workforce and mainly to improve the benefit levels of second-pillar pensions. Different measures were taken in the various countries, ranging from the introduction of compulsory coverage with supplementary occupational pension plans (Switzerland) to more decentralized and voluntary arrangements based on the 'contracting out' mechanism (UK). In the Netherlands and Denmark, coverage has been increased through collective agreements between the social partners. As a result, the share of employees included in private funded pension plans has increased substantially over the last two decades in almost all the countries belonging to this cluster. Where such development has not occurred (or has not been successful), as in the UK, policy makers have recently decided to introduce a higher degree of compulsion (that is *automatic enrolment*) in order to avoid gaps in coverage and problems of inadequate contributions (Pensions Commission, 2006).

In these countries, pension policy has also been strongly shaped by regulations for supplementary pillars. Especially after the 'pension scandals' of the mid-1990s in the UK, and the downturn in the financial markets from 2000 to 2003, interventions have been regarded as necessary in order to address problematic aspects of funded pension schemes, namely, to ensure the sustainability of defined benefit (DB) schemes and to protect members' entitlements in case of financial market downturns and mismanagement by pension fund administrators. The regulatory frameworks of supplementary pillars were modified in order to make funded pensions more secure and more resistant to shocks. Among other things, rules regarding investment limits and solvency requirements have been tightened. However, stricter regulation of pension funds has largely proved insufficient during the financial market crisis of 2008/09. It led to a massive decline in pension funds' assets, calling for further regulatory interventions. Moreover, with respect to the sustainability of funded schemes, the major stakeholders – employers as sponsors of supplementary pension plans – have frequently executed a switch, either from DB- to DC-type (defined contribution) schemes or from a 'final salary' to an 'average career salary' formula. Thus, like the single pillar countries, the reforms to earnings-related schemes in this second cluster have reduced benefit generosity as well as shifted the risks of guaranteeing a certain pension level onto individuals, in accordance with a stricter actuarial logic.

Finally, multi-pillar countries have adapted their pension schemes to varying labour market, family, and social structures. Changes have included: the modification of rules concerning vesting and portability of pension rights; a higher and/or aligned retirement age for men and women; new methods for calculating benefits; and the introduction of redistributive mechanisms, such as contribution credits for periods of non-employment. These changes have been accompanied by more or less severe retrenchment of public basic pensions and upcoming increases of the benefit eligibility age (Denmark, UK and the Netherlands).

Pension policy trajectories in the so-called '*transition countries*' – that is countries previously belonging to the Soviet bloc, which joined the European Union in 2004 and 2007 – have been shaped by both the original Bismarckian imprint of their pension systems and by the shift from a centralized socialist state to a market economy. Against this backdrop, however, these countries have embarked on two different paths (Müller, 2007; Natali, 2008). A first group – especially the Czech Republic and Slovenia – has reformed the pension system by 're-activating' the Bismarckian institutional design. It continues to rely on a dominant public PAYG pillar, which has been subject to parametric interventions in order to improve fiscal sustainability. This group of countries has taken only a few steps towards a multi-pillar architecture for their old age protection systems. In contrast, the drastic retrenchment of the public PAYG pillar in Bulgaria, Estonia, Hungary, Latvia, Poland and the Slovak Republic has been accompanied by the introduction of an innovative policy path. This has been characterized by compulsory affiliation to supplementary funded schemes, which are privately managed. However, in the wake of the recent financial market crisis and subsequent economic recession, Poland and Hungary have (at least partly) reversed their reforms of the 1990s in order to keep mounting public deficits in check. Hungary has moved towards a re-nationalization of its compulsorily funded pillar while Poland has (temporarily) reduced the contribution share flowing into its funded pillar (Guardiancich, 2011).

Table 1.3 Evolution of theoretical gross replacement rate of statutory pensions, 2007–2060

	2007	**2060**	**Percentage point change**
Denmark	39	38	–1
Germany	51	42	–9
Italy	68	47	–21
Netherlands	44	41	–3
Poland	56	26	–30
UK	35	37	+2

Source: European Commission, 2009, p. 97.

Table 1.3 provides an overview of the (estimated) development of the benefit ratio[6] in selected countries belonging to either one of the three clusters outlined above. A reduction of the ratio is expected in all countries except the UK, though the decline is much stronger in countries traditionally relying on single pillar pension systems.

Framing the analysis: from flexible workers to secure pensioners?

In view of increased labour market flexibility and recent, or still ongoing, pension reform processes, it is the objective of this book to provide an in-depth comparative analysis of the relationship between flexibility and security from a life course perspective. What do these developments mean for the social security of pensioners? So far, only a few studies on the reform of old age protection systems have addressed this topic (Bonoli, 2003; Meyer et al., 2007) but they have not systematically attempted to disentangle the relationship between labour market flexibility and old age security.

The analytical perspective taken here bridges the traditional research on pension (reform) policy and the emerging research strands on 'new social risks' and *flexicurity*. On the one hand, it assumes that some new social risk profiles may have a negative impact on an 'old' social risk like *old age*. More precisely, the major concern relates to the fact that new risks in the labour market may lead to a resurgence of the 'risk' of becoming old, after a few decades in which poverty rates among the elderly have constantly declined and being old no longer implied an income risk *per se* (Guillemard, 1982; Ferrera, 1998). 'The result of the presence of these new career profiles in the labour market may be, if pension systems are not adapted, the translation of the labour market and working poor problems of today into a poverty problem for older people in thirty or forty years' time' (Bonoli, 2006, p. 7).[7] However, both the obligation and the ability to counter this (future) risk by making adjustments vary according to the different structures of old-age security systems. On the other hand, adequate economic security in old age is likely to depend on the combination of flexibility and security mechanisms on the market at employable age.

Thus, the relationship between *labour market flexibility* and *old age security* may be framed analytically, as shown in Figure 1.7. The figure captures the interplay between labour market changes and ongoing pension reforms, as well as the consequences for the economic security of (current and especially future) retirees. Economic security is conceived

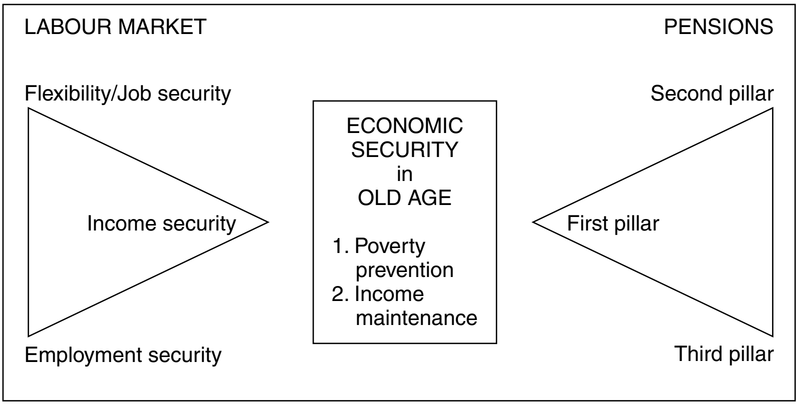

Figure 1.7 The interplay between the labour market and the pension system
Source: Authors' elaboration.

in accordance with the two essential functions and objectives of pension systems: (a) poverty prevention and alleviation; and (b) income maintenance in old age.

Framed as such, the interplay has two analytical as well as empirical *foci*. The first concerns the impact of 'flexible and secure' labour market arrangements on income security after retirement. Reduced *job security* and the spread of non-standard jobs and atypical (i.e. discontinuous and fragmented) employment careers may be harmful to the build-up of pension entitlements for a number of reasons. 'Flexible' workers are either not covered by public pension insurance schemes and employer-sponsored occupational pension plans, or they pay lower contributions. They are likely to receive meagre wages. Frequent spells of unemployment, or other interruptions to covered employment, may lead to inadequate old age pensions. However, pension entitlements are likely to depend on the robustness of 'security' mechanisms in the labour market, as the negative effects of longer spells of non-employment may be limited through effective active labour market policies reducing their duration (maintaining *employability*). Alternatively, the existence of redistributive provisions (credits) for workers temporarily outside paid employment and covered by unemployment insurance or assistance schemes (providing *income security*) may assist them – as may pension credits for periods in care activities.

Secondly, economic security in old age depends on the combination of first, second and third pension pillars, as well as on their interaction with labour market arrangements and trends. It should be re-emphasized here that, first, all current pension systems display a two-level configuration (Overbye, 1994) characterized by a basic scheme (universal or means-tested) plus a (public or private) earnings-related programme, but the combination and the relative weight of the first and supplementary pillars vary significantly between European countries. Secondly, the prospects for economic security in old age are changing drastically in all EU countries as a result of the effects of pension reforms implemented in the last three decades.

In *single-pillar* countries with public pension schemes that previously provided generous earnings-related benefits at a status maintenance level, pension reforms have effected a transition to a multi-pillar architecture. For these countries, income maintenance in retirement depends on a mix of (lower) public pension benefits (first pillar) and supplementary pension provision, mostly on a voluntary basis (second and third pillar).[8] Crucially, this transformation may generate inadequate coverage and insufficient contributions to the supplementary pillars. These problems mainly affect workers with atypical jobs or who are temporarily out of employment. Additionally, parametric reforms – especially those that have strengthened the contribution-benefit link and tightened eligibility conditions – may undermine the pension entitlements of workers with non-standard careers, because such careers produce shorter contribution records.

At first glance, *established multi-pillar* systems (Denmark, Netherlands, Switzerland and UK) seem to be better equipped to provide an at least adequate pension minimum – due to the existence of a national basic pension. Nevertheless, these countries may not be immune to the challenges stemming from the spread of atypical employment careers, given their strong reliance on supplementary funded schemes – which are exposed to the coverage and low contributions problems discussed previously. In addition, they are exposed to inherent financial market risks and some recent changes like the shift from defined benefit to defined contribution schemes. The income maintenance function may actually be endangered, and income inequality in old age may rise, not least because private supplementary schemes hardly contain any redistributive elements (apart from unisex annuity rates) to compensate for career breaks and other unfavourable features of atypical employment careers. Statutory pension schemes can perform better on that account – at least in principle (European Commission, 2006, p. 139). Finally, *new multi-pillar* systems like those emerging in Central and Eastern European countries present an ambivalent situation. On the one hand, the absence of a basic pension, in line with the Bismarckian tradition, may limit their poverty prevention capacity. On the other hand, compulsory affiliation to supplementary funded schemes would allow universal coverage of the workforce.

From these premises, the overarching research question motivating this book may be posed as follows: *What is the combined effect of developments in the labour market and of reforms of public and private pension schemes on the capacity of pension systems to provide income security – in terms of poverty prevention and income maintenance – to workers showing atypical employment patterns during their careers?* In both respects, the countries covered are very different in terms of the institutional structure of their pension systems. Standard replacement ratios show a large variance, at present as well as in future (see Table 1.3 above). However, these 'standard' levels do not tell us much about how workers with an atypical career actually fare. Therefore, the second central question is: *Have pension reforms included policy responses intended to adapt to more flexible labour markets, or have they reinforced the negative consequences of atypical work and irregular employment careers?*

The actual outcomes are expected to differ significantly depending on the countries' original pension arrangements, the direction of reform, as well as the flexibility and security patterns in the labour market. The countries included in this analysis have therefore been selected as either single pillar or multi-pillar pension systems. Germany and Italy have been chosen in the first cluster whilst Denmark, the UK, Switzerland and the Netherlands have been included as representatives of the second group. Finally, among the transition countries, the Polish case has been selected, as it represents a multi-pillar country that has embarked on a deliberate transformation of its originally Bismarckian and, later, communist pension system by introducing a compulsorily funded pillar.

The main analytical focus will be on *individual* entitlement although the spread of atypical employment patterns also influences the income situation of couple households at working age and during retirement. The growth of atypical jobs stems partly from employers' interest in utilizing labour power like 'water from the tap' and is facilitated by less strict employment protection. To a large extent, this is gendered flexibility, because it accompanies the gradual dissolution of the male breadwinner family. Atypical jobs – in particular (marginal) part-time work – are sought as a device for reconciling gainful employment and (mainly) females' care obligations. It is also a contribution to higher and more sustained labour force participation by women. Thus, couple households can increasingly dispose of more than one salary and, consequently, after retirement both spouses have access to their own pension portfolio. For example, the declining public pension amounts awarded to male retirees in Germany (see Chapter 2) have *not yet* led to higher poverty rates: successive cohorts of new retirees more often live in households where both spouses are eligible for their own pension (Goebel and Grabka, 2011). Changing family patterns push in the opposite direction, however: marriages are more often dissolved by divorce, and the proportion of one-person households (at all ages) is on the rise. It is thus legitimate to focus on individual entitlements.

Structure of the book

The seven country studies aim to investigate the interplay of labour market and pension reforms at the national level, as well as their consequences for the retirement income security of atypical workers. To that end, each chapter presents information on the sequencing and the main elements of labour market reforms, as well as on the development of atypical employment careers from about 1980 to 2009. In addition, there is an overview of the country-specific model of old age protection that was in place before reform, followed by a description of the reforms that have occurred during the last three decades. Particular attention is given to the transformation of public schemes, the expansion or changes to supplementary funded pillars, and the changing mix of different pillars. These transformations in the framework of old age protection are analysed in more detail for the most relevant categories of atypical workers. Finally, each chapter focuses on the combined impact of labour market developments and pension reforms on the retirement income prospects of workers who have held atypical jobs or pursued a non-standard employment career. This is an extremely complex exercise because of the large number of uncertain factors and variables. Quantitative estimates and economic simulations – which are often misleading if overly stringent assumptions are used – have not been attempted by the contributors to the book. However, all authors have made extensive use of available (national) data in order to (a) map the present and future income situation at retirement of atypical workers, and (b) identify emerging patterns of income inequality and potential old age security gaps.

The ninth and final chapter integrates the findings from the country studies and presents an evaluation of how the different labour market models and institutional arrangements for old age protection perform with respect to *poverty alleviation* and the provision of *income* *maintenance* after retirement. The chapter also provides an in-depth analysis of the flexibility-security nexus from a life course perspective by comparing the present and future old age security situations and scenarios of atypical workers.

Notes

1. For more on the concept of *flexicurity* see Viebrock and Clasen (2009).
2. In particular, Ute Klammer (2007) has repeatedly argued for taking a life course perspective on *flexicurity*.
3. Cf. Ebbinghaus (2006), Palier (2010), Clasen and Clegg (2011).
4. There has been a fundamental critique of the utility of such EPL indices, pointing to methodological weaknesses and to implicit normative lessons as they employ a 'cost only' approach, neglecting the positive externalities of regulation (see Berg and Cazes, 2008). Nevertheless, for the purpose of this study those indices are quite useful as they show the different levels of and changes to labour market rigidities among countries.
5. The figures and tables presented in the following include only the seven countries that have been studied in detail in the subsequent chapters.
6. 'Benefit ratio' is the average public pension benefit as a share of the economy-wide average wage. – The figures in Table 1.3 differ from the OECD calculations of 'gross pension replacement rates' (OECD, 2011, p. 121) or the 'theoretical pension replacement rates' as reported by the Indicator Sub-Group of the Social Protection Committee. For an explanation see European Commission, 2010b, p. 36.
7. In the synthesis report on *Adequate and Sustainable Pensions,* the European Commission (2006, p. 136) acknowledges: 'The pre-reform design of many statutory pension schemes in Europe were well-adapted to standard employment patterns such as full-time work and life-long careers, but these systems are less suitable for people with non-standard careers or employment patterns.'
8. Cf. Ebbinghaus (2011) for a comparative analysis of supplementary pensions in European countries.

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Part I

Traditional Single-Pillar Countries

2

Germany: A Flexible Labour Market Plus Pension Reforms Means Poverty in Old Age

Karl Hinrichs

2.1 Introduction

In Germany, as in most other European countries, the income position of elderly people has improved over recent decades. Declining poverty risk rates indicate these positive developments, although there are substantial differences among EU member states (European Commission, 2006, p. 54; OECD, 2009, p. 62). Looking at people aged 65 and older in Germany who actually receive means-tested basic security benefits, poverty for them appears to be a minor problem, particularly when compared with the number of poor children. In December 2008, no more than 2.5 per cent of people over retirement age drew (supplementary) means-tested benefits (that is 410,000 people). In contrast, 1.74 million children below the age of 15 – every sixth child – lived in private households claiming basic security benefits (ALG II; Duschek, 2011, p. 146; Bundesagentur, 2009, p. 37; see also OECD, 2008, pp. 138, 140). It is likely that the relatively favourable financial situation of today's pensioners is not going to last. There is an intense debate in Germany about the recurrence of poverty in old age. Labour unions, charities, seniors' interest organizations, the Left party, academic social policy experts, and others accuse the formerly incumbent governments of having enacted pension reforms whose combined effect will be a rapidly growing number of elderly people dependent on means-tested benefits.[1] The present Christian-Liberal government is confronted with the allegation of not taking adequate measures to prevent this scenario from coming true. It has, however, started a 'pension dialogue' in autumn 2011. Various social actors are asked to comment on a government proposal for improved social security in old age.

The current debate took on a new urgency in early summer 2007 when the OECD presented an updated version of its *Pensions at a Glance*. The report was given much attention in the German media because it calculated that, according to recent legislation, an average wage earner entering the labour market in 2004 at age 20 would be entitled to benefits from the *public* pension scheme of not more than 58 per cent of her last net wage, having continuously worked for 45 years until normal retirement age. Within the EU-15, only workers in Ireland and the UK would have to prepare for an even lower replacement ratio (OECD, 2007, pp. 35, 129).[2] Moreover, due to the strictly applied equivalence principle, the pension prospects of workers, who had steadily earned 50 per cent of the average wage, would amount to merely 32 per cent of net average earnings. This prompted the OECD (2007, p. 75) to warn of 'a risk of resurgence in old-age poverty' in Germany.

The anticipated reduction of about 20 per cent is only a part of the challenge, however. These calculations assume *constant* earnings levels throughout a working life (the average wage, 50, or 150 per cent thereof) and, moreover, *uninterrupted* covered employment until statutory retirement age. However, this kind of continuous employment career of 45 years was not even the norm in the past. As a result of increased labour market flexibility and more frequent interruptions in gainful employment (for example due to spells of unemployment), there will in future be more newly retired people entitled to far less than the standard pension. Adapting the pension scheme to 'atypical' employment career patterns could prevent the risk of poverty in old age.

Germany was the last among developed 'Bismarckian' welfare states to top up insufficient income after retirement with either a separate scheme or one integrated into pension insurance. In any case, the minimum benefits provided are means-tested (European Commission, 2006, pp. 57–64). Germany only introduced such a separate basic security scheme for old age (and disability) pensioners in 2003.[3] Including the average expenses for rent and heating, the benefit was €678 per month in 2009 (Duschek, 2011, p. 146), a level that is comparatively low (OECD, 2009, p. 65). In its explanation of the reform bill, the government admitted that changing employment careers may lead to more retirees receiving pensions lower than the social assistance level (Bundesregierung, 2000, p. 43). Therefore, this special scheme for old age and disability pensioners makes 'new risks' in the labour market, and the consequences of past (and future) pension retrenchments, socially more bearable. Increasing numbers of newly retired people with inadequate insurance entitlements now have better access to means-tested income support.

Very often, however, potential claimants perceive this mode of benefit access as stigmatizing. Moreover, if the number of beneficiaries is not limited to a minority of elderly people, the legitimacy of the public pension scheme could suffer: it may be concluded that mandatory contribution payments do not pay off. Finally, incentives to make additional retirement savings and remain in employment until reaching statutory retirement age (or beyond) are weakened. The combination of encouraging individuals to save more for retirement and work longer is precisely the main thrust of pension reform in 'Bismarckian' welfare states (Hinrichs, 2009).

The central question of this chapter is: *What are the consequences of pension reforms on social security in old age in the context of increasingly diverse employment patterns in Germany?* It is very likely that the future problem of employees retiring with increasingly inadequate entitlement to public pension benefits and, thus, being dependent on means-tested supplements, will be most serious in this country. This problem will probably also emerge as a significant issue in other Bismarckian countries, like Belgium and Italy, whose pension systems are obviously not well attuned to an increasingly flexible labour market either (Peeters et al., 2008; Jessoula, in this book). In Germany, the problem will become more severe because a series of reforms after 1989 reduced the standard replacement ratio of the public scheme. Equally important, provisions addressing socially adequate pension levels were removed and, thus, the contribution-benefit link was strengthened. The scheme was not adjusted to a more flexible labour market and changing employment careers. Rather, the combined effect of *political risks* and *new social risks* has laid the foundations for an increased dependence on means-tested benefits in old age.

Public Pay-As-You-Go (that is unfunded) pension schemes always face *political* risks and cannot easily be insulated from the 'rule instability' by constitutional provisions, such as quasi-property rights or 'grandfathering' (whereby new rules only apply to all new situations). Neither can institutional precautions (like self-administration, separate budgets, automatic government and other rules of self-constraint) eliminate political risks (Lindbeck, 1994; Diamond, 1997).[4] Policy changes tackling the scheme's financial sustainability may thus involve disappointing the income security expectations of the insured. Those policy-induced risks are exacerbated if they coincide, as they do, with *new social risks* which emanate from questionable premises about the successful operation of pension and other social insurance schemes.

The following section therefore deals with the general problem of how a social security system attuned to the preponderance of standard employment relationships (SER) produces a new *insecurity* as a result of socio-economic changes. The chapter then turns to an analysis of developments in the German labour market which can be regarded as critical to the life course of employees (Section 2.3). Section 2.4 looks at the pension reforms implemented from the 1990s which, besides lowering the standard replacement ratio, have particularly affected the social security of those employees who, during their life course, have been exposed to 'new social risks' in an increasingly flexible labour market. Section 2.5 attempts to evaluate the combined effects of labour market flexibility and pension reform on poverty in old age and discusses some developments that mitigate these trends. The final section briefly explores sustainable solutions for an old age security system still based on social insurance principles. These solutions should provide more 'security' (defined as minimizing dependence on means-tested benefits) and, at the same time, may make labour market 'flexibility' socially acceptable.

2.2 The erosion of the Standard Employment Relationship and 'new social risks'

As a norm, and a once predominant actuality, the 'standard employment relationship' (SER) in Germany developed through the interplay of state intervention in the labour market, the achievements of collective bargaining, and the rules of social custom. By these means, the labour contract was gradually enriched with individual and collective status rights regulating dependent labour and its exchange (Hinrichs, 1991; 1996). The SER implies continuous and stable employment. It is supposed to be dependent work, governed by directives, which is performed from the end of education until retirement at a defined age. The employment contract is open-ended; it does not rule out the (permanent) risk of dismissal or the option of terminating the contract voluntarily. Involuntary interruptions in employment are assumed to signify only temporary, short-term spells of unemployment. With length of service, and sometimes with age, the stability of employment increases (for example improved provision against dismissal or other seniority rights).

The SER concept assumes full coverage by all legal protection and participation rights, encompassing rights to the results of collective bargaining and full entitlement to occupational benefits (for example corporate pensions) and procedures (for example participation in training schemes for maintaining employability). In particular, 'normal' employment is expected to be full-time employment according to the prevailing working time standards with only *one* employer. Finally, a 'full-time job' – even at the lowest wage rate – should deliver a family wage which is sufficient to maintain the needs of a nuclear family. As a societal arrangement for production *and* reproduction the SER is clearly gender-biased, since it aligns itself with the conception of the 'male breadwinner family' (MBF). Consequently, the development of the SER constituted and stabilized the 'female homemaker family' as the opposite side of the coin.

Social insurance schemes are aligned with employment on the basis of assumed 'standard' conditions' but are separately organized. These schemes provide wage replacement in well-defined circumstances, namely, when the typical risks of wage labour occur and workers are temporarily unable to earn a market income (sickness, unemployment) or are no longer expected to do so (invalidity, old age). Workers employed on 'normal' conditions are fully integrated into those schemes. Accruing benefits are tied to the period of contributions paid and the level of former earnings. They are geared towards income maintenance. The pension (or the unemployment insurance) scheme 'makes sense' and should be considered legitimate if it does accomplish its given mission – namely, to deliver wage replacement *regularly* at a level higher than means-tested assistance benefits so that insured workers receive something for their contributions. Limited earnings inequality and stable employment careers are thus preconditions for the proper functioning of social insurance schemes (see Loose, 2008; Waltermann, 2010). Obviously, the SER discriminates against those workers who are unable to meet the conditions of 'normal' employment (or who prefer to deviate from this pattern) and, as a consequence, are worse off when actually affected by social risks. Women should be particularly concerned as the combined SER/MBF concept assumes lifelong marriages. For this reason, not much attention was paid to the social security of predominantly female workers in atypical or marginal employment who were merely earning a temporary or supplementary income, but who otherwise devoted their activities to social reproduction. This notion largely rendered state provisions for child and elderly care unnecessary although they would have facilitated continuous participation of married women in the labour market. Instead, cash transfers (child and housing allowances, and tax advantages) met the extra income needs of family households during certain phases of the life course. In tying social policy development to the SER concept, Germany was very similar to other 'conservative' welfare states (Esping-Andersen, 1996).

The argument made here is that the validity of the SER as a precept of labour market participation and as an assumed norm for earning (sufficient) social insurance entitlements is no longer viable. The SER as the dominant type of (male) wage labour was consistent with the 'Fordist production regime' of the first decades after World War II. It became too rigid a 'corset' both for employers in post-industrial labour markets and for the needs of a changing labour force, as more women started seeking employment. Emerging 'new social risks' (see for example Taylor-Gooby, 2004; Armingeon and Bonoli, 2006) are related to changes in the family and the labour market – in particular, the de-standardization of employment patterns – and to the direction (and speed) of related welfare state restructuring. The interplay of socio-economic changes and inadequate welfare state adjustment jeopardizes social protection against 'old social risks'. It means that institutions designed to reduce insecurity – the SER and social insurance schemes – increasingly fail to perform their assigned mission and, instead, generate second-order insecurity. The aim of the next section is therefore to show that employment patterns have become more diverse and that atypical careers, deviating from the SER pattern, have increased.

2.3 Labour market flexibility: more critical events during the life course

In Germany, as well as in other Bismarckian countries, an important reason for the growth of atypical employment patterns is the SER itself and the social security costs attached to regular labour contracts. The continuing need for a family wage drives up direct labour costs and a high 'tax wedge', even for low-wage earners, is predominantly caused by social insurance contributions. This affects the growth or even survival of low-productivity jobs, mainly in the service sector (Scharpf, 2002). Either total labour costs are too high for employers to make (or keep) those jobs profitable or, if the wage rate matches productivity, the accruing net income is too low to lift unskilled full-time employees above the poverty line and out of the category of 'working poor' (if workers are prepared to take up the job in the first place). The spread of atypical employment patterns is furthermore enhanced by employers' constant efforts to utilize labour like 'water from the tap' through different kinds of 'flexibility'.[5] In part, the spread of those strategies has been assisted by liberalised employment protection legislation for jobs at the 'margin' of the labour market (for example fixed-term contracts or agency work) whilst the protection of 'core' workers has remained relatively strict. Finally, the decline of jobs corresponding to the SER criteria is mainly the result of female employees' preferences for part-time work and from interruptions of continuous employment in order to cope with obligations outside the occupational sphere.

These 'deviant' employment patterns and career profiles affect people's income both during their employable years and after retirement. However, not all atypical jobs are also precarious, entailing higher risks of becoming unemployed or being poor after retirement. The share of precarious employment patterns has definitely increased but cross-sectional data do not show how many members of the labour force are affected at least once during the life course, or how long the respective (un-)employment episodes lasted. The *duration*, however, is the most decisive in assessing whether precarious jobs, or certain events during a person's employable years, will significantly impact on their risk of poverty in old age. Data from a large survey of the German labour force (the AVID 2005) allow for a comparison of the incidence of certain events and the time period, by year of birth (between 1942 and 1961 – Tables 2.2 and 2.3 below). These survey data also facilitate a separate appraisal of West and East Germany since the labour market situation and dynamics still differ substantially between the two regions.

Despite the considerable improvement in Germany's employment situation after 2005, *unemployment* remains a persistent problem. Long-lasting mass unemployment is reflected in changed working careers: the younger birth cohorts (born around 1960) have been affected by unemployment more often than preceding cohorts. They have experienced job discontinuity at an earlier age, and their spells of unemployment have lasted longer (Müller, 2008; Möller and Schmillen, 2008; Protsch, 2008). Uninterrupted careers are, therefore, on the retreat. The AVID 2005 data (Tables 2.2 and 2.3) confirm the decreasing share of workers untroubled by joblessness: more than 50 per cent of the younger birth cohorts (1957 to 1961) in West Germany experienced an episode of unemployment of at least one year. Those unemployment spells for either male or female workers in East Germany lasted about twice as long (about 10 years) for the younger compared to the older cohorts (1942–1946).

Two serious consequences arise from careers that lack continuity. First, workers who experienced a period of long-term unemployment regularly show a lower life time earnings profile compared to those unaffected by interruptions These negative effects on subsequent earnings have become more severe with lasting mass unemployment (Protsch, 2008).[6] Secondly, losing one's job at a greater age implies an above-average risk of becoming long-term unemployed. Very often, such an event leads to an involuntary exit from the labour force well before reaching statutory retirement age, and results in lower pension benefits. Compared to other OECD countries, long-term unemployment among older workers

Table 2.1 Atypical employment and unemployment in Germany, selected years 1991–2009

		1991	**1999**	**2005**	**2007**	**2008**	**2009**
1	Gainfully employed (million)	38.6	38.4	38.8	39.7	40.3	40.3
	– employment rate (15 to 64) *males*	78.4	72.8	71.3	74.7	75.9	75.6
	– ditto *females*	57.0	57.4	60.6	64.0	65.4	66.2
2	Employees	35.1	34.6	34.5	35.2	35.8	35.9
3	Obligatorily insured employees	29.9	27.5	26.2	26.9	27.5	27.4
	– in % of all gainfully employed	77.5	71.5	67.4	67.5	68.2	68.0
4a	Self-employed	3.5	3.9	4.4	4.4	4.4	4.4
4b	Solo self-employed	1.4	1.8	2.3	2.3	2.3	
	– in % of all self-employed	45.4	46.1	56.1	52.3	55.1	
5	Part-timers, obligatorily insured [1]	3.5	3.7	4.4	4.8	5.0	5.2
	– in % of all obligatorily insured employees (row 3)	12.0	13.4	16.7	17.8	18.2	19.0
6	Marginally employed (no other job) [2]		3.7	4.7	4.9	4.9	4.9
	– in % of all employees (row 2)		10.6	13.8	13.8	13.6	13.8
7	Employees on fixed-term contract	2.0	2.4		3.1		
	– in % of all employees	5.8	7.5		9.1		
8	Temporary agency workers	0.1	0.3	0.5	0.7	0.8	0.6
	– in % of all employees (row 2)	0.4	0.8	1.3	2.1	2.5	1.9
9	Low-paid workers (< ⅔ median) [3]		5.0	6.1	6.4	6.6	
	– in % of all employees	15.0			21.0	20.7	
	– low-paid full-time workers in %	11.3				12.7	
10	Registered unemployed	2.6	4.1	4.9	3.8	3.3	3.4
	– unemployment rate (% civil labour force)	6.5	10.5	11.7	9.0	7.8	8.2
11	Long-term unemployed (> 1 year)[4]	0.7	1.5	1.8	1.5	1.2	1.0
	– in % of civil labour force	1.9	3.9	4.3	3.7	2.9	2.5

Notes: [1]Figure for 1992 instead of 1991; [2]Since April 2003 'marginally employed' is defined as monthly earnings < €400); [3]Figure for 1995 instead of 1991; [4]Figure for 1993 instead of 1991.

Sources: BMAS, 2010: Tables 2.4, 2.5A, 2.4A, 2.6A (rows 1, 2, 3, 4a); Bundesagentur für Arbeit, 2010a, pp. 18, 24, 44, 46 (rows 5, 6, 10, 11); Bach et al., 2005, p. 3 (row 3); Sachverständigenrat 2006, pp. 265–6 and Kelleter, 2009, p. 1206 (row 4b); Sachverständigenrat, 2008, p. 431 (row 7); Bundesagentur für Arbeit, 2010b (row 8); Kalina and Weinkopf, 2010 (row 9).

(between 50 and 64 years of age) is still quite high in Germany and, like everywhere, older workers with low skills display the lowest employment rate, indicating that they prematurely terminated working life (OECD, 2005, pp. 51–63; European Commission, 2007, Ch. 2).

There is an increased number of people with flexible employment patterns who are at a greater risk of becoming unemployed or of not earning lifetime wages (liable to social insurance contributions) which are high enough to secure adequate pension entitlements (Table 2.1). However, depending on the database and precise definition, the figures vary somewhat. Work with temporary employment agencies is regularly considered to be atypical, a deviation from the SER concept, because the employer and the firm where the work is actually performed are not the same. Mostly, agency work is nothing more than a brief episode within a career and the tenure of jobs with an agency is even shorter – less than three months for about half of all terminated temp jobs. If these jobs are contracted on an open-ended basis and provide opportunities for acquiring occupational skills, they are not necessarily 'precarious' although they offer no secure bridge to steady employment for the previously unemployed (Eichhorst et al., 2010, pp. 21–22; Sachverständigenrat, 2008, pp. 305–7, 440–50). Still, client firms mainly utilize agency workers in order to cope with a fluctuating demand for labour. Thus, the number of agency workers fell in 2009 but was back to the pre-crisis level by June 2010 (about 800,000). However, the ultimate cause of the upward trend after 2004 is different: firms increasingly replaced their core staff with lower paid agency workers on a regular basis. The collectively agreed low minimum wages in the temp agency sector violate the principle of equal pay and aggravate the strategic misuse of agency workers to undermine the client firms' wage structure. Insofar as this strategy further increases the low pay segment in the labour market a certain share of agency work should really be considered precarious.

Likewise, the number of workers on fixed-term contracts has grown to over three million in Germany (but does not exceed the EU average – European Commission, 2008, p. 35[7]). Increasingly, firms use this flexibility device when hiring new staff. In 2009, 47 per cent of all recruitments were on fixed-term basis and, varying with the economic cycle, firms take on about half of these workers permanently when the contract expires (Hohendanner, 2010). The risk of not continuing to work for the same or another employer mainly affects the younger part of the workforce.[8] Panel data show that workers on fixed-term contracts (males in particular) are more likely to be unemployed two or three years later or still holding a fixed-term job than those who had an open-ended work contract at any point of observation (Giesecke and Groß, 2006; Giesecke, 2009; see also OECD, 2006, pp. 172–3). These findings suggest a question whether atypical employment is a transitory experience: Is lasting escape from those jobs and upward mobility quite frequent; or, are these workers trapped, swinging like a pendulum between unfavourable employment arrangements (including low pay or self-employment) and not having a job at all?[9]

Due to employers' interests in internal flexibility and the preferences of primarily female workers, *part-time employment* has grown substantially during the last two decades. In 2009, 5.2 million employees were working less than the collectively agreed regular hours but were fully integrated into the social security system (see Table 2.1). In Germany, part-time work is usually undertaken on a voluntary basis (European Commission, 2008, p. 35). This variant of part-time employment cannot entirely be considered 'precarious'. However, only in cases of a very high hourly wage can these workers reach an income level that corresponds to average earnings. In most cases, and if part-time work is carried out for a longer period, the accruing public pension is too low to lift them above the poverty threshold unless there is a spouse with sufficient retirement income.

More relevant in this respect is a recent development within the part-time segment of workers which has enlarged the number of 'precarious' jobs. *Marginal employment* below a certain threshold of weekly hours or monthly earnings has always been exempted from social insurance coverage. It is assumed that these (predominantly female) workers temporarily supplement the household's income and need no regular social protection. In April 2003, the legal framework was changed and afterwards so-called 'mini jobs', which offer earnings of less than €400 per month, have increased substantially. In June 2009, 4.9 million workers held a 'mini job' as their sole job; about four fifths of them were between 20 and 64 years of age.[10] Predominantly, these jobs are located in the service sector, are low-paid and typically 'female' (cleaning, catering, retail trade). In order to earn *full* pension credits, 'mini jobbers' have to 'opt in' and then pay the difference themselves between the employers' contribution (15 per cent) and the full rate (19.6 per cent since January 2012) to the public pension scheme. Less than three per cent of this group makes use of this option (Loose and Thiede, 2006, pp. 481).

The German Statistical Office defines 'atypical' workers as: those on fixed-term contracts; the marginally employed; part-timers with less than 21 weekly working hours; and temp agency workers. This group amounted to 22.2 per cent of all workers gainfully employed in 2008, up from 16.2 per cent in 1998. Correspondingly, the share of SER workers fell within this ten-year period from 72.6 to 66 per cent (Wingerter, 2009, p. 1083).[11] The latter are predominantly prime-age, qualified German males whereas, among atypical workers, 71 per cent are female, 39.2 per cent are below age 24, 39.9 per cent are without certified training, and 36.8 per cent are migrants from non-EU countries (Statistisches Bundesamt, 2008, pp. 15–19). However, one has to take into account two further deviations from standard employment.

During the 1990s and the first half of the 2000s, the number of *self-employed* grew considerably in Germany. Although the proportion is still quite low by comparison with the rest of Europe, the self-employed make up for about 11 per cent of all people gainfully employed since 2005. The rise was completely due to the 'solo self-employed'. In 2008, about 2.3 million, or 6.1 per cent of all gainfully employed people, conducted business on their own account but had no employees in their establishment (Kelleter, 2009). Very often, a self-employed person starts a business after becoming unemployed (and receives temporary financial support from the Federal Labour Agency). Others have to be considered 'false self-employed' and work for only one client. In many cases, it is their former employer who has externalized ('outsourced') the risks related to there being a steady demand for labour as well as the costs of social protection. To a large extent, the 'solo self-employed', as well as others who actually employ personnel, share two characteristics which may make their present and future economic situation precarious. First, only a few groups of self-employed people are *obligatory* members of social insurance schemes (farmers, craftsmen, artists). The large majority are outside compulsory coverage and cannot earn any entitlement to pensions and unemployment benefits. Because income distribution among the self-employed is extremely unequal (Kelleter, 2009, pp. 1215–16), many earn too low an income to provide adequately for old age (and other contingencies) on a private basis, or to join the public pension scheme voluntarily. Secondly, newly established businesses lack stability, so that there are forward and backward transitions between dependent and self-employed work (Betzelt and Fachinger, 2004; Schulze Buschoff, 2006). In view of widespread gaps in social protection among the self-employed, compulsory coverage, as such, is hardly contested anymore (Bundesregierung, 2008a, p. 52).

Finally, 'wage flexibility', that is, the spread at the lower end of the earnings distribution, has increased (Giesecke and Verwiebe, 2008). The result of the 'collapsing bottom' is a larger number of low-paid workers.

The upward trend started in about 1995 and accelerated after 2000 (see Table 2.1). The percentage of *full-time employees,* whose hourly earnings are less than two thirds of the median gross wage, stood at 11 per cent in 1995 and rose to 12.7 per cent in 2008 (Kalina and Weinkopf, 2010).[12] Further calculations show that such low hourly wages are much more widespread among atypical workers holding a part-time or 'mini job', or working with a temp agency (Brehmer and Seifert, 2008; Wingerter, 2009, p. 1087), and that the problem is not confined to the unskilled. The large majority of low-paid workers have received formal occupational training (Wingerter, 2009; Kalina and Weinkopf, 2010). A major reason for the expansion of low-wage jobs is that the work force is much less comprehensively covered by collective agreements (only about 60 per cent) than in the past, and labour unions are too weak in a number of service sectors to push through a 'living wage' (or to enforce the results of collective agreements effectively). Additionally, globalization has further increased the competitive disadvantage of workers with poor or outdated skills. Moreover, stricter activation has meant intensified pressure on unemployed people to accept lower paid jobs.

Although an incomplete take-up rate has to be taken into account, no more than 2.2 per cent of all obligatorily insured employees (350,000 full-time and 230,000 part-time workers) were topping up their insufficient earnings with means-tested basic security benefits in June 2010 (Bundesagentur für Arbeit, 2011, p. 23). The large majority of low-paid workers are not eligible due to the resources of other household members. From a life course perspective, the growth of low-paid workers is nevertheless alarming. Apart from the *current* financial hardships for them, it is obvious that working at such low wages for more than a short period will lead to inadequate pensions after retirement. The average period of being on low pay is indeed on the increase (OECD, 2006, pp. 176–8; Schank et al., 2008). In response to this development, the Government has enacted minimum hourly wages in a number of industries, although the introduction of a *general* statutory minimum wage and an extension of in-work benefits are still politically controversial. However, the minimum wages valid in certain industries are too low to generate adequate pension entitlements.

During the period 1991 to 2005, there have always been about 38 and 39 million gainfully employed people in Germany (see Table 2.1). However, the number of employees liable to social insurance contributions and, thus, earning regular entitlements to pension and unemployment benefits, has dropped by about 3.7 million. The declining share of compulsorily insured workers, down from 77.5 (1991) to around

68 per cent (2005 and after), is due to structural shifts towards service sector jobs, to cyclical effects and, not least, to the growth of marginal part-time jobs ('mini jobs') and self-employment (Bach *et al.*, 2005). This development has two effects: (1) the revenue problems of the social insurance schemes are exacerbated but relatively higher pensions still have to be paid to present retirees with a more favourable contribution record than succeeding cohorts (Fachinger, 2007); and (2) it expands the number of workers without adequate social protection coverage so that the declining reach of the public pension scheme can be expected to entail increased 'pockets of poverty' among elderly people.

2.4 Pension reforms: declining benefit generosity

The prime objective of all pension reform legislation since 1989 has been to contain the rise of the contribution rate resulting from demographic aging. In particular, the focus has been on employers' non-wage labour costs. Since the introduction in 1891, employers have paid half the contributions to the public pension scheme. In order to limit the employers' share, in 2001 a maximum rate was legally fixed – not higher than 20 per cent until 2020 and not more than 22 per cent before 2030. To meet these targets, a modified benefit formula applies to new retirees as well as to the adjustment of pensions in payment. As a result, the *net* replacement ratio for the 'standard pensioner' (average earnings for 45 years) will decline by about *one quarter* between the beginning of the 2000s and 2030 – from 69 to 52 per cent (Hain et al., 2004, p. 344; Kommission, 2003, pp. 104–8).[13] Thus, the 2001 reforms were an explicit departure from the, hitherto valid, principle of income maintenance achieved solely through public pensions. They marked a shift towards the 'multi-pillar approach' that puts more emphasis on individual responsibility (Hinrichs, 2005). Additional occupational or private pensions will be indispensable for ensuring a retirement income at a level similar to what the public scheme promised previously. In order to encourage supplementary retirement savings, voluntary contributions to certified private pension plans (so-called *Riester-Rente*) of up to 4 per cent of gross earnings are subsidized, or benefit from tax exemptions.[14]

The reduction of the standard replacement ratio affects all future pensioners. This component of the reform has been in the focus of the debate about the return of poverty in old age. However, for workers whose employment career differs from the assumed 'standard pensioner', it is crucial how periods of non-employment and low pay are treated when the public pension is calculated at the time of retirement.

Certain provisions were meant to favour insured people, who had only built up a low level of entitlement from contributions paid while in covered employment. Indeed, these measures largely attained their objectives in the past and led to less unequal public pensions (Stegmann and Bieber, 2010). However, in addition to *general* retrenchment, pension reforms since 1989 have repeatedly cut or even abolished entitlements for those periods – except for periods of child-rearing and caring for frail elderly people. The reduction or abolition of credits to secure a socially adequate pension level has strengthened the equivalence principle (that is, tightened the contribution-benefit link) and reduced the public scheme's redistributive (that is solidarity) features. Therefore, it becomes even more important to produce a continuous full-time employment career up to age 65 (in future, age 67) in order to achieve at least a modest public pension (see also Riedmüller and Willert, 2007, p. 155). In the following I will look into several of the changes which affect workers with non-standard careers in particular and which, depending on the individual's career and wage level, may lead to enormous losses (see also Lühning, 2006; Borgmann and Heidler, 2007).

One element that helped the long-term insured to attain socially adequate pensions was to *revalue* years with covered earnings lower than 75 per cent of average earnings so that they equalled a minimum level (*Rente nach Mindestentgeltpunkten*). In 1989, it was decided to abolish this advantageous provision for low-paid workers for all insurance years after 1991. As a result, workers with very low earnings will hardly ever have a chance to be entitled to a public pension that exceeds the poverty threshold, unless the period of part-time employment or low-wage employment is very short.

Moreover, until 1996, earnings during the first four years of covered employment were revalued to a level of 90 per cent of average earnings. Thereafter, only the first three years were taken into account and only at 75 per cent of average earnings. In 2004, it was stipulated that the revaluation of earnings takes place only if these three years were periods of occupational training (for example an apprenticeship). This cutback was implemented retroactively and applied to all workers except those close to retirement age. The same happened with credits for schooling and (university) education after age 16: they have been reduced from up to 13 years (before the Pension Reform 1992,) to 7 years at a maximum value of 75 per cent of average earnings. Again, the reform in 1996 cut the number of credited years to three and, in 2004, those credits were *completely* abolished for all workers retiring in 2009 and later.[15]

Because atypical workers are much more at risk than others of having their career interrupted by spells of unemployment, the impact of joblessness on their pension entitlements and the way the relevant provisions have changed is most important to them. The pension reform of 1989 did not lead to any substantial impairment compared to the previous rules: Contributions were paid on behalf of the recipients of unemployment insurance and assistance benefits on the basis of 80 per cent of previous earnings.[16] This has not changed for the recipients of unemployment *insurance* benefits (nowadays called ALG I). However, a smaller proportion of registered jobless people receive ALG I now: it is down from more than 50 per cent in 1991 to about 30 per cent today (BMAS, 2010, Tables 2.10 and 8.11). This is the result of tightened eligibility rules and the rising proportion of the long-term unemployed. The decline is also caused by the growth of atypical employment, because an entitlement to ALG I requires covered employment of at least 12 months within the last 24 months before registering as unemployed.

Moreover, since 2000, the credits earned by the recipients of means-tested unemployment *assistance* benefits were based on the much lower level of benefits *actually* paid (as notional 'earnings'). Another substantial deterioration occurred in 2005 when the Hartz IV law was implemented (Hinrichs, 2007). This law transformed the earnings-related, but means-tested, unemployment assistance scheme into a flat-rate, means-tested basic security scheme for the unemployed (ALG II). Since then, contributions on behalf of the recipients have been transferred to the public pension scheme on the basis of €400 of notional earnings per month. In January 2007, the basis was reduced to €205[17] and, beginning in 2011, these almost negligible contributions are abolished completely. The step-by-step reduction of contribution payments produced immediate savings for the federal budget and corresponding revenue losses for the public pension scheme. As a result, there will be lower public pensions for the long-term recipients of ALG II and correspondingly higher public expenditure for the minimum security scheme when more elderly have to be lifted above the poverty line.

The Hartz laws introduced a further retrenchment. Since 1987, unemployment insurance benefits have been claimable for up to 32 months for job-seekers aged 54 and older. Workers becoming unemployed after January 2006, who are entitled to these insurance benefits (ALG I), cannot receive them for more than 12 months (24 months for unemployed people 55 years of age and older). Thus, the long-term unemployed will become dependent on ALG II earlier and, consequently, earn no pension credits after 2010. Spells of unemployment during a career may have effects on supplementary pension saving as well. If people have contributed at all to a private pension plan before losing their job, many will be unable to continue saving while unemployed and the assets available for a pension will be lower at the time of retirement.

All opportunities to start drawing a pension before statutory retirement age without permanent deductions have been phased out. For each month the pension is claimed early, it is reduced by 0.3 per cent (3.6 per cent per year). In addition, not having earned credits up to statutory retirement age means a further loss. The most vulnerable members of the workforce are also those most in danger of being prematurely expelled from the labour market. The comparatively high unemployment rate in the age bracket 55–64 indicates that this group has little chance of becoming re-employed before ultimately retiring (OECD, 2006, pp. 251–2; Brussig, 2010). The problem is particularly severe for older workers with limited skills. The positive relationship between educational level and the employment rate in the upper age brackets shows this quite clearly (OECD 2005, p. 58). Low earnings – consistently related to low skills – and a short employment career often coincide. According to the AVID study, West German employees of both sexes in the lowest income quintile (due to low pay or part-time work) will end up with 29.5 insurance years compared to 34.0 years for those in the second to fifth quintile; for East Germans the respective figures are 37.9 and 40.6 (Heien et al. 2007, pp. 249–50).

Finally, in 2001, a reform of disability pensions came into effect that, in general, means lower benefits for insured people who leave employment for health reasons before reaching age 63. Their disability pension is reduced by 0.3 per cent per month prior to age 63 up to a maximum of 10.8 per cent. The individual contribution record prior to the occurrence of invalidity was, and still is, the most decisive factor for the pension level because it determines the additional non-contributory entitlements granted for the period up to reaching age 60. Clearly, an atypical employment career before becoming disabled is disadvantageous. As the average age of accessing a disability pension is about 50, more than 95 per cent of new beneficiaries face a deduction that, in most cases, amounts to the maximum rate. This is one reason why newly awarded disability pensions to males declined significantly after 2000 and are much lower than average old age pensions. For example, in 2009, the respective monthly amounts were €627 and €865 (Deutsche Rentenversicherung Bund, 2010, pp. 66, 104, 116). Financial hardship can be expected to be even larger because savings for a personal pension (*Riester-Rente*) will usually stop upon invalidity. Most individual and employer-sponsored pension plans of the 'defined-contribution' type do not provide for a disability pension.

2.5 The future: more poverty in old age and no good news?

The true effects of the whole range of rule changes implemented since 1989 cannot be read off from replacement rates for pensioners having followed a 'model career' (like the 'standard pensioner'). The OECD study (2009, pp. 117, 121) calculates the pension entitlements of workers with different wage levels but always complete employment careers. The calculations provide interesting comparative information and, furthermore, show how strictly the equivalence principle is applied in Germany's public pension scheme. The replacement ratio is the same for all wage levels up to the contribution ceiling. However, it is important to know to what extent those 'model careers' are actually representative. In order to evaluate the effects of the numerous general and selective retrenchments (and the individual coping strategies in response) for future pensioners with different career patterns one needs micro data, as in the large-scale survey of the birth cohorts from 1942 to 1961. However, except for a few estimates (Heien et al., 2007, pp. 273–6), calculations of expected total retirement income are not based on the present benefit formula for the public pension scheme.

The recent simulation study by Geyer and Steiner (2010) is also based on longitudinal micro data and covers people born between 1937 and 1971. It takes into account the effects of recent pension reforms and reveals significant differences in the development of public pensions in West and East Germany. Men in West Germany, who were born after 1956, will face somewhat lower benefits and a declining replacement rate as a result of pension reforms. The reforms will impact on younger women in West Germany as well, but this is more than outweighed by their longer participation in covered employment. Nevertheless, their pension levels will continue to be significantly lower than those of men. Most dramatic will be the decline in East Germany. Without an immediate and substantial improvement in the labour market situation, the retirement income prospects of younger birth cohorts there look poor. This is the result of widespread long spells of unemployment (see also Tables 2.2 and 2.3) which disproportionately affected workers with low qualifications and, correspondingly, low earnings and

Table 2.2 Incidence of particular episodes (more than one year) during the employment career for different birth cohorts (extrapolated after 2002) in West and East Germany, as a percentage

	1942–46 West	**1957–61 West**	**1942–46 East**	**1957–61 East**
Men				
Compulsorily insured GRV	95.9	97.2	99.4	99.5
– full-time	95.7	97.2	99.4	99.5
– part-time	3.0	2.9		
Self-employed	15.1	23.1	11.5	19.2
Marginal empl.	12.5	15.3	15.8	18.6
Education > 16	80.2	97.4	75.0	95.9
Unemployed	37.9	53.7	67.1	55.8
Women				
Compulsorily insured GRV	94.7	97.7	99.0	98.9
– full-time	91.2	96.9	98.6	98.9
– part-time	39.3	61.0	28.2	32.7
Self-employed	7.3	8.4	8.3	19.2
Marginal empl.	31.3	56.2	10.4	29.3
Education > 16	84.7	97.1	77.9	98.8
Unemployed	38.5	58.9	72.0	72.3

Source: Calculated from AVID 2005 database (http://www.altersvorsorge-in-deutschland.de/index.html).

pension entitlements. It was calculated that future male pensioners in East Germany, who were born after 1960, may end up with a public pension amounting to little more than 30 per cent of average earnings, and women may be entitled to even less than 30 per cent.

Some additional easily accessible data show that the decline of actual public pension payments has already begun. In *nominal* terms, the average monthly pension awarded to *newly* retired *men* in *West* Germany fell from €883 in 2000 to €816 in 2009. The 2009 amount is little more than what was awarded in 1990 (€793) but, in *real* terms (when adjusted to the consumer price index), it is about 30 per cent less. This development implies that the amount actually paid deviates increasingly from the standard pension after 45 years of average earnings. It was 94.5 per cent in 1990 and fell to 75 per cent within 19 years (Deutsche Rentenversicherung Bund, 2010, pp. 104, 238). The already substantial deterioration in nominal and, particularly, in real terms reflects

Table 2.3 Total number of years (average) particular episodes lasted during employment career for different birth cohorts (extrapolated after 2002) in West and East Germany

	1942–46 West	1957–61 West	1942–46 East	1957–61 East
Men				
Compulsorily insured GRV	34.3	32.2	38.8	32.4
– full-time	34.3	32.1	38.8	32.4
– part-time	2.8	3.8		
Self-employed	17.4	16.4	9.2	13.2
Marginal empl.	4.8	4.7	3.0	3.4
Education > 16	4.2	4.6	4.1	4.4
Unemployed	5.6	7.3	5.2	10.3
Women				
Compulsorily insured GRV	24.5	25.7	35.0	28.8
– full-time	19.5	17.7	32.7	25.9
– part-time	13.9	13.0	9.9	8.6
Self-employed	13.1	11.8	7.3	5.6
Marginal empl.	7.8	7.7	4.2	3.5
Education > 16	3.4	4.0	4.0	5.0
Unemployed	4.1	4.7	4.9	9.9

Source: Calculated from AVID 2005 database (http://www.altersvorsorge-in-deutschland.de/index.html).

the combined impact of individual *and* institutional changes, that is, of employment career shifts and of pension reforms since 1989 that strengthened the equivalence principle.

The deterioration will certainly continue. The impact of the legislated retrenchments can also be gauged from another calculation (Steffen, 2010, p. 2). In 2009, a covered worker on *average* earnings had to pay contributions for 27.1 years in order to be entitled to the basic security benefit (€678 per month). In 2030, no fewer than 32.8 years will be required for an average earner to be entitled to the basic benefit whilst workers who have always earned two thirds of the average wage would have to be employed for 49.2 years – from 18 to 67 years of age – instead of 40.7 years today. Such a long career is hardly realistic. Moreover, only if this low-wage worker had additional pension savings, along the lines of the government's assumptions for a *Riester-Rente*, would the combined pension benefits lift him or her above the poverty threshold after less than 45 years of uninterrupted employment, depending on the rate of return of supplementary savings (Bundesregierung, 2008b, pp. 88–9). Obviously, the difficulty of attaining a poverty free retirement income implies a serious threat to the legitimacy of the contributory scheme, when public benefits of the same (or a higher) level could be collected without previously paying contributions at all.

The grave financial consequences of pension reforms, and the implementation of the Hartz IV law, are also demonstrated in a comparison carried out by Mika and Baumann (2008). They calculate the pension amount for fictional members of two birth cohorts (1939 and 1955). It is assumed that both earn an average wage for 30 years and finally exit from paid employment at age 55. Such premature termination of employment happened quite often to workers born in the 1930s and in no way represents an extreme case. It has not disappeared from subsequent birth cohorts. There is still a large group of elderly and mainly low-skilled workers, who ceased to be employed during their late 50s. They are still several years away from eligibility for an old-age pension (Brussig, 2010). Taking into account the various legislative changes that apply to a person born in 1955, Mika and Baumann (2008) calculate a monthly amount of €678 for when a person first draws a pension in 2018 at age 63. This is nearly 25 per cent less than the amount the person born in 1939 could claim and, if living in a one person household, would possibly make her eligible for means-tested basic security benefits.

Pension security for workers deviating from a career on SER conditions may not always be as endangered as is feared by critics of increased labour market flexibility and pension reform policy in Germany. I will briefly discuss four developments that could possibly alleviate a heightened poverty risk in old age.

(1) The labour market situation for elderly workers has improved markedly since 2000 and there was no massive setback in the wake of the economic downturn of 2009. Germany met the EU target of an employment rate of 50 per cent among the population aged 55–64 for the first time in 2007 (Bundesregierung, 2008a, p. 56). The same year, legislation was introduced to raise the statutory retirement age gradually from 65 to 67 from 2012 to 2029. Within the age corridor of 63–67, taking retirement is flexible but this carries a maximum deduction of 14.4 per cent.[18] The higher retirement age is a reasonable response to the once excessively utilized early retirement pathways and a way of coping with further increases in life expectancy in view of a declining working age population. A higher retirement age is also beneficial for low-wage workers and those with discontinuous employment because they can earn additional entitlements. However, those employees who badly

need a longer working life for financial reasons are least able to remain employed until age 67 due to poor health or having lost their job. It is most likely that low-wage, low-skilled employees will continue to bear the risk of being squeezed out of employment prematurely and thus be forced to take out their public pension as early as possible at age 63, if not earlier in cases of disability. They will face even larger permanent deductions than today. 45.2 per cent of all new old-age pensioners (697,000) in 2009 experienced a reduction of their benefit due to retirement before the statutory age. On average, the reduction amounted to €117 (Deutsche Rentenversicherung Bund, 2010, p. 69).[19] Additionally, after retirement, savings for a private pension are usually discontinued, and accumulated assets (if any) have to be stretched over a prolonged retirement period.

(2) At the other end of the employment career, the average age of entry into the labour market has gone up for subsequent cohorts because of prolonging education beyond age 16 (see Tables 2.2 and 2.3). As those periods of education no longer enhance entitlement to public pensions, entering covered employment at an earlier age becomes most important in building a sufficiently long contribution record. It also extends the potential period of saving for private pensions (with the benefit of compound interest). The earlier economic independence of children also offers parents an opportunity to intensify their savings efforts (Pfeiffer et al., 2005). Requiring fewer years of schooling to attain the qualification for entering tertiary education (12 instead of 13), and the results of the Bologna process, might promote such a development. As with employment opportunities for older workers, a lower average age of entry is contingent upon the absorptive capacity of the labour market.

(3) Lower *individual* entitlements to public pensions do not necessarily mean that, in future, more elderly *households* will become poor and dependent on minimum security benefits. The upward trend in female employment (see Table 2.1) will be strengthened by expanded child care facilities. Women will receive higher pensions because of additional caregiver credits[20] and a more continuous and, thus, longer labour market participation will lead to higher second public pensions in elderly couples' households. To some extent this will ameliorate the income situation. Apart from a general decline in the stability of marriages and, hence, the chances to pool resources, elderly people living alone because they have never married or divorced are more prevalent among those with low skills or discontinuous employment. In contrast, one finds families that have been dual earners more often when

both spouses have obtained higher skills (Riedmüller and Willert, 2008, pp. 15, 30–3).

(4) Recently, provision for old age through second and third pillar pensions has expanded substantially (although there is no unequivocal evidence because of double counts or missing information about the regularity and level of contributions, or the prospective benefits). Between 2001 and 2007, the share of compulsorily insured workers also covered by an employer-sponsored pension scheme rose from 38 to 52 per cent (Kortmann, 2008). Along with this expansion, there was a shift towards defined contribution schemes and employee financing. Workers often earn their entitlements through their own contributions by voluntary 'earnings conversion', with or without an employer match. Additionally, after a sluggish start in 2002, contracts for subsidized private pensions (*Riester-Rente*) increased greatly. In December 2008, 12.2 million people were saving for this type of pension product, corresponding to about a third of all entitled employees (Bundesregierung 2008b, pp. 71–83). Although the number of contracts for a *Riester-Rente* has further increased to 14.4 million in December 2010, neither occupational nor private pensions will ever attain complete coverage on a voluntary basis. People in the middle and upper income strata can be expected to participate more often and, in fact, survey results show the skewed distribution according to individual and household income quite clearly (Börsch-Supan et al., 2008; Geyer and Steiner, 2009; OECD, 2009, pp. 103–4). Moreover, low-paid workers are more prone to interruptions and fluctuations to their earnings. They are least likely to be saving continuously for a private pension – if they take out a contract at all. Thus, the workers who need supplementary retirement income most will very often have to rely solely on public benefits. Those who may expect a public pension at or below the basic security level have good reason not to engage in voluntary pension plans because the yield of their savings efforts is taxed at a 100 per cent rate (see next section).

2.6 Flexicurity: flexible labour markets plus basic security in old age

Flexicurity has become *the* catchword for a successful strategy to overcome the unemployment problem and, at the same time, retain social security for workers confronted with an increasingly flexible labour market. Originally, the concept was directed at facilitating and cushioning transitions within the labour market; for example, from unemployment or training to employment, or from part-time to full-time work and back. Denmark and the Netherlands are nowadays the most prominent examples of the feasibility of protected flexibility. The role of the universal, flat-rate pension independent of previous employment is crucial in this regard (see chapters by Anderson and Ploug in this book).

However, a simple transfer of either the Dutch or Danish design of basic pensions to cope with increasing old age poverty in Germany is not feasible in the short term. No politician is proposing such a transformation of the German pension system. Lessons drawn from the Dutch and Danish experiences have to be compatible with the relevant institutional context. The German earnings-related, contributory public pension has to overcome two weaknesses: a changing employment landscape; *and* the retrenchments that have been part of several pension reforms since 1989.

After a long insurance commitment, a contributory public pension scheme should at least provide higher benefits than one is entitled to in old age from a non-contributory scheme. If this is not the case, there is no incentive to engage in covered employment. The legitimacy of an obligatory scheme suffers when there is nothing in return for one's contributions: they are perceived as a kind of 'tax'. Thus, it is the *first weakness* of the German public pension scheme that, due to the retrenchments described above, an increasing number of years in covered employment is required to attain the same level of benefits that the minimum security scheme provides. Workers with below-average earnings and/or discontinuous employment are highly unlikely to reach that threshold.

A 'standard employment career' will yield no more than a modest public pension, and extra savings are required for income maintenance. The comprehensive means test applied in the minimum security scheme for pensioners constitutes the *second weakness*. Taking into account a household's income from all sources, as well as accumulated assets, runs counter to political efforts to strengthen individual responsibility for retirement income. In fact, it provides a strong disincentive for workers who can reasonably expect a public pension at or below the minimum security level to engage in extra saving for old age and to forego consumption opportunities today. In this sense, a 'savings trap' is created, and this group of elderly people ends up in a financially less comfortable situation than they should have done. Apart from exposing potential beneficiaries to the procedures of means-testing, which are often perceived as dishonourable, a 100 per cent take-up rate of all eligible persons cannot be assured. A universal, non-targeted basic pension scheme is definitely advantageous for that reason.

The administration of the German public pension scheme is well aware of its declining effectiveness as a bulwark against poverty in old age, and several options have been discussed for coping with the weaknesses mentioned above (see Thiede, 2005; Loose and Thiede, 2006; Loose, 2008). Starting from the existing employment-centred public pension scheme, an important reform element, also mentioned by Loose and Thiede (2006, pp. 486–7), is to extend mandatory coverage to *all* gainfully employed persons who are not yet obligatory members of special schemes (like civil servants or doctors, lawyers, architects and other liberal professions). Thus the growing number of self-employed could be effectively protected, and transitions between dependent work and self-employment would have no negative consequences, but referring them to the public pension scheme would not be an adequate solution as long as the scheme itself is no longer reliably protecting against poverty.

So, such an extension of coverage would merely be a precondition to 'bringing (more) redistribution back into the public scheme'. This would be achieved by the following proposal.[21] After a long insurance career, say 35 years, a basic pension would be provided at *statutory* retirement age (or when disability occurs). The basic amount should be somewhat more generous than the assistance level and would be solely means-tested against the public pension, applying a withdrawal rate of less than 100 per cent. None of the present procedures for calculating the earnings-related pension would have to be modified. Likewise, for employees with a complete insurance career and average or above-average wages, nothing would change: their public pension would exceed the basic pension level (or the higher phasing-out zone). The beneficiaries of the basic pension were those long-term insured workers who fail to attain a public pension at or slightly above that level. Because other income components (from individual savings plans or occupational pensions) would be disregarded, their interest in increasing retirement income beyond the basic benefit would be encouraged. If a long insurance career were required to obtain at least the basic pension people would also have an incentive to take a job. A minimum security scheme, like the one recently implemented, would be indispensable for accommodating those unlucky workers who are unable to produce the required number of insurance years when they end up with very low public pension entitlement.[22] The difference between the earnings-related public pension and the basic pension would have to be tax-financed. The total amount of tax money spent for this purpose could be expected to grow as the level of earnings-related pensions declines and the number future retirees with irregular employment patterns and insufficient entitlements increases. In contrast, supplementary tax spending goes down as more entitlements are earned, because of employment opportunities and improved employability, especially of older workers.

The proposed arrangement is somewhat similar to the two-tier system of public old age security that has emerged in Sweden, Finland and Norway. The universal basic pension paid to all citizens after reaching retirement age has been transformed into a Guarantee Pension, solely tested against the public earnings-related pensions. Although this transformation meant a break with the Nordic principle of universalism, it was unspectacular because there were hardly any losses for present (and future) pensioners (Hinrichs and Kangas, 2003). In that sense, the proposal put forward here would strengthen the incentives to engage in gainful employment and additional retirement savings and make flexible employment patterns individually and socially more palatable because security in old age is always ensured.

2.7 Conclusions

Pension reforms in Germany since 1989 have *not* adjusted the public pension scheme to the risks emanating from an increasingly flexible labour market. Instead, reforms have strengthened the necessity of realizing a career that matches the traditional SER concept. The tension between a strengthened role for the SER and its actual decline disadvantages a growing number of workers, who are unable to meet the condition of long-standing, continuous full-time employment until statutory retirement age. This group will face an increased risk of earning retirement income below the poverty threshold. The puzzle is why German policy makers adopted reforms that will most likely lead to a resurgence of poverty in old age.

Pension reforms since 1989 have predominantly been intended to contain future expenditure and, as a consequence, preventing an even larger increase in the contribution rate. Changes which strengthened the contribution-benefit link supported these objectives, and there were plausible justifications for cutting the respective provisions. For example, a revaluation of earnings below 75 per cent of earnings would unfairly favour the growing number of part-time workers because the administration cannot distinguish employees whose low covered earnings result from low hourly wages from those who work short hours. Likewise, the ultimate abolition of credits for schooling and education was justified because they often benefited employees who secured high entitlements anyhow. The substantial reduction of the standard replacement rate, with individual savings efforts compensating for the fall, followed a paradigm change that was also influential in Germany (Hinrichs, 2005). The turn towards the multi-pillar approach was considered the most effective strategy for guaranteeing the scheme's financial sustainability and, above all, to keep employers' contribution rates in check.

The problematic long-term overall effects of these incremental and structural changes were possibly underestimated by the political actors who devised the pension reforms. They overestimated the effect of subsidies in motivating nearly a hundred per cent of workers to take out a contract for a *Riester-Rente* and top up the declining level of public pensions. Proponents of a more flexible labour market assumed atypical employment to be a springboard for stable integration and upward income mobility but miscalculated the growth and the permanence of those employment patterns which were eased by several re-regulations. Likewise, the move towards activation that was put into effect by the Hartz laws was expected to shorten unemployment spells but lower unemployment did not materialize before the demand for labour picked up (after 2005) as a result of economic growth. Thus, the increasing risk of poverty in old age will largely be the non-deliberate result of cumulative and uncoordinated reform activities, and partly the result of compartmentalization between (and within) the responsible ministries.

But what if the incumbent governments in the new millennium had deliberately accepted that an increasing number of retirees would depend on means-tested benefits as a result of their pension and labour market reforms? A recent shift gives cause for a different interpretation. So far, the municipalities have had to bear the major part of the expenses for the basic security scheme for old age and disability pensioners. The federal government will take over complete financial responsibility in 2014. This opens up new political opportunities for a rearrangement of basic and earnings-related pensions to cope with the consequences of a more flexible labour market. It will definitely not mean a return to the pre-1989 public scheme that provided income maintenance in old age. In view of the outlook of 'permanent austerity', it remains questionable whether the next steps in the endless series of pension reforms in Germany will lead to better protection of atypical workers along the lines of the one proposed in the previous section.

Notes

1. See for example Sozialverband Deutschland, 2007; Kistler et al., 2008 (a report prepared for a network of the German trade unions' peak organization, senior associations and two charities); Schmähl, 2007. In the 2008 report, even the Board of Economic Advisers included a section headed 'Risks of increasing old-age poverty must not be neglected' (Sachverständigenrat, 2008, pp. 378–86).
2. It should be noted that the OECD's (2007, p. 15) average-earnings definition results in a considerably higher amount (€41,046 in 2004) than the one used in the German context and in this chapter. The average gross earnings of workers insured with the public pension scheme came to only €29,060 in 2004 (Deutsche Rentenversicherung Bund, 2010, p. 238).
3. Before, pensioners with insufficient resources were referred to the general social assistance scheme. Benefits from the new basic security scheme are still means-tested and are not higher than before. However, the traditional obligation of adult children to support their elderly parents financially has been lifted.
4. Funded schemes are not completely immune from political risks either. Statutory regulations of pension funds may change as well as the relevant tax rules.
5. Researchers usually distinguish between external numerical flexibility, internal numerical flexibility, functional flexibility and wage flexibility – see for example Wilthagen and Tros (2004).
6. The consequences show up in the pension amount: calculations with the AVID data set show that, compared to never/less than one year unemployed persons, workers will obtain a public pension about 25 per cent lower if they have been unemployed for at least one year during their career (Heien et al., 2007, p. 236).
7. The EU (and OECD) figures are considerably higher than the ones shown in Table 2.1. They mainly differ because of Germany's apprenticeship system which still trains a significant share of school leavers for an occupation. If the apprentices, all on fix-term contracts, are excluded, in fact, the percentage of fixed-term work on an involuntary basis is lowest among the EU27 countries, except for Austria (European Commission, 2008, p. 35).
8. A representative survey among young employees (between 18 and 34 years of age) showed that, after completing certified job training of any kind, only one third immediately entered open-ended full-time employment, 43 per cent passed through one or more atypical jobs (and internships) first, and 25 per cent are still moving between different forms of atypical work and unemployment (Fuchs and Ebert, 2008).
9. For empirical studies on the 'bridge' or 'trap' question, see, for example, Gensicke et al. (2010) and Schäfer (2010).
10. The remaining fifth included students and pensioners. Another 2.2 million people held a 'mini job' as their second job in 2009.
11. Different categories of self-employed (solo self-employed, those with staff and family workers) make up for the rest (see the following paragraph).
12. See also Eichhorst et al. (2010, pp. 31–7). Rhein (2009, p. 6) calculated *annual* earnings of employees having worked at least 1,820 hours and arrived at

considerably higher shares of full-time working poor: 18 per cent in 1994 and 22 per cent twelve years later. The latter figure almost matches the US level (25 per cent). Frank and Grimm (2010, pp. 24–7), using social insurance data, compute a similar percentage of (obligatorily insured) full-time workers earning less than two third of the median monthly wage in 2009: 20.2 per cent in West Germany and 21.3 per cent in East Germany; among women about *one third* of all full-time employees is low paid.

13. In 2004, 2005, 2006 and 2010 it meant that new pensions and pensions in payment were not indexed, because the 'brake factors' included in the benefit adjustment formula nullified the effects of (low) wage growth in all preceding years. In fact, there should have been nominal *reductions*. As this is ruled out by law, lower adjustments (than actual wage increases) in subsequent years will again make up for the reductions that have not materialized yet.
14. In fact, after the reform of 2004, which will further lower the standard pension level, *continuous* savings of four percent of gross earnings throughout the *complete* working life will not suffice to attain the accustomed level of wage replacement in future. In its latest report on financial security in old age, the government calculates a roughly constant replacement level based on the assumption that employees *additionally* save all net income gains accruing from the gradual transition to the deferred taxation rule ('EET principle', that is contributions to public and private pension schemes and the interest yields are tax exempted while pensions are taxable upon receipt) (see Bundesregierung, 2008b, pp. 84–95).
15. Rule changes like this one produced the intended savings effect so rapidly because the reform legislation of 1989 contained a little noticed but extremely significant clause whereby certain circumstances relevant to the benefit calculation were to be appraised according to the legal rules valid when actually applying for a pension. Grandfathering is thus restricted to changes which explicitly define transition rules (Lühning, 2006, p. 517).
16. In 1996, it was stipulated that no further contributions in favour of unemployed people would be paid for those who do not qualify for unemployment benefits.
17. The contribution base of €205 equals 8 per cent of average earnings, so that one year of ALG II receipt generated an entitlement presently worth €2.19 in monthly pension benefits. In 2007, between 7 per cent (birth cohort 1957) and 10.9 per cent (birth cohort 1948) of all insured received ALG II, and the younger they were, the lower their hitherto earned entitlements per year in covered employment were (Loose and Ohsmann, 2010).
18. For seriously handicapped workers the 'standard' retirement age will rise to 65, and they will be eligible for flexible retirement at age 62 at the earliest but then face a permanent deduction of 10.8 per cent based on the entitlements earned when claiming the pension for the first time.
19. Of course, not all early retirement is involuntary. A considerable number of older workers may value the activities one can pursue or extend after retirement more than higher pensions and make use of flexible exit options.
20. While credits for other periods of non-employment and low earnings have been reduced or completely abolished, child care and informal care for people

receiving long-term care benefits were acknowledged as equal to paid employment and rewarded with quite generous pension credits, mainly to the benefit of women. These policy changes, and the fact that more women participate in the labour market for more years, complicate an evaluation of the combined effects of labour market flexibility and pension reforms, which both operate in opposite directions. On the future retirement income situation of women see also Heien et al. (2007); Bundesregierung (2008b pp. 52–3).

21. It was already part of a conference paper I presented in March 2007 and on which this chapter is based. Bert Rürup, then chairman of the Board of Economic Advisers, came forward with a somewhat similar proposal in 2008 (*Handelsblatt*, 2 January 2008; see also Sachverständigenrat, 2008, p. 383).
22. They would possibly form one group of discontented pensioners because of being subject to the comprehensive means test. A second group of displeased retirees could be those who have earned entitlements at or slightly above the basic pension and do not see an appropriate reward for having paid higher contributions or having worked more years.

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3
A Risky Combination in Italy: 'Selective Flexibility' and Defined Contributions Pensions

Matteo Jessoula

3.1 Introduction

In October 2010, the pension debate in Italy suddenly took on a new urgency when the president of INPS – the National Social Insurance Institute – stated that 'if projections of future pensions levels for some categories of atypical workers were revealed, there would be risk of social revolt' (*Corriere della Sera*, 2010). This is striking in the light of comparative data showing that public pension levels are currently higher in Italy than in most other European countries.[1] Also, it suggests that the interaction of pension and labour market rules is a hot issue in the Italian public debate, particularly concerning security in old age in the coming decades for atypical workers.

Since the Golden Age, the Italian welfare state has actually been characterized by a robust old age protection system, based on the 'Bismarckian compromise' forged in the 1950s-60s (Jessoula and Alti, 2010). The system aimed to guarantee adequate and continuous income, both in employment and in retirement, through the combination of specific pension and labour market arrangements. An inclusive single pillar retirement system (public and Pay As You Go) provided compulsory coverage for the employed population and delivered generous benefits through subsequent extensions of the earnings-related system to all compulsorily insured workers. The predominance of full-time permanent contracts and a high level of job security (through strong employment protection legislation) allowed long and mostly uninterrupted careers that resulted in full pensions. In addition, old age protection was reinforced by mandatory severance pay schemes for both public and private employees, in most cases providing generous lump sum benefits at retirement for those with continuous employment. In contrast to the high levels of security in old age for those previously in employment, redistributive measures targeted at 'outsiders' and aimed at combating elderly poverty have traditionally been limited.

Over the last two decades, this peculiar combination of employment and pension rules has been radically altered by reforms in both policy sectors. 'Flexibilization' of the Italian labour market has been pursued 'at the margin' or 'selectively' (Regini, 2000) by favouring the spread of atypical contracts, especially among younger cohorts. As for pensions, since 1992 an incremental reform process has substantially modified public Pay As You Go (PAYG) schemes and moved the Italian pension system towards a multi-pillar configuration. Like recent labour market reforms, changes in the field of pensions have mostly been targeted at younger cohorts entering the labour market since 1996, for whom the new National Defined Contribution (NDC) method (introduced in 1995) fully applies. Thus, the emerging pension system for younger generations is based on a peculiar combination of NDC public schemes and private voluntary defined contribution (DC) pensions – in addition to minimum protection through mean-tested benefits for those with no contribution records or an insufficient one.

Contributions-related schemes – both NDC and DC – individualize risks and deliver pensions that closely reflect the previous employment pattern and career. *What is, then, the pension scenario resulting from the interaction between the new pension rules and increasingly flexible labour market arrangements? In particular, what are the future prospects for old age security for the growing share of atypical workers?* This chapter addresses these two questions by first presenting (Section 3.2) the emergence and consolidation of the traditional model of old age protection during the Golden Age (roughly 1945–75). The subsequent sections focus on labour market reforms and developments (Section 3.3), and the reconfiguration of the pension system in the last two decades (Section 3.4). In Section 3.5, the interplay between novel labour market and pension arrangements will be discussed in order to single out likely pension prospects for non-SER workers, as well as to identify the changing pattern of old age security in Italy.

I will argue that, in the coming decades, old age security will be guaranteed only if the following conditions are met: participation and payment of full contributions in both the first and supplementary pillars, in combination with employment patterns allowing full uninterrupted careers and delivering at least average wages. These conditions seem to be out of reach for a large proportion of atypical workers.

3.2 Legacies from the Golden Age: an inclusive and generous pension system plus highly regulated labour market

In order to present the model of old age protection that emerged in Italy during the period of welfare expansion, it is first necessary to sketch briefly the evolution of pension rules from the introduction of compulsory insurance until the 1990s, and then focus on the interaction of these regulations with labour market arrangements. This will also allow us to capture the specific patterns of inequality generated by the interplay of pension and labour market policy.

Between the introduction of compulsory old age insurance for private employees in 1919[2] and the 1950s, the Bismarckian pension system guaranteed a varying degree of income security at retirement to public employees and most dependent workers in the private sector. The level of protection varied because public employees received relatively generous earnings-related pensions, while private sector workers were entitled to DC and rather low benefits. White-collar workers earning above a threshold, as well as the self-employed, were not covered, and there was no safety net to protect against poverty in old age.

Things changed in the 1950s–60s, when the public pension system became progressively more inclusive, as well as more generous, after the adoption of piecemeal reforms along three different trajectories. First, following the original Bismarckian orientation – according to which old age protection was primarily to be guaranteed for those in employment (CRPS, 1948) – compulsory coverage was extended to all private sector employees (1950) and to the three major categories of self-employed people – agricultural workers (1957), artisans (1959) and merchants and shopkeepers (1966). Coverage thus reached 100 per cent of the employed population. Secondly, a safety net was built in two stages: a 'minimum pension supplement' was introduced for those entitled to very low contributory benefits in 1952, and a means-tested, non contributory 'social pension' targeted at needy elderly people over 65 years (1969). Thirdly, the system became more generous both because eligibility conditions were relaxed – particularly with the introduction of 'seniority pensions' which allowed retirement with a low contribution record regardless of age[3] while the standard retirement age was left untouched at 60/55 for men and women, respectively[4] – and benefit levels were subsequently raised

(1958, 1962, 1963, 1965) until the adoption of an earnings-related system. This occurred in 1968 for dependent workers in the private sector, and in 1990 for the self-employed, thus completing the expansionary phase of the Italian pension system, which extended well beyond the Golden Age.[5]

The strengthening of old age protection also relied on the progressive adoption – between 1945 and 1969 – of the PAYG method *in lieu* of the funded system, which originally characterized public schemes. This shift actually allowed the full exploitation of favourable economic developments in the 1950s–60s in Italy, with high rates of economic growth – particularly during the so-called 'economic boom' of 1958–63 – a comparatively young and growing population, the expansion of employment – and the consequent increase of contributors – as well as limited unemployment.

Reforms adopted in the expansionary phase ultimately modified the nature and the original goal of the public retirement system, which had been to provide *status maintenance* in old age to certain categories of workers only. After the reforms, the single pillar pension system effectively guaranteed *income maintenance* to the whole workforce, as well as (limited) *protection against poverty* to those not entitled to contributory pensions.

This was also possible due to labour market conditions, which granted access to full pensions for most workers. Since the end of the Second World War, employment policy measures have emphasized building a highly regulated labour market geared towards keeping people in employment – namely, the 'male breadwinner' – rather than favouring flexibility and mobility. This was pursued through different measures and achieved in a few major steps. In 1949, placement services became a state monopoly and rigid bureaucratic procedures were set up for regulating labour market entry. As for exit, three elements must be emphasized. First, permanent, full time jobs dominated, while part-time and temporary contracts were virtually unknown. Secondly, rules for individual dismissals were tightened in 1966, when firing was restricted by law to well-justified cases, and in 1970, when Article 18 of the Workers' Statute prescribed that, in firms with more than 15 workers, employers were obliged to reintegrate fired employees if the Court declared dismissal illegitimate. Thirdly, in spite of limited resources invested in typical unemployment benefits (insurance and assistance) as well as in active labour market policies (ALMPs), special 'wage replacement benefits' (so called Cigo and Cigs) were paid in case of temporary (partial or total) working-time reduction without definitive dismissal, thus allowing firms to respond to crises without firing workers. All these measures framed a model centred on job security and stability. At 3.57 on the Employment Protection Legislation index (EPL) scale, Italy actually ranked among the highest of all OECD countries in 1990. Most private (and even more, public) employees enjoyed continuous careers, rare spells of unemployment, often spending their whole working-life in the same firm or institution – that is 'a job for a life' model. This ultimately resulted in full and very generous pensions for a large proportion of public and private employees: the earnings-related system delivered benefits equal to about 100 per cent of reference earnings after 40 years of contributions in the public sector and 80 per cent for private employees. Moreover, reference earnings were based on the very last few years of employment: the last year for public employees, and the last three years for private employees.

The same combination of factors also shaped the functions performed by the compulsory severance payments for both private and public employees. These workers were actually entitled to lump-sum payments – named TFR (*Trattamento di fine rapporto*) for private employees and *Indennità di buonuscita* for public employees – when they changed jobs, were fired or retired. Due to a pattern of employment based on permanent contracts and strong job security, many workers received these benefits at retirement. So, for past and current pensioners, both schemes often delivered supplementary old age benefits that, until the 1980s, and especially for public employees, were very generous.[6] In sum, at the end of the Golden Age, old age protection was very generous for employees in the public and the private sector because of three interrelated factors: (i) pension rules; (ii) the dominant employment pattern and labour market rules; and (iii) the existence of 'hybrid' severance payment schemes that often performed the function of old age protection.

As for the self-employed-traditionally a broad category in Italy, representing nearly 30 per cent of total employment – before the extension of the earnings-related system they only had access to patchy old age protection.[7] After the 1990 reform, however, they became entitled to generous old age benefits, though they paid much lower contributions (12 per cent of income) than employees (24 per cent of gross wages). This represented one of the most striking inequities of the system.

If labour market and pension arrangements favoured those already in employment – and especially the 'insiders' in core economic sectors – the opposite applies for those not in employment, particularly women whose employment rates were traditionally very low – 27.4 per cent

Table 3.1 Main labour market indicators, Italy, 1970–1990

	1970	1975	1980	1985	1990
Employment rate	52.0	51.4	53.9	51.9	52.6
Unemployment rate	3.2	3.4	7.6	10.4	11.5
Female employment rate	27.4	28.1	33.4	33.4	36.2
Long-term unemployed (≥1 year)*	–	–	–	64.1	68.6

* % of total unemployment.
Source: *OECD* (2010b).

in 1970 and 33.4 per cent in 1980 (Table 3.1). The strong 'familialism' typical of the Italian welfare regime therefore played a major role in ensuring old age security for most women through an intra-family redistribution, as well as widows' pensions. In addition, informal employment in the black economy – estimated at between 20–30 per cent of GDP in Italy – is important because it provides additional (non-taxed) economic resources for women and, more generally, to 'outsiders', thus contributing to household income both during working years and after retirement.

By the early 2000s, official statistics showed a high level of old age security in Italy with respect to both income maintenance and poverty alleviation. This development – ten years after the extension of the earnings-related system to all occupational categories and before most retrenchment measures legislated in the 1990s took effect (see Section 3.4) – is a consequence of expansionary pension reforms and the interplay of pension policy and labour market arrangements. The disposable income of people aged 65 and over was 96 per cent of the income of those aged 0–64 (the EU-15 average is 89 per cent), with pensions representing 83 per cent of the overall income for the former group. In addition, the ratio of median pensions relative to median earnings (0.74 in Italy) was the highest across EU countries, and public pensions replacement rates were high as well – that is, around 77 per cent for those retiring at 65 with 40 years of contributions (Ministero del Lavoro e delle Politiche Sociali, 2002). If we look at poverty alleviation, despite a comparatively high level of poverty risk[8] among the population below 64 years in Italy (19 versus 15 in the EU-15), at-risk-of-poverty rates for the elderly were lower in Italy (14) than in the European Union (17) – and the 5 point gap with respect to younger cohorts testifies to the crucial role of the retirement system.

This positive picture, however, was doomed to disappear. In the early 1990s, exogenous and endogenous challenges (Ferrera, 1998) dramatically reduced the financial sustainability of the pension system and caused labour market stagnation, prompting calls for a radical overhaul of consolidated arrangements in both policy sectors. Joint pressure from the EU convergence parameters set in Maastricht (1992) and financial markets (between 1992 and 1995) had an indirect but tremendous impact on the Italian pension system by exposing a critical financial situation, as well as inequities across occupational categories, which would be further worsened by the extension of the earnings-related systems adopted in 1990. The newly imposed *'vincolo esterno'* (Ferrera and Gualmini, 2004) effectively forced Italian cabinets to address both financial imbalances and (in order to contain costs) the distributive unfairness of the system by means of pension reforms.

At the same time, the definitive opening of the path towards economic and monetary union pushed national policy makers to make a U-turn in employment policies and legislate a thorough revision of labour market arrangements. The next two paragraphs will present, first, labour market developments, followed by a discussion of pension reforms, thus setting the stage for analysing the interaction between changes in the two policy fields in Section 3.5.

3.3 A new labour market: 'selective flexibility' without security

The labour market situation in Italy began to deteriorate in the late 1970s when unemployment increased sharply and employment stagnated (Table 3.1). As in other Continental countries, initial responses relied on the application – with limited adjustments – of existing policy instruments, especially the so-called 'labour reduction route'[9] and 'competitive devaluation' of the national currency in order to contain labour cost and promote exports. By the early to mid-1990s, however, this traditional employment policy approach had reached its limits: the strategy of recurrent devaluations was hindered by EMU, and Italian policy makers were forced to modify the policy repertoire substantially in order to tackle persistently high unemployment rates and declining employment levels (Jessoula and Alti, 2010).

After the government and social partners agreed on a commitment to wage restraint and guidelines for revising the labour market by signing two social pacts in 1992–93, the centre-left cabinet, headed by Romano Prodi, pushed forward a path-breaking reform of employment policies in 1997. The reform prompted a 'selective flexibilization' of labour market arrangements: flexibility was pursued 'at the margin', that is, by favouring the spread of 'atypical', flexible job contracts with lower labour and redundancy costs than 'typical' full-time permanent jobs, and relaunching part-time work. By contrast, job security for insiders remained untouched. Flexibilization was also accompanied by the ending of the state monopoly on job placement services, thus allowing the creation of private temporary work agencies, the development of ALMPs in order to promote employment, and a thorough decentralization of competencies concerning services aimed at matching labour supply and demand.

In 2001, Legislative Decree 368, implementing the 1999 EU Directive (1999/70/EC) on the framework agreement on fixed-term employment, changed the regulation of fixed-term contracts by removing the constraints that had characterized the use of temporary contracts in Italy. One year later, an attempt by the Berlusconi government to reduce employment protection for insiders provoked a harsh reaction from the major union Cgil, ultimately leading to the withdrawal of the proposal. Then, in 2003 a second reform (Law 30/03) further pursued flexibilization at the margin by introducing a number of new atypical contracts (on-call work, job sharing, and so on).

The effects of the reforms were significant and helped to modify the Italian labour market, which has subsequently assumed some unusual traits and displayed some novel trends. Labour market rigidity has sharply declined, as captured by the overall EPL indicator falling from 3.57 in 1996 to 1.82 in 2007 and the EPL indicator for temporary jobs, which fell from 5.38 to 1.88 in the same period. These were the results of deregulation aimed at promoting atypical jobs, which have spread rapidly since the mid-1990s. As shown in Figure 3.1, between 1993 and 2007, atypical employment, as a share of total employment, has increased from 9.3 per cent to 19.9 per cent (Ministero del Lavoro, della Salute e delle Politiche Sociali, 2008). About 12 per cent is temporary employment (including fixed-term part-timers), while (permanent) part-time employment counts for slightly less than 10 per cent.

3.3.1 Targeting atypical employment

At least four important features of atypical employment in Italy must be emphasized. First, out of about 23 million people gainfully employed in 2009, atypical employment in Italy refers to four different categories of worker: (i) about 3.2 million workers in part-time jobs; (ii) 2.1 million fixed-term dependent workers; (iii) a limited number of occasional workers (100,000); and (iv) the so-called *parasubordinati*. The latter are formally self-employed, though most of them work as employees for

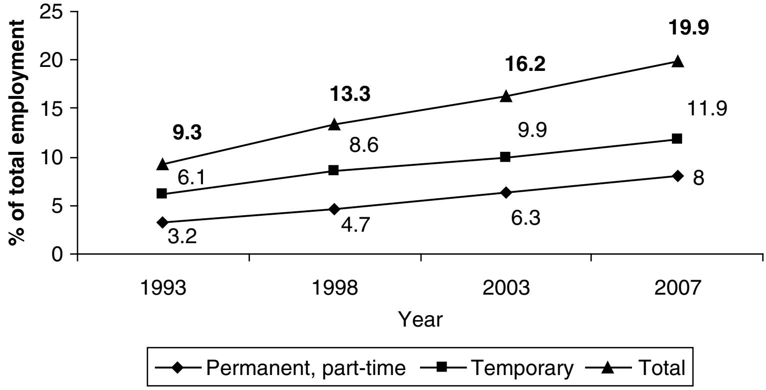

Figure 3.1 Incidence of 'atypical', flexible contracts (on total employment)

Note: Temporary workers referred to: fixed-term employees and project workers, including temporary part-time.

Source: Ministero del Welfare (2005), Ministero del Lavoro (2008).

a single employer as 'project workers' (after the 2003 reform). In the international literature these workers are usually identified as 'false self-employed', or 'economically dependent workers' (EIROnline, 2002). Though estimates vary (Raitano, 2007a, Muehlberger and Pasqua, 2009), this category comprises slightly less than 1 million workers, or about 4 per cent of total employment.

Secondly, as noted above, labour market flexibilization has been pursued 'selectively'. Not only has flexibility been introduced at the margin, with no impact on employment protection for those on standard contracts (the EPL indicator for regular workers has remained stable at 1.77 over the last two decades) but, also, atypical employment has mostly affected new entrants to the labour market. Table 3.2 shows that flexible contracts (specifically, fixed-term jobs) are widespread among younger cohorts, to a much greater extent than, for example, in the UK or in Denmark. In 2009, the incidence of fixed-term contracts in the age bracket 15–24 years reached 44.4 per cent in Italy, 3 percentage points more than the EU-15 average (41.5 per cent). As for economically dependent workers, 73 per cent are below the age of 40 (Raitano, 2007a). Also, in the period 1995–2001, more than 60 per cent of new job contracts were atypical (Ministero del Lavoro e delle Politiche Sociali, 2001). These figures suggest that most young people currently pass through some form of atypical job when they enter the labour market.

Table 3.2 Incidence of fixed-term workers as share of total dependent employment by age (%), 2005 and 2007

	IT	EU-15	DE	UK	NL	DK
15–24 years						
2005	37.0	41.6	57.9	12.4	41.7	27.0
2007	42.3	42.8	57.4	13.5	45.1	22.2
25–49 years						
2005	11.1	12.0	9.2	4.3	11.4	7.9
2007	12.2	12.6	9.9	4.3	14.1	7.0
50+ years						
2005	6.1	6.3	4.4	5.2	6.3	4.8
2007	6.4	6.6	4.7	5.0	7.9	4.7

Source: Ministero del Lavoro, della Salute e delle Politiche Sociali (2008), p. 102.

Thirdly, being on a temporary contract instead of remaining unemployed increases the chances of finding a permanent job (Gagliarducci, 2005) but transitions from flexible contracts to permanent jobs have proved to be quite difficult. A study by the Ministry of Labour estimated that 70.5 per cent of those employed on temporary contracts in 2006 were still on fixed-term jobs one year later (Ministero del Lavoro, della Salute e delle Politiche Sociali, 2008). The other 5.2 per cent were unemployed, 8 per cent abandoned the labour market, and only 16.4 per cent attained stable employment. Similarly, research by Ires (2005) reported that roughly 70 per cent of those employed as project workers in 2004 were still on project contracts one year later. Raitano (2007b) shows that these workers risk remaining trapped in these jobs in the longer run: roughly 35 per cent of those employed as *parasubordinati* in 1999 had the same employment status four years later, compared to only 17 per cent who had moved into dependent employment.

Fourthly, the wages of atypical workers – especially fixed-term and economically dependent workers – are significantly lower than standard employees' and the former earn 10 to 30 per cent less (*ceteris paribus*) (see below Section 3.5).

3.3.2 From recovery to the crisis: virtues and vices of a dual labour market

Seen from another perspective, however, atypical employment has contributed to employment growth during a period of low economic growth (GDP growth in Italy averaged around 1 per cent between 2001

Table 3.3 Main labour market indicators, Italy, 1992–2009

	1992	1995	1998	2001	2004	2007	2009
Employment rate	52.3	51.2	52.2	54.9	57.4	58.7	57.5
Unemployment rate	11.7	11.7	11.9	9.6	8.1	6.2	7.9
Female employment rate	36.5	35.4	37.3	41.1	45.2	46.6	46.4
Long-term unemployed (≥1 year)*	58.2	62.7	60.4	63.7	46.2	45.5	42.0

* % of total unemployment.

Source: OECD (2010).

and 2007). After the 1997 and 2003 employment policy reforms, labour market indicators displayed some positive trends. The employment rate rose from 52.2 per cent in 1998 to 58.7 per cent in 2007, reflecting an overall employment growth of almost 3 million workers, although sharp differences remain between the northern and southern regions. The gender gap also persists. Employment rates for men and women in 2007 are 70.7 per cent and 46.6 per cent respectively but it must be noted that the female employment rate increased by roughly 9 percentage points in one decade. Unemployment declined dramatically from around 12 per cent in 1998 to 6.2 per cent in 2007 (men: 4.9 per cent; women: 7.9 per cent), which was below the EU average. The composition of employment also changed, with a slight fall in self-employed people – from circa 30 per cent to 26 per cent of the total employed in 2007 – and an increase in dependent workers because of the spread of atypical jobs.

Nevertheless, when the global economic crisis set in between 2008 and 2009, not only did labour market indicators quickly deteriorate (Table 3.3) but, also, flexible workers were the first victims of the crisis. The shortcomings of 'selective flexibility' without security became dramatically apparent (Jessoula, 2010; Jessoula et al., 2010). The overall reduction of employment was around 1 per cent in 2009 but figures were much worse for atypical workers: about 400,000 jobs were lost among fixed-term workers (–7.3 per cent), project workers (–17 per cent), occasional workers (–6.3 per cent) and part-timers (–1.9 per cent). This is especially critical in the light of the weaknesses of the Italian unemployment protection system, both in terms of ALMPs and cash benefits. Concerning the former, after a brief period (1995–2003) in which the partial reshuffling of the employment policy menu led to increased expenditure on active measures – such that spending on active measures exceeded that on passive benefits – in 2004 the positive trend in ALMPs came to an abrupt halt and has subsequently been reversed. In 2007, Italy devoted only 0.5 per cent of GDP to ALMPs, the same as Poland but less than Germany (0.7 per cent) and much less than Denmark (1.3 per cent) and the Netherlands (1.1 per cent). With regard to cash benefits, the Italian unemployment compensation system – though improved in the last two decades[10] – remains highly fragmented and far from inclusive. Considering all types of ordinary and special benefits, in 2006 about 69 per cent of the unemployed could not rely on any kind of income protection and atypical workers were among those faring the worst. By definition, economically dependent workers are not entitled to unemployment benefits, while fixed-term and temporary agency workers, though formally covered in case of unemployment, are likely to face major obstacles in accessing ordinary unemployment benefits due to the strict eligibility requirements and the existence of minimum thresholds for contributions. As we will see in Section 3.5, this also has repercussions for the future pension prospects of workers experiencing spells of uninsured unemployment.

3.4 A new multi-pillar pension system for the youngster

After a decade-long debate on pension reforms and a policy stalemate during the 1980s, in the early 1990s joint supranational and international pressures forced policy makers to adopt – in addition to interventions in the labour market – radical retrenchment measures in the field of pensions.[11] Reforms aimed to contain costs in the public pension system – whose expenditure was around 12 per cent of GDP and represented over 60 per cent of total social protection expenditure – in order to improve public finances, and harmonize the rules for the different professional categories. Parallel to reforms in the first pillar, an encompassing reconfiguration of the old age protection system was launched with the introduction of a regulatory framework and tax incentives to develop supplementary funded pensions in order to compensate for the reduced generosity of public benefits in the future.

A detailed illustration of this process of institutional 'remodelling' is beyond the scope of this chapter. The next section presents the major changes to the pension system, with particular attention to interventions which are most likely to affect the old age security of workers with non-standard jobs or careers. These include: (i) the features of both reformed public pillar and supplementary schemes, with specific reference to the method of calculating pensions; (ii) the rules for implementing major changes in the first pillar – namely the introduction of the NDC system; (iii) the voluntary character of funded pillars as well as their main sources of financing.

3.4.1 Towards NDC pensions with a major 'grandfathers' clause'

The recent series of public pension reforms is impressive: reforms were enacted in 1992, 1995, 1997, 2004, 2007, 2009, 2010 and 2011. The 1992–93 Amato reform was important both because it adopted the first retrenchment measures in the first pillar and paved the way for the 'multi-pillarization' of the Italian pension system. Legislative Decree 503/92 introduced several path-dependent and parametric (though incisive) changes in the first pillar, while Legislative Decree 124/93 provided the first regulatory framework for supplementary funded pensions in Italy (see the following paragraph).

Major changes were introduced, however, by the Dini reform. In 1995, following a process of concertation between the technocratic Dini government, the unions, and the main employers' association, parliament approved a watershed reform (L. 335/95) that completely modified the functional logic of the public pension system. The replacement of the traditional earnings-related system with the new NDC system, in which pensions are calculated on the basis of contributions actually paid and the age of retirement (which was made flexible in the age bracket 57–65) represented a major departure from the principle of income maintenance through defined benefits at retirement. As is well known, NDC systems mean that contribution rates are fixed, while benefits vary according to different factors. In the Italian case, these factors are the individual retirement age, GDP growth[12] and demographic trends, because the coefficients for converting accumulated contributions into annuities are revised every ten years (three, after the 2007 reform), on the basis of the new mortality rates. A crucial point is that the NDC system only applied fully to new entrants into the labour market, while workers with at least 18 years of contributions in 1995 were fully exempted, thus introducing a robust 'grandfathers' clause' and a long phase-in period.[13]

The Dini reform also tightened eligibility conditions for seniority pensions (40 years of contributions were required by 2008) and replaced both social and minimum pensions with a new means-tested benefit called the 'social allowance', set at around €250 (or ITL 480,000) per month in 1995. For the purpose of this chapter, other measures were also particularly relevant. First, compulsory coverage was extended to *parasubordinati* – that is, economically dependent workers – with the creation of a new separate fund and regime within INPS. The contribution rate for this category was set at 10 per cent of income, a much lower level than for both private and public employees, whose contribution rates were and are 32.7 per cent and 32.35 per cent respectively. This makes a major difference in an NDC system, as we will see in Section 3.5. More favourable for atypical workers was the reduction from 20 to 5 years of the contributory period required in order to be entitled to an old age pension, which was made possible by the actuarial logic of the NDC system.

After the 1992 and 1995 'emergency' reforms, subsequent policy changes mostly included incremental adjustments to the new pension architecture. These were mainly effective in the short run, primarily affecting traditional standard workers retiring with earnings-related benefits. However, some measures have either directly or indirectly had an impact on the future pension prospects of atypical workers. A direct intervention concerned the contribution rates for *parasubordinati*, which were gradually raised from 10 per cent in 1997 to 26 per cent in 2010[14] – a significant increase although not sufficient to close the gap with public and private employees. Concerning indirect measures, first, the coefficients for calculating pensions in the NDC system were revised downward in 2007 (phased in by 2010), thus implying lower pensions in the future. Secondly, the replacement of the flexible retirement age (57–65) with new 65/60 thresholds for men and women respectively, whilst keeping unchanged the minimum contributory period of five years introduced by Dini, is likely to increase benefit levels substantially in the future, especially for males. Similarly, the recent introduction (L.122/2010) of a mechanism that automatically links the legal retirement age to changes in life expectancy is likely to raise pension levels further in future decades. I will discuss these points in more detail in Section 3.5.

Finally, with respect to non-contributory pensions, in the last decade the level of the means-tested 'social allowance' for the needy elderly has been increased several times, from about €360 in 2000, to €417 in 2011 for those between 65 and 70 years of age and €516 for the over 70s.

3.4.2 Developing voluntary funded DC supplementary pillars

In order to compensate for the retrenchment measures in the public pension system, Italian policy makers have favoured the development of funded supplementary pillars since 1993. Two points need to be emphasized: first, supplementary pillars were introduced on a voluntary basis, and they provide DC benefits only;[15] secondly, as I have argued elsewhere (Jessoula, 2011), the decision to develop funded schemes was made in extremely adverse conditions (especially economic and fiscal), and this had a crucial influence on the sources which were identified for financing supplementary pillars. The dismal state of the public finances, and high contribution rates in the first pillar, ruled out the provision of generous tax incentives or additional contributions in order to finance funded schemes, so the regulatory framework introduced by the Amato reform established the possibility to transfer the TFR contributions to funded schemes. More precisely, for workers employed after April 1993, in case of affiliation with supplementary funds contributions for the TFR – that is, 6.91 per cent of their gross monthly wages – would be fully merged into supplementary schemes. Collective agreements would define the share of the TFR to be transferred to supplementary schemes for workers already employed. In Section 3.5, the implications of such choices on the old age protection of the various occupational groups will be analysed. The regulatory framework also introduced limited tax incentives for members of occupational pension funds – so-called 'closed' pension funds – which are set up through collective agreements and managed by the social partners, thus constituting the second pillar of the new system. By contrast, 'open' funds created by financial institutions (banks, insurance companies and others) were initially conceived as residual individual retirement schemes, and in 2000 individual pension plans (PIP) were added.[16]

Since 1993, several measures have been adopted in order to expand the coverage of supplementary pillars and increase take-up rates. In 1995, parallel to the shift to the NDC system in the first pillar, the Dini reform introduced more generous tax incentives by making workers' contributions deductible up to 2 per cent of gross annual income with a maximum of about €1300. In 2000 this threshold was further raised to €5164 and 12 per cent of income (Legislative Decree 47/2000). In the early-2000s membership of supplementary funds was growing, though it remained at a comparatively low level (1.7 million out of 21 million gainfully employed). There was an attempt to legislate the compulsory transfer of the TFR to supplementary funds in 2001, which eventually failed due to the opposition of both the unions and employers' representatives. In 2005–06, two subsequent legislative provisions (Legislative Decree 252/05 and Law 296/06) radically modified the rules for transferring the TFR to supplementary pension funds. A quasi-automatic enrolment, based on the so-called 'silent consent' formula was introduced. According to this mechanism, workers had six months – from January to June 2007 – to decide if they wanted to keep the TFR or transfer it to supplementary pension funds. The default 'silence' option means that the TFR is automatically paid into the dedicated occupational pension fund. Similarly, new entrants in the labour market have six months to take this decision.

After the implementation of the 'silent consent' mechanism, members of supplementary schemes reached 5 million – 21 per cent of total employment – and the take-up rate for employees in the private sector is currently around 32 per cent. This figure, however, hides an extremely fragmented picture, as take-up rates are high (in many cases over 65 per cent) in core and unionized industrial sectors and in medium-large firms (see below), whereas they drop dramatically in economic sectors with a predominance of micro or small firms, and where the unions are weak – that is, commerce and services, tourism, food, textile. Also, as I will argue below, though access to supplementary schemes is formally open to everyone gainfully employed (and also to non-employed people in the case of individual plans) several factors hamper affiliation, especially of workers on atypical contracts.

3.5 After reforms: the uneven consequences of selective flexibility plus (N)DC pensions

Previous sections have shown that in the last 15 years two major transformations have occurred in Italy: the flexibilization of the labour market, and the transition from an inclusive and generous public pension system to a multi-pillar arrangement based on the combination of public NDC schemes and voluntary DC supplementary schemes. Also, these transformations have been pursued 'selectively': flexibility has been introduced at the margin and targeted to new entrants to the labour market, whose first job is now frequently on atypical – mostly temporary – contracts. In the field of pensions, the new NDC system fully applies to post-1995 labour market entrants only while long phase-in periods are intended to protect older workers' acquired rights. Both changes thus affect younger workers disproportionately.

This section focuses on the consequences of such novel labour market and pension arrangements in order to shed light on future prospects for old age security, particularly for atypical workers. Preliminarily, however, it is useful to illustrate the envisaged evolution of pension entitlements for standard workers both in the private and in the public sector. This will allow me to pinpoint the conditions under which adequate income maintenance at retirement will be ensured in future decades.

Afterwards, the prospects for the various categories of atypical workers will be analysed more in detail.

3.5.1 Typical workers and the conditions for future old-age security

The starting point is the acknowledgement that, in the period 2010–40, the level of public pensions will fall significantly due to the reforms of the 1990s. The first official projections, published in the early-2000s, showed a decline in replacement rates of about 20 percentage points for a private employee retiring at 60 with 35 years of seniority: from 67.1 per cent in 2010 to 48.5 per cent in 2040 (Ministero del Lavoro e delle Politiche Sociali, 2002). Even assuming – as in the plans of the various Italian governments – that for younger cohorts the total income from pensions will be roughly three quarters from first pillar benefits and one fourth from funded pensions, total replacement rates (including public and supplementary benefits) would remain rather modest, at around 60 per cent. Also, these figures assume the full transfer of the TFR to supplementary funds. As we will see below, this is currently the case only for a limited share of workers.

However, the increase in retirement age and its automatic link to changes in life expectancy – as well as the tightening of eligibility conditions for seniority pensions – have indirectly improved things with respect to benefit levels. Though the effective age at retirement (60.3 years, calculated for the newly retired in 2006) as well as seniority (32.1 years in 2004) are still comparatively quite low, in the next decades both will inevitably rise. This will result in higher replacement rates because the NDC method considerably rewards later retirement. The Social Protection Committee (ISG, 2009) estimated the replacement rate from public pensions in 2046 to be about 56 per cent, with an additional 12.4 per cent from supplementary pensions, for a total replacement rate just below 70 per cent, retiring at 63 with 38 years of contribution. Raitano (2009) calculated a replacement rate of 64.4 per cent from the first pillar plus 19.6 per cent from funded schemes, retiring in 2040 at 65 with 40 years of seniority. Though projections vary substantially according to hypotheses on a number of variables, the picture seems to be rather clear. Adequate income protection during retirement will be ensured if three conditions are met: workers pay full contributions in the first pillar; they have long, uninterrupted careers of about 40 years; and they subscribe to supplementary funded schemes by transferring the whole TFR to pension funds and contribute for their entire career.

Only a limited proportion of those currently employed is likely to match all these conditions. Even within the group of SER workers, these conditions are far from being achieved, mainly due to the modest coverage of supplementary pensions that also vary substantially across economic sectors, as well as in relation to firm size. About 4 million dependent workers, mostly employed in medium-large firms and unionized sectors – where the take-up rate of supplementary pensions is around 45 per cent on average – are likely to meet these conditions. Public employees (3.4 million), though generally not covered by funded schemes,[17] may expect to receive full public pensions and the full TFR amount at retirement because uninterrupted careers are still the norm. These categories may thus expect adequate income maintenance at retirement in the future.

By contrast, as the total take-up rate of funded schemes for private employees is slightly over 30 per cent, and it drops substantially in firms with less than 50 employees – that is, 12 per cent on average – the majority of dependent workers in the private sector employed in micro and small firms are likely to rely on public pensions and the TFR. Roughly, 52 per cent of employees work in firms with fewer than 50 employees. This may represent a problem because, first, even though the TFR has a guaranteed rate of return, this is rather low. That is why Italian policy makers in the last two decades 'bet' on higher returns from funded pensions when they favoured the transfer of the TFR to supplementary schemes. Secondly, we may expect more fragmented careers reducing the old age protection function of the TFR because of the lower level of job protection in firms with less than 15 employees (see Section 3.2 above). This group will not draw their TFR at retirement but every time the worker changes jobs or is made redundant. Finally, it has to be kept in mind that TFR is paid in a lump sum and not as an annuity.

The shift to the NDC system has also dramatically worsened the position of the self-employed. In the new system, the lower contribution rate (20 per cent) – which was actually advantageous to the self-employed in the earnings-related system – will result in meagre pensions. Also, it is hard to believe that supplementary benefits will fill the gap, due to the low take-up rate of funded schemes among these workers (around 15 per cent).

In addition to the analysis presented above, a further element must be mentioned in order to illustrate the future pension prospects of various categories of atypical workers. The NDC system is neutral with respect to earnings, that is, replacement rates are the same for workers at different wage levels.[18] This means that NDC pensions, though fair from a purely actuarial perspective, may not ensure adequate income maintenance at retirement for those with low earnings. In other words, in the context of sharply declining benefit levels, when considering not only relative figures (expressed in terms of replacement rates) but also absolute benefits, future pensions may fall short of guaranteeing income security at the lower end of the income scale. This is important, first, in the light of the combination of high income inequality – the S80/S20 income quintile share ratio[19] was 5.5 in Italy (the sixth highest across EU-25 countries) compared to EU-25 average of 4.8 in 2007 (European Commission, 2010b) – and the low level of wages, which are the result of about two decades of slow wage growth following the agreements on wage moderation in the early 1990s. These trends are captured by OECD (2010a) figures: in 1990–2005, the average annual deflated wage growth was 0.13 per cent in Italy, in contrast to a EU-15 average of around 1 per cent. Secondly, it is even more relevant with respect to atypical workers, who usually receive low pay in comparison with standard workers (see below).

3.5.2 Atypical workers: transferring labour market insecurity to old age?

Turning to future pension prospects for atypical workers, we will analyse the extent to which the various categories of non-standard workers are likely to match the conditions that should lead to adequate income maintenance in old age: that is, being fully integrated in both the first and supplementary pillars, having mostly uninterrupted careers and receiving at least average wages.

As we shall see, most atypical workers have several disadvantages. Low earnings and regulatory issues, as well as the interaction of employment patterns and social protection rules, all negatively affect their pension prospects. However, there are also differences across the various categories of non-standard workers, namely part-timers, workers on fixed-term jobs and *parasubordinati*. These groups will be analysed separately.

Workers on permanent part-time jobs are in a better position with respect to other atypical workers and their pension prospects seem to be more similar to SER workers. Part-timers pay full contributions in the first pillar, and the permanent nature of their contract may well lead to mostly uninterrupted careers. This favours either affiliation with supplementary pension funds or the provision of a rather 'generous' TFR at retirement. Also, they are entitled to maternity leave and related contributions credits for periods of non-employment for maternity and childcare purposes. This is particularly important in light of the gender profile of part-time work in Italy: 78 per cent of part-timers are women and 27.9 per cent of women work part-time in contrast with 5.1 per cent of men (Eurofound, 2011). This leads to a higher probability of spells of non-employment due to childcare, particularly given the underdevelopment of care services for children below the age of three in Italy (coverage is currently around 12 per cent of all children in the age group 0–3 years). Contribution credits for compulsory maternity leave (5 months) are quite generous because they are calculated on the basis of the last wage. The same applies to voluntary parental leave not exceeding six months until the child is three years old. Contributions are also credited for longer leave periods (maximum ten months to be shared between mother and father) and when the child is aged 3–8. In these cases, however, credits are based on 200 per cent of the value of the social allowance, and they may turn out to be less generous. Comparative data confirm the positive Italian performance in protecting pension entitlements in case of career breaks due to childcare responsibilities. A recent study by the ISG (2009) shows that the drop in the replacement rate is very limited for a break up to three years: around 1 percentage point only, the same as in Germany and much lower than in Poland. For these workers, the main challenge is represented by the low level of wages due to reduced working time, in combination with declining replacement rates and the neutrality of the NDC system with respect to earning levels. As mentioned above, this may well lead to inadequate income maintenance after retirement, even in the case of workers with full careers (40 years) on a part-time basis.

Fixed-term workers share a number of features with part-timers and 'typical' workers as well: they pay full contributions in the first pillar, are entitled to the TFR – which may be used to finance supplementary pensions – as well as maternity allowance, unemployment benefits and related contribution credits. However, the temporary character of the contract makes pension prospects for fixed-term workers worse than for the latter two categories. First, even though temporary contracts do not necessarily lead to discontinuous employment, evidence from a broad sample of Italian workers shows that fixed-term workers, in particular, experience more fragmented careers, with more frequent spells of unemployment and a shorter length of contractual relationships. Among younger workers who entered the labour market in 1998–2001, 82 per cent of fixed-term contracts ended within a 12-month period, in contrast with 32 per cent of standard contracts (figures rise to 94 per cent and 47 per cent respectively over a 24-month period), and 41 per cent of fixed-term contracts were followed by spells of non employment.[20]

In the NDC system, contributions are credited to workers receiving unemployment benefits so the inclusiveness of the unemployment benefit systems is a decisive issue. Unfortunately, as mentioned in Section 3.3, the Italian unemployment benefit system is far from being inclusive, and due to the rather tight eligibility conditions, fixed-term workers face major obstacles in fulfilling contribution requirements. Berton et al. (2009) estimate that only about 40 per cent of those on fixed-term contracts would actually receive ordinary benefits in case of unemployment and another 20 per cent would be entitled to less generous subsidies with less stringent eligibility requirements. The crucial point here is that, in an NDC system, fragmented careers with frequent spells of uninsured unemployment – even at the beginning of a career, as may be the case for fixed-term workers – are directly mirrored in pension entitlements. Replacement rates deteriorate sharply, for example, for a 40-year career that includes five years of uninsured unemployment,. Using calculations by Raitano (2009), the replacement rate for retiring at 65 with 35 years of contributions falls to 58.3 per cent, or 6 percentage points lower than retiring at the same age and having contributed for 40 years. Also, even assuming that fixed-term workers may receive unemployment benefits, the short duration of the latter (eight months maximum), combined with the NDC system, have a negative impact on prospective public pension levels. In contrast to what was said above with respect to childcare, comparative data show that Italy is among the countries that perform worst in protecting pension entitlement in case of long-term unemployment: a three-year break would mean a fall in public pension replacement rates by 3 percentage points (ISG, 2009). This may also be critical when taking into account how fixed-term workers fare with respect to supplementary benefits. Though formally entitled to the TFR, fixed-term workers are less likely to transfer their TFR to funded schemes due to their temporary employment status. The TFR may in fact represent an effective safety net allowance in case uninsured unemployment follows contract termination. Keeping the TFR will therefore not result in stronger old age protection for these workers, as the TFR will be paid out every time the contract ends. Once again, the combination of contractual discontinuity and social security rules may endanger income security at retirement, and most fixed-term workers – assuming they spend their whole career on temporary contracts (see below) – are likely to receive a public pension only, and it will generally be much lower than that for SER workers.

However, the most critical situation with respect to economic security in old age concerns so-called *parasubordinati* workers who, as illustrated above, are formally self-employed but working as disguised dependent workers on either collaboration or project contracts. Unlike both part-timers and fixed term workers, regulatory issues are also at stake for this particular group of atypical workers, and affect future pension prospects. First and foremost, though the contribution rate has been raised since 1995, when compulsory old age insurance was extended to *parasubordinati,* it remains well below the level for SER, part-time and fixed-term workers (26 per cent versus 33 per cent). Lower contributions mean lower pensions in the NDC system. Secondly, due to their formal self-employed status, they cannot rely on any form of job protection, nor are they eligible for any kind of unemployment insurance or assistance. Consequently, no contributions are credited when they are unemployed. Thirdly, as demonstrated by Berton, Richiardi and Sacchi (2009), this category suffers from severe wage penalization, ranging between 20–30 per cent with respect to typical workers, controlling also for age, qualifications and geographical area. A number of simulations of future public pensions levels for *parasubordinati* have been developed in recent years and they all point to the meagre level of protection in the first pillar for these workers (Borella and Segre, 2008; Raitano, 2007c; Ferraresi and Segre, 2009). Taking into account the lower contribution rate and a lower entry wage for these atypical workers, as well as some contributory gaps due to uninsured unemployment, Raitano (2007c) calculated that the level of pensions for *parasubordinati* would be roughly 45 per cent of standard employees' – a critical scenario indeed. The situation for this group does not improve when considering supplementary pillars. In principle, there are no obstacles to economically dependent workers subscribing to supplementary schemes. Nevertheless, it is very difficult for them to contribute, for at least two reasons. On the one hand, the meagre remuneration received by these workers leaves few resources to finance supplementary funds; on the other hand, *parasubordinati* are disadvantaged – with respect to both standard workers and the two other atypical groups – because they are not entitled to the TFR. As the TFR represents the major source of financing of supplementary (especially occupational) funds – in other words, it constitutes an 'institutional gate' that has allowed the development of funded pillars 'under adverse conditions' (Jessoula, 2009; 2011) – *parasubordinati* lack the fundamental resource to finance their DC pensions. To the same extent, they cannot rely on any form of severance pay. Therefore, it is likely these workers will rely on very low public pensions only. A male worker with a full (uninterrupted) career as *parasubordinato* would receive an old age benefit of around €750 per month in 2041, slightly above the (adjusted to GDP growth) amount of the means-tested non contributory social allowance (about €700). Female pensions would be lower – around €470 – due to even lower earnings (Borella and Segre, 2011). Moreover, as the assumption of uninterrupted careers seems unrealistic for these workers, benefits might turn out to be even lower. This represents a problem in at least two respects. First, there seem not to be economic incentives to engage in gainful employment; secondly, the means-tested social allowance – despite several increases in the last decade – is still conceived as a last resort safety net, and it is consequently very low.

However, the real magnitude of the problem depends both on how many years workers remain 'trapped' in the *parasubordinati* status over their career and – the same as for fixed-term workers – the length of their uninsured unemployment spells. It is extremely difficult to predict actual employment patterns or how long workers may remain on temporary contracts. An intense debate has arisen, especially among economists and sociologists, regarding the function of non-permanent employment. Scholars have, alternatively, argued that temporary contracts may represent an effective 'entry port' into the labour market, with no negative consequences over time, they may even bring some advantages for career development according to the 'stepping-stone' thesis or, by contrast, they might turn out to be traps with an array of negative effects (Scherer, 2004). As for the Italian case, it is plausible that most temporary workers – both *parasubordinati* and fixed-term – will switch to a permanent standard job later in their career, thus improving not only their employment status but also their pension prospects. Nevertheless, in addition to figures presented in Section 3.3, indicating the stickiness of temporary employment, it must be considered that both entering the labour market through under-qualified jobs (Scherer, 2004) – as might be the case for *parasubordinati* who are generally highly educated (Raitano, 2007a) – and experiencing repeated temporary jobs may well lead to several negative consequences. In particular, as demonstrated by Gagliarducci (2005, p. 430) 'people experiencing repeated fixed-term contracts, and especially career interruptions, have a lower probability of finding a stable job'. Therefore, assuming *parasubordinati* remain on this type of contract for the first 5 to 10 years, their pension entitlements would be 8 to 16 per cent lower than those for standard employees (Borella and Segre, 2011).

3.5.3 Pathways to old-age security for atypical workers

A number of conditions might contribute to improved economic security in old age for current atypical workers, and several measures might be adopted to this purpose. In accordance with the analysis presented above, this would not only imply reforming the pension system but also modifying the labour market and social protection rules at employable age.

On the latter front, a more inclusive unemployment benefit system and related (tax-financed) contribution credits would be of utmost importance for atypical workers with discontinuous careers, who are currently either not entitled to unemployment benefits (*parasubordinati*) or find it difficult to fulfil contribution requirements (especially workers on fixed-term contracts). More generally, measures aimed at raising employment rates would be beneficial for old age security in the future. In particular, supporting the growth of female employment – which has increased by almost 10 percentage points in the last decade but, around 46 per cent, is still well below average European levels – by developing childcare services and reconciliation policies, might have positive effects on household income at retirement. By increasing the share of households with two retirees entitled to contributory pensions, this trend might effectively counteract the projected reduction of individual entitlements. Also, in light of the comparatively low level of employment among younger cohorts (21.7 and 61.2 per cent in the age brackets 15–24 and 25–29; EU-15 average respectively 39.1 and 73.4 per cent) as well as high unemployment (25.4 and 13.2 per cent compared to 19.4 and 12.0 per cent in EU-15), active measures allowing a more rapid entry into the labour market would make assumptions concerning career length around 40 years (or 35 years if fragmented) more realistic. By the same token, stronger investment on ALMPs (currently very limited) would be likely to reduce the duration of unemployment spells, thus primarily improving the pension prospects for workers with fragmented careers.

As for pensions, measures should be adopted both in the first and supplementary schemes.

In the public system – aside from a generalized increase of benefits, which does not fit well with the climate of 'permanent austerity' (Pierson, 2001) and the persistently slow economic growth in Italy – several measures may be envisaged. Like some labour market measures outlined above (unemployment assistance for *parasubordinati* and contribution credits), all interventions would require – in different forms – more redistribution, especially in the first pillar, thus reducing the purely actuarial and insurance-based character of the NDC system which might well not be the optimal solution in an age of scarce resources. As demonstrated by other contributions in this book (see the chapters on Denmark, the Netherlands and Switzerland), the introduction of a relatively generous flat-rate universal basic pension would certainly help in preventing poverty in old age. However, it might be costly and it represents a major departure from the traditional approach to old age protection in Italy. Thus it may be difficult to gain consensus among political and social actors for such a reform. Possibly more in line with the Italian tradition would be the (re)introduction of a means-tested 'minimum pension supplement' – set at a higher level than the social allowance – for retirees entitled to old age contributory benefits, who fall below a certain threshold. Alternatively, a progressive replacement rate – ensuring proportionally more generous pensions to workers with low earnings – might be envisaged.

Among more limited, incremental measures that could be adopted in the short run, *parasubordinati* would benefit from an increase in contribution and accounting rates to the same level as for standard employees (33 per cent). This would result in a 25 per cent increase in pension levels, according to simulations by Borella and Segre (2011). Finally, workers with fragmented careers are disadvantaged by rules hampering the portability of contributions when passing from one pension regime to another in the first pillar (due to the change in their employment status). Though an NDC system facilitates the unification of the various contributory periods, until recently workers risked 'losing' contributions because they were portable only after a minimum insurance period of six years in a single regime. Law 247/07 has already made a step in the right direction by allowing the accumulation of contributions for shorter insurance periods in each regime (three years minimum)[21].

However, for effective income maintenance after retirement, atypical workers – as well as SER-workers – should combine public pensions with supplementary benefits. Here the crucial point is how to expand coverage and increase take-up rates especially among the atypically employed. For some categories of workers – and especially part-timers and workers on fixed-term contracts – the president of the Supervisory commission on supplementary pensions (Covip) has suggested a number of strategies, if the compulsory devolution of the TFR to pension funds does not seem realistic for political reasons. In the medium to long run, actions aimed at increasing workers' awareness and information on both their pension prospects and the relative convenience of supplementary pensions and the TFR might have some positive effects. As for more immediate measures, the periodical implementation of the 'silent consent' mechanism for those already employed (as the latter still operates only for workers entering the labour market or changing job) may represent an effective strategy in order to develop supplementary pillars. This would not help, however, for tackling the most serious situation facing the *parasubordinati*. That is why interventions on the first pillar as well as in other welfare sectors are of the utmost importance for this particular group.

3.6 Conclusions

Over the last two decades, Italian policy makers have launched a thorough reform of both pensions and labour market arrangements based on a transition to a multi-pillar pension system combining compulsory first pillar NDC and voluntary supplementary DC schemes with a more flexible labour market. Reforms, however, have been targeted at younger cohorts: the new NDC system applies to new entrants to the labour market after 1995 only; flexibility has been pursued ‘selectively’, that is, by favouring the spread of atypical – mostly temporary – jobs primarily among younger cohorts. The interplay of such pension and labour market arrangements entails a major intergenerational rupture because it puts an end to the ‘Bismarckian compromise’ crafted in the postwar decades that aimed to ensure adequate income maintenance both at employable age and after retirement.

As for old age protection, economic security in the future is likely to be guaranteed only if a long uninterrupted career delivering relatively high wages is coupled with payment of full contributions in both the first and supplementary pillars. These conditions, however, are not likely to be matched by a significant number of current workers; those with atypical jobs especially suffer from cumulative disadvantages.

For workers with fragmented careers (employees on fixed-term jobs and *parasubordinati*) as well as those with low earnings (part-timers and *parasubordinati*), the shift from an earnings-related to an NDC system, based on the whole working life and made neutral with respect to wage levels by strengthening the ‘equivalence principle’, has radically worsened pensions prospects. Though future pension entitlements in the first pillar are likely to vary across the various categories of atypical workers, in most cases they will be modest and *parasubordinati,* especially, run the risk of receiving contributory benefits just above the level of the means-tested social allowance. Also, the choice for voluntary DC supplementary schemes, to be financed primarily through the conversion of the severance pay TFR, has given rise to coverage problems and, in particular, workers on temporary contracts are unlikely to receive supplementary pensions in the future.

The combination of selective labour market flexibilization – as well as low (employment and income) security at employable age – and the transition to a multi-pillar pension system mostly informed by actuarial principles, and providing very limited redistribution, may thus lead to inadequate income maintenance at retirement for a large share of current young atypical workers. In addition, the level of means-tested pensions is still rather low and does not provide strong protection against poverty in old age.

In order to ensure adequate income security at retirement in future decades, a number of measures may (and need to) be adopted, concerning both the labour market and pension arrangements. In particular, in order to counter the cumulative disadvantages suffered by atypical workers, most policy interventions require the introduction and reinforcement of selective and redistributive mechanisms and, consequently, the reliance on different principles such as targeting and universalism. During the Golden Age, Italy generally refrained (with some notable exceptions like the shift to a National Health System) from relying on these principles, and the affluent decades allowed this choice. In the current phase of limited resources, there is possibly a need to move towards such a 'post-Bismarckian' compromise, at least if we accept the principle that retrenchment measures should not disproportionately affect the least advantaged.

Notes

1. See European Commission (2010a).
2. In the public sector compulsory insurance had already been introduced in 1864.
3. Since 1965, 35 contributory years have been required in the private sector. Two reforms (1956 and 1973) set the contribution requirement for public employees at 20 years for men, and 15 years for women, either married or with a child.
4. A minimum contribution record of 15 years was necessary to receive an old age pension.
5. After retirement, pensions were linked to wages growth.
6. For public employees, severance pay was generally calculated as follows: last monthly wage X number of years of contributions. In the private sector, after the 1982 reform, the TFR has been calculated as the sum of 1/13.5 of the annual earnings for each year of employment, revaluated at a fixed interest rate of 1.5 per cent plus 75 per cent of the inflation rate.
7. They were actually entitled to much lower benefits than public and private employees as their pension regimes provided DC pensions calculated on very low contribution rates. However, most retirees received minimum pension supplements, which used to be financed by other professional categories – primarily private employees – via intra-institutional (within INPS) redistribution as well as by the state through general revenues. Though less protected, then, the self-employed were definitely not losers when considering distributive outcomes.

8. Calculated with reference to 60 per cent of median income, see European Commission and Council (2003), European Commission (2006).
9. For a comparative overview see Palier (2010), Clegg and Clasen (2011); for details on the Italian case, Ferrera and Gualmini (2004), Graziano (2007), Jessoula and Vesan (2011).
10. For an overview, see Jessoula, Graziano and Madama (2010), Jessoula and Vesan (2011).
11. The literature on Italian pension reforms and the role played by exogenous pressures is vast: see Ferrera and Gualmini (2004), Ferrera and Jessoula (2007), Natali (2007), Jessoula (2009), Graziano and Jessoula (2011).
12. The total contributions amount is adjusted annually according to the average GDP growth of the last five years. After retirement pensions are now indexed to the consumer price index only, as established by the Amato reform.
13. A mixed system, partly NDC and partly earnings-related, applied to workers with less than 18 years of contributions in 1995.
14. These rates only apply to 'pure project workers' that is, they only pay contributions to *parasubordinati* pension fund.
15. DB schemes are envisaged for the self-employed, but none of these has actually been created.
16. For a detailed illustration of supplementary pensions in Italy, see Jessoula (2011).
17. Coverage is negligible among civil servants. Only one occupational fund was set up in 2004 in the education sector, covering 1.3 million workers out of 3.4 million public employees. Also, the take-up rate is low – circa 7 per cent of potential beneficiaries.
18. Apart from workers earning above the contributions threshold, that is, 93,000 Euros per year in 2011.
19. The ratio of total income received by the 20 per cent of the population with the highest income (top quintile) to that received by the 20 per cent of the population with the lowest income (lowest quintile).
20. See the detailed analysis in Berton et al. (2009).
21. The 2011 reform has recently introduced the full accumulation of contributions paid to different regimes.

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4
Poland: Are Flexible Labour Markets Ready for Individualized Pensions?

Igor Guardiancich

4.1 Introduction

During the past two decades, the Polish pension system and labour market has experienced dramatic transformations. Although the dynamics of change varied substantially, three periods marked these transformations: first, the growing inadequacy of benefits before the collapse of socialism; second, the unconsolidated state of affairs during the early 1990s; and third, a definitive break with the past ten years in a transition to democracy and capitalism.

Because of its socialist past, the nature of the Polish economic and labour market crises has been very different from that of Western Europe, leading to the greater influence of international financial institutions and the so-called 'new pension orthodoxy' (Lo Vuolo, 1996) of that period. The retirement system underwent an abrupt transformation in 1999, shifting from a single pillar, public PAYG retirement scheme based on the collectivization of risk to a multi-pillar structure in which the first pillar consists of a Non-financial Defined Contribution (NDC) public tier and a Financial Defined Contribution (FDC) private one. Hence, Poland embraced compulsory private pensions, thereby avoiding coverage gaps, and setting it apart from most of the other cases presented in this volume. Risks were individualized, and the provision of pensions shifted partly to the market.[1]

The transformation of the labour market was radical as well: starting from full and guaranteed employment, the Polish labour market turned into a segmented one, in which relatively well-protected workers co-exist with a growing number of atypical workers, who are employed under less favourable conditions in terms of social and employment protection. Even though positive economic developments and the willingness to reform have marked the period since Poland's accession to the EU, both the spread and the abuse of atypical contracts are causes for concern.

Policy makers have recognized the tensions between the structure of the labour market and pension regulation. The new pension system represents an unprecedented break with the past because it has reduced the most extreme imbalances between contributions and benefits. This is crucial for a country whose pension-related expenditure more than doubled during the early transition period. However, a defined contribution system requires a long and uninterrupted insurance period if it is to guarantee adequate income maintenance after retirement. Without a concomitant strengthening of the social safety net, the progressive 'flexibilization' and the multiple weaknesses of the Polish labour market may lead to individual contributory records that are insufficient to ensure social inclusion in old age. In fact, the Polish retirement system requires stable and prolonged employment in a labour market that is ill-prepared to guarantee such conditions.

The chapter proceeds as follows. Section 4.2 summarizes the key traits of the pension system inherited from socialism and its gradual reform during the 1990s. Section 4.3 provides detailed information about the abrupt 1999 pension system reform that transformed the single pillar public system into a multi-pillar one. Section 4.4 analyses the structural and legislative developments which led to the end of guaranteed full employment, thereby making worse the fragmentation of the increasingly dualistic Polish labour market. Section 4.5 explores the interaction between labour market flexibilization and pension reforms, illustrating the potential consequences for benefit and social adequacy for the main atypical employment groups. This section devotes particular attention to gender: women are predicted to be the ones paying the pension bill in full, since they are disadvantaged by interrupted work histories and a lower retirement age. The chapter concludes by proposing some reform options that may reduce social exclusion during retirement.

4.2 Old age insurance: from socialism to the 1999 reform

Poland inherited a complex and expensive single pillar old age retirement system from its socialist past. Despite the official rhetoric, the system provided differential treatment to different categories of workers and granted privileges to key clienteles. The traditional white- and blue-collar categories were substituted with new ones in 1954. So-called 'first-category' workers performed physically demanding work, often in unhealthy conditions, that was deemed necessary for the advancement of socialism. So-called 'second-category' workers were entitled to lower benefits, and retired later (women at 60, men at 65).

In addition, employee contributions were abolished during the socialist period; all funds were merged with the state budget and run as a unified scheme between 1950 and 1954. The Social Insurance Institution (ZUS), founded in 1933, administered the pension system. During the 1960s, coverage expanded rapidly, ending with the creation in 1977 of a separate scheme for individual farmers (Rzegotka and Sroka, 2005, pp. 42–4). ZUS gained autonomy in 1986, but its structure did not change until well into the transition (see Żukowski, 1996, p. 104).

Beginning in 1956, the retirement system employed a 'best years', defined benefit formula (calculated on the two best consecutive years out of ten, and later, twelve years), with replacement rates that fell with income. In addition, the Polish system lacked effective mechanisms for indexation. This led to the 'old pension portfolio problem': after retirement pensions progressively lost purchasing power.

Despite these shortcomings, the system ran smoothly until 1975. After that, both the disabled and women were allowed to retire at 55, with 30 years of insurance, including non-contributory periods such as maternity leave (up to six years for two children), and employment in part-time jobs that counted as full-time employment. The effect was dramatic: the real retirement age, which was 61 years for women and 64.5 for men in 1978, fell to 55 and 59 by 1992. New pensioners under the legal retirement age constituted 77.8 per cent of newly retired women and 86.3 per cent of men (Żukowski, 1996, p. 114). Moreover, there were few limitations on active employment during retirement.

During the 1980s, the situation deteriorated. Polish authorities responded to the increasingly rebellious Polish population by agreeing to some financially ruinous compromises. Miners, workers in public transport, teachers and another 250 occupational groups were awarded special retirement rights.

4.2.1 Transformational recession and social security: labour shedding, refinancing, retrenchment

After socialism collapsed, Poland entered a transformational recession.[2] GDP slumped and massive inflation eroded living standards, substantially increasing income inequality, and straining the system of social benefits and services. Parliament passed several acts during 1989–1991 to build a safety net for redundant workers (see Aleksandrowicz, 2007). Older workers whose firms closed down or who were laid off were allowed to retire. In 1990, Parliament introduced minimum pensions

Table 4.1 Pension crises characteristics, 1989–2002

	Cause	Effect
Pension expenditures/ GDP	Higher replacement rates; creation of KRUS; early retirement.	Doubled in 1989–94, from 6.5% to 15.8% of GDP; declined afterwards.
Pension revenues/GDP	Evasion, non-compliance and arrear write-offs. The tax administration could not cope with the atomization of contributors.	20% decrease in contributions; 5% fall in covered wage bill during 1992–2002.
Pension balance/GDP	Contribution erosion and higher expenditures.	Deteriorated sharply: budget transfers peaked in 1994 at 6.1% of GDP, and fell afterwards.
Number of pensioners	Early retirement laws in 1989–91.	Increased by 37.5% during 1989–99.
Number of insured	High unemployment; low participation; and informalization.	Fell by 15% in 1989–98.
Contribution rate	Refinancing preceded retrenchment.	Grew constantly during the 1980s; stable at 45% of total payroll during 1990–98.
Replacement rate	The new 1991 benefit formula made the majority better off.	Rose sharply from 56% to over 72% of average wages in 1989–91; stagnated until 1996 and then fell.

Source: Guardiancich (2009), p. 139.

equal to 35 per cent of the national average wage (39 per cent since December 1993), and increased the benefits for those aged above 80.

Between 1990 and 1995, the number of retirees swelled from 5.5 to 7 million. Among OECD countries, Poland had the highest share of disability pensioners in the working age population in the mid-1990s (Wójcicka et al., 2002, p. 202).

As a result, expenditures more than doubled, and the contribution rate for pensions, sickness, maternity and work injury insurance had to be raised to 45 per cent in 1990. At the same time, state revenues collapsed because there were fewer contributors. The number of insured people fell by almost two million because of unemployment and lower labour market participation, as well as contribution evasion, under-reporting and amnesties for state-owned enterprises, whose arrears were periodically written off (Chłoń-Domińczak, 2004, pp. 183–91; World Bank, 1994, p. 33). The extent of the crisis is summarized in Table 4.1.

The various emergency measures increased the complexity of the Polish pension system. A series of partial reforms followed, including the recalculation of old age pensions, more transparent redistribution, the separation of farmers from ZUS, and the revision of disability pensions. Aside from these reforms, the Polish pension system underwent mild retrenchment during the 1990s, but these deteriorations followed an expansion of benefits during early transition. The limited extent of retrenchment can be attributed to the strength of the so-called socio-political trend, headed by the trade unions, Solidarność[3] and the successor union All-Poland Alliance of Trade Unions (OPZZ), which opposed curtailing pension rights (Ratajczak, 2005, pp. 187–9).

During this period, Polish social insurance consisted of two main schemes: the general social insurance system covering employees and the self-employed, and the scheme for farmers. There were also separate provisions for military forces, the police, and other uniformed services, as well as for judges and prosecutors, which were tax-financed and based on different rules (EPC, 2007, p. 270). This general structure survived the 1999 reform that restructured the old age retirement component of these schemes. The following paragraph provides a snapshot of the general social insurance scheme as it has operated (including reforms) since about 1991.

4.2.1.1 General social insurance system

In Poland, general social insurance covers the risks of old age, sickness, maternity, inability to work, loss of the breadwinner, work injury, and occupational diseases. In 1991, the old age single pillar system was modestly reformed.

The financing of the pension system remained PAYG, but the pension calculation formula changed radically (Chłoń et al., 1999, p. 7). Old age benefits were split into three parts: (i) a flat-rate component equal to 24 per cent of the reference wage (average national gross wages); (ii) an earnings-related component equal to 1.3 per cent of the applicant's assessment base for each year of contributions; (iii) a supplement of 0.7 per cent of the applicant's assessment base for each non-contributory year (parental leave, years spent in university, in the military, or caring for various categories of disabled), not exceeding one third of contribution years. The assessment base was extended from the best three consecutive years out of last 12 years in 1993 to the ten best out of 20 years by 2000. The assessment base had an upper ceiling of 250 per cent of the national average wage. However, contributions – 45 per cent of gross wages for employees, and 40 per cent for self-employed on declared income (which could not be lower than 60 per cent of the average wage) – had to be paid on the full wage, thereby providing an incentive to high-wage earners to evade contributions.

The new formula increased the benefits level for roughly 70 per cent of pensioners, while the rest got less than under the previous rules. The formula and retroactive wage indexation meant a sharp rise in the average replacement rate, which jumped from 55.9 per cent in 1989 to 72.6 per cent in 1991. Moreover, early exit continued unabatedly because non-contributory years were easy to obtain, there were no reductions in benefits, and employment during retirement was widespread – some 40 per cent of retirees actually worked (Müller, 1999, p. 96).

In order to reduce expenditures, the Government lowered the assessment base in 1992 and applied an indexing formula that combined wage and price changes in 1996. Restrictions on gainful employment during retirement were introduced, and the early retirement of workers dismissed for operational reasons was slowed in December 1994 by introducing pre-retirement benefits. Early retirement was ended in January 1998. The Constitutional Court ruled against the arbitrary reduction of the assessment base so it was allowed to increase stepwise between 1995 and 1999.

Overall, the reforms did not particularly harm retirees (Żukowski, 1996, p. 118): coverage was still extensive, pension benefits were shielded against inflation, and the system guaranteed relative security. Moreover, even though the 1991 changes strengthened the link between contributions and benefits, the reforms also introduced a minimum pension guarantee. All this came at a price, however. The impact of the transformation to a market economy on social security was borne by the state, which incurred very large debts in order to build a safety net for redundant workers and repair the revenues-contributions imbalances of ZUS. The latter required a budget transfer of 6.1 per cent of GDP in 1994. Also, as noted above, contributions had to be raised to an impressive 45%. Hence, after years of ambivalent interventions, the key motivation for the 1999 structural reforms, called 'Security through Diversity', was to restore the financial viability of the existing pension system.

4.3 Restructuring of Polish retirement: security through diversity

The post-1999 Polish social insurance system includes old age pensions, disability and survivors pensions, sickness benefits and occupational injury insurance. These programmes are financed by the four sub-funds

Table 4.2 The Polish old-age pension system in 2009

	First pillar – Tier 0	First pillar – Tier 1	First pillar – Tier 2	Second pillar	Third pillar
Provider	Public	Public	Private	Private	Private
Coverage	Mandatory	Mandatory	Mandatory	Voluntary	Voluntary
Principle	Employment-related	Employment-related	Employment-related	Occupational	Individual
Type	Means-tested	PAYG-NDC	FDC	FDC	FDC
Function	Redistribution	Insurance	Insurance	Insurance	Insurance
Objective	Poverty alleviation	Basic income maintenance	Basic income maintenance	Complementary individual needs	Complementary individual needs
Financing	General taxation	Earnings-related, shared with employer	Earnings-related, shared with employer	Individual, shared with employer	Individual
Benefits	Guaranteed minimum income	Notional account of indexed contributions	Based on accumulated assets	Based on accumulated assets	Based on accumulated assets

Source: adapted from Holzmann and Guven (2008) and Benio and Ratajczak-Tuchołka (2007), p. 194.

of the Social Insurance Fund (FUS). The public single pillar Polish pension scheme has been replaced with a multi-pillar institutional design which consists of two parts: the compulsory insurance system and voluntary pension schemes, as shown in Table 4.2. There is also a basic benefit similar to social assistance that is tax-financed.

This section focuses on compulsory pension insurance and only briefly discusses supplementary voluntary pension schemes. In contrast to the other cases analysed in this volume, supplementary schemes play a marginal role in the coverage and income replacement of Polish retirees. Compulsory insurance covers employees, farmers, freelancers, the self-employed outside agriculture, the clergy, MPs, recipients of unemployment benefits, persons on childcare leave and recipients of maternity allowances. It is based on both public and private provision.

4.3.1 Basic safeguards

There are two basic poverty alleviation instruments in Poland: social assistance benefits and a minimum income guarantee within the first pillar (the so-called tier 0). Social assistance benefits are granted to households whose income falls below a certain threshold: PLN 477

Table 4.3 Social security contributions in 2008

Specification	**Total contribution, as % of qualifying wages**	**Share financed by employer and employee, as % of qualifying wages**	
		employer	**employee**
Social insurance			
Old age	19.52	9.76	9.76*
Other insurance (disability, survivors)	6.00	4.50	1.50
Sickness	2.45	–	2.45
Work accidents	0.67–3.33	0.67–3.33	–
Fund of Guaranteed Employee Benefits**	0.10	0.10	–
Labour Fund (unemployment)	2.45	2.45	–
Health Insurance	9.00	–	9.00
Total Contribution Rate	40.19–42.85	17.48–20.14	22.71

* If the insured person contributes to both first pillar tiers, the contribution is 2.46% to the NDC scheme and 7.3% to the FDC tier.

** This Fund covers any employee financial claims in case of employer insolvency.

Source: adapted from ZUS (2010), p. 20.

(€120)[4] for single households or PLN 351 (€88.5) per person in the family. The age of the recipient plays no role in this non-contributory scheme. The new pension system also provides an overall minimum pension safeguard for pensioners who have reached the statutory retirement age (60/65 for women/men), have contributed for at least 20/25 years (women/men), and whose total first pillar pension (public and private) falls below a certain threshold.[5] The difference is topped-up from the state budget (Holzmann and Guven, 2008, pp. 136–7; ZUS, 2010, pp. 29–30).

Both the coverage and amount of these guarantees are quite low. The old age minimum pension amounted to PLN 706.29 (€177.98) in March 2010, that is 44.2 per cent of the previous month's average old age pension and 53.6 per cent of the gross minimum wage. 7.9 per cent of all pensioners in March 2009 received the minimum pension.

4.3.2 The public and private compulsory tiers

What sets the Polish pension system reforms apart from the other cases presented in this volume is the radical character of the changes introduced in 1999. Poland completely embraced the defined contribution principle in the two tiers of its new first pillar: tier 1 is PAYG and is based on the Non-financial Defined Contribution (NDC) logic, and tier 2 is a fully funded, Financial Defined Contribution (FDC) scheme.

The new pension scheme was limited to workers who were younger than 50 in 1999. These were subdivided into two groups: those younger than 30 were compulsorily insured in both the NDC and FDC tiers, and those aged between 30 and 50 could choose whether to be insured only in the NDC tier, or in both. For the NDC part of the system, ZUS collects contributions and manages the scheme. The pension level is based on the contributions paid by employees and employers (Table 4.3), and the benefit formula is very different from the one introduced in 1991.

Contributions are capped at 250 per cent of the base amount, thereby implicitly limiting the maximum payable benefit. Contributions are credited to an individual's notional capital, whose rate of return is 100 per cent of the real wage bill growth (before 2004 it was 75 per cent). There is no minimum vesting period, except what is required for a minimum pension. The statutory retirement age, which will reach 60/65 for women/men in 2014, does not apply to some 270,000 workers (who perform physically demanding work in unsafe or unhealthy conditions), who have been entitled to 'bridging pensions' since January 2009. Bridging pensions allow for earlier retirement and are financed through additional employer contributions for the years prior to the statutory retirement age. Bridging pensions were part of the original 1999 reform package, but it took ten years to pass the law.

ZUS pays out the annuities, which are calculated on the basis of unisex tables of life expectancy at retirement. Hence, there is some redistribution from men to women because the difference in life expectancy between men and women at retirement is 11 years. In 2008, a policy adjustment was introduced that modestly increased pension payouts. Price indexation was replaced with a composite index based on prices and 20 per cent of wages. In 2009, there were 15.5 million contributors and 7.4 million beneficiaries (4.98 million receiving old age pensions, 1.23 million receiving disability benefits, and 1.23 million receiving survivors' pensions).

Tier 2 consists of mandatory, private, and fully-funded Open Pension Funds (OFEs). At the end of 2009, there were 14 OFEs, with 14.36 million members and managing PLN 179 billion (€45.1 billion) in assets, or about 13.3 per cent of GDP. The management of OFEs is shared among public and private institutions. New labour market entrants have the right to choose an OFE (otherwise they are assigned to a default fund), which invests their contributions under the supervision of the Financial Supervision Authority (KNF). Each pension fund is managed by a separate legal entity: the Pension Fund Society (PTE). However, private pension contributions are collected and allocated by ZUS. At retirement, insured persons use the capital that has accumulated in their OFE to purchase an annuity from a private company.

There are guarantees concerning the minimum rate of return, but they are rarely triggered. Fees on assets and on contributions charged by OFEs have been capped due to the inability of the industry to self-regulate. Because of fee-capping and centralized contribution collection, Polish pension funds operate with low costs compared to other reforming countries.[6] On a negative note, OFEs suffered heavy losses during the financial crisis, and this triggered a heated debate on their suitability to provide socially adequate benefits. At the time of writing (January 2011), Donald Tusk's centre-right government has decided to drastically, but temporarily, reduce the contribution rate to the funded pillar from 7.3 per cent of gross wages to 2.3 per cent.

4.3.3 Voluntary insurance

Polish policy makers also introduced occupational and individual pension plans in 1999 and 2004: Employee Pension Programmes (PPEs) and Personal Pension Accounts (IKEs), that is, pillars two and three. In contrast to the other case studies in this volume, these pillars still play a marginal role in Poland. The first pillar's FDC tier does clearly crowd out these schemes. Although they are encouraged by tax exemptions, their effect on coverage and on future pension benefits is minimal.

By 2008, 1 per cent of registered enterprises offered one thousand PPEs, providing coverage to less than 3 per cent of total employees. These meagre results are mainly the result of insufficient tax incentives for employers and employees (Allianz, 2007, pp. 76–7). Contributions to PPEs are deductible up to 7 per cent of the wage base for the payment of social security contributions to the first pillar (Holzmann and Guven, 2008, p. 139). In April 2004, PPEs were simplified, thereby liberalizing contributions, unblocking investment and widening tax exemptions, but the effects were limited.

IKEs complement PPEs, but the government overestimated the number of opt-ins. In mid-2008, some 6 per cent of total employees were insured (less than 900 thousand). The reasons for their limited appeal are, again, inadequate tax incentives, penalties for early withdrawal and high overall social security contributions.

4.3.4 Contributions matter

For the purposes of this chapter, the analysis of differences in contribution bases is of utmost importance. The first pillar covers almost all of the gainfully employed and, under certain circumstances, social security contributions are also credited during periods of non-employment, thus benefiting people with fragmented working histories. These credits, however, are quite modest (see Benio and Ratajczak-Tuchołka, 2007, pp. 198–9).

The contribution base for dependent employees (permanent, fixed-term, part-time and so on) is their gross wage, which has a *de facto* lower limit because it is equal to the minimum wage, and an upper limit of 250 per cent of the average national wage. The contribution base for the self-employed has not changed: it is still based on declared income with a lower limit of 60 per cent of the average wage. In practice, almost all self-employed people (outside agriculture) declare this minimum and, consequently, they earn only small entitlements (Chłoń-Domińczak, 2004, p. 176).

Contribution credits are paid in case of maternity leave, parental leave and unemployment according to the following rules. The maternity allowance after the birth of a child is payable during maternity leave periods and is equal to the last earned salary. The allowance is paid for 20–37 weeks, depending on the number of children. A care allowance is available for those bringing up a child under particular circumstances, and is payable during a leave period of maximum 60 days. Both allowances are subject to social security contributions, which are paid by the employer or ZUS. The maternity allowance is equal to 100 per cent of average monthly earnings for the last 12 months, or of income constituting the basis for allowance assessment. The level of the care allowance is 80 per cent of the basis for assessment of the sickness allowance (ZUS, 2010, pp. 54–7).[7]

Parental leave is granted to all workers in employment relationships lasting more than six months. The leave is unpaid, but there is a means-tested family allowance in case of poverty. In 2008, parental leave paid a very low monthly allowance of PLN 400 (€100.8). Since 2009, the contributions flowing to ZUS during parental leave have been based on the minimum wage rather than the amount of the allowance. Social assistance is the basis for calculating the pension contributions for someone caring for a disabled child.

University students and the unemployed have seen their pension rights deteriorate significantly. Pension credits have been eliminated for students, on the grounds that they should not be given unfair

Table 4.4 Beneficiaries and insured in KRUS, 1991–2009 (thousands)

	1991	1995	2000	2003	2005	2006	2007	2008	2009
Beneficiaries	1,791	2,049	1,887	1,755	1,662	1,586	1,508	1,456	1,426
Insured	1,750	1,427	1,452	1,589	1,582	1,615	1,598	1,574	1,570

Source: KRUS (http://www.krus.gov.pl).

advantages in view of their more favourable earnings prospects. For the unemployed, pension credits are based on the actual amount of the unemployment benefit. A minimum of one year of employment during the previous 18 months is required. The amount of the benefit is flat-rate: PLN 717.0 (€180.7) in January 2010 for people with an employment record of 5–20 years, 80 per cent of that for shorter and 120 per cent for longer periods. After three months, the benefit is reduced by about 21.5 per cent. Benefits are granted for 6, 12 or 18 months, depending on the regional unemployment rate. The Labour Fund pays social contributions to ZUS, and the base is the actual level of the unemployment benefit.

4.3.5 Farmers' pension system

Finally, it is important to devote some attention to the pension rules for agricultural workers, because they represent an important and large group in the Polish employment structure. These workers were covered by ZUS until 1991, when the Farmers' Social Insurance Fund (KRUS) was established as a separate entity. KRUS has been only marginally reformed since its introduction.

Instead of being a 'social insurance' fund, KRUS is a tax-transfer scheme whose beneficiaries outnumbered the insured until 2005 (see Table 4.4). The Fund spends roughly 2 per cent of GDP per year (progressively diminishing), of which, in 2009, 83 per cent was provided by the state budget.

The system's simplicity is matched by its inefficiency. The eligibility criteria are: age 60 for men and 65 for women, and a contributory period of 25 years. The flat-rate contribution for old age, disability and survivor pension insurance is payable quarterly and amounts to 10 per cent of the minimum old age pension per month, that is, PLN 204 (€51.2) per quarter in 2010. Farmers owning larger estates contribute up to 48 per cent of the minimum pension per month. A farmer's old age pension is easily calculated, again in relation to the minimum old age pension, and consists of a contributory and a supplementary part (EPC, 2007, pp. 273–4).

It is important to emphasize that the scheme is prone to abuse: the self-employed who qualify as self-subsistence farmers can opt for paying much lower contributions to KRUS instead of being insured with ZUS (Chłoń-Domińczak, 2004, pp. 160–2).

4.4 Evolution of the Polish labour market

Poland endured some 40 years of a centrally planned economy, where full employment was artificially guaranteed (see Kornai, 1992). In contrast to most socialist countries, self-employment in the private sector was tolerated and produced a fair share of the national income.

The transition to a market economy had a tremendous impact on the labour market. During the last two decades, two trends stand out: (a) very negative structural indicators, such as a low employment rate (especially for women), high unemployment, a large informal labour market, and mass emigration; and (b) the spread of atypical, flexible employment relationships and, hence, the emergence of a dual labour market.

4.4.1 Structural weaknesses

For a broad overview of the Polish labour market, this section draws on, and updates, Kopycińska (2008). The potential supply of labour chiefly depends on the natural growth of the population and on its age structure. After continuously increasing during socialism, the Polish population stabilized at roughly 38 million people in the period 1990–2008. The decline of the fertility rate – which reached its nadir (1.22) in 2003 – contributed to this outcome; it also affected the age distribution of the population. Population ageing is in line with the EU average. The share of people below working age reached 15.3 per cent in 2009, while the proportion at and above working age was 71.2 per cent and 13.5 per cent, respectively, in the same year. Because of demographic trends, the increase in the Polish working-age population probably ended in 2009–10.

The real supply of labour depends on the number of occupationally inactive people and on net migration trends. Although the working age population has increased by more than 2.5 million since the early 1990s, the active population declined by some 2.2 million. This demonstrates three trends. First, redundant workers were forced into early retirement before 1999. As disincentives had not been put in place, the number of pension system beneficiaries increased from less than 5.6 million in 1990 to roughly 7.5 million in 2009. Secondly, the high costs of social security insurance are partly responsible for the large share of people employed in the informal economy. Walewski (2008) estimates that between 9 and 10 per cent of the active population (1.3–1.4 million people in 2004–06) work in the informal sector and that undeclared work is the sole source of income for 90 per cent of this group. In particular, workers in labour-intensive jobs, who face a high tax wedge, enter unregistered employment relationships without any source of protection. Thirdly, temporary stays abroad (mainly due to unemployment at home) increased from roughly one million in 2004 to 2.27 million in 2007. The accession of Poland to the EU in a period of economic expansion played a fundamental role here. The recent economic crisis in Europe, in fact, triggered the reversal of migration trends.

In addition to lower participation, the employment rate (held artificially high during socialism, that is, 80.2 per cent in 1990) fell in absolute terms by 8.3 percentage points due to the defensive restructuring of state-owned enterprises by 1993. After that, the contraction of employment slowed because of the expansion of the private sector, only to deteriorate in 1998–2004, when another recession hit the economy. A brisk recovery preceded the 2008 financial crisis, and during the global economic recession the Polish economy did surprisingly well. The overall employment level remained stable (just below 60 per cent of those aged 15 to 64). Unemployment mirrored the ups and downs of economic activity. It skyrocketed from zero during socialist times to 16.4 per cent in 1993, dropped to about 10.3 per cent in 1997–98 because of economic recovery and passive labour market measures (early retirement and disability), and then deteriorated sharply, almost doubling by 2002. The steep drop since – unemployment fell below double digits in 2007 – was mainly driven by mass emigration (Zientara, 2008, pp. 421–2). Due to the financial crisis, total unemployment increased only slightly, to 8.2 per cent in 2009. Long-term unemployment grew until 2005, slowly abating afterwards.

In sum, the Polish economy suffers from a number of structural problems. As we would expect in an economy dominated by the male breadwinner model, most indicators are consistently worse for women than for men. Female employment rates (52.8 per cent in 2009) have been at least 10 percentage points lower than those of men (66.1 per cent in 2009) throughout the post-socialist period (see Table 4.5). To be sure, the position of women on the labour market is improving, but this is due to the spread of part-time jobs (see later paragraphs). The employment levels of older workers in the age bracket 55–64 are the second

Table 4.5 Structural indicators of the Polish labour market

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Employment 1564										
Total	55.0	53.4	51.5	51.2	51.7	52.8	54.5	57.0	59.2	59.3
Men	61.2	59.2	56.9	56.5	57.2	58.9	60.9	63.6	66.3	66.1
Women	48.9	47.7	46.2	46.0	46.2	46.8	48.2	50.6	52.4	52.8
Employment 5564										
Total	28.4	27.4	26.1	26.9	26.2	27.2	28.1	29.7	31.6	32.3
Men	36.7	35.6	34.5	35.2	34.1	35.9	38.4	41.4	44.1	44.3
Women	21.4	20.4	18.9	19.8	19.4	19.7	19.0	19.4	20.7	21.9
Unemployment rate										
Total	16.1	18.3	20.0	19.7	19.0	17.8	13.9	9.6	7.1	8.2
Men	14.4	16.9	19.2	19.0	18.2	16.6	13.0	9.0	6.4	7.8
Women	18.2	19.9	21.0	20.5	20.0	19.2	14.9	10.4	8.0	8.7

Source: Eurostat (2010).

lowest in EU-27 after Malta (32.3 per cent compared to the EU average of around 46.0 per cent). Regional disparities are huge; for example, in Warmińsko-Mazurskie, registered unemployment was still 19 per cent at the end of 2007.

4.4.2 From socialist security to flexible insecurity

Like the pension system, Polish labour market institutions underwent several reform phases. These phases were mirrored by a constantly changing Employment Protection Legislation index (EPL). The evolution of employment legislation will be discussed first, followed by an analysis of the changes in the EPL Index. The section concludes with a discussion of active labour market policies (ALMPs).

At the beginning of the transition to democracy and capitalism, the 1974 Labour Code was still in place. The Code was rooted in socialism and skewed against the employer, guaranteeing high employment protection for employees. In the period 1989–1991, the old Code was adapted to the necessities of a market economy. After adapting the Code, the unions had little interest in eliminating labour market rigidities, reforming non-restructured sectors (public administration, mining, shipyards) or lowering non-wage labour costs (Zientara, 2008).

The Code was prone to abuse. Employers frequently avoided paying contributions by using illegal or semi-legal employment and by lowering the contribution base. Another employer strategy was to arrange ‘chains’ of fixed-term contracts of less than 29 days, which were not subject to social security contributions. Since February 1995, however, the latter possibility has been strongly limited. All contracts lasting more than 15 days became liable to contributions, as well as chains of contracts, if the time span between two of them is shorter than 60 days (Żukowski, 1996, pp. 117–18). The 1996 amendment to the Labour Code increased protection for 'insiders' in the Polish labour market – groups with stable employment relationships in sheltered sectors – and introduced other employee-friendly measures. Firing employees during mergers was prohibited, the working week was shortened from 42 to 40 hours, and the rules governing fixed-term contracts were changed so that the third fixed-term in a row (when it was signed within a month of the date of expiration of the second fixed-term contract) became a permanent contract (Zientara, 2008, p. 420).

The new millennium has been marked by the unions' less active involvement in politics, and this soon resulted in a more business-friendly stance, even after the Left Democratic Alliance (SDL) took power in 2001. Subsequently, what halted the drift into neo-liberalism was the influence of prospective EU membership with its multiple social safeguards. The Labour Code was amended twice, in 2002 and in 2003, to meet EU legal requirements.

The first amendment enacted numerous flexibility-enhancing measures to liberalize the Polish labour market (EIROnline, 2002). The amendment introduced both a new type of contract that made it easier to hire workers to replace employees on extended leave, and more flexible rules governing mass layoffs. The temporary suspension of non-Labour Code employment law provisions was allowed for firms in financial distress. In particular, the amendment discontinued the third fixed-term contact rule and allowed for an unlimited number of consecutive non-permanent contracts (Rymsza, 2005, p. 27).

Just one year later, however, due to the need to comply with EU regulations, the 2003 reform was a *de facto* departure from the 2002 changes, which would have become void with the accession of Poland to the EU (EIROnline, 2003). The amendment focussed on sick leave, working time, annual and childcare leave, workplace harassment, and the employment of minors. All of these policy measures had to be brought in line with the *acquis communautaire*. Most importantly for this study, the provision for an unlimited number of fixed-term contracts was almost entirely eliminated. Collective layoff procedures were again lengthened, and entitlement to severance pay in cases of restructuring was extended. The reforms constituted a relative increase in the EPL indices and, unsurprisingly, employers voiced their discontent with the new measures. Notwithstanding this 'return to the past', a relatively unprotected second labour market quickly emerged in Poland. Wratny (2007) correctly regards the flexibilization of the Polish labour market as a cause for concern.

As a result of the continuous reforms, the Employment Protection Legislation index was constantly in flux. Socialist Poland had pro-labour legislation which had been adapted to a market economy. Hence, in the early 1990s, the overall EPL index in Poland was 1.40 (lower than the OECD average), with high protection against collective dismissals (4.13), relatively strong protection of regular (SER) jobs (2.06) and very low protection of temporary employment (0.75). The latter EPL index was lower than in most continental European countries, and in line with some post-socialist countries such as Hungary. Despite some amendments to the Labour Code, the EPL did not substantially change until 2002. As Poland entered a pro-business phase and further liberalized its labour market, the protection of temporary employment fell to 0.25, a level similar to the United Kingdom. However, the adoption of EC legislation slightly strengthened workers' rights as of 2003–04. The overall EPL index has been 1.90 since 2004, the protection for permanent jobs has remained stable and the protection of temporary employment has increased to 1.75, a level slightly lower than in Italy.

Finally, all flexible labour markets rely on active labour market policies (ALMPs) to some extent. Total spending on ALMPs in Poland was equal to 0.56 per cent of GDP in 2008, and the number of participants was equal to 4.58 per cent of the labour force. These numbers are low compared to advanced Western European countries but still in line with the OECD average. Despite a number of reforms, Bieliński et al. (2008) present a grim picture of the effectiveness of these measures. Some of the resources allocated to ALMPs do not translate into improved employment prospects for beneficiaries. At the same time, even those policies characterized by positive net efficiency (internships and traineeships) are chiefly targeted at relatively advantaged groups, neglecting the less employable ones. In sum, many of the ALMPs enacted in Poland are misdirected and thus have little impact on the situation of the unemployed. They render the prospects for atypical workers even less auspicious. The following paragraphs provide an overview of the different atypical employment patterns, such as fixed-term contracts, the abuse of self-employment, and part-time work.

4.4.2.1 Fixed-term contracts: from marginality to pathology

Fixed-term contracts are frequent in low-skilled jobs and are also used when a worker is hired for a fixed term by a temp agency. As shown

Table 4.6 Fixed-term and permanent dependent employment in Poland

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total dependent employment	10,225	9,904	9,904	10,107	10,480	11,028	11,666	12,179	12,260
Permanent	9,027	8,375	7,986	7,817	7,791	8,014	8,375	8,895	9,017
Fixed-term	1,198	1,529	1,918	2,290	2,689	3,014	3,290	3,284	3,244
Share of fixed-term (in total employment)	11.7	15.4	19.4	22.7	25.7	27.3	28.2	27.0	26.5
Share of fixed-term (in total employment of those aged 15–24)	35.5	46.5	55.8	63.1	66.5	67.3	65.7	62.8	61.7

Source: OECD (2010).

in Table 4.6, fixed-term employment as a share of total dependent employment in Poland almost tripled between 2001 and 2009, although it slightly declined after 2007 (while permanent employment increased). According to Mieczysław Kabaj of the Institute of Labour and Social Affairs (Wratny, 2007, p. 9), 'this form of employment is starting to dominate in Poland, to turn into a peculiar pathology, which is contrary to the experience in the majority of OECD countries and to the recommendations of the European Union'.

The 2002 Labour Code amendment could be a plausible cause but Grotkowska et al. (2005, p. 22) argue that it is impossible to identify the precise reasons for the popularity of fixed-term contracts in Poland. They question the importance of legislative changes and emphasize the role played by the 1998–2003 recession. In any case, fixed-term contracts offer less job protection than permanent employment. These workers do not require a formal dismissal procedure, because fixed-term contracts expire at the end of the contracted period. If contract duration is longer than six months, the parties may negotiate a two-week notice clause, which is applicable from day one (Gutkowska et al., 2007, pp. 258–9).

As pointed out above, since 2003 employers have once again been obliged to comply with the third fixed-term contract rule.[8] However, the ease with which they circumvent this regulation may explain the continuing popularity of fixed-term employment. The European Commission has already voiced its reservations about the length of the period between subsequent fixed-term jobs before a contract becomes permanent, stating that it should be extended (Wratny, 2007, pp. 3–9).

Table 4.7 Self-employment in Poland, 2000–2007 (thousands and shares)

	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Self-employed	3,254	3,231	3,083	2,990	2,956	2,972	2,911	2,942
Of which solo self-employed	2,669	2,703	2,565	2,459	2,400	2,411	2,327	na
Self-employed (share of total employment)	22.4	23.0	22.4	21.1	21.0	20.7	19,5	18.9
Of which solo self-employed (share of total employment)	18.3	19.2	18.6	17.9	17.1	16.8	15,6	na

Source: LFS data, as of fourth quarter, GUS (2010).

Several points deserve mention about the age, motivation and educational composition of fixed-term contract holders, (for details, see Grotkowska et al., 2005, pp. 21–2). First, among younger workers, fixed-term contracts are now more widespread than standard employment relationships (not less than 60 per cent of those dependent employees between 15 and 24 held a fixed-term contract during 2004–09). Of course, younger workers experience frequent employment interruptions and, thus, discontinuous careers. Secondly, roughly half of those on fixed-term contracts identify the impossibility of finding a permanent job as the reason for accepting such a job arrangement (this percentage is lower among job market entrants). Finally, both men and women on fixed-term contracts seem to be less educated than those on permanent contracts – suggesting these jobs require lower skills and qualify for lower salaries.

4.4.2.2 Self-employment: growing possibilities for abuse

Socialist authorities tolerated self-employment – it was widespread even before Poland embarked on the transition to a market economy. Rostowski (1989, pp. 194–5) reports that, in 1986, the private sector's official share of national income was 18.2 per cent (10.2 per cent in agriculture and 8 per cent in the registered non-agricultural private sector). These figures underestimated the true scope of self-employment. However, they indicate that Polish entrepreneurship would have enjoyed a boom during the 1990s.

Table 4.7 shows that the number of self-employed stabilized in the period 2000–2006 at around 20 per cent of total employment. By 2008 there were almost three million employers and solo self-employed people in Poland.

Although self-employment cannot be *stricto sensu* counted as an atypical employment category, it has to be included in this study, because it is so prone to abuse. Indeed, 'false self-employed' will have to be counted as atypical, less protected type of employment, given 'the existence of systematic linkages between large corporate firms on the one hand and small producers on the other', especially in the 'disguised forms of wage labor deriving from such practices as the leasing of capital goods and the provision of credit to self-employed producers on unfavorable terms' (Hanley, 2000, p. 384).

In fact, Polish civil law contracts combine insecurity with an incentive to abuse social protection rules (compulsory social insurance for the self-employed was introduced only in 2000). Polish researchers have estimated that the number of false self-employed is close to two million people (almost two thirds of all self-employed) and that the primary reason for their diffusion is the lower tax wedge (Czarzasty, 2007). This means that, in addition to being defenceless against exploitation (Labour Code protection does not apply), false self-employed are excluded from different social security regulations, and they do not enjoy unemployment protection if their 'employment relationship' is interrupted.

Additionally, many solo self-employed migrate from the general social insurance security system (ZUS) to the agricultural scheme (KRUS) in order to pay lower contributions. Contributions are relatively high and earnings-related in the former but low and flat-rate in the latter. Eligibility conditions are also easy to fulfil. The obligatory farmers' social security system applies to anyone with a farm with an area exceeding one reference hectare, and it includes their family members (Grotkowska et al., 2005, p. 35; KRUS, 2009, p. 5).

In both cases, the false self-employed are subject to social security regimes that do not provide adequate income maintenance in old age. Without supplementary pension provision, which is rare in Poland, these groups face a substantial poverty risk in retirement. To counter these developments, Parliament adopted tougher rules against abuse. The Personal Income Tax Act, in force since January 2007, changed the definition of non-farming business activity, making false self-employment easier to identify.

4.4.2.3 Part-time work: a phenomenon prevalently affecting women

The Labour Code permits employment for less than the forty-hours per week required by law. The law forbids discrimination against employees working fewer hours and requires employers to inform them of full-time employment opportunities.

Part-time employment has remained roughly stable in recent years at less than ten per cent of total dependent employment. In 2009, women constituted only 44.4 per cent of dependent employment but they formed 72.9 per cent of part-time employment. The latter represents a slight increase compared to 2000 when women made up 67.3 per cent of part-time employment. Caring for children is a frequent reason for women's part-time work. However, different segments of society give different reasons for preferring part-time work: for younger people, further education predominates; for prime-age workers, the impossibility of finding full-time employment is the main reason; and for older workers, it is disability or illness (Grotkowska et al., 2005, pp. 22–3). Part-time jobs frequently provide meagre salaries that will, if not supplemented with additional insurance, lead to insufficient pension benefits in old age.

4.5 The new pension orthodoxy and atypical employment: a dangerous combination

Rymsza (2005, p. 30) argues that the flexibilization and short-termism of Polish employment clashes with the new pension system, which requires workers to have stable, long-term contractual relationships in order to maintain their standard of living in old age. Thus it is important to compare the retirement prospects of standard employment relationships with other, atypical, contractual forms. This section evaluates the performance of the new pension system with respect to typical workers, depicts its (few) positive traits; finally, it discusses the nexus between Polish pensions and labour market developments and legislation.

4.5.1 Pension system performance and evaluation

A number of studies have calculated the benefit adequacy of the new Polish pension system under stable conditions (no legislative changes). Regrettably, simulations very much depend on the assumptions made, and no pair of studies is comparable. In addition, with the notable exception of maternity leave, most credited periods of inactivity count less towards pension benefits now than in the old system. Hence, for simplicity these provisions are excluded from computations, so the results apply only to standard employment relationships.

The original simulations in the research project 'Security through Diversity' drew an optimistic picture of the adequacy of an NDC plus FDC system for future retirees (Chłoń et al., 1999, pp. 36–9).[9] Since, ideally, defined contributions maintain final-wage replacement rates

Table 4.8 Gross replacement rates for SER

Age	60	61	62	63	64	65	66	67	68	69	70
Insurance years	**35**	**36**	**37**	**38**	**39**	**40**	**41**	**42**	**43**	**44**	**45**
					Old system						
Total	69.5	70.8	72.1	73.4	74.7	76.0	77.3	78.6	79.9	81.2	82.5
					New system						
First tier	22.9	24.5	26.2	28.0	30.0	32.2	34.5	37.0	39.7	42.6	45.9
Second tier	21.8	23.2	24.7	26.3	28.0	29.9	31.8	33.9	36.2	38.7	41.3
Total	44.7	47.7	50.9	54.3	58.0	62.1	66.3	70.9	75.9	81.3	87.2

Source: Chłoń, Góra and Rutkowski (1999), p. 38 and own calculations.

across the income spectrum, it is easy to compare the new system's performance with the old one, assuming an assessment base equal to the average wage.

As shown in Table 4.8, the new system is less generous than the old one for shorter accumulation periods and earlier retirement, whereas it rewards only those who have much longer accumulation periods (44–45 years) and later retirement (at 69–70). Despite lower contributions, the second tier should (according to the assumptions) accumulate roughly as much as the first one due to higher returns.

At any rate, the table above has to be interpreted with caution. Considering the effective exit age, deferred retirement (after 65) is not realistic, even in the medium run. Similarly, under current labour market conditions, few people have uninterrupted employment records of 35–45 years (see Holzmann and Guven, 2008, pp. 148–9). Moreover, most subsequent evaluations explicitly reject these assumptions because they were overly optimistic given the poor performance of the labour market between 1998 and 2004 (see Balcerzak-Paradowska et al., 2003). Also, it is impossible to factor in systemic events, such as the 2007–09 financial crisis. Even though the overall yields of the OFEs were fairly positive, they fluctuated widely. The year 2008 marked the worst performance in OFEs' one decade of existence, with a staggering minus 14.1 per cent nominal rate of return.

Finally, in Bismarckian systems based on defined benefit formulae, earlier retirement for women is an advantage. This is not the case in NDC systems, because the accumulation period is shorter and hence benefits are lower. The Polish pension system employs unisex life expectancy tables to calculate annuities. This implies some redistribution from men to women. However, it does not fully compensate for shorter accumulation due to the lower statutory retirement age of women.

Based on the factors discussed above, Jajko-Siwek (2007, pp. 7–10) shows that under typical conditions, even high-income employees should buy additional insurance in the voluntary private pension market in order to achieve acceptable income maintenance levels (above 60 per cent replacement of previous income). However, only a tiny fraction of labour market participants is insured in the second and third pillars. As previously discussed, the reasons for this are low tax incentives and high compulsory social security contributions.

On the positive side, some structural features of the Polish pension system protect both typical and, especially, atypical employees better than other cases considered in this volume do. First, compulsory funded schemes do not create portability or coverage problems, even though they crowd out supplementary insurance. Second, there is a fairly developed array of assimilated periods, which are hardly generous, but at least encompassing. They may represent a fair basis to start upgrading the Polish retirement system with more generous explicit redistributive mechanisms.

4.5.2 The pensions-labour market nexus

Benio and Ratajczak-Tuchołka (2007, p. 209) claim that the Polish pension system puts certain citizens at risk of social exclusion because of the low level of actuarially strict mandatory provision, the insufficient protection of women outside marriage, and the underdevelopment of supplementary insurance. This chapter not only supports this assessment but also shows that atypical contractual relationships and abuse worsen the overall picture.

The two main disadvantages that atypical contractual arrangements have in the new pension system are shorter, interrupted contributory records, and lower contribution bases. These weaknesses can result in a low level of notional and financial assets, thereby triggering the minimum pension guarantee, or contributory periods that do not even qualify for the minimum pension guarantee (in the case of long-term careers, housewives, and unregistered employees) because of forms of employment that do not meet the requirements of the pension system. Each atypical employment relationship has its specific drawbacks.

Fixed-term contracts, held by a hefty 26.5 per cent of all dependent employees in 2009, theoretically stand on equal footing with permanent contracts. However, the likelihood of unemployment is by definition higher for those on fixed-term contracts. Furthermore, the eligibility conditions for unemployment benefits are stringent and in most cases benefits can only be drawn for six months. This means that workers on short-term contract may not be eligible for compensation, and a large part of the long-term unemployed is left unprotected. Consequently, at the end of 2009, there were less than 370,000 unemployment benefit recipients out of 1.89 million registered unemployed (c. 19.5 per cent of total). The inefficiency of ALMPs definitely does not improve this situation. Moreover, fixed-term jobs are concentrated among younger cohorts (more than 60 per cent in the age group 15–24). This has to be considered in the light of both the full application of the NDC and FDC schemes to these cohorts, as well as the elimination of contribution credits for university years, which create a cumulative disadvantage for those with higher education.

Civil law contracts that apply to the solo self-employed combine several negative traits. First, contributing for 35 years at the level of the minimum assessment base for the self-employed (60 per cent of the average wage) barely guarantees a replacement rate higher than the minimum pension (Benio and Ratajczak-Tuchołka, 2007, p. 204). Second, the protection against job loss is by definition non-existent, and these people may directly end up on social assistance. Third, solo self-employed people frequently register as fictive farmers in order to pay lower contributions than those due in the general social insurance scheme. As a consequence, they will be entitled to future pension benefits close to the minimum: each year of insurance earns entitlement to a contributory part (one per cent of the minimum old age pension) and a supplementary part (85–95 per cent of the minimum old age pension). These problems are widespread, as almost two thirds of all self-employed (two million people) are false, while the share of fictive farmers is hard to determine.

The main disadvantage of part-time jobs is low monthly salaries. Although the share of part-time employment in Poland is comparatively low (less than ten per cent of total dependent employment), it is mainly women who take up these jobs. This highlights the main problem with Polish retirement policy, that is, the unfavourable circumstances for female workers. A number of interrelated deficiencies in family policy create incentives for women to seek flexible (part-time) employment arrangements, to rely on scant family allowances, or even to exit the labour market altogether (only 52 per cent of women work). Three problems concerning the inadequacy of family policy stand out. First, employer-based social security was essentially dismantled and taken over by small, local, and fiscally collapsing authorities (the *gminias*) in the early 1990s. Second, access to childcare, nursing and elderly care facilities gradually contracted because of this decentralization of social services. Social service infrastructure is particularly lacking in rural areas. Third, the costs of care services have not only swelled in absolute terms but they also have to be increasingly borne by the household. While a child's parents had to cover some ten per cent of total costs before transition, they are currently required to finance about 40 per cent (Grotkowska et al., 2005; Balcerzak-Paradowska et al., 2003; Heinen and Wator, 2006).

On top of that, women fell prey to Polish conservatism, which clung to a differentiated statutory retirement age despite a proposal to the contrary (equalized retirement age at 62). Retiring five years earlier than men, coupled with similarly shorter pension accumulation, reduces the replacement rate by almost 20 per cent. The 1999 reform should have provided greater incentives for women to retire later. However, in 2006, the average retirement age was 57.9 for men and 56.0 for women, and only 15.1 per cent of women and 26.6 per cent of men retired at or above the statutory retirement age (Chłoń-Domińczak, 2009, p. 170).

Finally, it is important to address the group of 1.3–1.4 million active workers whose main source of income is an unregistered employment relationship in the informal economy. Unskilled workers in particular are forced to forego social security coverage in order to get a job (Walewski, 2008). The main advantage of these informal arrangements lies in their flexibility and the relative ease with which informal workers can simultaneously keep their other (unemployment or social assistance) benefits.

4.6 Conclusions

During the past two decades, the Polish old-age pension system and labour market went through three distinct evolutionary periods. Late socialism provided generous, albeit deteriorating, retirement rights coupled with full employment guarantees in a decaying economy. In the early 1990s, the fundamental mismatch between labour demand and supply gave rise to unprecedented challenges, which resulted in the sharp deterioration of both pension- and labour-related structural indicators. These elicited, a decade into the transition, an abrupt response by policy makers and a gradual one by employers, and led to the most radical pension system reform in the region and the creation of a rather flexible dual labour market.

One of the central findings of this chapter is that there are severe incompatibilities between these two parallel trends. The excessive fiscal concerns that motivated Polish policy makers in reforming the public retirement system led to an individualization of risk through the introduction of a two-tiered NDC and FDC first pillar. These reforms force workers to seek permanent full-time employment relationships if they want to earn a reasonable pension benefit in retirement. However, the labour market offers exactly the opposite type of employment. Employers and policy makers alike favour flexible, atypical contractual forms. Part-time, fixed-term, unregistered jobs and false self-employment grew disproportionately not only in order to increase economic competitiveness, but also to circumvent existing legislative rigidities and to evade excessively high taxes and social security contributions.

The combination of these two trends is cause for concern. An increasingly strict pension system embedded in a flexible labour market may further divide employees into two classes: those enjoying a standard employment relationship, whose income maintenance is largely guaranteed by life-long steady contributions, and a plurality of insufficiently insured atypical workers, who face the risk of being either entitled to minimum pensions or to means-tested social assistance. Additionally, the latter group is, on average, much younger than the former group. Moreover, the new combined NDC-FDC pension system applies fully to younger workers, thereby requiring long and uninterrupted contribution histories to guarantee income maintenance. Finally, cutting across the two classes are women, who are disadvantaged due to their role as housewives in an overtly conservative society.

Atypical forms of employment entail *de facto* lower protection standards than permanent employment, possibly not even guaranteeing poverty alleviation during old age. Part-time contracts do not yield adequate income levels, and even though they apply to less than ten per cent of dependent employees, the majority of these are women. Fixed-term employment spread like wildfire in the 1990s and 2000s, especially among the youngest cohorts (more than 60 per cent of those aged between 15 and 24). Fixed-term contracts frequently apply to low-paid jobs and increase the likelihood of jobless spells. Because unemployment insurance is rather ungenerous and ALMPs inefficiently targeted, prolonged periods of unemployment may severely reduce these workers' contribution records. Civil law agreements encourage widespread false self-employment (potentially up to two million people). This is a cause for concern because these people's contribution bases are so low. Women have cumulative disadvantages in this system, as they work part-time and retire earlier than men. Thus women will probably constitute the bulk of the elderly poor once the new system based on defined contributions is fully operational. Finally, the least protected of all are those who exit the formal economy altogether and forego any social insurance coverage.

Despite these very real problems, one should not forget that there are positive traits in both the Polish pension system and its labour market. The mandatory funded tier prevents the kinds of coverage and portability problems that emerge in countries such as Italy or Germany, which adopted a voluntary approach to private pension provision. Even if the system is hardly generous, there is a relatively broad array of non-contributory periods that earn entitlement to social insurance, and some of them – such as parental leave – have recently been improved. In particular, the labour market has seen both structural and legislative improvements. Since 2004, the protection of temporary employment has been significantly improved, resulting in an EPL index not much lower than that for permanent contracts, and as the economy picked up again after 2003, the overall employment level increased and unemployment rates fell. Finally, Poland was the only EU-27 country that in 2009 experienced a positive economic growth rate at the height of the financial crisis.

In sum, the preconditions for upgrading the Polish system to ensure not only poverty prevention but also income maintenance in old age are present. Simple interventions in the realm of pensions, such as explicit redistribution, may be insufficient. Most experts agree that the problem lies in the conservative and, at the same time, socialist roots of Polish social policy. The position of women in Polish society should be strengthened, both through family policy interventions and by creating greater incentives to stay longer in the labour market. The efficiency of ALMPs should be significantly increased via better targeting and by earmarking more conspicuous resources. The widespread abuse of atypical contractual relationships should be fought with vigour, as improved employment protection legislation does not sufficiently address the problem. Eventually, these issues may find a solution, and more resources may be devoted to redistribution, if the Polish economy continues to grow strongly, as it has in the past few years.

Notes

1. In order to be consistent with the rest of the book, the OECD definition of pillars is used: the first pillar has universal coverage; the second and third pillars consist of occupational and individual supplementary schemes.
2. The concept 'transformational recession' refers to the severe economic crises following the passage from central planning to a market economy. This

entailed macroeconomic stabilization, price liberalization and privatization of state-owned property.
3. In the early 1990s, Solidarność was both a trade union and the conservative political group that ruled until 1993. Both emerged from the dissident labour movement founded in the 1980s, which crucially contributed to the collapse of socialism in Poland.
4. 1 PLN = 0.252 Euros on 29 October 2010.
5. Various types of minimum pensions cover different risks: old age, disability, survivorship and so on. For details, see ZUS (2010).
6. For a comparison with Latin America, see Rudolph and Rocha (2007, p. 20).
7. On the gender dimension of social security reforms, refer to Balcerzak-Paradowska et al. (2003).
8. The rule does not apply for probationary periods, fixed-term contracts substituting an employee during an absence from work, and for seasonal/cyclical work (Gutkowska et al., 2007, pp. 258–9).
9. Assumptions: average wage earners, starting career at age 25, average wage growth: 4 per cent, thus notional rate of return 3 per cent (old indexation rules), return on capital 6 per cent, administrative fees: 5 per cent on contributions, 0.6 per cent on assets, annuity company fee: 6 per cent of balance at retirement, 2 per cent return on annuities and constant current life expectancy.

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Part II

Traditional Multi-Pillar Countries

5

Lessons from the UK: When Multi-Pillar Pension Systems Meet Flexible Labour Markets

David Natali

5.1 Introduction

The British pension system represents an interesting case for testing the capacity of public and private programmes to provide security in old age for both standard and non-standard workers.[1] Britain has a multi-pillar pension system that it is based on the complex articulation of public and non-public retirement schemes. Moreover, the British pension system is embedded in a liberal market economy with a largely deregulated labour market. Such a multi-pillar system does not provide a high level of protection against old age risks for everyone. As Bridgen and Meyer (2007) argue, the British system consists of low public benefits and a mature but heterogeneous occupational and personal pensions sector built on voluntarism. The weaknesses in the British system have led some authors to speak of a 'pension crisis' (Pemberton, 2006; Ring, 2005), while others have said British pensions are in a 'sorry state' (Whiteside, 2006).

The peculiarity of the British 'liberal' multi-pillar model rests on four key elements. First, and in contrast to many other European countries, the UK has not experienced a 'golden age' in pensions characterized by strong old age security for workers in a highly regulated labour market. In contrast, the British pension system has shown long-term problems of limited and uneven protection across occupational and social groups (Taylor-Gooby, 2005). These shortcomings have been consistent with the key principles of the system: low public protection (below the poverty line), private sector voluntarism, and the contributory logic of both public and private retirement schemes.

Secondly, both retirement programmes and labour market institutions were reformed along liberal lines well before the introduction of similar measures in the rest of Europe. Retrenchment of public pensions started at the beginning of the 1980s, in parallel with labour market deregulation.

Thirdly, the current problems in the UK pension system are mainly related to benefit adequacy (the ability to prevent poverty in old age and to provide adequate resources for the elderly) rather than to the financial viability of either the public or non-public schemes (see Clark, 2006; Pemberton, 2006). Whilst many European countries are facing increased budgetary tensions due to the growth of public pension spending, in the UK the main challenge is the risk of widespread poverty among pensioners. Pension reforms and labour market trends have both contributed significantly to 'security' and 'savings' gaps, especially for atypical workers (for example part-time, temporary and self-employed workers), and for other social groups. In particular, the 'scandal' of women's pensions (much lower than those of men in both first, second and third pillars) has characterized the long-term evolution of the system (Thane, 2006). These groups are among the so-called 'under-pensioned' (PPI, 2003a; 2003b), that is, people with inadequate benefit entitlements.[2]

Consequently, recent legislative innovations have aimed to improve old age security, especially for less protected groups. Reforms have affected both public schemes and supplementary private pension funds. These reform efforts and their projected outcomes therefore represent an interesting source of insights for other European countries experiencing increased problems with old age security for atypical workers (Bridgen and Meyer, 2007).

The present chapter analyses the interaction between a flexible labour market and a fragmented multi-pillar pension system, and the ability of the latter to provide old age security to atypical working careers. The analysis in the chapter focuses on atypical employment (part-time, fixed-term jobs and, though not strictly atypical, self-employment), particularly women, who earn lower pensions because of lower earnings, atypical contracts, and more frequent spells of non-employment, and so on. While Section 5.2 focuses on the flexible labour market in Britain (which is the result of long-term dynamics and reforms introduced since the early 1980s under a Conservative government), the rest of the chapter aims at assessing present and future old age protection trends for standard and non-standard workers. Sections 5.2 and 5.4 introduce the complex set of retirement programmes in the UK and their interaction with a deregulated labour market. Section 5.3 describes the pension system that was consolidated between the 1940s and 1990s, while the interplay of pension programmes with labour market trends is analysed in Section 5.4. This permits an assessment of current gaps in both income security and savings for current pensioners and workers whose entitlements are largely shaped by past legislation.

Sections 5.5 and 5.6 present the most recent pension reforms introduced by the New Labour Government, as well as projections of future old age security for atypical and standard workers. While recent legislation is expected to reduce old age insecurity for atypical workers, the 'under-pensioned' problem is projected to persist, and more effective measures are advocated by experts. Section 5.7 concludes with a discussion of the problematic interaction between retirement programmes and labour market institutions in UK, emphasizing the measures proposed to eradicate old age insecurity for large swathes of the elderly, and their outcomes.

5.2 The British flexible labour market: reforms and trends

The first step in assessing old age protection in the UK for typical and atypical workers is to summarize the key traits of the British labour market and the weight of atypical jobs in it. The UK does not have a history of active labour market regulation like many other European countries. Even before the Conservative reforms of the 1980s, the actors involved in the employment relationship were free to determine employment contracts and conditions with little legal interference (Gregg, 1999; Kim and Kurz, 2002). In the second half of the twentieth century, there was no regulation demanding formal justification for fixed-term contracts, standard employment contracts never enjoyed much legal protection, and employment relationships were more short-term than elsewhere. The UK's scores on employment protection legislation (EPL) indexes have always been low (see the introductory chapter for the comparative analysis of EPL indicators). The British labour market is thus a typical example of a liberal regulatory regime, with a limited role for the state in protecting against major employment and social risks (Samek Lodovici, 2000).

That said, some other features of the UK system seemed to go against these liberal trends, especially up to the end of the 1970s: unionization rates were high in comparative terms, and nominal wage increases were higher than in the rest of Europe. The UK also had a system of industry minimum wages set by the Wage Councils.[3]

In the 1980s, several measures introduced by Conservative governments addressed such rigidities and led to further deregulation (almost unparalleled among developed countries, see Gregg, 1999). Employee rights within companies and collective bargaining procedures were weakened. Much of the statutory regulation of collective bargaining (such as the extension of industry-level collective agreements to non-unionized enterprises) was abolished. Unemployment insurance coverage and benefits were cut, with the burden of unemployment support shifted from social insurance schemes to means testing. In 1986, the Thatcher government replaced Supplementary Benefits (a means-tested scheme) with Income Support (to cover daily subsistence costs) and the Social Fund (of loans and grants) in order to contain social expenditure growth. In 1996, the Major Government introduced the Jobseekers Allowance, which simplified the complex set of social insurance and assistance benefits for unemployed claimants (Griggs and Bennett, 2009).

Labour market deregulation was accomplished through the abolition of Wage Councils, relaxation of unfair dismissal regulations and privatization of state-owned industry and services (Wood, 2001). As stressed by Deakin and Reed (2000), the decentralization of wage bargaining developed in parallel with de-unionization. In 1998, the New Labour Government enacted the National Minimum Wage Act, which introduced a pay threshold enforced by inspection and legal sanctions. This has had important effects on pay gaps (for women, for example) (Neal, 2003). Decentralized and uncoordinated wage bargaining has increasingly characterized the system, and employment rates have risen in comparative perspective (Clasen and Clegg, 2003; Nickell et al., 2000).

These and other dynamics have thus contributed to the progressive deregulation of the labour market. As stressed above, the OECD Employment Protection Legislation index for UK is one of the lowest in Europe: 0.7, compared to 1.4 in Denmark, 2.2 in Sweden and 3.0 in France (OECD, 2004). Also, atypical contracts accounted for much of the overall increase in employment rates, especially for women.

The last two decades have seen the introduction of labour market and welfare reforms consistent with New Labour's activation paradigm (Walker and Wiseman, 2003). Social assistance reforms were accompanied by employment policy measures to modernize the welfare state and to make it compatible with a more flexible labour market (Powell, 2009; Trickey and Walker, 2001). Under New Labour, welfare and labour market reforms aimed to 'reactivate' the unemployed and 'make work pay'. The UK, along with other Anglo-Saxon countries, is characterized by low spending on active labour market policies (ALMPs), but from the

Table 5.1 Structural indicators of the UK labour market

	1985	1990	1995	2000	2005	2006	2007	2008
Employment 1564								
Total	65.1	71.1	68.1	71.0	71.7	71.6	71.5	71.5
Men	75.9	80.5	74.8	77.7	77.7	77.5	77.5	77.3
Women	54.2	61.7	61.4	64.5	65.8	65.8	65.5	65.8
Employment 5564								
Total	47.0	49.2	47.5	50.4	56.8	57.3	57.4	58.0
Men	62.3	62.4	56.1	59.8	65.9	66.0	66.3	67.3
Women	32.7	36.7	39.3	41.4	48.0	49.0	48.9	49.0
Unemployment rate								
Total	11.6	7.0	8.8	5.6	4.8	5.4	5.4	5.7
Men	11.9	7.3	10.2	6.2	5.2	5.8	5.7	6.2
Women	11.1	6.7	7.0	4.9	4.3	5.0	5.0	5.1
Structural unemployment (+12 months)								
Total	5.7	2.4	3.8	1.6	1.0	1.2	1.3	1.4
Men	6.5	3.0	5.1	2.1	1.3	1.6	1.6	1.7
Women	4.6	1.5	2.2	0.9	0.7	0.8	0.9	0.9

Source: Eurostat (2010).

end of the 1990s total spending increased from 0.22 per cent of GDP in 1998 to 0.45 per cent in 2005 (OECD, 2008). The New Deal programmes addressed new sources of social risks for specific groups: lone parents: young people; the disabled; and the long-term unemployed. While specific programmes were launched to develop targeted employment projects, further innovations consisted of the introduction of Pathways to Work (targeted at unemployed persons receiving Incapacity Benefits), the Employment and Support Allowance (ESA), and the extension of the Jobseeker's Allowance scheme to include lone parents (Griggs and Bennett, 2009). A milestone in this wave of labour market measures to deal with new social risks was the introduction of the National Minimum Wage in 1999. This first step was followed by the introduction of tax credits (like the Working Families' Tax Credit) and other in-work benefits. Activation policies were then accompanied by increased conditionality and work responsibilities for working age claimants (Evans, 2002; Wright, 2009).

Three key trends have thus characterized the British labour market in recent decades. First, the UK has experienced high employment rates: in 1984, the total employment rate was 65.1 per cent, increasing to 71.1 per cent in 1990. The most recent period (1990–2008) has seen much stability (see Table 5.1) as a consequence of two trends: the slight decline of male employment, and the increase of female employment rates. At the beginning of the 1990s, women already accounted for about 45 per cent of total employment in the UK (Anderton and Mayhew, 1994). Eurostat data show that the female employment rate was 54.2 per cent in 1984 and 61.7 per cent in 1990. Trends in the last decade show further growth – that is, 65.8 per cent in 2008 (Table 5.1).

Secondly, a shift from standard to non-standard forms of employment has occurred – especially through the progressive widening of part-time contracts. At the beginning of the 1980s, part-time workers (mainly women) represented 18 per cent of employment (against an average 12 per cent in the EU) whilst at the end of the 1990s the proportion had risen to over 23 per cent (with a peak of 24.4 per cent in 2000). In 1985, fixed-term contracts covered about 6.9 per cent of total employees. This figure was still at above 7 per cent at the end of the 1990s and then declined. Self-employment increased to 13 per cent in 1990 to then slightly decline to 12 per cent in 2000 (Samek-Lodovici, 2000).[4] Table 5.2 shows that the last decade has seen a stable proportion of part-time jobs at 24 per cent of total employment, a fall in fixed-term contracts (from 6.6 per cent to 5.3 per cent of total employees) and an increase in self-employment (especially for men).

Atypical employment has thus increased, even though most employees continue to be employed in permanent full-time contracts. Recent data show much stability in these trends (Edwards, 2006; Connolly, 2008). According to the OECD (2008), full-time employment stagnated at around 76 per cent during the 2000s. About 40 per cent of the gainfully employed are in non-standard employment – self-employment, part-time and fixed-term work (PPI, 2003b).

While the rate of self-employment increases with age, both younger and older workers are more likely to be in non-standard employment. In addition, women are still more likely than men to be in non-standard employment (PPI, 2003a). Yet, men and women are usually in different types of non-standard employment: about 70 per cent of self-employed people are men, while 80 per cent of part-time workers are women (Table 5.2).

Thirdly, as a consequence of the developments described above, income and earnings inequality grew, and the upward trend was faster in the UK than in any other European country (Gregg and Machin, 1994).[5] Data from the Office of National Statistics (ONS, 2007) show

Table 5.2 Fixed-term and part-time employment, self-employment in UK

	1985	1990	1995	2000	2005	2006	2007	2008
Share of fixed-term employment								
Total	6.9	5.1	6.9	6.6	5.7	5.7	5.7	5.3
Male	5.5	3.5	6.1	5.7	5.2	5.0	5.1	4.7
Female	8.7	6.9	7.8	7.6	6.2	6.4	6.4	5.9
Share of part-time employment								
Total	20.4	20.8	23.2	24.4	24.2	24.3	24.2	24.2
Male	3.2	4.0	6.5	7.9	9.1	9.2	9.4	9.8
Female	44.3	42.6	43.7	43.8	41.9	41.7	41.4	41.0
Self-employment								
Total	11.5	13.3	12.9	11.9	12.7	12.9	13.1	13.0
Male	14.8	17.9	17.7	15.8	17.2	17.3	17.5	17.5
Female	6.8	7.3	7.0	7.2	7.4	7.7	7.8	7.7

Source: Eurostat (2010).

that in 57 per cent of poor households in the UK, there is someone in employment, up ten percentage points from a decade ago. The combined effect of welfare, tax and employment reforms has led to growing inequality and the parallel increase in poverty from the early 1980s to the late 1990s (Connolly, 2008, p. 229).[6]

Atypical workers thus represent a large part of the labour force and, as shown below, their pension entitlements have long been at the centre of academic and political debate (see Whiteside, 2003; Mc Govern et al., 2004).

5.3 The British multi-pillar pension system throughout the twentieth century

To assess the entitlements of present British pensioners, it is important to first examine past pension legislation as it affects present pensioners and determines the pension entitlements of active workers. At the end of the twentieth century, old age security was provided by a particularly complex multi-pillar pension system (Bonoli, 2000; 2003). The system was based on three key principles: low public protection, private sector voluntarism and the contributory logic of (public and private) retirement schemes (benefits were strictly related to labour activity). The public pension system consisted of a flat-rate basic pension and a supplementary state earnings-related scheme (SERPS). Workers had the

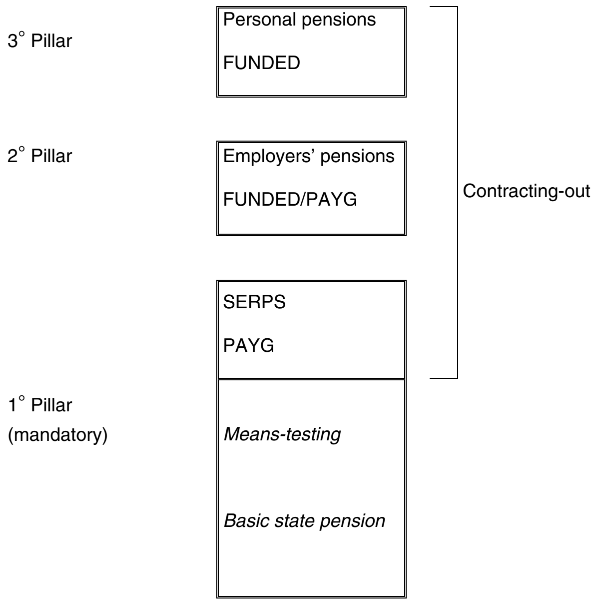

Figure 5.1 UK pension system of the 1990s

option of contracting out of the public earnings-related scheme and choosing private cover instead (Figure 5.1).

In many respects, low public benefits failed to prevent poverty, and the uneven coverage of the economically active population by occupational and personal pensions left many citizens without sufficient income in retirement. As the following section shows, earnings-related schemes (both public and private) did not (and still do not) cover 100 per cent of working-age people: neither the self-employed nor the unemployed qualified for public (SERPS/S2P) pensions. Protection was further reduced by gaps in the number of qualifying years for public schemes (this is the case of people with caring responsibilities) and interruptions in private pension contributions. All this led to gaps in both public pension security and private pension savings.

As a consequence, means testing played a key role in pension policy (Taylor-Gooby, 2005; Whiteside, 2006). All these traits are specific to the 'liberal' multi-pillar model that contrasts in many respects with the 'universalistic' multi-pillar model of the Netherlands and Denmark, where protection is more widespread, means-testing plays a more limited role and the development of supplementary schemes is not based on voluntarism.

Table 5.3 Evolution of British pensions (1940s-1990s): major reforms

Reforms	**Content**
National Insurance Act 1946	Basic State pension
National Insurance Act 1959	State Graduated Pensions Contracting out rules introduced
Social Security Pension Act 1975	SERPS, State Earnings Related Pension Scheme
	Home responsibilities protection (HRP), contribution credits available from 1978
Social Security Act 1980	Public pensions cut by indexing to prices
Social Security Act 1986	Public pensions cut. More favourable rules for contracting out
Pension Act 1995	Public pensions cut

This complex system is the result of a long period of 'repeated reforms' where innovations were achieved by adding new components rather than by replacing old programmes with new ones (Pemberton, 2006). The first mandatory non-contributory and means-tested programme was introduced in 1908 and a contributory scheme was established in 1925, but the Beveridge Plan of 1942 and the consequent National Insurance Act of 1946 represented the cornerstone of the system (Table 5.3).

The Basic State Pension (BSP), introduced by the National Insurance Act of 1946, represented (and still represents) the first layer of the system, providing flat-rate protection for wage earners and the self-employed. The scheme was financed by social contributions, while pension rights accrued on the basis of one's contribution record. The BSP has traditionally been below subsistence level so contributors without other resources had to resort to means-tested schemes (Whiteside, 2003; 2006). In 1978, Home Responsibilities Protection (HRP) was introduced to reduce the number of years of contributions required to secure a full BSP. Credits were granted for taking care of children, and older or disabled people.

Such limited protection left ample room for earnings-related schemes, and the latter were developed through two complementary strategies: the introduction and subsequent strengthening of public earnings-related schemes; and the consolidation of occupational pension funds (Natali, 2008).

The 1959 pension reform improved the protection provided by the first public pillar. However, budgetary pressures, divisions between and within the political parties and the social partners, and the long tradition of non-public pension funds contributed to the definition of a developmental path that was quite different from both continental European and the Nordic models (see Bonoli, 2000; Pemberton, 2006). The Basic State Pension was thus supplemented by the earnings-related State Graduated Pension, but it was less generous than earnings-related schemes in continental Europe and was organized according to the 'contracting-out' principle. The earnings-related scheme became obligatory (for dependent workers, not for the self-employed) but participants could contribute to the public tier or, alternatively, opt for a supplementary non-public scheme. An increasing proportion of the middle class did supplement basic state provision through private occupational pensions and tax-sponsored private-sector schemes. At the end of the 1960s, about 50 per cent of all workers were covered by occupational schemes.

In 1976, the Labour government introduced SERPS, the State Earnings Related Pension Scheme, trying to add a Bismarckian Pay As You Go programme to the basic safety net (Figure 5.1). The subsequent reforms by the Conservative government curbed this attempt at paradigmatic change. The limited maturation of pension rights under SERPS made possible the return to more meagre statutory benefits (Natali, 2008).

The Conservative reforms greatly reduced the generosity of benefits from SERPS. Public protection was less generous than in countries with pension schemes based on social insurance, and 'contracting out' – especially in favour of personal pensions – was encouraged through tax incentives. Secondly and, in particular, third pillar programmes gained an increased role in providing higher protection for the active part of the population, especially the middle class. Changes in the 1980s were consistent with the implementation of a 'liberal' multi-pillar model: cutbacks to SERPS contributed to reducing the expected replacement rate of the public earnings-related scheme from 25 per cent to 20 per cent. In addition, new and more generous tax exemptions were introduced to further develop supplementary (and in particular individual) pension funds. At the end of the 1980s, 40 per cent of workers paid contributions to SERPS, while 55 per cent participated in occupational and personal pension schemes. Ten years later, the number of workers contributing to SERPS had fallen to 20 per cent, whilst 30 per cent of all workers were members of occupational schemes and a similar percentage (29 per cent) were covered by individual schemes (Taylor-Gooby, 2005, p. 123).

At the end of the twentieth century, private (occupational and individual) pension schemes became less and less capable of fulfilling their mission. On the one hand, most of them were mainly fully funded and increasingly of a 'defined contribution' type. A large literature on this topic demonstrates that employers' retreat from 'defined-benefit' schemes has had a very large impact on the pension income of atypical workers whose fragmented careers and lower wages, lead to insufficient contribution records and lower pensions (see Bridgen and Meyer, 2007). This was consistent with the expected reduction both of contributions paid by employers and of future benefits: trade unions forecast huge cutbacks in future provision of about two thirds of their average actual level, with an annual saving to industry of GBP 18.5 billion (€21.83 billion)[7] (TUC, 2005). On the other hand, since the 1970s, employers have started to retreat from occupational pensions entirely: from more than 12 million members of occupational schemes in the late 1960s to about 10 millions in 2000 (DWP, 2006a).

To sum up, the public first pillar remained consistent in terms of its policy goal – poverty prevention – especially after the reforms of the 1980s. State intervention was less ambitious than in many other European countries, leaving room for occupational and individual schemes to offer higher levels of protection. This resulted in lower public pension spending. According to ILO (2000) data, public pension expenditure was around 8 per cent of GDP in 1985. Second and third pillar coverage was 50 per cent of the active population, with pension fund assets amounting to about 80 per cent of GDP.

5.4 Old age (in)security for atypical employment relations: the status quo

But has this complex pension system provided adequate protection against the risks associated with old age? At the end of the twentieth century, British public pensions provided low old age security – below the poverty line for many – because the BSP can reach a maximum of 16 per cent of National Average Earnings, while SERPS ranges from zero to 29 per cent of NAE (PPI, 2003a; 2003b). Occupational and personal schemes are thus necessary to increase pensioners' income. However, their development was uneven. As a consequence, the risk of poverty in old age for UK citizens has been considerably higher than for younger age groups (Taylor-Gooby, 2005). The following discussion is based on actual pensioners' income and on the pension entitlements of active (standard and non-standard) workers accrued through legislation in force at the end of the twentieth century.

As a consequence of the institutional complexity mentioned above, old age protection has been fragmented. Contrary to the original Beveridge

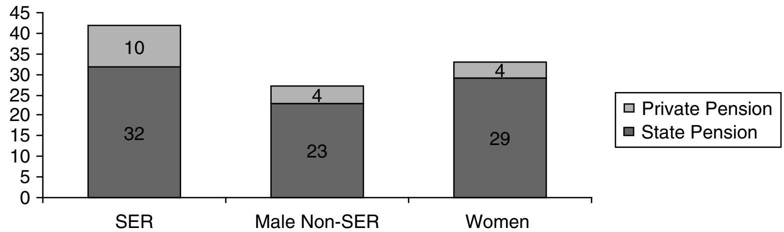

Figure 5.2 Pension income (as a percentage of National Average Earnings) for standard (SER) and atypical (Non-SER) careers and for women, 2003
Source: PPI (2003a).

programme of universal social security schemes, some social and occupational groups have been more protected while others have been less so. Such fragmentation has characterized both the public and the occupational and personal schemes. As to the former, protection varied by gender – that is, women received lower public benefits than men – and by status, with standard contracts receiving more protection than non-standard jobs. The Basic State Pension was not universal: qualification depended on annual earnings (above a certain limit). Contribution credits (HRP) proved insufficient to lift the pensions of women to any great degree. The self-employed did not qualify for SERPS, and contribution credits were low. In 2002, up to 5 million people did not qualify for BSP, and up to 12 million people did not qualify for SERPS (PPI, 2003a).

As for occupational schemes, coverage varied by sector and size of business. The public sector has provided widespread coverage while private service sector coverage has been low. Moreover, large enterprises offered more opportunities for occupational funds than small and medium enterprises (Bridgen and Meyer, 2007; Pensions Commission, 2005; 2006; Clark, 2006).

The following discussion focuses on atypical employment (part-time, fixed-term contracts and self-employment), particularly among women. Figure 5.2 shows the relative pension income of retired people after standard and non-standard careers, and of women, in 2003.[8] Standard careers are represented by the case of a worker who was first employed at 21, worked full time for 44 years, at median earnings, made private pension contributions of 8 per cent of salary per year, and then retired at 65.

Non-standard careers (Non-SER) are represented by the case of a worker with a short spell of temporary work (without private pension provision), a longer spell of self-employment (with less regular and lower contributions), 80 per cent of median earnings, retiring at 67.

For women, we consider a female worker with two children who has a career break lasting seven years, who worked part-time for five years with low earnings and retired at 68 (PPI, 2003a).

5.4.1 Old age protection for atypical workers

The pension income of male atypical workers is much lower than it is for those with standard careers. The first cause of this 'security gap' is lower earnings. Part-time workers earn on average one fourth of the average full-time wage. Average full-time earnings for temporary employees are much lower than the average wage of permanent employees.[9] And even if temporary jobs are often a stepping stone to permanent work, people who started in temporary work have, on average, lower earnings for the rest of their career (PPI, 2003a, p. 13). The direct impact of lower earnings is thus to reduce entitlements to statutory public schemes (especially for SERPS, see Figure 5.2).

The second cause of more limited pension income is the fact that atypical careers do not enjoy the same social rights and obligations as standard workers. In particular, part-time employment of up to 15 hours worked per week is completely exempt from social contributions. In case of need, retirees are dependent on means-tested programmes. And atypical workers employed for more than 15 hours per week tend to receive lower employment protection and pension entitlements. Self-employment in particular means lower entitlements because of exclusion from SERPS (Kim and Kurz, 2002).

Moreover, the protection provided by supplementary schemes has traditionally been lower for non-standard employment (this is the so-called 'savings' gap) (Figure 5.2). This group of non-standard employees work in industries with low employer pension provision. Very few part-time and fixed-term employees work in manufacturing, where employer pension provision is higher. According to Bridgen and Meyer (2011), in 2007 84 per cent of public sector workers had access to occupational schemes, 54 per cent of workers in manufacturing, and only 31 per cent in the retail sector.

Only one third of part-time workers and about half of the self-employed have private pensions (Mc Govern et al., 2004). Additionally, occupational pension coverage is more common at higher managerial levels, but atypical workers are rarely employed in these positions.

The same conclusion can be drawn for active workers whose entitlements are largely shaped by past legislation. The lower level of protection for non-standard workers is demonstrated by their limited contribution record to private pension schemes (Figure 5.3).

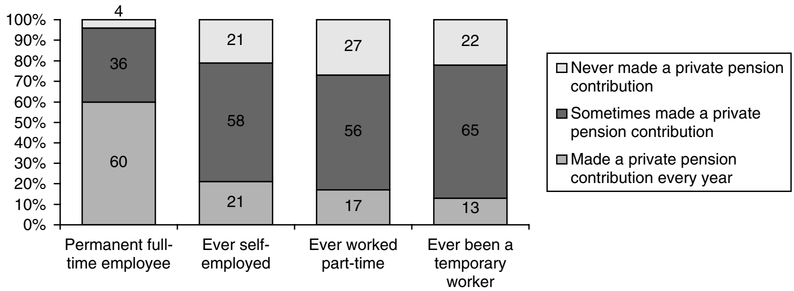

Figure 5.3 Patterns of private pension contributions: Standard (SER) and Non-SER employees, 2002

Source: PPI (2003c).

Atypical workers (especially temporary and part-time workers) are, in fact, less likely to make regular contributions to occupational or individual schemes. And four fifths of the self-employed have little or no savings (Figure 5.3).

5.4.2 Old age protection for women

Current female pensioners receive low benefits from both statutory schemes and occupational pension funds (Figure 5.2). This limited protection is, first, related to the fact that British pensions are based on labour market participation and on the contributory principle: the level of benefits is linked to employment (Thane, 2006). The system was designed to operate in a labour market characterized by full-time employment for men and in a social environment in which marriage and single-earner households were the norm in the UK in the first part of the twentieth century (PPI, 2003a, p. 12).

The statutory state pension is dependent on contributions made before retirement and thus public pensions (BSP and SERPS) are greater for people with higher earnings. At the beginning of the twenty-first century, one sixth of women pensioners were entitled to the full BSP, compared with more than 90 per cent of men (Thane, 2006). About two thirds of recipients of means-tested benefits are women. As stressed by Bridgen and Meyer (2007), the introduction of SERPS improved pension rights for women, and introduced the first measures for the recognition of contribution credits for care activity. The protection of the female workforce through occupational and individual schemes has been traditionally poor, as well. Until the 1980s, the majority of women had no access to adequate occupational pensions or sufficient income from

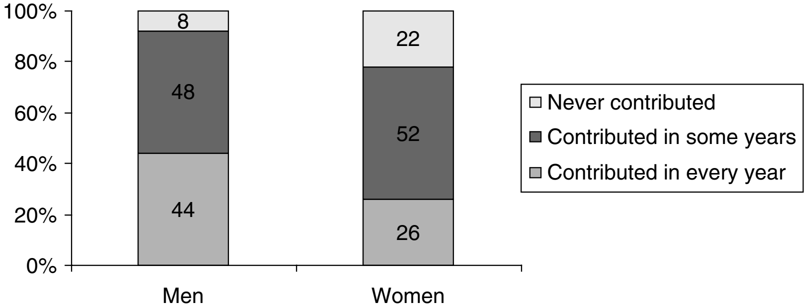

Figure 5.4 Patterns of private pension contributions: men and women employees and self-employed, 2002
Source: PPI (2003b).

personal pensions. In the post-war period, some occupational funds did not admit women, and the introduction of provision for widows in such schemes was a slow process (in particular, improvements were the result of the requirements introduced by the 1975 reforms).[10] Female membership peaked in the 1990s and has declined since then. Female workers in the public sector have traditionally enjoyed more protection (larger coverage and higher protection), while coverage in the service sector, especially in manufacturing, has been more limited.

Female workers face the same obstacles as men in respect of occupational and personal pension funds (Figure 5.4): one fifth of active women do not pay any contribution to supplementary schemes, and one out of two occasionally makes some contribution (but not every year). Thus both basic and earning-related schemes disadvantage women because female employment is characterized by shorter (and more interrupted) careers, lower earnings, fewer opportunities to save, and higher life expectancy than men.

To sum up, atypical jobs are particularly affected by limited old age security in both public and private schemes. Current pensioners and future retirees with atypical careers face limited and uneven old age protection. These limitations affect women, as well.

5.5 The New Labour strategy for twenty-first century pensions

The last wave of legislative measures from the New Labour Government (since 1997) has confirmed the multi-pillar model of the past, while

Table 5.4 New Labour's major pension reforms, 1999–2008

Reforms	Content
Welfare Reform and Pensions Act 1999	Increased means-tested benefits Introduction of Stakeholder Pensions
Child Support, Pensions and Social Security Act 2000	Increased benefits for low-income groups, SERPS replaced by State Second Pension
State Pension Credit Act 2002	Introduction of Pension Credit, higher means-tested benefits
Pensions Act 2004	Reduced costs for supplementary schemes (through less generous indexation) and introduction of the Pension Protection Fund (PPF)
Pensions Act 2007	Increased benefits for low-income groups, higher indexation, higher legal retirement age Contracting-out limited to private DB schemes
Pensions Act 2008	Introduction of Personal Accounts through 'auto-enrolment'

aiming to improve old age protection (especially for atypical workers and the under-pensioned in general). This section looks at the key traits of the UK pension system after the legislative measures introduced by the Labour Government, in particular: the 1999 Welfare Reform and Pension Act; the Child Support Pensions and Social Security Act of 2000; and the Pension Reform of 2004. This is followed by a summary of the measures in the last Pensions Act of 2007 and those in the Pensions Act of 2008 (Table 5.4).

When New Labour came to power in 1997, the state pension system and voluntary private pension savings were perceived as increasingly inadequate and inequitable. These limitations were related, first, to the public pillar and thus echoed some of the worries made explicit in earlier periods. Together with many experts and academics, policy makers agreed on a diagnosis of poorly developed state retirement schemes: obvious gaps in protection (as mentioned above); excessive complexity; and too much means-testing. Means-tests, it was argued, represented a strong disincentive to save (Barr, 2004; 2006; Barr and Diamond, 2006).

It was argued that the main problem with the second and third pillars was the 'failure of the pension market to increase coverage rates for people on average and low incomes. For personal pensions (third pillar), both a lack of demand and a supply gap were identified as problems. This was due to low savings, high charges and risks, and low levels of trust in the market (DWP, 2007). In the case of occupational employer-sponsored schemes (second pillar), overall participation declined from 65 per cent of all employees in 1979 to 54 per cent in 2004 (DWP, 2008). The parallel switch from defined benefit to defined contribution schemes was expected to further reduce protection for workers.

5.5.1 The New Labour reforms between 1999 and 2004

New Labour governments have, first, introduced reforms to statutory and voluntary schemes in order to improve security for the most disadvantaged social groups, while respecting the liberal roots of the system (Bridgen and Meyer, 2007). In the state pension schemes, policy measures aimed at increasing benefits from the Basic State Pension (BSP): through higher contribution credits (for caring for children or older or disabled persons) and a more favourable benefit calculation. In 1999, the Blair government introduced the Minimum Income Guarantee, a typical means-tested scheme providing higher protection for the elderly than the basic pension. And in 2003, the government introduced the new Pension Credit (PC). It consists of two components: the Guarantee Credit and the Savings Credit. The Guarantee Credit is an income-related benefit for people aged 60 or over targeted at low income pensioners (working less than 16 hours per week). Moreover, the income test for the credit is more generous than for previous means-tested benefits. It provides more help to workers with low contribution records and aims to prevent inactivity traps. Savings Credit (SC) attempts to reward saving and ensure that anyone who has made some private saving for retirement will be better off than those who have not saved. However, those who do not have a full BSP will not receive credit for all of their savings. While GC is payable from age 60, SC is only payable to pensioners from age 65 (PPI, 2010).

The PC ensures that no one aged 60 or over need live on less than GBP 109.45 (€129.15) per week (GBP 167.05/€197.12 for couples). These amounts may be higher for people who have caring responsibilities, are severely disabled or have specific kinds of housing costs. Around GBP 7 billion (€8.26 billion) was set aside in 2005–06 to increase pensioners' income through the Pension Credit. As a result, 1.8 million pensioners (1.3 million of whom are women) have been lifted out of absolute poverty (UK Government, 2005, p. 9).

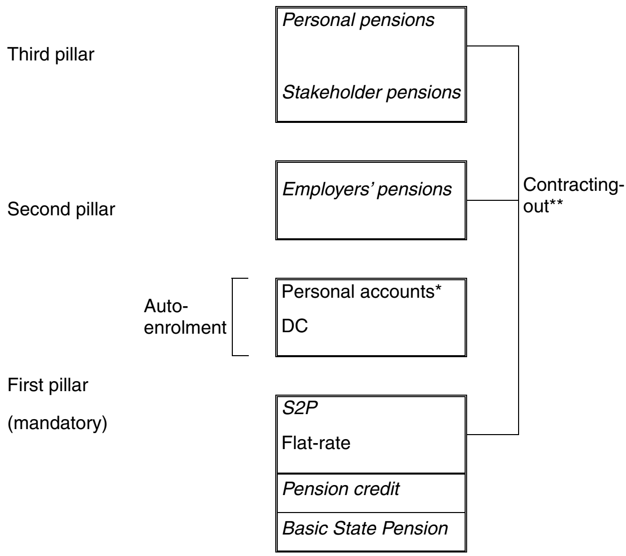

Figure 5.5 The UK pension system after the most recent reforms

Note: * The employer can decide to start or continue to provide a pension itself.
** Contracting out will be limited to 'defined benefit' schemes.

In 2002, New Labour replaced the earnings-related statutory scheme (SERPS), introduced in 1975, by the State Second Pension (S2P). This provided earnings-related benefits until 2007, but afterwards has started to provide flat-rate benefits that are particularly favourable for individuals with low earnings.[11] If compared to the earnings-related programmes of continental European countries, the UK schemes are particularly limited in terms of coverage and generosity. They are only relevant for workers at the bottom end of the income distribution, and their distributional effects are closer to a basic income than a true income replacement scheme (Arza, 2007). Employees earning more than the annual National Insurance Lower Earnings Limit but less than a new statutory Low Earnings Threshold (GBP 12,100 in 2005–06) (€14,278), as well as qualifying carers and disabled people, are treated as if they had earnings of GBP 12,100. The overall effect is that, after a full working life, low wage employees are expected to receive at least twice as much from the S2P than they would have got from SERPS (UK Government, 2005, p. 11). S2P is thus projected to offset some of the effects of low earnings and career breaks. All these measures have, thus, started to change the British pension system (Figure 5.5).

In the area of supplementary pensions, the Blair government introduced, in 2001, a new private Stakeholder Pension (SHP) targeted at middle and low earners with no access to company pension schemes. It is a personal pension account, fully-funded, strongly regulated and with low management charges and no taxes. In particular, SHP has allowed participants to vary contributions and move between schemes without financial penalty. This new scheme was designed to address administrative problems and inefficiencies in the pensions market and to deal with the above-mentioned 'savings' gap.

Until the 1980s, another peculiarity of the UK system was the existence of a 'lightly' regulated 'pension market'. Yet, since the early 1990s, scandals related to the mis-selling and mis-management of personal and occupational pensions have led to attempts to introduce stronger controls (Natali, 2008; PPI, 2005). Measures introduced during the last decade have imposed stricter requirements concerning solvency and transparency. The Minimum Funding Requirement Act of 1994 included new rules for minimum solvency: a minimum funding level specified the level of financial assets that funds are required to have in order to deal with unexpected market conditions. In addition, the Pensions Act of 2004 revised the previous legislation to protect members of occupational funds (Taylor-Gooby, 2005). The Act introduced the Pension Protection Fund (PPF), which started operating in April 2005. The PPF provides protection to members of eligible occupational pension schemes when the sponsoring employer becomes insolvent and leaves the pension scheme underfunded (UK Government, 2005, pp. 24–5).

The reforms discussed above are intended to improve the security in old age provided by public and supplementary private schemes, especially for the most disadvantaged groups (women, atypical workers, and so on). In particular, the introduction of the Pension Credit, the establishment of the State Second Pension and the wider protection of occupational and personal schemes' members were intended to strengthen poverty prevention by increasing the adequacy of old age protection for those most in need.

5.5.2 The Pensions Act 2007 and the Pensions Act 2008

At the beginning of the twenty-first century, the traditional shortcomings in UK old age security remained: public pensions remained low, and the coverage of occupational pension schemes continued to decline. In 2002, the New Labour Government initiated a new reform process to redesign the pension system. To deal with long-lasting problems, the government announced the establishment of a Pensions Commission in the Pensions Green Paper published in December 2002. The Commission was to review the UK's private pensions regime and long-term savings arrangements and, to a broader extent, it was to look at how the UK pension system was developing over time (Natali, 2008). Against this background, the government issued two White Papers in May and December 2006. The subsequent Pensions Act of 2007 put into law the most important measures proposed in these White Papers. This was followed by a second Pensions Bill, announced on December 2007, and passed as the Pensions Act of 2008. The two pieces of legislation represent major innovations affecting the UK pension system.

A number of measures in these two Acts are related to the first public pillar, both its first tier (Basic State Pension, BSP) and second tier (State Second Pension, S2P). The key goal has been to increase the generosity of the state system and its fairness to women and carers, through the introduction of new qualifying conditions. At the same time, the measures confirmed the liberal logic (to reduce poverty in old age) of the UK system. The Pensions Act 2007 reduced the number of years required for a full Basic State Pension: from 39 (women) and 44 (men) to 30 for everyone. The system of Home Responsibility Protection (see above) was also replaced by a more inclusive system of credits for BSP and S2P. This should increase the number of women and atypical workers with spells of unemployment receiving the full BSP (Cleal, 2007). The bill also changed the indexation mechanism of BSP from prices to earnings. Finally, the State Second Pension (S2P) will become flat-rate sooner, and this is expected to reduce inequality between men and women. Finally, 'contracting out' is confirmed, but limited to non-public defined benefit schemes (Natali, 2008).

The overall package means that the performance of the public pillar for men and women will converge. While the new measures will increase spending, the raising of the state pension age (from 65 to 66 by 2026, to 67 by 2036 and to 68 by 2046) will reduce costs, thus keeping total pension spending stable in the next decades.

The most innovative part of the broad reform was finalized in 2008. The Pensions Act 2008 revised the rules governing voluntary pension schemes and an important aspect of the Act was the introduction of so-called Personal Accounts (PA). The aim is to set up multi-employer occupational DC schemes for workers with no access to company pension funds. These new schemes would be based on the automatic enrolment of workers in the scheme by their employer, but workers would have the opportunity to opt out. This represents both a departure from the voluntary approach of the past and a rejection of a 'pure' compulsory approach. The 2008 reform has introduced a new pension savings scheme: the National Employment Savings Trust (NEST) to be activated from 2012.

Employees will pay contributions of 4 per cent of their yearly earnings (between a minimum and a maximum level), matched by 3 per cent from the employer and 1 per cent in the form of tax relief from the state. Employers will decide whether they want to set up a new scheme, continue offering a pension scheme themselves, or to send contributions to the clearing house for personal accounts.

Personal Accounts are intended to deal with some of the deficiencies of the pensions market stressed above. First, they would contribute to maximizing the coverage of supplementary schemes, especially for lower earners (PPI, 2007). People who are not eligible for auto-enrolment (for example people aged under 22, those who earn less than GBP 5000 (€5900) a year, and the self-employed) will have the opportunity to opt in. Also, one of the key functions of PA will be to allow the accumulation of contributions from more than one employer, thus promoting *de facto* pension portability (DWP, 2006a, p. 49).

Personal Accounts are also expected to reduce administrative costs because of their large scale and lower set-up costs. Marketing costs should be reduced as well, and consumer protection is likely to increase. In particular, small-scale employers would now have access to a simple instrument for contributing to the wellbeing of elderly workers, while avoiding the risks and costs related to setting up a pension fund at company level.

To sum up, the UK case – part of the multi-pillar cluster – has confirmed the ongoing transformation of the pension system. Recent reforms introduced by New Labour have confirmed the multi-pillar design (Figure 5.5). At the same time, recent innovations are designed to change some of the basic principles of the system. The public pillar is moving away from the earnings-related principle; it increasingly aims to provide a flat-rate protection to social groups at a high risk of poverty in their old age. The introduction of PC and S2P is expected to make statutory pensions more equal and to offer more protection for those with atypical careers (see below). And private pension voluntarism has been partly abandoned. Supplementary schemes will now be based on a mix of voluntary and compulsory participation through the auto-enrolment mechanisms, more strict regulation and supervision by public authorities and new forms of public/private partnership.

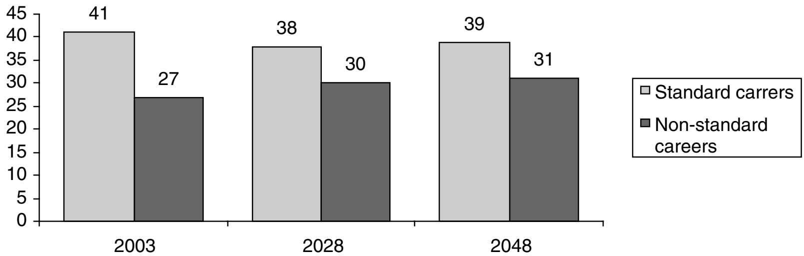

Figure 5.6 Total (public and private) pension incomes (% of National Average Earnings)

Source: PPI (2003a).

5.6 Projected future old age security for standard and non-standard careers

From a financial point of view, innovations introduced by the Blair government have increased public pension spending. As the Department for Work and Pensions (DWP, 2008) reports, in 2007 the public budget allocated GBP 10 billion (€11.8 billion) a year more than it otherwise would have under the legislation of 1997. This is nearly 1 per cent of the national increase in incomes (irrespective of population ageing).

People with atypical careers (part-time, temporary contracts and self-employment), especially women, are expected to improve their relative pension entitlements in the future. The following discussion refers to atypical careers first and subsequently to the specific case of women.

For atypical workers, recent reforms are not expected to solve the 'under-pensioned' problem fully, but they are expected to reduce it. Although the negative consequences of atypical careers should be partially reduced, future pension income is projected to be only marginally higher than it is for those retiring today (DWP, 2006b; 2006c). The increase represented by the State Second Pension (S2P) will offset (to some extent) the impact of low earnings in terms of pension entitlements. Also, the Pension Credit should partially address the problems of those with low or non-existent private pension contributions, and those who spent their working life in self-employment. However, pension income is still significantly based on labour market participation and this means that many people with atypical careers will receive low pension incomes in the coming decades. In particular, workers earning less than the Lower Earnings Limit (LEL), will not receive S2P for their earnings, and the same is true for the self-employed (PPI, 2003a, p. 33). Moreover, contribution credits for S2P are only awarded to carers or disabled people who qualify for credit in the Basic State Pension (PPI, 2003a, p. 34). Eventually, a higher proportion of pensioners is projected to be entitled to Pension Credit, thereby reducing the loss of pension income from lower State Second Pension and lower private pension schemes.

Projections show that pension income for atypical workers is expected to increase for future generations (in 2048 pension income relative to National Average Earnings should be 4 percentage points higher than it was in 2003) and the difference between the pension income of standard careers should be reduced (Figure 5.6).

As stressed above, the more limited difference between the pension income of standard and non-standard careers should be achieved by the availability of S2P in years in which the individual is employed, offsetting low earnings. PC also partially offsets the impact of making fewer private pension contributions and years where self-employment is not covered by S2P. The impact of working until 67 is still substantial, increasing final retirement income by up to 10 per cent.

The 'security gap' is expected to persist, however. A large proportion of the population is likely to have periods of non-standard work during their working life: around 40 per cent of workers in any one year are not in full-time, permanent employment. For many in this group, this will lead to periods of lower earnings and potentially lower protection by the state pension system, as well as fewer opportunities to build up private pension savings.

As shown in the previous section, the reform of supplementary pension schemes should largely favour atypical careers and reduce 'savings gaps'. Personal Accounts are portable and flexible, so as to accommodate more frequently unstable careers. The reform could benefit four different groups of people in different ways. As stressed by recent contributions (PPI, 2007), around two million employees who currently receive an employer contribution of less than 3 per cent could benefit from the reform by having their employer pension contribution increased to 3 per cent. About nine million employees, who were not saving in a work-based pension scheme at all in 2004–05, and would now be eligible for auto-enrolment, could benefit from saving in a work-based pension scheme with an employer contribution of at least 3 per cent. Approximately 3.5 million employees, who were not saving in a work-based pension scheme but would not be eligible for auto-enrolment (for instance because they do not earn more than GBP 5000 (€5900) a year) could choose to opt in to Personal Accounts on a voluntary basis. Employees below the age of 22 would benefit from an employer

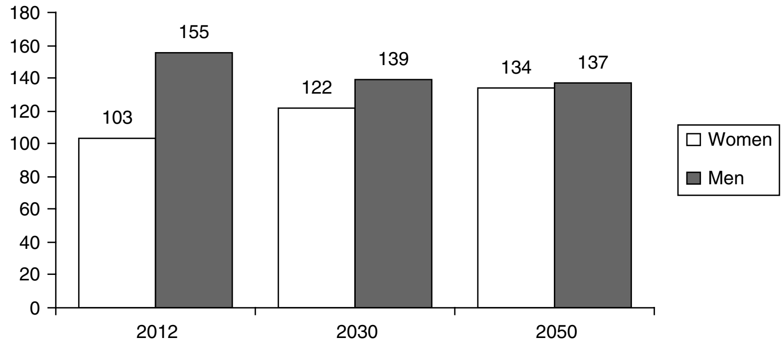

Figure 5.7 Projected income from basic pension and SERPS/S2P for median-earning men and women at the legal retirement age (in GBP per week) (2012, 2030 and 2050)

Source: Steventon and Sanchez (2008).

contribution of at least 3 per cent if they opt in, but people earning less than GBP 5000 (€5900) would not. There are also around three million self-employed people and around nine million economically inactive ones who will not be eligible for auto-enrolment or an employer contribution. This group could choose to opt in to Personal Accounts as an alternative to existing forms of saving (PPI, 2007, pp. 8–9). Taken together, recent measures improve the opportunities of hitherto less protected non-standard workers to take advantage of inclusion in supplementary schemes.

As far as women are concerned, their future retirement prospects seem to be more favourable. In particular, the gender gap is expected largely to decline over the next decades: pension income from public schemes for men and women should be almost equal (Figure 5.7).

These developments should be the consequence of increasingly similar median net incomes (Steventon and Sanchez, 2008).[12] Moreover, as a result of the most recent legislative innovations, the proportion of women receiving the full amount of Basic State Pension should peak at 75 per cent in 2010 and 90 per cent (the same percentage as men) by 2025. This is the result of the reduction of the qualifying years required for a full BSP – from 39 for women and 44 for men to 30 for both women and men – as well as more favourable contribution credits for caring activities. Also, the more flat-rate State Second Pensions are expected to help women the most.

The introduction of Personal Accounts (NEST) through auto-enrolment is projected to further increase retirement incomes for standard and non-standard careers for both men and women. The government's latest estimate is that 9–11 million people will be eligible for auto-enrolment, of which 3.5–4 million will be women (DWP, 2007).

5.7 Conclusions

The long-term evolution of the British old age protection system is not characterized by a clear-cut distinction between a 'golden age' – based on widespread and generous old age security and strict labour market regulation – and a 'silver age' in which the retrenchment of public pensions interacts with labour market deregulation. By contrast, retirement programmes have been characterized by persistent gaps in both security and savings. The British public pension schemes have largely failed to prevent poverty, while supplementary funds have had an uneven coverage (concentrated on some socio-occupational groups). The comparison with the Danish and the Dutch case (see Ploug, and Anderson in this volume) proves particularly interesting in demonstrating how two types of multi-pillar systems (usually interpreted to belong to the same pension cluster) differ in protecting against old age risks. British pensions consist of a 'liberal' multi-pillar model characterized by low public benefits below the poverty line (low basic state pensions and low SERPS/S2P); uneven coverage of second and third pillar schemes (as a result of private sector voluntarism); and a strong link between labour market participation and pension outcomes.

In many respects, the British pension system critically departed from the Beveridge ideal that aimed to provide universal protection against social risks. The UK pension system was fragmented and provided uneven old age security to different social groups and occupations. Moreover, means-testing has played a key role.

These gaps are mainly related to the tensions between labour market trends – for example high female employment, widespread non-standard careers – and pension legislation originally designed for male, standard (full-time and long-term) employment. The British labour market is, in fact, largely deregulated – with about 40 per cent of the labour force experiencing non-standard employment – while pension entitlements for atypical workers have been lower than those in standard employment relationships.

Data concerning the pension income of present pensioners and the pension entitlements of current active workers demonstrate the limited old age security for atypical workers and women. This limited level of protection is the result of both public schemes and occupational and personal pension funds. The former (both the Basic State Pension and earnings-related programmes) are contributory schemes and thus provide less protection for those more in need; that is, those with interrupted careers, lower earnings, and so on. Private schemes provide only partial coverage: mostly those with more stable careers and employed in large enterprises benefit, especially in the public sector, while atypical careers are disadvantaged.

Reforms introduced by New Labour in the last decade have been intended to deal with those risks, while reinforcing the multi-pillar model. Low public pensions have been increased, while private sector voluntarism has been partially revised through the auto-enrolment mechanism. State pensions have improved, especially for low earners, carers and, thus, women in particular. The new means-tested scheme (Pension Credit) contributes to poverty alleviation for many pensioners. Higher benefits from Basic State Pension and the introduction of the flat-rate State Second Pension have contributed to increased protection as well. New measures have also been introduced for supplementary pension funds. The introduction of Stakeholder Pensions and then Personal Accounts have addressed the savings gaps by increasing coverage and contribution rates.

As a consequence, projections show reduced gaps in the future for atypical workers and for women, but the 'under-pensioned' problem is expected to persist in the coming years (especially in supplementary schemes).

Problems remain in terms of the limited coverage offered by public schemes for periods of care. Moreover, the coverage of earnings-related public schemes is likely to remain non-universal. Workers earning less than the Lower Earnings Limit will not receive S2P for their earnings, and the same applies to the self-employed. The other main problem is related to the institutional complexity of the system and the resulting effectiveness of legislative innovations. Policy makers have dealt with this complexity when they have tried to reform the system and implement new measures. Implementation problems have been evident in the case of Stakeholder Pensions, and tensions could emerge in the implementation of Personal Accounts as well. Eventually, as shown by the 'Old' Labour experiment with SERPS, new measures need time to become institutionalized. And a rapid political turnover may lead to further policy change.

Notes

1. In the following, atypical and non-standard careers are used as synonyms.
2. They are represented, in particular, by: women; disabled people; ethnic minorities; people living to very old ages; and people with non-standard work.

3. In the words of Blanchflower and Freeman (1994, p. 54), 'the country's labour performance was below par and some have put stress on the adverse economic effects of rigidities in the labour market'.
4. Government policy encouraged self-employment through the UK Enterprise Allowance Scheme that was set up in 1983 in order to reintegrate unemployed people in the labour market. The scheme accounted for one fourth of the new self-employed in the 1980s (Anderton and Mayhew, 1994).
5. For a review of the theme, see Cook and Lawton (2008).
6. In line with SILC data, the income quintile share ratio has increased in the last decade: from 5.2 per cent in 1998 to 5.8 per cent in 2007 (well beyond the EU average).
7. 1 GBP = €1.180 on 4 February 2011.
8. The analysis is based on the Individual Model (IM) used by the Pension Policy Institute (PPI). It makes comparisons of retirement incomes for different individuals over different periods of time, and is used to highlight the characteristics that reduce retirement income, and estimate by how much. The IM looks at pension incomes for individuals, and assumes that they are single – for example, when calculating entitlement to the Pension Credit.
9. The incidence of in-work poverty for atypical workers is particularly high, see Connolly (2008, p. 237).
10. The introduction of SERPS represented one of the first attempts to deal with such gaps: by improving protection for blue-collar workers and women (both those with autonomous rights and widows) but not for self-employed. Still old, single and widowed women represented the largest group at risk of poverty (Thane, 2006).
11. The maximum combined benefit from SERPS and S2P that can be received by anyone at or above the Upper Earnings Limit since 1978–79 and reaching SPA in 2010–11 is GBP 158.83 (187.42 Euros) per week (PPI, 2010).
12. The official pay gap fell from 17 per cent in 1997 to 13 per cent in 2007, and it is expected to decrease further in the future (DWP, 2007).

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6 Switzerland: Building a Multi-Pillar Pension System for a Flexible Labour Market

Silja Häusermann and Hanna Schwander

6.1 Introduction

The Swiss multi-pillar system has been widely praised over the last two decades for its capacity to adjust to shifts in economic and demographic circumstances. The regime also enjoys widespread support in the Swiss population, because its structure means that the pension security of all Swiss residents is based on the interplay of three different pillars. A closer look at the distributive implications of this system, however, reveals that the idea of all Swiss pensioners resting securely on three pillars in their old age does not hold true. The Swiss three pillar system, in place since 1985, targeted its coverage mainly at standard employees. A range of important reforms since 1985 has enhanced pension security for atypical workers but they are still at considerable risk of receiving an inadequate income in old age.

Switzerland is a particularly good example of the interplay between labour market flexibility and pension reforms for three reasons. The first reason concerns the structure of the Swiss labour market. As in most European countries, part-time and fixed-term work have become widespread over the last two decades, as well as unemployment. However, unlike developments in most of its neighbouring countries, this 'flexibilization' of the Swiss labour market was *not* the result of a deliberate deregulation policy. Rather, Swiss labour law has always been very liberal, with only weak employment protection (OECD, 2010), and Switzerland has always had a significant number of (mainly female) atypical workers. Adapting pension policy to flexible labour markets in other countries mobilized conflict about both labour market deregulation *and* social security reform, but the labour market side of the reforms was never politicized in the Swiss case. We will show in this chapter that this situation facilitated a range of reforms to the pension system in Switzerland.

The second reason Switzerland is an important case for the study of how income security in old age can adapt to flexible labour markets is linked to the multi-pillar tradition of its pension system. The first pillar (basic coverage) was introduced in 1948 and the second pillar (occupational pensions) developed incrementally on a semi-private basis, becoming mandatory in 1985. The third pillar (private savings) was introduced on a voluntary basis, also in 1985. Multi-pillar systems are a double-edged sword for atypical workers. First pillars generally provide universal coverage – which benefits atypical workers – and more or less modest basic benefit levels, but second (and third) pillars tend to be more strongly linked to standard employment. This is true in Switzerland. However, since the system has been operating through multiple pillars for about three decades, reforms to improve pension security for atypical employees appeared on the political agendas early on, alongside reforms that aimed to stabilize the overall finances of the pension system.

Finally, the Swiss case is important because a range of reforms have improved pension security for atypical workers. From the portability of private pensions to the introduction of pension 'splitting' and pension credits for education, as well as improved coverage for atypical workers, a series of reforms have adapted the three pillar system to more flexible labour markets. We will show that, in Switzerland, the heritage of liberal labour market regulation on the one hand, and the timing of Swiss pension reforms on the other, explain the success of these reforms. As we will show in this chapter, the specific improvements in old age income security for atypical workers counterbalance – and even outweigh – the negative effects these workers experience through general pension retrenchment in the first and second pillars.

Despite this record of reforms, Switzerland cannot be seen simply as a success story of pension security for atypical workers. Indeed, while some reforms still need time before their positive effects on atypical workers become clear, other reforms have not been radical enough to eliminate discrimination against atypical work entirely. Today, atypical workers – in Switzerland predominantly part-time working women – still face risks with regard to income security in old age. Some of these risks result from direct regulatory disadvantages, while others are more

Table 6.1 Structure of the Swiss pension system, mid-1980s

Function	**First Pillar**	**Second Pillar**	**Third Pillar**
Additional savings		Additional voluntary occupational pension coverage (depending on the employer) for earnings above 3 times the maximum first-pillar pension	Un-subsidized voluntary private pensions
Income maintenance		Mandatory occupational pension (BVG/LPP Obligatorium) introduced in 1985. Insures income between a lower boundary of twice the yearly minimum first-pillar pension, and an upper boundary of 3 times the maximum first-pillar pension	Tax-subsidized voluntary private pensions: tax deductible up to about €4000 p.a. (corresponds to about 8.5% of the median annual income). Introduced in 1986
Poverty prevention	Basic pensions: universal coverage for all residents aged 20–64 (AHV/AVS), introduced in 1948. Benefits vary between 20 and 40% of the median income Supplementary means-tested pension benefits (EL/PC), introduced in 1966; cover the subsistence level (about 40% of the median income)		

Source: adapted from Bonoli (2007).

generally the result of labour market patterns. Hence, today, promoting more standard employment among women seems to be the most efficient means of ensuring a more widespread income security in old age for the entire workforce.

This chapter is structured as follows. In Section 6.2, we briefly describe the structure of the Swiss pension regime (Table 6.1) in the mid-1980s, as well as its effects on both standard and non-standard workers. We then present (Section 6.3) the major developments in the Swiss labour market since the 1980s in order to illustrate the challenges facing Swiss pension policy by the early 1990s. Section 6.4 describes the pension policy responses throughout the 1990s and early 2000s, and Section 6.5 offers an assessment of the distributive consequences of these reforms. The final section concludes.

6.2 Swiss old age income security until the mid-1980s

In this section, we briefly present the main characteristics of the Swiss pension system until the mid-1980s. Our aim here is to show that even though Switzerland always had a flexible labour market, the Swiss multi-pillar system had a wide range of gaps in coverage for atypical workers from the very beginning. It is important to stress that this regime emerged incrementally between 1948 and 1986. The system was not designed with specific coverage or benefit levels in mind but was gradually adapted to political demands and external constraints. The Swiss three pillar system as it existed until the mid-1980s was mainly a policy response to the social and labour market context of the late 1960s and 1970s. The relevant parameters that shaped this system were strongly performing labour markets and stable family structures: hence the focus on standard employment and the strong gender bias regarding 'indirect pensions' in the form of derived rights for dependent spouses.

As a result, until the 1980s, the Swiss three pillar system provided only patchy income security for atypical workers, especially low income earners, housekeepers, and the self-employed. This bias towards standard employment, however, did not lead to substantial poverty risks, nor was it strongly politicized (Häusermann, 2010a). Atypical employment was predominantly performed by three groups: women who were indirectly covered through marriage; the self-employed in the liberal professions who had the means to provide for their own private old age income security; and by foreign workers who – in periods of slack demand for labour – were excluded from the Swiss labour market (see Section 6.3 below). Thus, the insider bias of the traditional Swiss pension system was not perceived as a serious political problem until the late 1980s when unemployment started rising, divorce rates went up, self-employment increased, and foreign workers no longer served as a buffer against unemployment.

The public pension first pillar (AHV/AVS[1]) covers the basic needs of all retirees on a Pay As You Go basis. It provides universal coverage and is highly redistributive because contributions (8.4 per cent of the salary, split equally between employers and employees) must be paid on all incomes (without a ceiling) while benefits are only modestly income-related. The benefit level can vary between a floor (about 20 per cent of the median income) and a ceiling that is twice as high as the floor (about 40 per cent of the median income). Since the mid-1970s, benefits have been adjusted every two years using a 'composite index' based on the average of the inflation rate and the rate of wage increases. This means that real wage increases are only partly reflected in pension levels (given that wages have increased more steeply than prices since the 1970s in Switzerland). Within these limits, the benefit level is based on contributions. All residents are required to participate in the programme and to pay contributions regardless of employment status. This means that even students or housekeepers have to pay a modest annual flat-rate contribution. Unemployed people pay contributions based on their unemployment benefit, which is treated as a salary, and the self-employed pay contributions up to 7.8 per cent of their income.

An important complement to the AHV/AVS in terms of poverty prevention takes the form of means-tested pension supplements (EL/PC[2]). These means-tested benefits were initially introduced in 1966 as a transitional scheme that was supposed to become obsolete as regular pensions grew to levels comparable to those in neighbouring countries. When the financial climate turned from expansion to austerity during the crisis of the 1970s, however, it became clear that EL/PC would become a permanent feature of the Swiss pension regime (Häusermann, 2010a).

The first pillar has always been the main source of pension income for low to middle income earners, and this is especially true for atypical workers. However, even the universal first pillar did not provide complete coverage for non-standard work. The most important problem concerned workers with low contribution records because, contrary to many other European countries, the Swiss pension schemes have always been based on the principle of defined contributions (except for the means-tested pension supplements EL/PC). Indeed, many atypical workers, especially women working part-time or who withdrew from the labour market for educational purposes, accumulated very few pension rights during their working life, and this often resulted in low pensions.[3] Moreover, the minimum (full) pension in the first pillar amounts to only about 20 per cent of the median income, which demonstrates how vital the means-tested pension supplements soon became. This is particularly true for divorced women who could not rely on derived spousal pension rights. These means-tested pension supplements (EL/PC) are calculated for each beneficiary on the basis of actual expenses (including living costs, housing, medical and care expenditures). Until 1985, the supplements remained below the level of social assistance. For these reasons, divorce remained the most important source of female old age poverty until the early 1990s. Leitner and Obinger (1996) even argue that old age poverty in Switzerland was generally female poverty, due to both the low female labour market participation and the male breadwinner orientation of the first pillar.

The second pillar's occupational pensions benefits are intended to reflect a pensioner's previous income directly. Private second pillar occupational pensions have a long history in Switzerland, dating back to the early twentieth century (Leimgruber, 2008) but the early private funds only provided patchy coverage. When left-wing parties became increasingly vocal about the need to increase first pillar pensions in the 1960s, the right countered these claims with a strategy that privileged the extension of the – far less redistributive – second pillar pensions. Eventually, the conflict resulted in a mandatory second pillar. In January 1985, occupational pensions became compulsory for all employees over the age of 24 earning at least the access threshold, which was, and still is, set at the level of the maximum first pillar pension. Incomes below the access threshold are insured exclusively in the first pillar. This is why this threshold is called the 'coordination deduction'. Second pillar pensions are thus calculated on the basis of contributions levied on the 'insured part' of the income, or the income between the upper and lower boundaries. The contributions are capitalized and distributed as annuities after retirement according to a defined contributions formula. According to a regulation enacted in 1985, a full occupational pension requires a contribution period of approximately 40 years. Occupational pensions are financed by contributions split equally among employees and employers, with age-dependent contribution rates varying between 10 and 18 per cent.[4] With regard to benefit generosity, it is important to distinguish between the mandatory and the voluntary part of income insurance. Incomes between the access threshold and about 75,000 CHF (about €65,200)[5] per year are automatically covered. Employers, however, are free to offer insurance and more generous benefits, both within and beyond this range for their most valued employees.[6]

In terms of the distributive consequences of the mandatory second pillar for standard and non-standard workers, it is very important to note that even though mandatory coverage was introduced in 1985, the effects of expanded coverage on actual pension levels will become evident only several decades later, when the newly covered pensioners have contributed enough to receive a substantial benefit. Still, we can evaluate the fit between second pillar coverage rules as introduced in 1985 and non-standard work. In this respect, four observations are particularly important. First, the access threshold was defined in absolute terms, irrespective of the activity level (part-time or full-time). This implied that many part-time workers had either no access to the second pillar, or that only a very small part of their income was insured. Also, people combining several part-time contracts suffered the full deduction for each income. This meant that the income taken into account for eligibility was (and still is) not the whole annual income, but earnings from each specific job. Hence, people who are simultaneously employed in several jobs may not be eligible for a second pillar pension at all if the individual incomes from their various jobs all fall below the access threshold. Secondly, the portability of occupational pensions was severely restricted. In most cases, employees lost a large part, or even all, of their employers' contributions when they changed jobs. This regulation was obviously at odds with flexible labour markets but very much in line with the idea of tying employees to their employers. Thirdly, the second pillar covered (and still covers) only employees with labour contracts exceeding three months of employment. Finally, most self-employed people have no second pillar coverage. They may take out insurance with the public pension fund on a voluntary basis but only about a third of them do so[7] (Balthasar et al., 2003). This brief review of eligibility conditions for the second pillar shows that occupational pensions were created for standard workers and not for atypically employed people. However, the adverse effects of occupational pension rules on people in atypical employment remained largely invisible during the 1980s for two reasons: most part-time, fixed-term and low-income workers were married women; and the distributive effects of the occupational pension scheme only become visible in the long run.

The third pillar allows people to tailor pension coverage to their individual needs through non-compulsory private pensions. Third pillar contributions are tax deductible up to an annual limit of about €4000 for employees (about 8.5 per cent of the annual median income).[8] Above this amount, pension savings are entirely private. In principle, third pillar pensions could compensate for inadequate occupational pensions for the self-employed or housekeepers. However, even though individual accounts are widespread in Switzerland, pension incomes from the third pillar represent only a marginal portion of overall income after retirement (see Figure 6.3 below).

This section has shown that the early Swiss three pillar system, as it existed until 1985, included many gaps in coverage for non-standard employees. In the first pillar, pensions remained below the subsistence level, and the mandatory second pillar provided only patchy coverage to non-standard workers. These gaps were, however, not politicized, since they mostly affected married women as well as the self-employed in liberal professions. So, gaps in coverage did not usually result in the actual risk of poverty. The public's perception of the distributive effects of the second pillar had changed, however, by the 1990s when unemployment and atypical employment became even more widespread and divorce rates rose.

6.3 Characteristics and development of the Swiss labour market

Three aspects are particularly important in an analysis of the interplay of Swiss pensions policy and labour market trends. First, flexibility is not new. The Swiss labour market has always been characterized by very liberal employment regulation. Hence, in contrast to other continental countries, flexibility was not the result of deregulation because there was nothing really to deregulate. However, and this is the second aspect, atypical employment has become more widespread since the 1980s due to structural changes such as de-industrialization, rising female labour market participation and changes in immigration policies. Thirdly, the analysis of atypical employment in Switzerland cannot be detached from a gender perspective, since female part-time work is by far the most common form of flexible work. We now present these three aspects in more detail.

Switzerland regulates few aspects of the employer/employee relationship. With a score of 1.14 on the OECD Employment Protection Legislation index, the Swiss labour market belongs with the least regulated labour markets in the OECD, such as liberal countries like Australia, Ireland, Canada and the United Kingdom (Venn, 2009). Neither the use nor the maximum number of successive fixed-term contracts are regulated and only oral notice to the employee is required

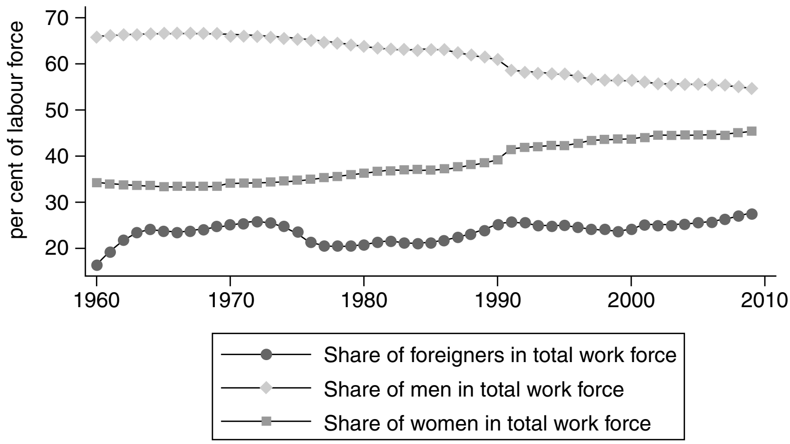

Figure 6.1 Share of male, female and foreign workers among the Swiss workforce

Source: SAKE 2010.

before individual dismissals. Public authorities and workers' representatives are to be informed of collective dismissals but their approval is not required. Additionally, wage flexibility is high, and union attempts to introduce a minimum wage have failed so far.

The main characteristics of the Swiss labour market in the 1970s and 1980s were a comparatively high male employment rate (80 per cent of men above the age of 15 in 1980)[9] and low unemployment. Flückiger (1998, p. 369), for example, described Switzerland as an 'employment paradise'. During the 1960s and early 1970s, Switzerland actually experienced a shortage in the supply of labour, to which trade unions and employer associations responded with an increase in foreign labour (see Figure 6.1). Consequently, Switzerland also had one of the highest levels of foreign workers among the industrialized economies (Straubhaar and Werner, 2003, p. 62). Since labour shortages were solved by importing labour, female participation rates remained relatively low until the 1990s (see Figure 6.1), when they began to rise more quickly because of divorce and increasing levels of female education.

After the first oil crisis in 1973–4, Switzerland experienced its first bout of unemployment. The jobless rate reached 0.7 per cent of the workforce in 1976. This may seem like a very low level, but it was the first time Switzerland experienced anything like unemployment and there was no unemployment insurance at that time. Unemployment declined

Table 6.2 Unemployment rates in Switzerland, 1991–2009

1991	1993	1995	1997	1999	2001	2003	2005	2007	2009
1.8	3.8	3.4	4.2	3.1	2.5	4.2	4.5	3.7	4.2

Source: Authors' elaboration from OECD Online Employment Database.

again by the end of the 1970s, partly because foreign workers lost not only their jobs but also their residence permits, so they had to leave the country (Straubhaar and Werner, 2003). In this sense, Switzerland initially – and quite cynically – managed to 'export' unemployment and atypical employment. There are no specific pension regulations for foreigners, who leave Switzerland after making contributions to the Swiss insurance system. They receive a regular first pillar pension based on their contribution record and they can – just like Swiss citizens who emigrate – withdraw their entire second pillar capital upon leaving the country. In this sense, foreign workers' status as labour market buffers has generally resulted in low pension levels for them. The 'victims' of this policy of the 1970s continue to be affected by low pensions. The rise of unemployment to 2.4 per cent in the mid 1980s after the second oil crisis in 1982 came as a shock to both the public and the authorities (Flückinger, 1998), especially given Switzerland's robust employment performance in the past. However, unemployment rates were still comparatively low throughout the 1980s.

Hence, until the 1990s, full male employment, high rates of job tenure, and a relatively large share of foreign workers as employment buffers characterized the Swiss labour market. Atypical employment – despite the fact that it was always legally allowed – was a non-issue, which is reflected in the fact that proper yearly statistics on the share of fixed term or part-time employment do not exist.

Switzerland eventually had its first lasting experience of unemployment in the 1990s when the Swiss economy underwent a long recession. Unemployment rose to 4.2 per cent by 1997 (Sheldon, 2010). From the 1990s onwards unemployment also appeared on the political agenda (see Table 6.2).

The sudden rise of unemployment in the 1990s – as compared to the low levels of unemployment during the crisis of the 1970s – is largely explained by two developments. By the 1990s, most foreign workers had permanent residence permits, which meant that they no longer acted as an 'unemployment buffer'. The bilateral treaties between the EU and Switzerland strengthened this development by guaranteeing

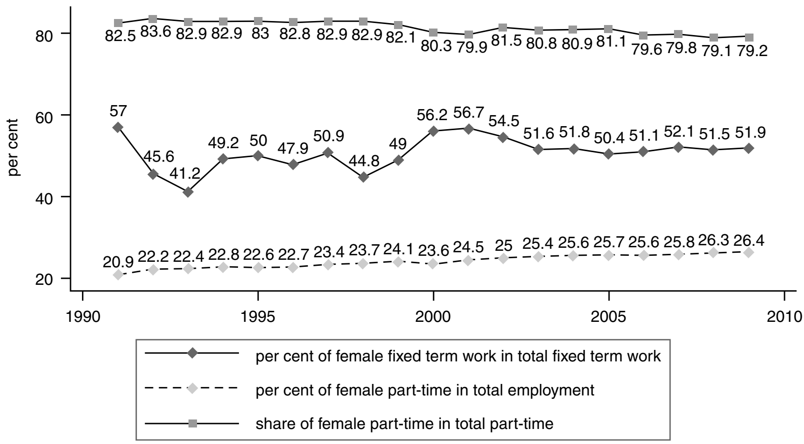

Figure 6.2 Gender and atypical employment in Switzerland
Source: SAKE 2010.

labour mobility between Switzerland and the EU. Secondly, after 1990, women were more strongly attached to the labour market and did not retreat from it when jobs became scarce (see also Figure 6.1). The stock market and financial crises in 2001 and 2009 also led to a new rise in unemployment, which rose 1.5 percentage points, affecting not only low-skilled but also high-skilled employees (Sheldon, 2010). In sum, unemployment has become a reality in Switzerland, even though it remains low (4.2 per cent in 2009) compared to the rest of Europe (9.6 per cent).

Regarding the development of atypical work, we need to distinguish between part-time employment and fixed-term employment. Fixed-term employment is widespread in Switzerland – between 12 and 14 per cent – mainly due to the vocational training system. Two thirds of young people enter the labour market through firm-based vocational training (the apprenticeship system). If, as it is the case for national statistics, these apprenticeship contracts are not counted, the proportion of fixed-term workers is significantly lower: 5.3 per cent in 1991 and 7.5 per cent in 2009, which is similar to Danish figures.[10]

Part-time employment is an even more common form of employment in Switzerland. In 2008, Switzerland had the second highest rate of part-time workers among the countries studied in the book, second only to the Dutch 'part-time economy'.[11] Part-time work has increased steadily over the past four decades: in 1970, 12.2 per cent of the workforce was employed part-time; this rate increased to 14.6 per cent in 1980 and to 18.8 per cent in 1990 (a rise of 50.1 per cent compared to 1980, and 84.5 per cent compared to 1970). According to the Swiss labour force survey, 1.26 million persons worked on a part-time basis in 2005, representing 31.7 per cent of the total labour force (BFS, 2006, p. 8).

A very important characteristic of atypical work in Switzerland needs to be emphasized when we look at the implication of different kinds of employment on pension rights: atypical work in Switzerland is first and foremost female part-time work. Figure 6.2 shows that part-time work is almost exclusively female (with a gender ratio of about 80:20 per cent); fixed-term work is less gendered than part-time, but it is also less common than part-time work. Overall, female part-time work represents as much as a quarter of the total workforce.

Particularly low incomes must also be counted among the problems that recent labour market transformations imply for income security in old age. In general, there is a link between low income and non-standard employment: if precarious employment is defined as high insecurity and low salaries (SECO, 2003), its share has increased slightly (from 2.5 per cent of employment in 1992 to 3.8 in 2002). Furthermore, women, the young, and those with low skills are most strongly affected by precarious employment. The increase in this kind of employment has also been stronger among women than among men (from 3.6 per cent in 1992 to 5.8 per cent in 2002 for women, from 1.6 per cent to 2.2 per cent for men) (SECO, 2003). Finally, about 6 per cent of full-time workers, but 29 per cent of part-time workers could be described as working poor (poverty being defined by a household income of less than 60 per cent of median income) in 2000 (Streuli and Bauer, 2001).

Another exception to dependent full-time employment is self-employment, which has developed unevenly in Switzerland. The proportion of self-employed people fell for many years (mainly because of the diminishing relevance of the primary sector) before starting to rise significantly in the 1980s and 1990s (Flückiger and Falter, 2004). In 2005, the proportion of self-employed people reached 14 per cent of the labour force. As with dependent employment, self-employment is dominated by female part-time workers: only 44 per cent of the female self-employed work full-time, in contrast to 90 per cent of the male self-employed (SAKE, 2006, p. 9).

In the context of atypical and precarious work relationships, 'false self-employment' is an issue. 'False self-employment' denotes an employment relationship in which an individual declares him- or herself self-employed but is actually dependent on a single client. False self-employment is often used to avoid social security contributions. In Switzerland, it is estimated that 18.3 per cent of all self-employed people in 2004 could be classified as false self-employed (SAKE, 2006, p. 12).

Overall, we conclude that the Swiss labour market is currently characterized by two types of flexibility. As well as the traditionally low level of employment protection legislation, there are a large proportion of atypical workers in the Swiss labour market. Atypical work, especially part-time, has increased in Switzerland since the 1980s and has become very common since the 1990s. Equally important is the fact that atypical work is highly gendered. Unemployment has become a reality in Switzerland, despite remaining at a comparatively low level.

6.4 Adapting the multi-pillar system to flexible labour markets, 1985–2010

In the previous section, we have seen that flexibility has always been a key trait of the Swiss labour market. Also, atypical forms of employment expanded continuously between the 1970s and the 1990s. Thus, they have become very common in an unpoliticized and uncontested way. Indeed, atypical employment in Switzerland – especially female and part-time employment – is considered 'natural' for women, because it applies to the majority of female employees. We have shown in Section 6.2, however, that the Swiss three pillar system had a number of gaps with regard to income security in old age for non-standard workers. In the first pillar, the benefit levels for people with incomplete or interrupted contribution records remained very low. In many cantons, first pillar benefits were even below social assistance levels. In the second pillar, non-standard workers fared poorly, not only in terms of benefits, but also with respect to coverage, since self-employed, short-term employed, and individuals with incomes below the access threshold were usually not covered at all. For beneficiaries with low incomes, benefits remained very low.

These gaps became politically salient in the 1990s. We can explain this politicization in a number of ways. On the one hand, the increase in atypical work and growing labour market instability changed perceptions about the prevalence of labour market risks; on the other hand, societal changes in the form of more single person households and higher divorce rates helped to put the pension coverage of the atypically employed on the political agenda. In this section, we discuss reforms to the pension system that were adopted in response to increasingly flexible labour markets. We focus on the reforms specifically targeted at atypical workers, not only because of the objectives of this book, but also because they were numerous and important aspects of the Swiss pension policy agenda, and distinct from the 'general' reforms that were aimed at financial consolidation and retrenchment. The capacity of Swiss pension policy to adapt to flexible labor markets can partly be explained by the late development of the Swiss pension system: when atypical work spread, the pension system was still developing. Also, reforms improving pension rights for atypical workers also served as compensation for retrenchment. They represented the necessary balancing element between two pension reform packages that have implemented both overall retrenchment and enhanced old age protection for atypical workers (Häusermann, 2010a).

Of course, general retrenchment also affected atypical workers negatively, but proportionally less so than standard employees and certainly less so than in many other countries. This is for two reasons: first, the Swiss pension regime had always been based on defined contributions, so atypical workers had less to lose than in other countries; secondly, retrenchment was enacted in only two instances, and these reforms targeted standard workers more than atypical workers. In 1995, the female retirement age was raised from 62 to 64, in exchange for the introduction of better pension coverage for non-employed and divorced women. In 2003, overall pension levels were lowered in the second occupational pillar by means of a reduction of the 'conversion rate' from 7.2 to 6.8 per cent. The conversion rate indicates the yearly rate at which individual funds are converted into rents. For instance, a person with CHF 100,000 (€86,900) in second pillar funds, receiving a yearly pension of CHF 7200 (€6260), will receive only CHF 6800 (€5910) per year after the 2003 reform. Given that most atypical workers did not have access to occupational pensions until then anyway, this retrenchment affected them less than standard workers, who are the main stakeholders in the second pillar. So, the reform record we are reviewing in this section led to improved pension rights for atypical workers, and these improvements were not offset by overall retrenchment, as was the case in other European countries.

Before the 1990s, it were mainly the women's organizations which had pushed for more generous old age pensions for atypical workers but they did not have sufficient support in the political parties and trade unions to be effective. During the late 1980s, however, left and centre parties, as well as several trade unions, became more receptive to these claims

(Häusermann, 2010a; b). Consequently, the coverage of part-time and other atypical workers became a lively issue in the reform of the first and second pillars.

In the first pillar, both the reform of the means-tested pension supplements and the revision of the basic pension scheme, AHV/AVS, can be seen as measures that enhance pension security for atypical workers. As discussed in Section 6.2, the means-tested pension supplements, EL/PC, were initially intended to be a transitional benefit for people with particularly poor contribution records. From the 1980s onwards, however, the EL/PC were successively institutionalized through two reforms. In 1985, a broad coalition of all political parties, trade unions and employers decided to increase benefit levels. In 1996, another reform further increased EL/PC benefit levels, especially for people living in their own homes, so that they would not have to sell their property, and improved information about eligibility and benefit access. These means-tested pension supplements are obviously very important to pensioners with incomplete contribution records and low pensions. Suter and Mathey (2000) found that by the late 1990s, EL/PC had reduced the old age poverty rate by 20–50 percentage points (depending on the definition of the poverty line). The EL/PC benefits today are on average – that is with cantonal variations – about 20 per cent above the average social assistance levels (Nova and Häusermann, 2005). They correspond to about half of the Swiss median income and are indexed to the inflation rate regularly.

In the first pillar, AHV/AVS, there is one reform in particular that included improvements for part-time and other atypical employees (it was the tenth reform of the AHV in 1995).[12] To understand the importance of this reform in terms of pension security for atypical workers, it is crucial to bear in mind that atypical work in Switzerland is strongly gendered. For a long time before the reform, left-wing parties and women's organizations had advocated improved pension rights in the first pillar for women with low or discontinuous employment records. Opposition to this improvement came from both sides: market-liberal actors opposed the higher costs; and conservative forces wanted to maintain the idea of joint 'couple's pensions' in order to strengthen the model of the traditional family. The Swiss 'couple's pension' pays married couples a benefit equal to 150 per cent of the main earner's (usually the husband's) pension upon retirement, regardless of the wife's individual pension contribution record. This meant that women usually lost their individual right to a pension when their husbands retired, and were left with very low pensions in the event of divorce. Indeed, after divorce, the pensions of both former spouses were calculated only on the basis of their individual contribution records. Since most women stopped working (or at least reduced working hours considerably) upon marriage, divorce had become the biggest cause of female old age poverty. Representatives from both left- and right-wing parties managed to draft a compromise that included the complete individualization of a couple's pensions. Contributions by both spouses during the entire duration of marriage are added, divided in half, and paid into two separate, individual pension accounts. This was a net improvement for most married women, who generally earn less than their husbands. Additionally, the reform introduced pension credits for women who interrupt work to raise children. After the successful implementation of the reform, the pension rights of men and women were radically equalized, so that, in the 2000s, about a third of both men and women enjoy maximum pensions (Nova and Häusermann, 2005, pp. 26–7). In sum, this reform was very effective in raising the pension benefits of people with discontinuous employment records. The reform was not explicitly framed in terms of pension security for atypical workers but in terms of gender equality. But, since atypical work and gender are so closely related in Switzerland, the reform must be seen as an initiative to achieve that. Of course, the increase in women's retirement age to 64 affected all female workers negatively, in both standard and atypical employment. However, given the high employment rate of older workers in Switzerland, this restrictive element of reform did not reduce the benefits for atypical workers.

Several reforms adapted second pillar occupational pensions to more flexible labour markets: pension portability was introduced in 1994; and pension coverage was extended to low-income and part-time workers in 2003. More recently, temporary work has also been protected more generously. The issue of occupational pensions portability was put on the agenda by a popular initiative (see Häusermann, 2010a for details). Before this reform, people lost up to half their pension savings when changing jobs. With growing labour market instability, unemployment, and job market mobility, this regulation became more and more controversial and difficult to defend. In reaction to the popular initiative, Parliament adopted the Law on the Free Transferability of Occupational Pensions (FZG/LLP[13]) in 1994 (see Bonoli and Häusermann, forthcoming, for details).The transfer value of a pension is now equal at least to the entire sum of mandatory contributions paid by both the employee and the employer. In addition, this reform included two elements of social modernization. First, women's pension savings are no longer dissolved upon marriage. Until 1995, women received their contribution payments in cash when they were married because the law assumed that they would leave the workforce. Secondly, pension savings accumulated during a marriage would henceforth be divided in the event of divorce.

The 2003 reform introduced the most important changes in terms of enhancing the pension security of atypical workers in occupational pension schemes. The major goal of this reform was retrenchment – lowering benefit levels in response to the ageing of the population. However, very early on, the left demanded better coverage for atypical work and low incomes as a trade-off. As explained in Section 6.2 above, the access threshold and coordination deduction of about €16,000 per year adversely affected both part-time and low income workers. Only workers who earned more than this threshold were eligible for insurance at all, and only their income above the threshold was insured. The left demanded that the threshold be proportional to the activity rate (that is someone working 50 per cent would be eligible for insurance with an annual income of €8000). In response, Parliament initially proposed a rather generous solution that would introduce a distinction between the access threshold and the coordination deduction. The access threshold would be lowered to about €12,000 per year, and the coordination deduction would correspond to 40 per cent of the income. For part-time workers, this would have been a major improvement since a much larger part of their income would have been insured. This would have meant that someone earning €16,000 per year with a 50 per cent job would a) be eligible for occupational pension insurance, and that b) €9600 of his or her salary would have been insured (60 per cent). Before the reform, this person would not have had any insurance at all. Eventually, however, the proposal was watered down. While the access threshold was lowered to about 13,000 per year, the coordination deduction remained set at about €15,000 per year, irrespective of part-time or full-time work. If we use the same example as above, the reform meant that the person would now be eligible for pension insurance but only €1000 per year would be insured. This still represents an improvement compared to the *status quo ante*. The 2003 reform thus improved second pillar pension coverage for part-time and low-income workers but it did not go as far as initially planned, and it maintained the existing discrimination against part-time workers. In addition, the overall lowering of second pillar pension levels – the conversion rate of capitalized savings into pensions was lowered from 7.2 to 6.8 per cent – obviously affected atypical workers. However, many of them did not have any substantial coverage in the second pillar and the retrenchment affected them proportionally less than standard workers, who are the main stakeholders in the second pillar.

The third, and most recent, reform of the second pillar was adopted by decree in 2008. It improved the situation of fixed-term (or short-term) workers. The government decided that, if a short-term contract of less than 3 months were renewed by the same employer, the duration of all these contracts must be aggregated for insurance calculation (BSV, 2009). The object of this reform was to fight the misuse of fixed-term work by employers, who tried to circumvent second pillar coverage and contribution payments by hiring and re-hiring people on short-term contracts only.

These three reforms should not conceal the fact, however, that adaptation to flexibility remained incomplete, and atypical workers still fared worse in the second pillar than standard workers. This is partly a failure of the reforms, and partly due to the inherent characteristics of funded defined contribution pension schemes, which depend on stable

Table 6.3 Reforms in the Swiss multi-pillar pension system since 1985

Function	First Pillar	Second Pillar	Third Pillar
Additional savings			
Income maintenance (ideally at around 60% of previous earnings)		1994: Portability of occupational pensions in case of job mobility 2003: Lowering of access threshold for part-time and low-income workers 2005: increased coverage for temporary employees	
Poverty prevention (up to 50% of the median income)	Introduction of pension splitting between spouses and childcare contribution credits (1995) Increase in means-tested pension supplements (1985, 1996)		

employment and contribution payments in order to provide adequate protection in old age. Table 6.3 uses the illustration of the three pillar system developed in Table 6.1. It summarizes the reforms, showing the objectives for atypical workers in bold, and the relevant provisions under each of the pillars.

6.5 After the reforms: current situation and future prospects

In this section, we attempt to assess the distributive implications of the reforms by evaluating old age pension coverage and benefit levels for standard and non-standard workers. Significant reforms were implemented, which clearly improved the situation of non-standard workers (see Table 6.3). Old age poverty, in particular, was greatly reduced. With regard to income maintenance, however, the Swiss three pillar system still displays a strong imbalance between standard and non-standard workers.

Reforms to the first pillar played an important role in lifting atypical workers above the poverty line, even though this poverty line, or basic pension level, remains comparatively low at 40–50 per cent of the median income. Today, any pensioners whose insurance rights do not grant them an income at this level can apply for pension supplements. The reforms in the first pillar were also very important in improving women's pension security.

The picture is more mixed when it comes to second pillar pensions, that is, income maintenance policy. Here, the reforms that were implemented have certainly not solved all problems. Nevertheless, the 2003 reform did extend coverage to about 100,000 additional individuals (2.2 per cent of the labour force), most of them women (BSV, 2003, p. 342). On the other hand, no reforms to enhance pension security for atypical workers have been implemented in the third pillar.

The crucial question in this section relates to the distributive outcomes of the Swiss reforms in terms of coverage, poverty prevention, and income maintenance for non-standard workers compared to standard workers. Obviously, the assessment of these distributive consequences is difficult, since the effects of pension reforms only become apparent in the longer term. This is particularly true of changes to funded pension schemes. In addition, there are no precise projections or simulations of the effects of reform in Switzerland. Nevertheless, we will assess the distributive outcomes on the basis of available data on the current situation and future scenarios by discussing the three pillars sequentially. Official pension statistics generally do not differentiate between standard and non-standard workers but they do report coverage rates and benefit differentials for men and women. This – given Switzerland's gendered labour market – provides important insights into old age security.

In the first pillar, basic pensions (AHV/AVS) now guarantee truly universal coverage, which does not discriminate between standard and non-standard workers. As a result of the reforms of the 1990s, first pillar benefits for men and women, as well as for standard and non-standard workers, have become almost equal. Given their specific employment status (more standard, full-time and higher income jobs), men contribute about twice as much to the AHV/AVS as women. Nevertheless, benefit levels for male and female pensioners have become more or less equal, because of both the redistributive character of the AHV/AVS and the splitting of pension credits[14] (BFS, 2003, p. 39). About 30 per cent of both male and female single pensioners, and about 60 per cent of pensioner couple households, receive the maximum pension (BSV, 2009). As a result, pension security for atypical workers is currently off the agenda for reforming first pillar. Most demands have been satisfied.

Reforms of the means-tested pension supplements (EL/PC) have played an important role in poverty prevention within the first pillar for non-standard workers. With the increases in the level of these benefits in the 1980s and 1990s, EL/PC managed to reduce old age poverty levels in Switzerland by 20 to 50 percentage points (Suter and Mathey, 2000). In 2000, between 6 and 20 per cent of pensioners (depending on the canton) received these benefits (Consoc, 2003). Because they are based on a poverty line of about 40 per cent of the median income, means-tested pension supplements have eliminated old age poverty in Switzerland. This assessment must be qualified, however, by two observations: first, 40 per cent of the median income is a rather low level of subsistence; and secondly, it is estimated that about a third of all pensioners who are entitled to means-tested pension supplements do not apply for them because the receipt of the supplements is stigmatizing (Leu and Priester, 1997, p. 403). Nonetheless, in combination, AHV/AVS and EL/PC provide effective poverty prevention for non-standard workers.

In the second pillar (occupational pensions), the 2003 reforms have increased the coverage of non-standard workers noticeably but it still remains patchy, and there are important differences in benefits. In the late 1990s, about 85 per cent of employed men were covered by the second pillar, as compared to only 65 per cent of female employees

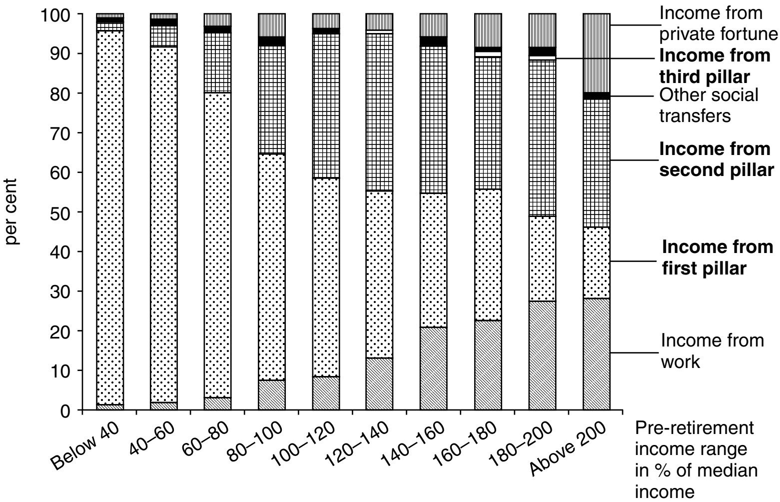

Figure 6.3 Composition of the monthly gross household income (equivalent incomes, corrected for household size)

Source: Balthasar et al. (2003), p. 166.

(SGK-N, 2003). The 2003 reforms extended coverage to about 100,000 low income and part-time workers, most of them female (BSV, 2003). In consequence, the percentage of insured women grew more quickly in the 2000s than it did for men, but women still remain under-represented. In 2008, women represented 41 per cent of the actively insured (BFS, 2009a), an increase of only 4 percentage points over a decade. A further extension of the coverage of atypical work could be achieved by an even lower access threshold, or by more women working (nearly) full-time.

With regard to benefit levels, the distributive outcomes for standard and non-standard workers have remained more or less stable. Obviously, the effects of increased coverage are not yet visible in actual benefit levels. In 2008, women represented about 30 per cent of second pillar pension beneficiaries, a level similar to 2000. Women's share of accumulated assets amounted to about 28 per cent. Most importantly, female pensions correspond on average only to about 50 per cent of male pensions. These proportions have remained unchanged during the last decade (BFS, 2001, 2009b). Women remain concentrated at the lower end of the pension benefit scale. Half of female second pillar pension beneficiaries (but only 20 per cent of their male counterparts) receive less than CHF 10,000 per year (about €8700, or 14 per cent of the median annual salary) (Consoc, 2003). These numbers illustrate clearly that part-time work results in low second pillar pensions. The increased coverage of atypical workers since 2003 will not change this result dramatically, given the relatively low level of part-time wages.

Generally, low salaries lead to low pension payments. This is why the distributive effects of the three Swiss pension pillars are very distinct. Figure 6.3 presents the only available data on the composition of income sources for pensioner households. It is based on a survey conducted in 2001 and it presents the sources of monthly gross household income.

Figure 6.3 shows that pensioners who earned up to the median income before retirement rely first and foremost on the first pillar after retirement. It is only for medium-level incomes and, above that, second pillar pensions represent an increasingly large share of household income. Third pillar pensions remain marginal because only higher income strata accumulate substantial third pillar savings, and these groups also benefit from a range of other income sources, such as private wealth or employment earnings even after retirement. It must be noted that the snapshot presented in Figure 6.3 is likely to change over time, with second pillar pensions becoming more important. They were introduced only in the mid-1980s, so no generation has achieved full contribution records yet. However, the overall dimensions are likely to stay the same: the lower income levels rely mainly on the first pillar, while the middle classes draw on a combination of first and second pillar pensions, and people with higher incomes draw on a combination of different income sources. A government report using data from 2005 (BFS, 2007) confirms this stability: only about 23 per cent of pensioners receive pension benefits from all three pillars; 38 per cent combine income from the first and the second pillar; 34 per cent still rely on the first pillar exclusively. Gender differences are pronounced: only 15 per cent of male pensioners live on first pillar pensions alone, while this is the case for 47 per cent of female retirees.

The distributive effects discussed so far are based on the current situation or recent developments. Very few simulations of future reform effects exist. Two exceptions are the contributions by Bonoli and Gay-des-Combes (2003), and Bertozzi and Bonoli (2003), who simulated future (year 2050) pension incomes for different household types. They find that the lack of substantial second pillar pensions will remain the most important reason for pensioners falling below the poverty line and having to apply for EL/PC. These projections show that any future extension of second pillar pension coverage will not fundamentally alter the distributional outcomes for standard and non-standard workers because the levels of second pillar pensions will remain low.

Self-employment (and part time employment) will remain the main determinants of insufficient second pillar coverage (Bonoli and Gay-des-Combes, 2003). This explains why self-employed people are more likely than former standard employees to remain active on the labour market after retirement (Flückiger and Falter, 2004). Nearly 25 per cent of the self-employed in Switzerland do not contribute voluntarily to second or third pillar savings schemes. Even more important from our perspective, about 20 per cent of the self-employed (that is about 3 per cent of the overall labour force) are estimated to be economically dependent workers, that is, 'false self-employed' working for only one client (Flukier and Falter, 2004). These workers will only have access to first pillar pensions, they will have pensions at the poverty line (40–50 per cent of the median income), and no reforms are on the agenda to change this situation.[15]

In sum, the Swiss three pillar pension system after the reforms of the 1990s and 2000s performs well with regard to poverty prevention for non-standard workers. When it comes to income maintenance through the second and third pillars, however, the gap between non-standard and standard workers has not become much smaller.

6.6 Conclusions

We have shown in this chapter that the Swiss three pillar pension system is particularly important for analysing the interplay between labour market flexibility and old age income security. The first reason is that, contrary to other European countries, labour market flexibility was not the result of a deliberate labour market deregulation strategy. Rather, labour law has always been very flexible. Indeed, atypical employment is the most common form of employment for women in Switzerland. Secondly, within a layered pension system, measures responding to the flexible Swiss labour market structure could be integrated incrementally and very pragmatically. These reforms improved poverty prevention for non-standard workers significantly. They also increased the coverage rate of atypical workers in the second pillar and introduced fully portable occupational pensions. Expanded coverage, however, does not necessarily lead to adequate pension levels in defined contribution systems such as the Swiss, which is why pensions for atypical workers in the second pillar are, and will remain, very low. Also, general retrenchment measures (raising the retirement age in the first pillar for women, as well as lower pension levels in the second pillar) counterbalanced these improvements to some extent. Nonetheless, they did not offset the beneficial effects of the reforms for atypical workers because retrenchment mostly targeted standard workers.

Why were reforms improving the pension rights of non-standard workers possible at all? We have shown in this chapter that two factors contributed to the success of these reforms. The first is timing. The Swiss three pillar system was constructed incrementally, and this process paralleled the transformation of the labour market. This means that the Swiss system – in contrast to other European pension regimes – did not have to make a detour through the industrial era. Rather, given its late development, it evolved directly into a more piecemeal, layered, fragmented system of multiple pillars, which could be adapted flexibly to new challenges. Secondly, the non-politicization of labour market flexibility proved to be helpful to the success of the reforms. Flexible labour markets are an uncontested fact in Switzerland. Hence, reforms to enhance pension security for atypical workers were very pragmatic and not as politicized as in other countries.

Poverty prevention has thus largely disappeared from the Swiss pension reform agenda, while income maintenance is still an issue. Here, however, the limits of occupational, funded pensions in providing adequate pensions to non-standard workers become evident. Since these schemes are strongly based on the equivalence principle and strictly contribution-related, low salaries will always result in low pensions. Unless some form of solidarity and redistribution is introduced in this scheme, all that can be done to lower second pillar pension benefit differences in Switzerland between standard and non-standard work is to increase (female) activity rates and to raise the incomes of non-standard workers.

Notes

1. AHV/AVS: Alters- und Hinterlassenenversicherung/Assurance Vieillesse et Survivants.
2. EL/PC: Ergänzungsleistungen / Préstations Complémentaires.
3. The most important condition for a full pension was and still is a contribution record of 44 (men) or 43 (women) years.
4. Employees aged 25 to 35 contribute 10 per cent of their insured income, while the oldest age group (above 55) contributes 18 per cent.
5. 1 CHF = €0.869 on 16 July 2011.
6. For this reason, there is much variation in benefit provision in terms of coverage and generosity across pension funds and across economic sectors (Bonoli and Häusermann, forthcoming).

7. The reasons for this low rate are twofold. Higher-income self-employed in the liberal professions usually rely on private forms of wealth management, while the 'false self-employed', as well as small entrepreneurs and farmers, tend to forego occupational pensions because they cannot afford them.
8. For the self-employed, tax-favoured contributions are permitted up to 20 per cent of the annual income, with a maximum of CHF 32,000 (27,800 Euros).
9. SAKE, *www.sake.bfs.admin.ch.*
10. SAKE, *www.sake.bfs.admin.ch.*
11. There is no reliable time series data on part-time work available before 1990.
12. For a detailed analysis of the reform process, see Bonoli (2000), Häusermann (2010).
13. Freizügigkeitsgesetz in der Beruflichen Vorsorge / Loi sur le Libre passage dans la Prévoyance Professionnelle.
14. Splitting was also enacted retroactively, so that it resulted very quickly in an equalization of pension levels. Splitting, however, applies only to married couples, which is why marriage is and will remain an important factor in ensuring full first pillar pensions for women (BFS, 2003).
15. The government currently advocates an increase in contributions levied on artists' (low and cumulative) salaries to the first pillar AHV/AVS. This small reform will, however, not change the weak position of the self-employed in the second pillar.

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7
The Danish Flexicurity Model and Old Age Protection

Niels Ploug

7.1 Introduction

The story of combining labour market flexibility and economic security in old age is in many ways different in Denmark from other European countries, both in terms of the development of the system and its outcomes. On the one hand, flexibility in the Danish labour market is not linked to the creation of atypical jobs. For more than 50 years, labour unions have advocated flexibility as long as it ensured workers had jobs based on standard conditions concerning wages, working hours and social rights. On the other hand, income security in old age is not the result of any recent sweeping pension reform. It is partly based on the universal state old age pension and partly on the development of a second pillar of labour market pensions. The extension of labour market pensions in the 1990s to cover private sector employees was the most important change in terms of income security. Public sector employees had been covered by supplementary labour market pensions since the late 1960s and the state old age pension has not been subject to any major reform since its introduction in the late 1950s. The flexible aspects of the Danish labour market, as well as the extension of the second pillar pension system to cover private sector employees, came about as the result of negotiations between the parties in the labour market. The Danish model is robust because it is based on agreements between employers' and employees' organisations that take into consideration the economic realities of the labour market.

Liberalization, 'flexibilization', and market orientation are recommended by international organisations such as the OECD in order to achieve good economic performance. These recommendations run contrary to the prevailing categorization of the Danish welfare state as belonging to the Scandinavian type of welfare system with heavy state regulation, a major focus on social security for the individual, and little room for the market. The result is the development in Denmark of an old age pension system that is different from the systems in most other European countries.

The purpose of this chapter is to present the developments that have led to the creation of this system and to evaluate it in relation to income security (or insecurity) in old age. Despite the comparatively good Danish results in terms of poverty prevention for the elderly, the analysis will show that even Denmark faces potential problems with income security in old age. More precisely, the Achilles' heel of the Danish old age pension system is that contributions for second pillar pensions are paid only for people in active employment; no entitlements are earned during unemployment, sickness, maternity leave or other kinds of leave from the labour market.

7.2 Before the reforms: the origin and content of the Danish flexicurity model[1]

Over the last two decades, 'flexicurity' has become one of the most important buzz words in the European debate on the future of labour markets. The flexicurity concept originated in the Netherlands and referred to the major reforms of Dutch labour market policies that took place some 15 years ago. These reforms where striking. They changed the, at the time, somewhat rigid Dutch employment protection system into a more flexible one (Wilthagen and Tros, 2005). While the developments in the Netherlands were a revolution that changed the operation of their labour market, the development of the Danish flexicurity model was an evolution which took place over a longer time span and started as early as the late 1960s.

The flexicurity model is one of the main reasons why Denmark – along with the Netherlands – has one of the most efficient labour markets and successful economies in Europe, until the financial crisis in 2008. The Danish miracle was characterized by a reduction of unemployment from 12 per cent in the early 1990s to below 2 per cent in the first half of 2008, an average economic growth rate of 2.0 per cent during the last ten years, the reduction of public debt from 55 per cent of GDP in 1997 to 18 per cent in 2007, a surplus in the state budget and in the balance of payments for more than ten years, and a reduction of foreign debt from 25 per cent of GDP in 1997 to 4 per cent in 2007.

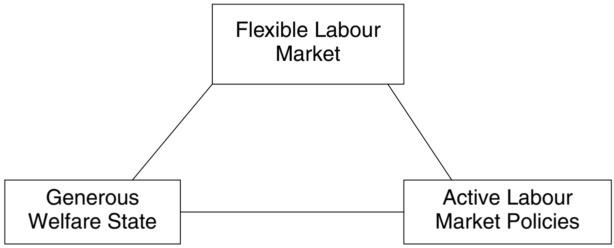

Figure 7.1 The Danish flexicurity model

As noted, the Danish flexicurity model has a history of more than 50 years, and this long tradition sets it apart from the Netherlands.[2] Because it developed over a long period, the Danish model cannot be considered to be the result of deliberate planning. One might also say that there is no Danish flexicurity model as such, but a 'state of affairs' in the labour market that ensures both a flexible labour market *and* social security for the work force. It is the purpose of this section to try to explain how this model, or state of affairs, emerged.

The flexicurity model has three legs: a flexible labour market, a generous welfare state, and well developed active labour market policies (see Figure 7.1).

The first step in the creation of the framework for what is known today as the Danish flexicurity model was taken during the 1960s (Møller, 1981). This was a time when a number of reforms leading to the creation of the modern Danish welfare state were implemented. In 1964, a commission was appointed to analyse the organisation of the unemployment benefit system. This scheme was (and is) organised on a 'Ghent' model, that is, insurance is voluntary and the funds are administered by the trade unions. In line with Danish corporatist traditions, the Commission was a tripartite body, with representatives from employers, employees and the state.

The Commission's mandate was twofold: to propose solutions to the problems associated with both the financial structure and the benefits of the unemployment benefit scheme; and to consider the organisation of the employment services. The financing of the unemployment benefit scheme was, in general, left to the State. In practice, members of the unemployment benefit funds paid a membership contribution but revenues were insufficient to finance the full cost of unemployment benefits. The state covered the deficit out of general revenues because politicians did not want to impose major financial burdens on either employees or employers. Thus, apart from a tax deductible membership fee paid by employees – who could voluntarily join an unemployment benefit fund – the state bore the main responsibility for financing high levels of unemployment.

Replacement rates were very important to the trade unions. In 1970, it was decided to introduce a maximum unemployment benefit of 90 per cent of the average wage in the private sector for a benefit period of up to 2½ years. Access to benefits was also easy – in most cases immediate – in the case of job loss. These policies met the demands put forward by the trade unions. Unemployment benefit funds continued to be part of the business of the trade unions and the Ghent system was maintained even though the state took on the financial liability when there were high levels of unemployment. However, the employment service was transferred from the trade unions to the state, and a system of consultations (that is tripartite committees) was created both at the national and regional level.

These very important reforms created the organisational and financial cornerstones of what later came to be known as the Danish flexicurity model – though nobody was thinking or talking about that at the time. The reforms were just a continuation of the pragmatic way labour market and social problems were solved in Denmark. One indication of this pragmatism is the 1964 Commission appointed by a Social Democratic government. The Commission put forward its major proposals at the same time that a new Social-Liberal government took office. Despite the change in government, the reform proposals were adopted unchanged by the new government.

This first step toward the flexicurity model took place at the same time as a major extension of the universal Danish welfare state during the 1960s and 1970s. The welfare state expanded quickly during these decades. In 1960, 9.2 per cent of the workforce was employed in the public sector, primarily in the municipalities, a core unit in the Danish welfare state.[3] In 1975, the figure had risen to 22.2 per cent. More crucially, welfare expenditure (mainly social services) increased from 6.2 per cent of GDP in 1960 to 10.8 per cent in 1971. By the mid-1970s all the major components of the universal Danish welfare state were in place: the state old age pension system; the supplementary labour market pension system for public sector employees; and the flexible labour market.

The second step in the development of the Danish flexicurity model took place primarily in the 1980s. After almost 15 years of very low levels of unemployment (between 2 and 4 per cent in the 1960s), joblessness emerged as a problem from the mid-1970s onwards. The average unemployment rate reached 5.3 per cent in 1975–9, rising to 8.0 per cent in 1980–84. Initially, unemployment was fought with Keynesian macro-economic policies but by the early 1980s, it became obvious that this was neither effective nor efficient. This realization marked the beginning of about 15 years of trial and error in the development of the Danish version of active labour market policies.

The first programmes to combat youth unemployment were initiated shortly after the dramatic rise in unemployment during the mid 1970s.[4] These programmes were followed by a number of more general employment plans that required municipalities to set aside resources for projects to combat unemployment.

1982 saw a change of government, from a Social Democratic government to a Conservative-Liberal coalition. This also meant a change in policies to fight unemployment. The new government wanted to abolish the special programmes to fight youth unemployment and instead aspired to increase the capacity of the educational system.

The government also modified its existing programmes for the adult long-term unemployed. Because the maximum period on unemployment benefit was 2.5 years, a large number of unemployed had already begun to exceed this limit during the late 1970s. Instead of expelling them from the system, subsidized jobs were created – primarily in the public sector – that allowed the long-term unemployed to re-qualify for benefits. If an individual was still unemployed after a second 2½ years benefit period, he or she would be offered yet another subsidized job.

The new Danish government changed important features of this 'unemployment policy as a 'perpetual motion machine' as it emerged in the 1970s. Instead of a second (or third) subsidized job, the long-term unemployed received an educational grant for 1½ years in order to improve their occupational skills. Alternatively, they could get an 'entrepreneurial grant' for 3½ years for setting up their own business or, as a third option, they could receive unemployment benefits for yet another 2½ years. If none of these measures led to regular or self-employment, the individual would be expelled from the unemployment benefit system. Moreover, during the late 1980s, the implementation of active labour market policies was decentralized, so as to cope better with large regional differences in the level and structure of unemployment.

However, the economic situation in Denmark remained very unfavourable during the second half of the 1980s. Even though the active labour market policy tool box was substantially improved, unemployment rose to ever higher levels, reaching an all time peak of 12.4 per cent in 1993.

It took another change of government, however, to arrive at an effective mix of macro-economic and labour market policies that would lead to an improvement of the situation. This policy mix created the preconditions for the emergence of the flexicurity model.

In addition to effective active labour market policies (ALMPs), the Danish flexicurity model rests on two additional elements. One is the ease with which employers can adapt their workforce to the economic situation. They can dismiss employees easily, and there have been no legal changes to this policy. Indeed, Denmark scores below the OECD average on the 'Overall EPL' index. The Danish score of 1.63 is below the OECD average of 1.94 and well below the scores of 1.95 for the Netherlands and 2.12 for Germany (see Figure 1.2 in Chapter 1).

The other element is that dismissed employees have easy access to generous welfare benefits, especially unemployment benefits that are paid for a relatively long period of time.

An important reason why these two elements became central to the Danish flexicurity model had to do with the structure of the country's firms. Not only is Denmark a small country; most Danish firms are also small, at least when measured by the number of employees. If we consider Danish firms with more than one employee, only 1.5 per cent of firms had more than 100 employees, and 80 per cent employed between 1 and 9 workers in 2007 (Danmarks Statistik, 2010). All firms need flexibility, but small firms are in greater need because their economic ability to keep employees whose labour power they temporarily cannot utilise is less than for bigger firms.

Due to firm structure and labour market flexibility, job turnover is quite high in Denmark. As the OECD (2010) reports, the gross worker reallocation rate is one of the highest in the OECD, surpassed only by Iceland and Turkey – and much higher than in other Nordic countries.

The Danish welfare state is characterized by relatively easy benefit access and relatively modest benefit levels: actually, as there is a cap on the 90 per cent compensation rate mentioned above, the net replacement rate of unemployment benefits for an average production worker is 58 per cent (Hansen, 2006). This modest benefit level is politically acceptable because the risk of unemployment has proven to be quite low for people with average or above average earnings. Although the risk of unemployment is much higher for people with low qualifications and low wages, the net replacement rate for a worker earning 75 per cent of an average production worker's wage is 75 per cent. Because membership in the Ghent-type unemployment benefit system is voluntary, non-members who become unemployment are shifted to social assistance. Benefits are strictly means-tested but available for all those in need. However, the benefit level is quite low with a net replacement rate of 39 per cent. An unemployed spouse would normally not be eligible for social assistance if their partner were working, since that income would be subject to means-testing. The impact of unemployment on old age security will be dealt with in the subsequent sections of this chapter.

As discussed above, active labour market policies – the third element of the Danish flexicurity model – developed on a trial and error basis during the late 1970s and the 1980s. ALMPs became an especially important part of the labour market and the economic policy mix in the 1990s. ALMP expenditure increased from 0.4 per cent of GDP in 1980 to a peak of 1.9 per cent in 1995 (the EU-15 average was 1.0 per cent in the same year), thus contributing to the Danish 'employment miracle' that brought the unemployment rate down from 12.4 per cent in the 1993 to an all-time low of 1.4 per cent in mid-2008. In the same period, the overall employment rate increased from 72 per cent to 76 per cent of the population aged 15–64 years. In the age bracket 25 to 60, the employment rate went up from 82 to 87 per cent.

7.3 Before the reforms: income security in old age in Denmark

The Danish old age pension system consists of four elements: the state old age pension, the labour market supplementary pension scheme (ATP), labour market supplementary funded pensions (second pillar) and private pensions (third pillar).[5]

The state old age pension scheme was introduced in 1957 and is designed to pay a universal old age pension to all citizens irrespective of income. Full implementation took more than a decade. From 1970, every person who has lived (work is no requirement) in Denmark between the ages of 15 and 65 is entitled to a full state old age pension. Before this, the state old age pension was means-tested and available only to elderly people in need. For decades, the net replacement rate of the state old age pension – for someone with no additional pension income – has been very stable at around 50 per cent of an average production worker's wage (Hansen, 2006). In addition to the universal basic pension, there are several supplements to which old age pensioners are entitled, including housing benefits and subsidies for medicine and public transportation.

The labour market supplementary pension scheme (ATP) was inspired by the development of supplementary public pension plans in the other Scandinavian countries. It was introduced in 1964 as one of several policies aimed at dampening private consumption in an overheated economy. However, the Danish ATP scheme is different from the version implemented at that time in other Nordic countries, because it is fully funded. Contributions are very low and based on weekly hours worked rather than on wages, and there is no indexation after pension payments begin. ATP covers all wage earners in the private and public sector.

Labour market supplementary pensions are funded, defined contribution schemes, based on industry-wide collective agreements in the labour market. They were introduced in two separate steps: in the public sector in the late 1960s and in the private sector in the beginning of the 1990s. The rapid growth of employment in the public sector during the 1960s led to a change in the working conditions of employees in public service. At that time, most public employees were civil servants and public sector employment was inflexible, since public servants could not be made redundant. Moreover, civil servants had the right to a tax-financed pension with high replacement rates. This pension scheme was changed, so that, in future, the majority of the public sector employees would be subject to employment conditions similar to those in the private sector: contracts based on collective agreements. As compensation for reduced employment security, a number of funded, defined contribution occupational pension plans were set up for most groups in public service.

This change had important repercussions for the development of the Danish old age pensions system 20 years later. In the early 1980s, the pension debate in Denmark centred on the inequality between those who had some kind of supplementary pension arrangement based on savings – that is most public employees – and those who did not. The latter group included the vast majority of ordinary workers in the private sector, where about two thirds of the workforce was employed.[6] For this group, the prospect of having to rely solely on the state old age pension, and the small ATP pension, was unsatisfying. Some private sector workers had third pillar pensions from individual retirement savings, but for the majority this was not the case. There was a demand for a supplementary pension scheme for those without true earnings replacement in old age. The breakthrough for a pension reform in the private sector had to wait for the negotiations between the social partners in 1991, however. The trade union for industrial workers played a leading role in this process. As early as the 1980s, this union had threatened to go its own way if a solution to the pension problem in the private sector were not found quickly. Members of this trade union are typically those with middle incomes and they faced a large fall in income after retirement.

The tradition in collective bargaining at that time was that the trade union for industrial workers completed its negotiations first and then other trade unions attempted largely to copy the results attained in the industrial sector. The 1991 negotiations between the trade union for industrial workers and their employers led to an agreement on the introduction of a decentralized supplementary pension scheme that covered only workers within this collective agreement. This was a break with the idea of a central fund put forward in a 1985 proposal from the Federation of Trade Unions (LO). The employers, as well as the Conservative and the Liberal Party (in government at the time), strongly opposed the idea of a central fund, but the individual trade unions had themselves gradually departed from the Federation's proposal and adopted the idea of a decentralized system of pension funds. According to the 1991 agreement, the newly introduced pension scheme was to be managed by a board with an equal number of representatives from the employees and the employers. This compromise made it possible for the employers to support the new pension arrangement because they would be able to influence the funds' investment strategies and impose strict rules for investments in industrial companies.

In a meeting of the coordination committee of the Federation of Trade Unions, which brings together representatives of all affiliated unions, the industrial workers' union defended its approach. Afterwards, most other trade unions entered negotiations with the employers in their sector and largely copied the pension agreement of the industrial workers. Thus a truly substantial pension reform was adopted. Pension schemes in other sectors were established quickly, with initial contribution rates of 0.9 per cent in 1993.

The incremental development of Danish old age pensions resulted in a multi-pillar system that diversified the risks of its individual components and resembles proposals made by international organisations during the late 1980s and early 1990s. However, the reform process in Denmark was much more an outcome of path dependency than an OECD or World Bank inspired radical change to an existing pension system. In the fierce Danish debate following the 1985 decision of the Federation of Trade Unions to pursue an occupational pension system based on centralized funds, the Social Democratic paper, *Aktuelt,*

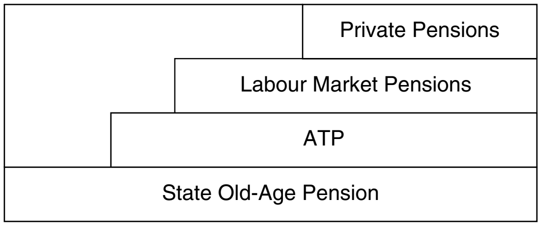

Figure 7.2 The Danish old-age pension system

conducted a series of interviews with centrally placed people in the decision-making process. In one of these interviews, an economist from the Federation of Trade Unions stated that

> The starting point for The Federation of Trade Unions has always been that the existing supplementary pension schemes should be respected. A new scheme covering all wage earners would therefore not be realistic in light of the many who today are covered by existing arrangements. (Aktuelt, 1988)

Because the first phase of developing labour market pensions for the public sector in the late 1960s had resulted in a decentralised pension fund, this approach was considered to be the only viable option for the pension reforms of the private sector some 20 years later. The multi-pillar old age pension system that emerged out of these long-term processes has four components (see Figure 7.2). The rules governing access to labour market pensions are crucial for income security in old age (see below).

7.4 Labour market reforms in the 1990s

In January 1993, a coalition government took power under the leadership of the Social Democratic Party although a majority government is very rare in Denmark. Soon after taking office, the new government passed a number of reforms by very thin majorities, in several cases by a single vote. These included a tax reform and a labour market reform that both took effect in January 1994. Due to favourable economic developments and the policy changes that were implemented, the unemployment rate began to fall steadily, reaching a level some 15 years later of 1.7 per cent (in mid-2008).

As discussed, reforms were based on more than 15 years of trial and error in labour market and economic policies, from the mid 1970s until the early 1990s. Reformers also relied on several reports issued by Government Commissions that had analysed labour market problems in the beginning of the 1990s. However, the government did not follow the commissions' recommendation and apply clear economic incentives in the fight against unemployment. Instead, policy makers decided to try to solve the problem of the gap between the qualifications of the unemployed and the wage level in the labour market by placing greater emphasis on education and training.

It is important to note that these decisions preceded the European Union's negotiation of similar goals for labour market policy during the Lisbon Summit in 2000. It is beyond the scope of this chapter to analyse the developments that led to the Lisbon Strategy. The Danish government responsible for labour market policy reforms in the 1990s, however, was quite convinced that their reforms had been an important source of inspiration for the EU's new approach. Because of its long experience with persistently high rates of unemployment, Denmark became a laboratory for developing policy solutions, which inspired other countries.[7]

During the 1990s, Danish policy makers adopted a procedure for introducing and subsequently adjusting policy measures to make them conform to the annual budget process. The labour market reform of 1994 thus entailed additional interventions which were implemented in three phases. The first phase took effect in January 1994, the second phase began in 1996, and the third phase in 1999 (Mærkedahl, 2000). Despite the changes and adjustments made after 1994 in order to make policy measures compatible with the changing economic situation, the priority of using active labour market policies instead of economic incentives has remained fundamental to Danish labour market policies.

The new institutional set-up for steering labour market policy strengthened the role of the social partners, especially at the regional level. This approach stands in contrast to the general trend of declining corporatism in Danish policy making, as well as at the international level (Blom-Hansen, 2000). Corporatist governance structures in the area of labour market policy in Denmark, however, have a long tradition, due to the Ghent-type unemployment protection system.

A key component of the 1996 reform was an attempt to strengthen active measures. Reforms emphasised that activation efforts be based on the unemployed persons' needs and potential on the local labour market.

In order to strengthen the flexibility of the organisational structure and to make sure that individual skills and preferences were taken into account, the reform introduced individual action plans in the form of a contract between the public employment service and the unemployed person. This reform also implemented more flexible job training and extended educational opportunities (Arbejdsministeriet, 2001).

In 1999, an early retirement scheme, introduced in 1979, was changed in order to discourage the withdrawal of older workers from the labour market. Originally, the scheme allowed early retirement at the age of 60. The reform stipulated that employees who postponed retirement until age 62 would receive a higher benefit, and if retirement was delayed until 65 – when eligibility for the state old age pension began – employees would receive a large tax deduction. These incentives aimed at keeping as many older people in the labour force as possible.

This series of Danish labour market reforms is noteworthy for at least three reasons. First, the reforms actually seemed to work. The results – a sharp decrease in the number of unemployed people, and an increase in economic activity without creating bottlenecks in the labour market – were the result of an effective (and fortuitous) combination of economic policies and labour market reforms. Unemployment went down from nearly 12 per cent in the early 1990s to around 4 per cent in the late 1990s. GDP growth was quite high (above 3 per cent in most years during the 1990s), yet did not lead to strong upward pressure on wages. Wage pressure had thwarted attempts to increase economic growth in the mid-1980s. Even though economic policy is an important part of the Danish success story, the results could not have been achieved without the reform of active labour market polices (Torfing, 1999).

Secondly, reforms of labour market policy were implemented without strengthening economic incentives. The usual recommendation from economists is to lower compensation rates in income support systems in order to force the unemployed out of the benefit system and into the labour market. This recommendation is also prevalent in the reports from the expert commissions which analysed the Danish labour market prior to the reform process. But it was an explicit goal of the Social Democratic-led government not to place more financial pressure on the unemployed. Instead, the key to success was seen to be a combination of more flexible administration of active labour market policies and an emphasis on increasing the qualifications of the unemployed. Adapting to the needs of the local labour markets and developing a variety of training opportunities tailor-made to the individual unemployed was the goal of the reforms.

Thirdly, the reforms did not imply any deterioration of working conditions for employees. Thus, one element of the reforms was the creation of jobs based on special employment conditions. These are jobs in a private firm or in the public sector where the worker receives an ordinary wage including social benefits – including contributions to labour market pensions – and the employer receives a subsidy for employing this person. The subsidy is equal to the unemployment benefit this person would have otherwise been entitled to. The working conditions for these kinds of jobs are subject to the same kind of regulations laid down in collective agreements that apply to any other job. This meant that the formation of an atypical, secondary labour market with lower wages and fewer rights to social protection or shorter working hours was prevented in Denmark. Consequently, the share of atypical temporary employment has remained low (9.1 per cent in 2007) and has even declined in the last decade. Moreover, part-time workers (17.7 per cent in 2007) enjoy the same social rights as full-time workers (see next section).

Taken together, the labour market reforms of the 1990s did not make workers worse off with regard to their social protection rights, including their rights to labour market pensions in old age. A high level of organisation among both unions and employers is not only responsible for the fact that approximately 80 per cent of jobs are subject to collective agreements. It is also important for the corporatist regulation of the Danish labour market because active measures – and the job creation scheme in particular – developed by means of tripartite political negotiations.

7.5 After the reforms: current situation and future prospects

As described in Sections 7.2 and 7.3 of this chapter, major reforms of old age pensions and labour market policies were adopted in Denmark during the late 1980s and the early 1990s. No substantial changes or reversals to these policies have taken place since then. The old age pension system is basically the same today as it was at the beginning of the 1990s when supplementary labour market pensions were extended to the private sector. There has been no significant reform of the state old age pension in recent decades. Active labour market policies were changed during the 1990s to adapt to changes in the labour market. In a situation where fewer and fewer people were unemployed, the conditions for receiving unemployment benefits have been made stricter, and there is more emphasis on participation in activation programmes.

The new labour market pension schemes were intended to reach a contribution rate of 9 per cent as soon as possible. The rate is negotiated as part of the collective bargaining that takes place every second year. The 9 per cent goal was reached in 2003 and, after the 2010 round of negotiations, the contribution rate will increase to 12 per cent within the next two years. One third of the contribution is paid by the employee, whereas the employer shoulders two thirds. However, contribution rates vary across schemes. In general, rates are determined by collective agreements, and in 2010 the level was set at 12 per cent for manual workers and 17 per cent for employees with an academic degree. The difference in contribution rates is based on the expected number of years in employment, which is, on average, shorter for employees with an academic degree. In practice, the system is decentralised and consists of some twenty pension funds. Of these, some are further divided to cover different sub-groups of employees, like the fund for unskilled workers that covers a wide range of people ranging from employees in the construction sector to employees in industry. Schemes are also quite flexible over the portability of entitlements: for the individual worker, no costs or other penalties are associated with a change from one area of employment to another. The system covers everyone employed in the public sector and nearly everyone employed in the private sector. Even though no official statistics exist on coverage, surveys indicate that almost 90 per cent of private employees are covered.

The most important change in relation to poverty in old age occurred in the statutory ATP system. Reforms during the 1990s made it compulsory for people on social benefits (in case of unemployment or sickness) to pay a higher than normal contribution to the ATP pension system. The ATP contribution is deducted from the unemployment, sickness or social assistance benefit. Thus, the ATP system has acquired an important role in securing retirement income (beyond state old age pensions) for workers with discontinuous employment profiles. However, the eventual ATP benefit is low. A person who has paid a full contribution to the ATP scheme for 40 years receives a net replacement rate of 7 per cent of an average production worker's wage. This is not much; but for persons with low incomes, the amount is not negligible (Hansen, 2006).

Unlike the ATP scheme, the collectively negotiated labour market pensions do not cover periods of unemployment. Employees are covered and contributions are paid only as long as they are employed.

In second pillar funded pension schemes for both public and private employees, workers who temporarily leave the labour market because of unemployment, sickness or maternity do not pay contributions, and they do not earn pension entitlements. This can lead to gaps in second pillar pension coverage.

However, gaps in coverage have little to do with the labour market reforms during the 1990s or the Danish flexicurity model in general. Also, problems that may exist in the Danish old age pension system may be a matter of perspective. A dynamic analysis carried out by the Ministry of Economics showed that very few – approximately 2 per cent of people in the workforce – have no savings at all in a labour market pension fund (Regeringen, 2000). Static analysis from the ATP administration reveals that at any given point in time, large numbers –12 per cent of all employees – are not contributing to the labour market pension system (ATP, 2007). The difference between these two statistics is due to the dynamic Danish labour market with its high turnover rate. At any given point in time, a person might not be contributing to a labour market pension fund, but the chances are very high that this person will have a job (or a number of jobs) for most of his or her working life for which contributions are paid. The ATP study shows that taxi drivers and people employed in restaurants and cafes are some of the major groups not covered by labour market pensions. These are also occupations with high rates of job turnover, and many working in these sectors are only temporarily employed.

Other groups with incomplete contribution records in second pillar schemes are those who are not fully integrated into the labour market between the ages of about 20 and 65. Because labour force participation rates are among the highest in Europe for both men and women, the large majority of Danes are actually employed during most of their potentially active years. For some groups, however, this is not the case: here one finds more women than men, as well as immigrants. However, it is important to note that these groups are still eligible for the state old age pension. This matters for income security in old age (although for people who have lived in Denmark for less than 40 years, there will be a proportional reduction in the state old age pension).

Part-timers, another category of atypical workers, are fully covered by the state old age pension, and they receive benefits from the ATP scheme based on the number of hours worked, and from labour market pension in relation to their monthly wage. A recent analysis conducted by a government-appointed Welfare Commission suggests that even though the reforms of the 1990s resulted in major improvements in the coverage of the old age pension system, there is still need for additional improvement. The Commission notes that the labour market pension schemes for the private sector started in 1991 with a contribution rate of 0.9 per cent and reached 9 per cent in 2003. This means that only workers who retire after 2050 have had 40 to 45 years of contribution at a rate of 9 per cent (Velfærdskommissionen, 2006). For those retiring before around 2050, the Commission considers the contribution rate has been too low.

In addition to this analysis of long-term trends, there are important short-term developments. Despite high coverage rates, there is a wide variation in the level of actual contributions. This is important for an assessment of whether there will be an old age security problem in the future. Despite the lack of official statistical data on the collectively negotiated labour market pension schemes, the Welfare Commission was able to shed some light on this problem. Their data showed that in 2003 about 30 per cent of workers between the age 25 and 64 (about 900,000 people) paid less than DKK 6000 (about €805 per year)[8] into their second-tier pension account. 700,000 of this group relied on some kind of income transfer from the state – unemployment benefit, social assistance, sickness benefit or early retirement pension – as their main source of income during 2003 and, thus, contributed to the scheme for less than 12 months. 80,000 were housewives and 120,000 were employed but apparently not covered. The latter group includes taxi drivers and restaurant workers (see above).

While these results are hardly surprising given the rules of the labour market pension schemes, one of the Commission's other findings was very surprising. The Commission found that 43 per cent of employed people in the age group 25 to 64 paid less than 9 per cent of DKK 200,000 (equal to €26,829) into their pension accounts in 2003. This applied to 1 million people or one third of the total work force. Moreover, DKK 200,000 was not a high wage in the Danish labour market – the average production worker's wage was close to DKK 280,000 (€37,560).

Therefore, the Commission suggested an additional compulsory funded pension arrangement with a contribution rate of 6 per cent of income to cover all workers. Because the contribution rate for the ATP pension – which comes close to fulfilling the objectives of the proposed pension arrangement – is close to 1 per cent of wages, the proposal would mean an increase in pension savings of 5 percentage points on top of the contribution to the labour market pension scheme. For employees covered by the new labour market pension scheme, which has a contribution rate of 12 per cent in the 2010 collective agreement, the proposed scheme would mean an overall supplementary pension contribution of approximately 17 per cent of earnings.

The analysis of the Government Welfare Commission has been followed up by the Danish National Institute of Social Research (SFI) (Jørgensen, 2007; 2008). The influence of the dynamic Danish labour market on the individual level of old age pensions comes out quite clearly in the analysis of individual labour market attachment in the period 1995–2005.[9] Only 19 per cent of the sample had a full-time job every year during the 11-year period. Their contribution to old age pension savings was on average 9.7 per cent of their earnings. 5 per cent of the sample had not been in employment at any time during the 11-year period. Their contribution to old age pension savings was on average 2.1 per cent of their income. The average labour market attachment during the 11-year period was 8.9 years, and the average old age pension contribution was 7.5 per cent of income. 81 per cent of people included in the sample had some kind of break in their labour market attachment during the period in question. The most common reason was illness: 50 per cent received sickness benefit sometime between 1995 and 2005. 41 per cent drew unemployment benefits, 18 per cent claimed benefits on the basis of a leave arrangement, while 15 per cent received social assistance payments at some point in time.

Jørgensen (2007) concludes that people receiving social assistance, people on an early retirement pension, people with low educational attainments, and people who have been divorced all have very low pension savings and, therefore, have to face very low pensions from the second-tier old age pension scheme.

Despite these potential threats to income security, the Danish system appears a robust system for preventing poverty in old age. This is confirmed by recent figures comparing the Nordic countries. The percentage of people aged 65 and above living at risk of poverty – that is with an income below 60 per cent of the median income – is actually lowest in Denmark. Only 21 per cent of the Danish elderly live below this threshold, while figures for the other Nordic countries are: 40 per cent in Finland; 36 per cent in Iceland; 33 per cent in Norway; and 28 per cent in Sweden. The EU average is 27 per cent (NCM, 2010).

7.6 Conclusions

Labour market reforms in Denmark in the 1990s were quite successful. Based on reforms of the tax system in the 1980s and expansionary economic policies, Danish policy makers reduced unemployment dramatically. Indeed, Denmark used to have one of the highest unemployment rates in Europe and had one of the lowest in 2008. What is more, this remarkable turnaround was achieved without any serious deteriorations of social protection. The reforms have also not led to the creation of specific groups of precarious workers. One of the central arguments of this chapter is that the Danish flexicurity model is one of the major reasons for this success.

If we look at the recommendations for labour market reform made by international organisations in the context of the question posed in the introduction of this chapter, we can say that there has never been strict state regulation of the Danish labour market. On the contrary, the Danish labour market is one of the most flexible and least restricted labour markets in the OECD group. Flexibility is ensured through collective agreements between employers' and employees' organisations.

However, there is strong state involvement in the security part of the flexicurity model. There is easy access to unemployment benefits for relatively long periods, mainly financed out of general taxation. An important part of this system is the condition that, after some period of unemployment, a jobless person takes part in one of the extensive active labour market programmes; that is, he or she engages in training activities and other measures designed to reintegrate unemployed people quickly back into the labour market.

The old age pension system – and the old age pension problem, if there is one – also appears to be different in Denmark, compared to most other European countries. During the 1960s and 1970s, Denmark did not develop a public old age pension scheme on the defined benefit, Pay-As-You-Go principle, which would secure earnings replacement for the large majority of workers, as was the case in many other countries in Europe. As a result, Denmark was not faced with the challenge of sweeping reforms because of demographic changes. The challenge in Denmark, however, was to expand the labour market pension schemes, which had existed for public employees since the late 1960s, to people employed in the private sector. This happened in the early 1990s.

Together with the flexicurity model, the construction of the pension system can be seen as another aspect of the fortuitous development of the Danish welfare system. Flexicurity and labour market pensions emerged gradually, without a well-designed plan. Thus, Denmark ended up with an old age pension system that in many ways conforms to the recommendation of international organisations (like the World Bank) to combine tax-financed poverty relief in old age with savings based income security for the retired elderly.

Nevertheless, there are problems in the old age pension system that need to be addressed. Because of the lack of coverage during interruptions of actual employment, a significant share of workers do not pay full contributions to the labour market pension scheme for all of their potential working life. The payment period is reduced because of unemployment, sickness, maternity leave and other interruptions to continuous employment. Official statistics on second-pillar pensions are scarce. Information is mainly based on data and calculations from the Welfare Commission. These calculations point to a potential problem and prompted the commission to suggest an additional compulsory scheme with a contribution rate of 6 per cent.

Because of the flexible Danish labour market – and the lack of comprehensive statistical data – it may well come as a surprise when fewer retirees than anticipated are able to collect a full second-pillar pension in the future. In terms of poverty risks for the individual, this should not be a severe problem because every retiree is protected by the state old age pension. However, it may pose a problem in the future for adequate income maintenance in old age, as well as for state finances, if more retirees are entitled to a higher level, or even the full amount, of the state old age pension. These problems are not a product of the labour market reforms in the 1990s, and as long as there is political support for the state old age pension part of the pension system, the risk of poverty in old age in Denmark will remain low in comparison to other countries.

Notes

1. The presentation of the Danish 'flexicurity' model is based on Bredgaard et al. (2005).
2. Christiansen and Petersen (2001) provide a short analysis of the dynamics of the development of the Danish Welfare State from 1900 to 2000. Due et al. (1994) provide insights into the development of the Danish model of labour market regulation.
3. Municipalities administer all welfare benefits except unemployment insurance, that is, family allowances, sickness and early retirement benefits and old age pension. Welfare services, like kindergartens, schools, nurseries and old age care, is the responsibility of municipalities as well.
4. An analysis of the early development of active labour market policies in Denmark can be found in Ploug (1989).
5. Ploug (2003) and Green-Pedersen (2007) offer an extended overview on the creation of the present Danish old age pension system; Kangas et al. (2010) compare the development of the second-tier old age pension schemes in Finland, Sweden and Denmark.

6. 62 per cent of the Danish work force is employed in the private sector, 31 per cent in the public sector (State, regions and municipalities) while 7 per cent are self-employed (Danmarks Statistik, 2010). The employment structure in the Danish labour market in relation to private, public and part-time has been stable for many years.
7. This is in many respects similar to the development that created a solution to the Danish old age pension problem (Ploug, 2003).
8. 1 DKK = 0.134 Euros on 16 July 2011.
9. The data base is a 10 per cent sample of the population aged 25–64.

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8

The Netherlands: Reconciling Labour Market Flexicurity with Security in Old Age

Karen M. Anderson

8.1 Introduction

The Netherlands is regularly praised in international policy circles for two central aspects of socio-economic policy: its multi-pillar pension system and its 'flexicurity' reforms. The Dutch multi-pillar pension approach has a long tradition, but flexicurity is a more recent policy innovation. Enhancing labour market flexibility has been a core element of the overhaul of labour market policies that resulted, at least in part, in the 'employment miracle' of the 1980s and 1990s (Visser and Hemerijck, 1997; see also Becker and Schwartz, 2005; and Van Oorschot, 2002). This remarkable turnaround stands in sharp contrast to the economic malaise of the 1970s and early 1980s, when the Netherlands was a classic case of 'welfare without work'.

The combination of multi-pillar pensions and flexible labour markets might at first glance appear to be a recipe for inadequate retirement provision. Indeed, critics of multi-pillar pension systems point to the dangers of placing so much of the risk of financial markets on workers. Similarly, critics of labour market deregulation emphasize the growing vulnerability of workers to the vagaries of economic swings when unemployment protection decreases. The Dutch experience demonstrates, however, that there is a viable response to the challenge of ensuring adequate retirement income in a political economy characterized by multi-pillar pension provision and increased labour market flexibility. Dutch labour market reforms have contributed to the expansion of employment, especially of women and older workers. In addition, labour law reforms and occupational pension policy adjustments have resulted in expanded benefit access for non-standard workers. However, not all atypical workers are treated equally. Part-time workers have access to earnings-related occupational pensions under the same conditions as full-time workers, but temporary and on-call workers still face gaps in coverage, as do some categories of the self-employed. Moreover, patterns of part-time work – by far the most common category of atypical work – are highly gendered (Yerkes, 2009), as women are far more likely to work part-time than men. Even if part-time jobs qualify for employment protection and occupational pension accrual, and female poverty in old age is very low, women's overall pension levels are much lower than men's, because women's earnings as part-time workers are lower than men's mainly full-time earnings.

The Dutch approach to combining more flexible labour markets with retirement security rests on two essential institutional preconditions seldom available to other European welfare states. First, the importance of the flat-rate, state pension in preventing poverty in old age can hardly be exaggerated. The Dutch basic pension is fairly generous in international comparisons, and it provides an adequate retirement income regardless of previous labour market status. This means that atypical employment does not necessarily lead to old age poverty as it often does in other countries. Secondly, recent changes in labour law and the extensive system of pre-funded occupational pensions have resulted in improved coverage for non-standard workers. The latter factor is heavily influenced by Dutch corporatism: employers and unions make collective agreements 'in the shadow of hierarchy' (Visser and Hemerijck, 1997). The government provides a strong legal framework for collective agreements, ensuring that tripartite bargaining results in as little government interference as possible in labour negotiations. At the same time, governments have substantial influence on the overall direction of labour agreements, especially provisions concerning atypical workers. Since the 1980s, Dutch governments have prioritized the expansion of employment, including atypical employment (particularly part-time), and they have adopted legislation to enhance the retirement provision of atypical workers.

The Dutch success story is puzzling because it differs so much from the experiences of countries with similar socioeconomic institutions. The Dutch economy is characterized by high levels of coordination by employers and unions, and central elements of social welfare policy are conservative/Bismarckian. Yet the Netherlands has performed much better than its coordinated/conservative cousins (Germany, Austria, Belgium) in combining increased labour market flexibility with retirement security. This chapter emphasizes the role of corporatism and policy legacies in shaping this specifically Dutch outcome. To be sure, scholars disagree about the extent to which the Dutch employment miracle is attributable to the revival of social partnership in the 1980s (Visser and Hemerijck, 1997) or to the weakness of organized labour (Hoogenboom, 2011). The analysis in this chapter cannot adjudicate this debate. Whether or not union weakness or the renewal of social partnership drove labour market policy is not at issue: the key point is that many, if not most, of the key decisions concerning labour market flexibility and pension reform involved bipartite or tripartite bargaining. Dutch policy makers took conscious steps to improve the status of atypical workers both in the labour market and over occupational pension coverage. Dutch governments played the lead role in these decision-making processes, with the social partners largely reacting to government cues (see Wolinetz, 2001; Woldendorp and Delsen, 2008; Salverda, 1999). Pension policy choices made in the 1950s and 1960s also contributed to the relatively uncontested inclusion of atypical workers into existing occupational pension schemes. Because the flat-rate basic pension protects against old age poverty, occupational pension schemes only had to cover incomes above the state pension threshold. Given that the incomes of atypical workers are generally lower than those of standard workers, the inclusion of atypical workers in occupational pension schemes was not considered onerous. Moreover, the collective nature of occupational pensions means that the additional costs of covering atypical workers were subject to the constraints of collective bargaining. To the extent that the discipline of the market mechanism keeps wages in line with productivity, the costs of extending occupational pension coverage to atypical workers would be borne by all wage earners in a sector or firm.

This chapter begins with a brief discussion of the structure of the Dutch multi-pillar pension system in the 1980s and today. Section 8.2 emphasizes the interplay of the public flat-rate pension and collectively bargained occupational pensions in providing retirement security for standard and non-standard workers. Section 8.3 reviews the central developments in the Dutch labour market since the 1980s, especially the reforms aimed at increasing labour market flexibility. Section 8.4 discusses recent pension reforms and their impact on non-standard workers. The final section discusses future prospects for the Dutch approach to combining labour market flexibility and security in old age.

8.2 The three-pillar pension system

Like other multi-pillar pension systems, the Dutch pension system relies on a division of labour: the first pillar public pension offers basic income support, the second pillar comprises earnings-related benefits, and the third pillar includes private individual pension savings. The state is responsible for the first pillar, the social partners for the second, and individuals for the third. One of the central arguments of this chapter is that the specific Dutch approach to multi-pillar pension provision is one of the keys to combining increased labour market flexibility with adequate income protection in retirement. This section details the main features of the Dutch multi-pillar pension system at two time points: the mid-1980s (the pre-reform period) and today.

The state pension and occupational pension schemes were originally designed to respond to the needs and preferences of full-time breadwinners in standard employment. Full-time breadwinners enjoyed generous coverage, including derived rights for spouses and children. Like many other continental European countries, wages and pensions were based on family status until well into the 1970s. Breadwinners received higher wages than singles, and women were often paid lower wage rates and excluded from occupational pension entitlement. The rapid growth in female labour market participation in the 1980s and 1990s, as well as the increase in dual earner couples, undermined the effectiveness of this approach. Domestic political pressures, as well as European Community (EC) law, resulted in the removal of the last discriminatory practices by 1990 (see Van der Vleuten, 2007).[1] By the 2000s, the 'one and a half earner model' had replaced the old breadwinner model (see Section 8.3 for details).

The state pension (AOW, *Algemene ouderdomswet*) pays a fairly generous flat-rate benefit to all residents aged 65 and over who have lived in the Netherlands for 50 years between the ages of 15 and 65. Residents earn pension entitlement by living in the country, rather than by paying contributions. The pension is reduced by 2 per cent for every year of missing residence.[2] The AOW benefit is equal to 70 per cent of the net minimum wage; in 2011, the benefit for a single person was 984.75 Euros per month (net), not including vacation supplements.[3] For married pensioners the net pension is 50 per cent of the net minimum wage, or (net) €685.98, not including vacation payment for each spouse. The pension amount is indexed twice per year to net minimum wages, following the adjustments set by parliament. In 2007, AOW expenditure totalled about 5 per cent of GDP.

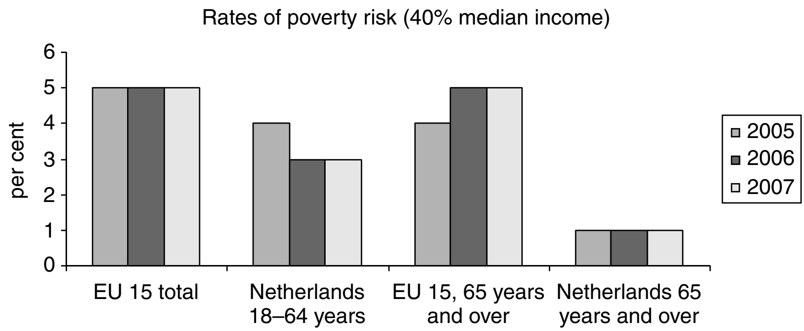

Figure 8.1 Rates of poverty risk in the Netherlands and EU-15
Source: Eurostat (2010).

The AOW was based on the breadwinner principle until 1985. Married breadwinners (usually the husband) received a benefit intended for both spouses. Like today, single pensioners received a benefit equal to 70 per cent of the net minimum wage. The couple benefit equalled 100 per cent of the net minimum wage. An EC directive adopted in 1979 required statutory social security schemes to conform to relevant EC legal principles concerning gender equality, and the Dutch policy response was to divide the couple benefit in half so that both spouses were individually entitled to an AOW pension. Before 1985, married women who were not breadwinners were not entitled to an AOW pension in their own right.

The AOW is highly effective at preventing old age poverty. As Figure 8.1 demonstrates, the poverty rate for those over 65 years old in the Netherlands is very low compared to the EU-15 average for those 65 and over, and those 18–64 years old (it is also lower than the poverty rate for those aged 18–64 in the Netherlands itself).

AOW financing is Pay As You Go (PAYG) and contributions levied as part of the two lowest income tax brackets finance benefit outlays (17.9 per cent of income in 2010 up to a ceiling of €32,738). Since its introduction in 1957, financing has been designed to be self-regulating and the level of pension contribution has been set every year so that revenues cover expenditures. Since the late 1990s, however, there has been an upper limit on contributions (18.25 per cent) and general revenues finance shortfalls. The AOW Reserve Fund, established in 1997, will help to finance benefits, starting in 2020, out of its forecast €115 billion reserves. Reserves are financed by annual government deposits. At the end of 2010, the fund had €45 billion in reserves.

The Dutch second pillar consists of collectively negotiated occupational pensions. The very high coverage of collective agreements ensured that in the 1980s, 85 per cent of dependent workers participated in occupational pension schemes. The current coverage rate is about 90 per cent. The regulatory framework for occupational pensions gives the social partners wide discretion to organize pension schemes, so there is some variation across schemes in terms of contributions and benefit levels. At the end of 2010 there were 578 pension schemes: 474 company pension schemes; 68 compulsory sectoral pension schemes; 19 non-compulsory pension schemes; and 12 professional pension schemes for professions such as doctors, dentists, and accountants.

Occupational pensions are defined benefit schemes, and in the 1980s and 1990s, the typical occupational benefit for a worker with 40 years of service was 70 per cent of the final wage, including the AOW. Since 2005, however, pension funds have overwhelmingly switched to career average benefit formulae. This means that a worker with 40 years of employment will draw an occupational pension that, combined with the flat-rate AOW, pays a benefit equal to 70 per cent of average career wages. Employers generally pay two thirds of the pension contribution and wage-earners one third. Contributions are the same for all members of a pension scheme; there is no differentiation according to sex or age.

The AOW and occupational pensions have been closely integrated since the introduction of the AOW in 1957. Occupational pensions explicitly take the AOW into account by exempting the income covered by the AOW from occupational pension accrual. Occupational pension rights thus accrue only for income above the so-called 'AOW franchise' or AOW offset. The offset represents the gross AOW benefit, and this amount is subtracted from a wage-earner's gross income in order to determine the pension-carrying income for occupational pension purposes. As later sections elaborate, the level of the AOW offset is an important determinant of occupational pension benefit levels, particularly for atypical workers. The level of the offset is determined in collective agreements. The higher the offset, the lower the pension-carrying income, and vice versa. Until the 1990s, the AOW offset was usually based on the (higher) benefit for a couple, resulting in coverage gaps for singles, dual earners, and many atypical workers with low earnings. As later sections show, successive governments and the social partners have cooperated in efforts to get pension schemes to use a lower offset based on the individual AOW benefit in order to remedy these problems.

Table 8.1 Pension benefits as per cent of GDP

	2001	2020	2040	2060
AOW	4.7	6.8	9.0	8.3
Supplementary pensions	4.1	7.3	12.9	13.4

Source: Westerhout et al. (2004), p. 31.

In the 1980s, vesting periods and other exclusionary rules were common. For example, the typical minimum age of participation was 25, and part-time workers and married women were often excluded from participation, or they participated under unfavourable terms. Occupational pension eligibility rules were modernized in the 1990s. Today, the minimum age for participation is 21, the vesting period is two months, and occupational pension funds are legally required to include part-time workers and workers with fixed term contracts. Unemployment spells, disability, and parental leave earn pension entitlement in most occupational pension schemes but the rules vary across the 578 pension schemes (Anderson, 2011).[4] Occupational pension portability has been legally guaranteed since 1987.

Occupational pensions are fully funded, and in early 2008 (before the 2008–09 financial crisis) they had a combined average coverage ratio of 132 per cent. This means that nearly €500 billion in pension liabilities were backed up by €657 billion in assets. About one third of pension fund assets are held in company pension funds and two thirds in sectoral pension funds. The professional pension funds are small in comparison, with about 3 per cent of total assets in the second pillar, or about €18 billion (all data from DNB, 2010).

In 2005, the AOW made up slightly more than one half of retirement income for individuals, with supplementary pensions accounting for about 40 per cent and the AOW for about 51 per cent (CBS, 2010). The aggregate size of the first and second pillars is approximately equal in terms of the value of benefit pay-outs but as the accumulated pension rights in the second pillar grow, this proportion will change in its favour (see Table 8.1).

To summarize, the AOW and earnings-related occupational pensions provided generous retirement provision for standard workers in the 1980s. This is largely because of the generosity of the AOW and the quasi-mandatory coverage of occupational pensions. To the extent that workers were in full-time, standard employment, they drew breadwinner-based benefits sufficient to provide adequate income replacement. Those with incomplete earnings profiles or low income could rely on the AOW for minimum provision.

By the 1980s, the breadwinner and standard employment orientation of the AOW and occupational pensions were out of sync with demographic trends. Women entered the labour market in large numbers in the 1970s, so many aspects of public and occupational pension provision were out of line with empirical reality. In particular, part-time employment and flexible work were often excluded from occupational pension coverage.

8.3 The labour market: from the Dutch disease to flexicurity

The Dutch labour market has changed dramatically in the last three decades. First, women have entered the labour market in large numbers. Second, atypical – especially part-time – work has increased substantially. Third, governments across the political spectrum have introduced far-reaching reforms in order to replace ‘passive’ policies like early retirement and extended unemployment benefit with ‘active’ measures such as retraining and job placement programmes. This section analyses these changes, beginning with the last point.

During the past two decades, the Netherlands has recovered from ‘the Dutch disease’ by increasing employment and implementing major reforms of the welfare state. The Dutch story has been told well by others (Visser and Hemerijck, 1997; Hemerijck and van Kersbergen, 1997; Cox, 2001) so this section will emphasize the aspects of welfare state reform that are relevant to flexible labour markets and retirement security. The ‘Dutch miracle’ is often attributed to the revival of social partnership beginning with the 1982 Wassenaar accord. At Wassenaar, the social partners agreed to pursue wage restraint and the reallocation of work – including reduced working time, expanded part-time employment, and measures to fight youth unemployment – in order to restore economic growth. In the 1990s, governments started to implement far-reaching reforms of social protection in order to increase activation and cut costs. To put it another way, the Netherlands used to be everyone’s favourite example of a ‘passive’ welfare state in which labour shedding was often the preferred approach to adjusting to structural economic change. After two decades of reform, the Netherlands is now portrayed as a model of ‘active’ welfare policy.

As noted, the Netherlands was a strong case of the male breadwinner model until the 1980s. Thus, the post-War period of economic growth

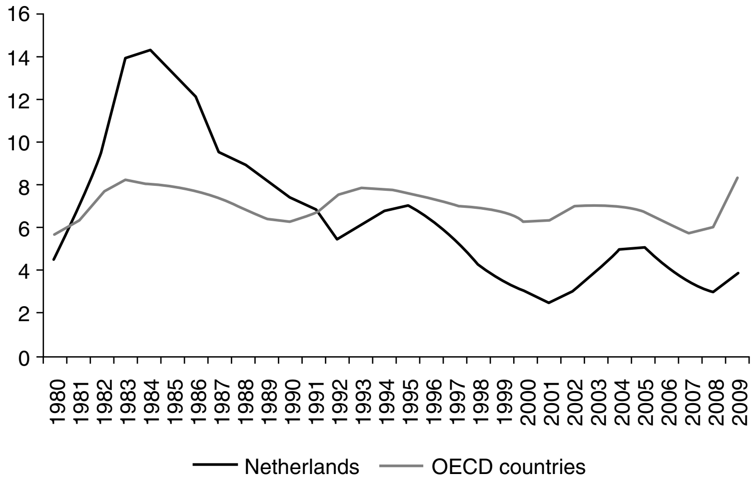

Figure 8.2 Unemployment in the Netherlands and the OECD, 1980–2009
Source: OECD (2010a).

and full employment was premised on labour market and social security institutions organized according to the breadwinner principle. Wages were high enough for the breadwinner to support a family, income replacement rates from social security and contractual agreements were similarly organized, derived rights for spouses and children were generous, and strong employment protection and industrial policy promoted lifelong employment for many, if not most, workers.

As in the rest of Western Europe, the economic stagnation and unemployment of the early 1970s shook the Dutch model of labour market and social security to its foundations. Unemployment rose from less than 5 per cent in 1980 to more than 14 per cent in 1984 (see Figure 8.2). Government budget deficits ballooned as social benefits were expanded to cover the growing ranks of the unemployed. By 1990, the central government budget deficit reached 5.7 per cent of GDP (OECD, 2010b).

In the 1970s, Dutch governments initially responded to the surge in unemployment by expanding early exit options (Trommel, 1995; Ebbinghaus, 2006). Believing the economic downturn to be temporary, the government and social partners introduced policies aimed at shedding older workers in order to create employment opportunities for younger workers. There were three main exit routes: unemployment insurance, contractual early retirement, and statutory disability insurance.

By the 1990s, the Netherlands was home to one of the highest rates of early exit in Europe. A series of tough reforms beginning in the mid-1980s has made early retirement much more difficult, largely by tightening or eliminating programmes, or by ending public financing or co-financing of them. Thus, the state and social partners now pursue some of the strictest policies in the EU-15. The disability and unemployment insurance exit routes have been mostly closed off and the collective schemes now offer early exit only to those willing to accept lower occupational pensions and/or those who save for early retirement.[5] In other words, the costs of early retirement have been individualized or shifted entirely to occupational schemes. These changes, coupled with favourable economic conditions, have resulted in a significant increase in the *de facto* retirement age. The labour market participation rate (excluding those on unemployment benefit) of workers aged 55–64 rose from 25.8 per cent in 1995 to 41.7 per cent in 2006 (the labour market participation rate of those aged 15–64 only increased from 57.8 per cent in 1995 to 64.5 per cent in 2006) (OECD, 2008).

The reform of unemployment protection since the 1980s has focused on cutting costs and getting the jobless back into employment as quickly as possible. Until 1987, a three tier system (for details, see Hoogenboom, 2011) provided income protection to the unemployed. Unions and employers administered generous earnings-related schemes for certain categories of standard workers while local governments ran less generous schemes for workers whose benefits had expired and workers who did not qualify for the scheme run by the social partners. A major reform, adopted in 1987, cut benefits but extended coverage to previously excluded workers, including atypical workers. The subsequent 2002 reform ended corporatist administration of both unemployment and disability insurance, after devastating criticism of the social partners' exploitation of these schemes for labour shedding. Reforms implemented in the late 1990s and 2000s dramatically increased work incentives by strengthening the obligation of benefit recipients to seek work or to participate in training. Reforms also reorganized the content and delivery of active labour market policies (ALMPs), substantially increasing their importance. Today, the Dutch unemployment protection system covers nearly the entire labour force – including most atypical workers (except the self-employed) – but this has come at the price of reduced benefit generosity and much tougher work incentives for all categories of workers (Van der Veen and Trommel, 1999; Van Oorschot, 2004; Cox, 2001).

Dutch spending on active labour market policies is well above the OECD average, but has fallen since 2002. In 2001, Dutch expenditures were 1.5 per cent of GDP, compared to the OECD average of 0.7 per cent of GDP. In 2008, Dutch spending had declined to 1.0 per cent of GDP, and OECD average spending to 0.6 per cent of GDP. The decline in Dutch expenditure no doubt reflects the very low levels of unemployment achieved in the Netherlands since then.

8.3.1 Flexicurity in the Dutch Context

The shift from passive to active labour market policies has not been accompanied by far-reaching deregulation. Unlike Denmark and Switzerland, for example, the Dutch labour market is highly regulated. Centralized incomes policies were the norm in the 1950s and 1960s, and employment protection legislation is still fairly stringent. Today, collective bargaining is much more decentralized than in the immediate post-War decades. The Dutch labour market has more in common with Germany than it does with Denmark or Switzerland. It was, and still is, difficult for employers to lay off employees, and further reform of the laws of dismissal is politically explosive. According to the OECD measurement, Dutch employment protection has been reduced somewhat since 1998, but it is not far from German levels. On the OECD Employment Protection Legislation scale, the Netherlands scored about 2.7 before dropping to slightly lower than 2.

As I elaborate below, the Dutch approach to flexicurity revolves around clarifying the legal status of fixed-term contracts, expanding part-time employment, and improving the legal status of agency and on-call work. As these forms of employment have increased, they have been incorporated into the Dutch system of social protection, so that most non-standard employment is covered by statutory and collectively bargained social security schemes. In other words, employers now have more means at their disposal to respond to fluctuations in production, but the majority of employees still works full-time (63 per cent – according to Dutch definition, see below) and an even higher proportion (91 per cent) has a permanent employment contract (Vrooman et al., 2007, p. 133). In sum, Dutch policy makers have not deregulated the labour market; instead, they have introduced new forms of regulation to cover employment relationships that do not fall under the category of the standard, full-time, permanent labour contract (Van Oorschot, 2004). The Dutch approach to these new forms of regulation relies both on

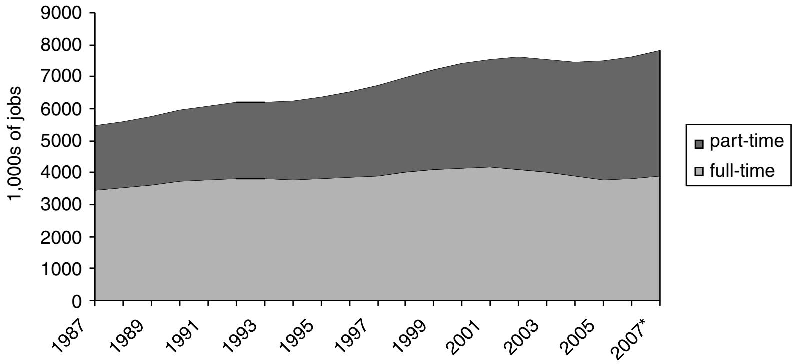

Figure 8.3 Part-time and full-time work, 1987–2007 (Dutch definition)
Source: CBS (2010)

legislation and collective bargaining: statutory provisions regulate the status of non-standard employment at the same time as the social partners negotiate the details of expanding occupational social security to non-standard workers.

8.3.2 The increase in non-standard work

The incidence of non-standard employment has increased significantly since the 1970s. This section focuses on the two most important types of non-standard work in the Dutch context: part-time work and what the Dutch call 'flexible work'.[6] I begin with several definitions specific to the Netherlands. First, the Dutch definition of full-time employment is any job that involves at least 35 hours of work per week. Part-time work is widespread, so it is common to distinguish between 'big' part-time jobs (24–34 hours per week) and 'little' part-time jobs (12–23 hours per week). Persons working less than 12 hours per week are not usually considered to be employed.[7] These definitions deviate from the ones used by the OECD, where any job involving less than 30 hours of work per week is considered part-time, and anyone working one hour or more per week is considered to be employed. The discussion in this chapter relies on the Dutch definition of part-time work, with references to the OECD definition where relevant.

Government policy has encouraged the expansion of part-time work since the 1970s, and the Netherlands now has the highest rate of part-time employment in the OECD (Visser, 2002). Between 1981 and 1995 the labour supply in the Netherlands increased from 5.1 million to 6.6 million people. Most of this is traceable to the dramatic increase in

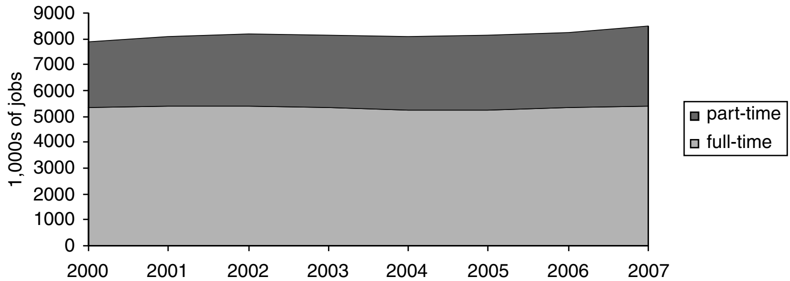

Figure 8.4 Part-time and full-time work, 2000–2007 (OECD definition)
Source: OECD (2010b).

(part-time) female labour market participation, which rose from 33 per cent in 1981 to 49 per cent in 1995 (SER, 1997, p. 134). Among married women with children under five, the increase was more dramatic: from 14 per cent in 1981 to 45 per cent in 1995 (SER, 1997, p. 135). The growth of part-time employment in the 1970s and 1980s paved the way for the entry of mothers into the labour market, and the Netherlands remains the only OECD country in which more women work part-time than full-time (Visser, 2002). In 2007, 68 per cent of women worked part-time.

Despite the dramatic rise in female labour market participation, the Centre-Left government (Christian Democrats, Labour and Christian Union) in office in 2007–,10, was not able to achieve its own goal of 61 per cent female labour market participation. In 2006, only 56 per cent of women were in employment (Vrooman et al., 2007, 135). One surprising aspect of this pattern is the high employment of mothers, which has increased from 46 per cent in 1991 to 72 per cent in 2006 (Portegijs and Keuzenkamp, 2008, p. 17). The lowest employment levels of women are found among those over 40. Figures 8.3 and 8.4 below illustrate the dramatic increase of part-time employment in the Netherlands according to both the official Dutch and OECD definitions.

'Flexible' employment is an important and growing category of non-standard employment. The Central Bureau of Statistics defines flexible employment as jobs involving employment contracts of less than one year or employment in which there is variation between an agreed level of minimum and maximum number of hours per week. 'Regular' workers with fixed hours and non-permanent contracts lasting longer than one year usually enjoy the same or similar working conditions as

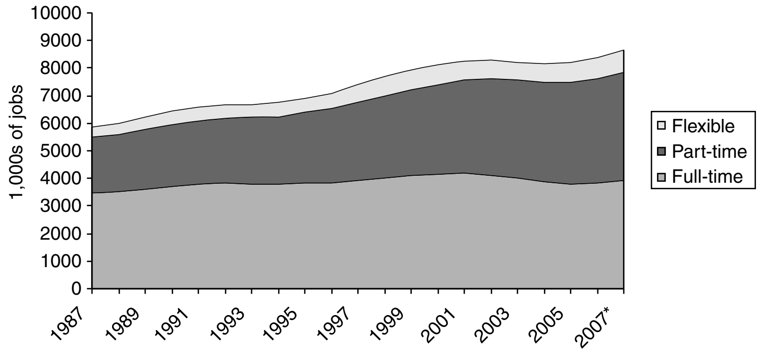

Figure 8.5 Flexible and regular employment, 1987–2007
Source: CBS (2010)

permanent staff. Nevertheless, flexible work has also increased significantly since the 1980s, albeit not nearly as much as part-time employment. Women, younger workers, and ethnic minorities are much more likely to be employed in flexible jobs than men. In 2006, about 200 thousand workers were employed in temporary agencies.

As Figure 8.5 below shows, flexible jobs and part-time jobs have increased since 1995 while the number of permanent, full-time jobs has remained constant since 1969.

To summarize, the dramatic growth of part-time employment has taken place within the confines of the normal employment relationship. The overwhelming majority of part-time workers have permanent contracts and enjoy the same working conditions as full-time workers (see below). In other words, part-time work is now 'normal' employment in the Netherlands, even if it is atypical or non-standard by international comparisons. Other types of work are considered atypical or non-standard, chiefly temporary and on-call employment. This segment of the labour market is not large by international standards but the social protection of these groups has been the source of some concern, largely because employers' calls for more labour market flexibility would mean increasing their ranks.

8.3.3 Labour market reforms

This section discusses the main reforms of the labour market during the 1990s and 2000s. Two reforms have improved the status of part-time work. First, the 1996 Equal Treatment Working Hours Act (*Wet Verbod op Onderscheid naar Arbeidsduur*) guarantees the equal treatment of full-time and part-time work in terms of wages, working conditions and fringe benefits such as occupational pensions. This law has contributed to the improvement of occupational pension coverage for part-time workers, as I discuss below. Secondly, the 2000 Law on the Adjustment of Working Time (*Wet Aanpassing Arbeidsduur*, WAA) gives employees the right to request part-time work (if currently working full-time) and vice versa. The employer may refuse if there are legally acceptable reasons.

For flexible work, the most important reform is the Flexibility and Security Act from 1998.[8] As noted, until the 1990s, the Dutch labour market was marked by strong employment protection. This resulted in strong protection for labour market insiders with permanent jobs and widespread insecurity for labour market outsiders. Employers had been pleading for more labour market flexibility for years, complaining that they could not respond adequately to market fluctuations. In 1995, the Cabinet responded to these concerns with its Green Paper, 'Flexibilization and Security' (*Flexibilisering en zekerheid)*. This Green Paper was the basis for an agreement with the social partners negotiated in the Labour Council (bipartite organization) that the Cabinet later proposed as legislation in March 1997. The central goal of the legislation was to make permanent employment more flexible and to improve the social security provisions of non-standard workers. The law makes it easier for employers to dismiss fixed-term workers by shortening the length of the dismissal procedure and clarifies the conditions under which workers on temporary contracts can get permanent contracts. Under the new law, after three consecutive fixed-term employment contracts, or if consecutive contracts add up to three years, the contract automatically becomes permanent. The old rule was that fixed-term contracts automatically became permanent at renewal. In addition, the 1998 Act on Temporary Employment Agencies (*Wet Allocatie Arbeidskrachten door Intermediairs,* WAADI) liberalized the market conditions for private employment agencies. The new rules make it easier to start a temporary employment agency.

Salverda (1999) argues that Dutch cabinets have been the agenda setters in expanding the social protection of both part-time and flexible workers. The Centre-Left government addressed the social rights of part-time workers in a major policy paper in 1987, and as noted above, the Cabinet took the initiative concerning the rights of flex workers in 1995. Given the importance of tripartite consultation concerning socio-economic policy and the willingness of the social partners to incorporate new legal provisions in collective agreements, the government could hardly have ignored the social partners. However, it was the Cabinet that played the lead role in these reform processes, with the social partners largely reacting to government initiatives.

8.4 Pension reforms

8.4.1 The basic pension

The AOW is a central element in the pension provision of non-standard workers because entitlement is based on residence and not on employment. The AOW has been fairly resistant to reform, largely because of its widespread popularity and its success in alleviating old age poverty. Two aspects of AOW have been the focus of reform, however, and both of these issues have important implications for the retirement security of non-standard workers. First, legislation adopted in 1984 individualized the AOW. Secondly, the rapid increase in AOW expenditures inevitably led to continued attempts to rein in costs. A series of incremental reforms has reduced the generosity of the AOW relative to real wages. This is especially problematic for atypical workers because the AOW plays a major role in their retirement provision.

Legislation adopted in 1984 individualized AOW entitlement and financing to conform to EC law. The breadwinner benefit was divided in half so that each spouse received 50 per cent of the net minimum wage. The benefit for single pensioners remained 70 per cent of the net minimum wage. Pensioners with a spouse younger than 65 received a supplement (Anderson, 2007, pp. 735–6), which, however, will be phased out in 2015.

AOW individualization only affected the retirement provision of non-standard workers indirectly. All residents of the Netherlands received AOW benefits: a breadwinner drew a couple benefit and singles received an individual benefit. It did not matter whether the breadwinner or an individual beneficiary was an atypical worker or not, it only mattered what his or her family status was. The breadwinner basis of the AOW thus had no direct financial impact on atypical workers, but the tight coupling of the AOW and occupational pensions led indirectly to widespread gaps in occupational pension coverage for singles and dual earners because of the role of the AOW offset. The next section discusses this issue at length.

Despite its mainly poverty alleviating function, the AOW is relatively costly, and expenditures have increased steadily since 1957. The contribution rate has increased from 6.75 per cent of income (up to a ceiling) in 1957 to 17.9 per cent in 2010. The rising cost of the AOW has been a recurring item on the political agenda for at least three decades.

In the 1980s, growing AOW costs prompted *ad hoc* cost-cutting measures even if politicians could not agree on more comprehensive reform. As budget deficits grew, governments began to suspend the indexation of the AOW benefits to contract wage increases. What began in 1980 as an *ad hoc* measure to control costs gradually turned into a more or less permanent feature of the annual budget negotiations. In 1989 the Centre-Left government made AOW indexation conditional on moderate wage increases and increased labour market participation. This informal rule was later transformed into legislation with the Law on Conditional Indexation in 1992 (Wet Koppeling met Afwijkingsmogelijkheid WKA). The WKA stipulates that if there are more than 82 inactive (not in employment) for every 100 active employed, there will be no indexation. Indexing was suspended in 1993, 1994, and 1995 (Alber, 1998, p. 28; Visser and Hemerijck, 1997).

The 'Purple Coalition' (Labour, Social Liberals and Liberals), in power 1994–2002, failed to introduce fundamental cost-saving measures in the AOW, largely because of the electoral risks associated with such a strategy. Instead, the government settled for improving the financing of the AOW by introducing a special AOW Savings Fund. The Reserve Fund would be invested in government bonds and would start to help finance AOW pensions in 2020. By 2010 there was €45 billion in the AOW Spaarfonds.

The 2008–09 economic crisis provided an opportunity to break the AOW reform stalemate. As part of its crisis package announced in March 2009, the Centre-Left government proposed an increase in the state pension retirement age from 65 to 67, starting in 2020.[9] Unions opposed the move, but were unable to stop the reform. The minority coalition government, in office since October 2010 (Christian Democrats and Liberals, supported in Parliament by the anti-immigrant Freedom Party), partially retreated from this proposal, announcing a one-year increase in the retirement age, from 65 to 66, in 2020. The increase in the retirement age is designed to reduce the long-term growth in AOW spending as the old age dependency ratio increases.

To summarize, Dutch policymakers have struggled for three decades to improve the financial sustainability of the basic pension, without much success. Reform of the AOW has been a controversial issue in nearly every election campaign since the early 1980s and the only substantial change that governments could muster support for was the introduction of the AOW Savings Fund. As the number of AOW beneficiaries increases, however, the cost of the AOW will start to strain public finances. Unless policy makers find a way out of this financing dilemma, a return to the benefit freezes of the 1980s and 1990s seems inevitable. Given the importance of the AOW for non-standard workers, this would mean an erosion of the poverty alleviation function of the AOW.

8.4.2 Occupational pensions

Occupational pension reform since the 1980s has focused on two things: adjusting eligibility and benefit rules to accommodate diverse employment profiles, and modernizing the financial supervisory framework. Reforms addressed pension portability, eligibility, and benefit formulae. In addition, policy makers adopted a comprehensive reform of the regulatory framework for occupational pensions that had important implications for the pension security of all categories of workers.

As noted, occupational pensions are negotiated as part of collective agreements, so legislation only provides the legal framework governing access to schemes, benefit accrual, and rules concerning the investment of assets. The government and social partners agree that occupational pensions are the province of the social partners, so governments generally avoid intervention. If the government wants to influence occupational pension policy, the typical route is to avoid legislation and to try to negotiate directly with the social partners in order to get them to move policy in a particular direction. These bargains often take the form of covenants backed up by the threat of legislation. For more far-reaching changes of the regulatory framework, legislative adjustments are required.

Pension portability reached the political agenda in the mid-1980s, after a decade of increasing labour market mobility. In 1987, the bipartite Labour Foundation (*Stichting van de Arbeid*, STAR) urged the cabinet to introduce legislation to guarantee portability by allowing wage earners who changed jobs to transfer pension assets to the pension scheme of their new employer. Regulations forbid the cashing in of pension assets, and when workers changed jobs they usually could not take their pensions with them. In 1994, Parliament passed legislation amending the regulatory framework to guarantee the portability of pension rights as well as the mandatory inclusion of part-time workers (Anderson, 2007). Prior to this, pension schemes were not required to include part-time workers.

Despite these improvements, policy makers agreed that the occupational pension system required more far-reaching modernization. The government and social partners were particularly concerned about controlling pension contributions because of their share in total non-wage labour costs, maintaining the value of the AOW (so as not to increase the pressure on occupational pensions), increasing access to supplementary pensions, and modernizing benefit rules in order to increase flexibility and individual choice (Stichting van de Arbeid, 1997). In 1997, the Social and Economic Council (Sociaal-Economische Raad, SER) was the platform for the negotiation of a 'Pension Covenant' between the social partners and the government. In particular, the social partners agreed to reduce reliance on final pay benefit schemes (because of their high cost) and to expand coverage of part-time and flexible workers.

One of the core elements of pension modernization concerned the integration of the AOW and occupational pensions. The rules governing the coupling of AOW and occupational pensions are especially important for the size of the combined first and second pillar benefit at retirement. Most pension schemes have modernized the rules concerning the level of the AOW offset as a result of legislation protecting non-standard workers (fixed-term and part-time workers) and the Pension Covenant. As noted, the 'franchise', or AOW offset, is a crucial variable influencing pension entitlement for non-standard workers. Pension schemes have switched from a breadwinner-based offset to ones based on a single pensioner in order to improve coverage for dual-earner couples. Moreover, current law requires pension schemes to pro-rate pension accrual so that part-time pension entitlement is calculated not on the actual wage but on the equivalent full-time wage. The example depicted in Table 8.2 shows the dramatic improvement in occupational pension entitlement for a person working half time, earning a salary of €15,000, and par-

Table 8.2 The role of the AOW offset

New rules concerning AOW offset	**Old rules concerning AOW offset**
AOW offset = €10,000 Pension accrual 2% per year Benefit = 70% of average wages Annual salary= €15,000 for half-time job (equivalent full-time salary is €30,000 per year)	AOW offset = €10,000 Pension accrual 2% per year Benefit = 70% of average wages Annual salary= €15,000 for half-time job (equivalent full-time salary is €30,000 per year)
Calculation of annual pension accrual: €30,000–10,000 offset = €20,000 pension-carrying income for the equivalent full-time job €20,000 x 50% = €10,000 (pension accrual for that year) €10,000 x 2% = €200 (pension accrual for that year)	**Calculation of annual pension accrual**: €15,000 annual income – €10,000 offset = €5,000 pension-carrying income €5,000 x 2% = €100 (pension accrual for that year)

ticipating in a pension scheme with a 2 per cent annual accrual rate. Assuming an AOW offset of €10,000 with no pro-rating, the pension-carrying income would equal €5000. With pro-rating, the pension-carrying income would be twice as high: €10,000. Given that the vast majority of part-time employees are women, these rule changes also meant a significant improvement in pension outcomes for women.

The Pension Covenant between the government and social partners was largely successful, except for one thing: the social partners did not want to switch from final salary to average salary schemes (Stichting van de Arbeid, 2001). The 2001–02 stock market downturn changed all of this because pension funds lost so much money that there was a massive shift from final salary defined benefit schemes to average salary defined benefit schemes, as well as significant increases in pension contributions. The stock market downturn prompted substantial cuts in occupational pension benefits, sharp premium increases, and led to a tense renegotiation about the regulations governing the coverage rate of occupational pensions. Since the early 1990s, most Dutch pension funds had been investing significantly in equities (30–40 per cent of assets), so when stock prices fell, the pension funds sustained heavy losses. The reserves of many pension funds fell below the required 105 per cent coverage rate (the ratio of assets to liabilities) for the first time in 2002 (for details, see Anderson, 2011).

8.4.3 Revision of the regulatory framework

The Pension Covenant and the legislation concerning the equal treatment of part-time work resulted in significant improvements to the occupational pension coverage of atypical workers but two important issues remained unresolved. The first issue concerned access to occupational schemes in terms of age and vesting periods. The second issue focused on the financial supervision of pension funds. Whereas the first issue is crucial for atypical workers, the second issue is important for all categories of workers. Occupational pensions are capital-funded, so pension fund solvency determines whether pension accrual and payments are fully indexed to inflation or wages.

Even before the 2001–02 stock market downturn, revision of the regulatory framework (*Pensioen- en spaarfondsenwet*, PSW) had been on the political agenda for several years. Policy makers focused on two issues: updating rules for calculating the coverage ratio and clarifying the 'ownership' of both pension fund deficits and surpluses. The new legislation (The Pension Law, *Pensioenwet*) took effect in 2007 and had three goals: to increase transparency; clarify the roles of the social partners, pension fund/insurance companies, and pensioners; and to modernize the rules governing pension fund solvency. Pension funds are required to inform participants about their pension accrual, and issues like what to do in cases of under- or overfunding have been clarified. The law also updates the financial aspects of pension fund governance (valuation of assets and liabilities) to account for changes in financial markets and accounting practices. In general, the new law means that pension funds should aim for a funding level of 125 per cent (the ratio of assets to nominal liabilities).

The new Pension Law, like the old regulatory framework it replaced, does not require the indexation of pension accrual or pension payouts. The indexation of pension accrual is crucial in average pay schemes, because pension funds need some mechanism for ensuring that pension rights maintain their real value as they accumulate. The minimum coverage ratio requirement of 105 per cent is based on nominal liabilities, that is, unindexed pension liabilities. Most pension schemes provide indexation conditional on solvency, which means that pension funds need a much higher funding ratio (assets equal to about 140 per cent of nominal liabilities) if they are to achieve this ambition. Before the financial crisis, most pension funds enjoyed healthy coverage ratios, so the indexation of pension rights did not seem to be in danger.

The 2008–09 financial crisis provided the first real test of the new supervisory framework. By the end of October 2008, the average coverage ratio for pension funds had fallen to 109 per cent, prompting most pension funds to suspend or reduce the indexation of pension rights and pension payouts. By early 2009, pension funds had sustained such large losses that many announced contribution increases. 350 of the 650 pension funds had coverage ratios below the legally required 105 per cent level. According to the Central Bank's statistics, pension funds' assets totalled €697 billion at the end of 2008, a fall of €66 billion compared to the previous year. Given these difficulties, the social partners pressed the government to extend the deadline for restoring solvency (105 per cent coverage of liabilities) from three to five years.

Historically low interest rates and increases in longevity were another blow to the financial health of occupational pension schemes. Low interest rates increase the present value of future pension promises, so pension funds had to reserve more assets to cover liabilities. Increased life expectancy also increased the 'price' of pension promises. By 2010, the occupational pension sector was in crisis, buffeted by financial market turbulence, low interest rates, and rising longevity. Many current retirees receiving occupational pensions will see their pension payouts frozen or nearly frozen for several years, and many current workers will see their pension accrual frozen. Several pension funds have even reduced benefits.

8.5 After reform: current situation and future prospects

The great advantage of the Dutch multi-pillar approach is its widespread occupational coverage and strong protection against poverty in old age. Because flat-rate statutory pension benefits are earned by residence, people with incomplete earnings profiles (and those who have never worked in paid employment) also qualify for generous minimum income protection. Two groups are exceptions to this, however: immigrants and Dutch wage earners who work for long periods of time outside the Netherlands. Means-tested social assistance for the elderly is available for those with insufficient AOW rights, and mobile workers can insure themselves with the Social Insurance Bank for the period of time spent outside the Netherlands. According to the most recent estimates, about 9 per cent of AOW beneficiaries receive a reduced benefit. This is twice the 1995 level (4 per cent) (Vrooman et al., 2007, p. 140). However, according to one estimate, only about 70 per cent of those eligible for supplementary social assistance benefits apply for them (Wildeboer Schut and Hoff, 2007, pp. 90–1, cited in Vrooman et al., 2007).

The first comprehensive research into the pension coverage of atypical workers was conducted in 1996 and found that 9 per cent of workers over age 25 did not participate in occupational pension schemes. Employers not offering pension schemes accounted for 2 percentage points and workers not participating accounted for 7 percentage points. Women comprised two thirds of this group. Half of the workers not participating had a flexible contract, 43 per cent had less than two years of service, and 38 per cent were between 25 and 29 years old. Employers not offering pension schemes were primarily in the banking and insurance sector and in other services (Van der Witte and Smidt, 1997). Research in 2001 revealed that the number of workers covered by a pension scheme had increased from 73 per cent to 84 per cent (all ages) but that gaps in coverage were most likely to occur in small employers, recently established employers, and employers in the recreational and cultural sectors (SER, 2002). By 2005, the number of employees covered by occupational pension schemes had climbed to 89.5 per cent.

The passage of the new Pension Law in 2006 also improved coverage: the waiting period was reduced to two months; and the minimum age was reduced to 21 years. In addition, collective agreements in sectors with many new employers include provisions for the establishment of pension schemes (Tweede Kamer, 2007). For example, a binding collective agreement – including an occupational pension scheme – now covers temp agencies.

Although dependent atypical workers enjoy improved occupational pension coverage, the self-employed without personnel (*Zelfstandigen zonder personeel*, ZZPers) do not. This group includes freelancers in various sectors (like the care sector) and self-employed members of the building trades. Unlike dependent workers, most self-employed are not covered by collective occupational pension schemes.[10] Coverage is expensive, and the self-employed often forego coverage or only buy partial coverage on the private pension insurance market.

The number of self-employed without personnel has increased substantially during the past decade, from 400 thousand in 1996 to 956 thousand in 2009. During the same period, the number of workers in dependent employment remained stable. Unlike other atypical workers, the majority of ZZPers are men, and two thirds work full-time (SER, 2010, p. 18). Not much is known about the social protection of this growing group,[11] so estimates of their pension coverage vary from 20 per cent to 50 per cent (SER, 2010, p. 79). One of the biggest obstacles to second pillar pension coverage for this group concerns the high cost of individual pension insurance. ZZPers do not benefit from the economies of scale and average premiums that collective second pillar schemes are based on.

Despite the significant expansion of occupational pension coverage to non-standard workers, there is considerable inequality in overall pension outcomes between standard and non-standard workers. The most common form of non-standard work, part-time work, is highly gendered, so women's occupational pensions are considerably lower than men's in absolute terms. Part-time employment means lower income, and in 2006 only 43 per cent of women were economically independent (Merens and Hermans, 2009). In all age groups, men's absolute occupational pension accrual is higher than women's, and the difference increases substantially with age. In the age group 35–45, men have twice the pension accrual of women; in the age group 45–50 men have three times the pension accrual of women; and in the age group 50–55 men have four times the pension accrual of women. For those 60–65, men have six times the pension accrual as women. If we look at the combined first and second pillar replacement rates, however, women have higher pension accruals than men in all age groups (age 25–65), because occupational pension accrual is pro-rated, and the AOW covers a higher proportion of income than it does for most full-time workers (Eenkhoorn, Hakkenes-Tuinman and Van de Grift, 2009).

There is no indication that Dutch women are likely to substantially increase their labour market participation anytime soon. As noted, mothers have a very high labour market participation rate, but in surveys only 25 per cent state a preference for full-time employment. In contrast to most other European countries, a mother's employment is not affected by the age of children. Mothers of small children are employed at about the same rate as mothers with children in other age groups (Dijkgraaf and Portegijs, 2008, p. 17). Cultural attitudes reinforce the part-time employment patterns of Dutch women. In a 2006 survey, a majority of Dutch respondents said that children should not be in childcare full time. Moreover, a majority of men and women think that mothers should not work full-time (Portegijs, 2008). What is more, once women shift from full-time to part-time work after the birth of children, they tend not to go back to work full time, even after children are school-age or out of the house.

In sum, standard and non-standard workers – with the exception of the self-employed without personnel – enjoy more or less the same levels of pension security. The AOW pension is neutral with regard to employment history, and occupational pensions do a good job of replacing previous employment income. However, substantial differences in occupational pension income between standard and non-standard workers are likely to remain as long as part-time employment is so widespread. To the extent that the choice for full-time or part-time work is voluntary, women's lower occupational pension levels are the result of micro-level choices and not the design of pension schemes.

8.6 Conclusions

This chapter has emphasized the comparatively good performance of the Dutch multi-pillar pension system in providing income security for non-standard workers. Old-age poverty is very low, and most categories of non-standard workers enjoy full access to occupational pension schemes. Part-time and fixed-term workers accrue occupational pension rights on the same terms as full-time and permanent employees. Agency work and on-call work, however, often lead to occupational pension gaps, although the legal status of these groups has improved significantly in the past two decades. Thus the Netherlands would seem to be a clear success story in combining labour market flexibility and retirement security. Two developments, however, threaten this optimistic picture. First, the occupational pension system is currently experiencing its worst crisis ever, which is not surprising given that these are funded schemes that invested significantly in equities. It will take several years, or perhaps a decade, for many pension funds to fully recover from their losses, and this will have major repercussions on future collective bargaining rounds and retirement incomes for both standard and non-standard workers.

Secondly, the fate of the state pension is uncertain. As this chapter emphasizes, the AOW is highly effective in preventing old age poverty, but it is expensive, and Dutch policy makers have yet to find a politically feasible answer to the question of how to finance the AOW as the old age dependency ratio increases. In June 2010, the social partners negotiated a 'pension pact' that included raising the AOW retirement age to 67 by 2025 and indexing benefits to actual wages, which are higher than contract wages. Retirement starting at 65 would be possible with a 6.5 per cent deduction per year. The current government is reluctant to translate the deal into legislation because of the higher costs involved. Given the deterioration of AOW benefits relative to real wages since the early 1980s, maintaining the value of the AOW is especially important for the retirement incomes of non-standard workers.

This chapter has argued that corporatist bargaining processes are the key to understanding the qualified success of combining labour market flexibility with income security in old age in the Netherlands. Governments have usually led reform processes, often in response to trends like part-time employment and flexible work that were already underway. However, there are two remaining obstacles to achieving genuinely adequate income security for atypical workers. First, the largest group of atypical workers, women working part-time, shows little enthusiasm for increasing their working time. This means that despite public policy efforts, women's retirement income will remain lower than men's. Second, despite the Dutch employment miracle and the high expenditure on ALMPs, too little has been done to improve the labour market status of weak groups, like low-skilled workers, immigrants and the long-term unemployed. These groups remain difficult to employ, and as such they face even worse retirement security than the atypical workers who are gainfully employed.

Notes

1. Breadwinner wages certainly increased the costs of employing (male) breadwinners, but this issue never became the object of political conflict, because of full employment for breadwinners.
2. Pensioners with a child under 18 receive a supplement, as do pensioners with a spouse younger than 65 with little or no income. The partner supplement will be phased out in 2015.
3. Vacation supplements are standard elements of collective agreements, so they are a natural component of income-related social security provisions like pensions. The vacation supplement typically equals to 8 per cent of the annual wage (roughly one month's pay) and is usually paid in the month of May. The vacation supplement built into the AOW follows these principles and equalled €58.62 per month, gross.
4. Between 1975 and 2010, unemployed workers could apply to a foundation called the FVP (*Fonds Voorheffing Pensioenverzekering*) for the payment of occupational pension contributions. FVP was established in the early 1970s by the social partners; in 1999 the fund was privatized. The acronym remained the same (FVP), but the actual name changed to the Foundation for the Continued Financing of Pension Insurance. In January 2011, the FVP Foundation stopped financing pension accrual during unemployment.
5. The 'life course savings scheme' (*levensloopregeling*) introduced in 2005 allows workers to save part of their gross salary every year, to a maximum of two years of accumulated leave (see van Huizen and Plantenga, 2010).
6. There is little debate about other forms of atypical work (the false self-employed and project contract workers) that are important in the other countries analysed in this volume.
7. This definition is used by the Central Bureau of Statistics (CBS) and the Netherlands Bureau of Economic Analysis (CPB).
8. See Wilthagen et al. (2004) for a good discussion.
9. The proposal stipulates that workers with physically demanding jobs should be subject to less stringent rules.
10. Some categories of the self-employed, like painters and glass-setters, may participate in the collective agreement for firms in that sector.
11. ZZPers are not eligible for statutory unemployment insurance and disability insurance.

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Part III

Conclusion

9

Flexible Today, Secure Tomorrow?

Matteo Jessoula and Karl Hinrichs

A quarter of a century ago, in his analysis of the 'growth to limits' of Western welfare states, Peter Flora (1986) identified three major challenges to existing social protection systems: (a) population ageing and the need to redraw the social contract across generations; (b) changes in the gender division of work that required a new contract between the genders; and (c) a shift in values that called for a new relationship between the State and citizens, with a stronger role for other institutions, primarily the market. These challenges were the consequence of several (more or less) slow-moving macro-transformations – such as slower economic growth, the emergence of a post-industrial economy, demographic shifts, female mobilization and increased education – as well as decisions by policy makers that led to an extraordinary expansion of the public sector and, finally, increased economic internationalization. All this required 'long and complex processes of institutional adaptation' (Flora, 1986, XXVI) in order to prevent *system* and *social disintegration*. In other words, in order to preserve the capacity of welfare states to ensure socio-economic security as well as equality, the *institutional maladjustment* of social security schemes to changed circumstances was to be tackled by a comprehensive restructuring of welfare arrangements. In particular, Flora emphasized the 'explosive force' of the intergenerational issue – the sustainability and adequacy of pensions – due to the interaction between population ageing and the gender revolution.

Flora's diagnosis is still impressively up-to-date. On the one hand, the seven country chapters of this book have shown the relevance of the three challenges outlined above to current economic security in old age, and to future decades as well. On the other hand, the book has focused on a further challenge that the comparative literature has not adequately addressed: the interplay of labour market transformation – namely increased labour market flexibility and insecurity – and pension reform processes. This interaction is a further potential source of institutional maladjustment in welfare programmes, possibly leading to system *dis*-integration, that is, to a reduced capacity for pension arrangements to provide economic security in old age. If pension systems are not adapted to modified labour market conditions in time, they may be able to ensure neither adequate *income maintenance,* nor the *prevention of poverty*.

The evidence presented in this book points to a critical encounter between labour market transformation and old age protection systems in the countries selected for analysis. Nevertheless, there is considerable variation in these countries' capacity to achieve both goals for social security. This variation depends on the different labour market and pension arrangements that have shaped the peculiar *type* of problem regarding economic security in old age, as well as the *timing* of the emergence of this problem. Specifically, the risk of system *dis*-integration seems to be lower where atypical workers are more *integrated* into both the labour market and the old age protection system.

The actual importance of this analysis is also demonstrated by Eurobarometer surveys on the major issues of concern for Europeans. Data show that unemployment (36 per cent) and pensions (30 per cent) are the first and the third issues of concern in the EU-25[1] – much more than environmental challenges (13 per cent), immigration (14 per cent) or even terrorism (25 per cent). Figures are even more striking when addressing concerns for the next generations (unemployment 40 per cent, pensions 30 per cent), (European Commission – Eurobarometer 2007). The crucial point here is that, in accordance with the analytical framework presented in Chapter 1 (see Figure 1.7), the issues are closely linked: when analysing economic security in old age, labour market performances as well as institutional features are remarkably important. As we will illustrate below, the risk of system dis-integration is reduced in countries where, i) the pension system has been adjusted to transformations in the labour market or the pre-existing pension architecture has already been effective in protecting non-standard workers; ii) increased labour market flexibility has been counterbalanced by stronger *income security* at working age as well as *employment security* – the latter being crucial for boosting employment and containing unemployment especially for flexible workers.

In the next sections, we present the main findings of our research. We first illustrate how in the countries selected for analysis, the diverse combination of flexibility and job security, employment security and income security leads to different labour market models, characterized by varying relationships between standard and atypical employment. We then focus on the interplay of labour market and pension schemes, considering the differential capacity of pension systems to provide economic security in old age under changed labour market conditions. Variation in the *integrative* capacity of pension systems may either be the result of pre-existing institutional arrangements, or the consequence of reforms aimed to adapt to post-industrial labour markets in the last three decades.

9.1 Labour market flexibility and reforms: homogenous versus segmented systems

Since the early to mid-1990s, labour market flexibility has advanced and the relevance of SER has declined throughout Europe. A look at the overall EPL index shows that a process of convergence is under way, as employment dismissal rules have been relaxed in countries that previously had medium or high levels of employment protection. This is especially true for workers on temporary contracts in Denmark, Germany, Italy and the Netherlands. In contrast, there has been little change in more deregulated labour markets such as Switzerland, the UK and, to a certain extent, Poland where a limited reinforcement of employment protection has occurred. Similarly, atypical – that is, temporary and part-time – employment has been on the rise in almost all countries.

However, the seven country chapters show considerable cross-national variation in both the level and the type of labour market flexibility. Moreover, in order to capture the extent of labour market integration of atypical workers, it is not only necessary to look at institutional elements – regarding job, employment and income protection – but also to analyse labour market performances. The latter are important because under more flexible post-industrial conditions, labour market attachment is crucial for achieving economic security both during working years and, subsequently, after retirement. We found evidence of major cross-country differences along this dimension too. Three groups of countries can therefore be distinguished, each characterized by a different labour market and employment policy model. The three groups can be placed on a continuum which goes from *segmented* to more *homogenous* labour markets (see Figure 9.1).

Germany, Italy and Poland comprise the first group, characterized by *segmented* (Germany) or *highly segmented* (Italy and Poland) labour

Figure 9.1 Segmented versus homogenous labour market and employment policy models

Source: Authors' elaboration.

market arrangements. In these countries flexibility has been pursued 'at the margin' since the early-1990s by favouring the spread of atypical employment: part-time employment has increased by roughly 8 percentage points in Germany and Italy (1983–2009). The growth of fixed-term employment was about 7 percentage points in Italy in the same period and in Poland (in 2003–2009 only). By contrast, job security for insiders has remained relatively untouched. This is captured by the EPL index for regular workers. There has been no change in Italy (1.77) and Poland (2.06), and even higher figures (that is, more protection) in Germany (2.58 until 1992, 2.68 until 2003, 3.0 afterwards). 'Selective' flexibilization, however, has not been accompanied by more protection in terms of income and employment security, especially for the growing group of atypical workers. Pursuing flexibility at the margin has thus led to the emergence or enlargement of different groups of atypical workers in these countries: mostly on fixed-term contracts in Poland (26.5 per cent of dependent employment in 2009); while the share is lower (though on the rise) in Germany (14.5 per cent) and Italy (12.5 per cent). In the latter two countries, however, part-timers are more numerous: 21.9 per cent of total employment in Germany; 15.8 per cent in Italy. In Poland and Italy, economically dependent workers, or the 'false self-employed', also constitute a relevant group with distinctive problems in terms of security in old age (see below). Meanwhile, investment in ALMPS – a crucial element for the smooth functioning of flexible labour markets and the effective integration of workers with interrupted careers – has remained limited. Unemployment benefit systems (UB) have become less generous and even more 'exclusive' due to retrenchment interventions (e.g. the Hartz IV reform in Germany, see Hinrichs in this book) or the interplay of (old) eligibility rules and (novel) labour market conditions. Only 30 per cent of the unemployed receive unemployment insurance (UI) benefits in Germany – the rest receive social assistance. Figures are even lower in Poland (20 per cent), while in Italy, the lack of a social assistance safety net providing a minimum income guarantee for 'outsiders' reinforces the exclusive character of the unemployment compensation system, which delivers contributory benefits only to about 30 per cent of the unemployed (cf. Jessoula et al. 2010; Jessoula and Vesan 2011). This is critical because only recipients of UI benefits generally receive pension credits for spells of unemployment. Italy is thus a typical case where failed social protection integration at working age means a deterioration in old age protection. Finally, with respect to labour market trends and performances, the three countries show higher levels of unemployment than the other cases included in the book. Italy and Poland also feature dramatically lower total employment rates, as well as lower female employment rates. In sum, both the institutional features and performance of labour markets do not ensure effective integration of atypical workers during working age and this creates major security gaps between the atypical and standard workers. We will see below the consequences of this state of affairs for economic security after retirement.

At the opposite end of the spectrum lie the United Kingdom and, especially, Denmark. In both countries labour market flexibility has not significantly increased since the early-1990s. The diffusion of (particularly female) part-time work represents the major deviation with respect to the SER: in 2009, the share of part-time work in total employment was 18.9 per cent in Denmark and 23.9 per cent in the UK. By contrast, temporary employment – which is actually a more critical form of atypical employment because it is generally imposed by firms and more likely leads to interrupted careers – has not spread as in the three countries considered above. The share of fixed-term employees was already modest and it has further fallen in 1983–2009 from 11.1 per cent to 8.9 per cent in Denmark, and to 5.7 per cent from 6.3 per cent in the UK. Meanwhile the EPL-regular workers index has even increased for the UK (0.95–1.12) and only slightly fallen in Denmark (1.68–1.63), even though both countries already had a rather flexible labour market with a low level of job security for the whole workforce. Despite generalized flexibility, since the early to mid-1990s, flexible workers (standard and atypical) in both countries have profited from higher employment security due to the traditionally high Danish expenditure on ALMPS – in line with the flexicurity strategy (cf. Ploug, this book) – and New Labour's 'activation push' in the UK (cf. Natali, this book). A less fragmented picture also emerges concerning income security during unemployment: a thorough process of 'benefits homogenization' has actually characterized the British case in 1990–2010 (Clasen 2011) while Denmark has maintained the 'inclusive' character of its unemployment benefits system (Goul

Andersen 2011). Finally, these countries are characterized by above average (compared to the EU-25) participation and employment rates, for both the whole population and for women, which demonstrates a strong attachment to the labour market. All this contributes to less striking differences between standard and atypical employees, and to better labour market integration of the latter, especially in Denmark.

The other two countries analysed in the book, the Netherlands and Switzerland, exhibit a less clear-cut labour market configuration, sharing features with both groups illustrated above. Considering the diffusion of atypical jobs, they are closer to the 'segmented' cluster, with a tremendously high (and increasing) level of part-time employment (36.7 per cent for the Netherlands, 26.2 per cent in Switzerland), which is also highly gendered as women's share exceeds 80 per cent. Fixed-term employment is also widespread, though much more so in the Netherlands – around 18.3 per cent of dependent employment – than in Switzerland (13.2 per cent). Similarly, the strictness of employment protection legislation for regular workers in the Netherlands (EPL: 2.72) is close to levels found in Germany, Italy and Poland. Nevertheless, well-developed ALMPS and the inclusiveness of the unemployment benefits system (cf. Hoogenboom 2011) are crucial factors in integrating atypical workers, and thereby significantly reducing labour market segmentation. By contrast, in Switzerland, homogeneity is more attributable to the long tradition of a liberal labour market with a relatively low level of job security (EPL: 1.16), even for standard employees. In spite of these differences, Switzerland and the Netherlands also show the highest total employment rates (respectively 78.6 and 74.7 per cent) and the lowest unemployment (3.6 /4.5 per cent and 3.7 /4.4 per cent in 2007/2010) among the countries analysed here, as well as tremendously high levels of female employment (72.3 per cent and 69.4 per cent). Accordingly, both countries can be placed closer to the 'homogenous' pole than the segmented one.

9.2 Adapting pensions to post-industrial labour markets: a critical challenge

As illustrated in the previous section, labour market arrangements in the countries analysed in this book vary substantially along the segmentation-homogeneity continuum. Also, the integration of atypical workers seems to be more advanced in the Netherlands and Switzerland than in Germany, Poland and Italy. The same holds true for part-timers in Denmark and the UK, where there are more homogenous labour markets, with a modest and declining share of workers on fixed-term contracts. In the light of such differences, this section analyses the effects of the interplay between labour markets and pension schemes on economic security in old age. Again, three clusters can be broadly identified (Figure 9.2) that are somewhat different from the three groups presented above with reference to labour market arrangements. Although insecurity during working age represents a major source of inadequate economic resources after retirement, the country chapters also show that the different pension models play a crucial role in mitigating, reproducing, or even reinforcing inequalities which emerge in the labour market. Depending on pre-existing institutional arrangements for old age protection and the content of pension (as well as employment policy) reforms, countries in the three groups display a differential capacity to ensure economic security in old age – in terms of poverty prevention and income maintenance – under post-industrial conditions. In other words, they differ in effectively integrating non-SER workers with respect to old age protection.

In the first group – including Germany, Poland and Italy – pension reforms have mostly failed to adapt to more flexible labour markets, with particularly damaging results for the growing share of atypical workers. Building on Flora's intuition, we label these countries 'dis-integrating systems', characterized by *institutional maladjustment* of pension architectures to changed labour market conditions. At the opposite pole, the Netherlands can be considered as an 'integrated system': it has been able to integrate atypical workers, and it is likely to provide adequate economic security in old age to most of the currently employed. The UK and Switzerland may be defined as 'integrating systems' because several measures adopted in the last two decades have started to adjust pension systems to transformed labour markets, thus enhancing security for atypical workers. In between integrated and integrating systems lies Denmark, where concerns regarding adequate income protection in old age have recently been raised.

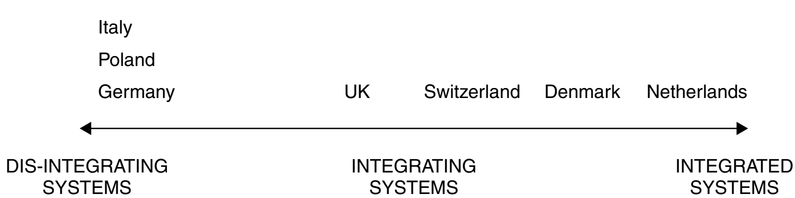

Figure 9.2 Labour market flexibility and pension reforms: dis-integrating, integrating, integrated systems
Source: Authors' elaboration

Before presenting the main evidence for the three groups it is necessary to stress that the interaction of more flexible labour markets with (reformed) pension arrangements has posed critical challenges to policy makers in the countries analysed here. Nonetheless, differences can be found with reference not only to the type of problems that have emerged but also to the *timing*. In the UK and (partly) in Switzerland, gaps in protection for the elderly appeared as early as the mid- to late 1990s. In Germany, income security for retirees is currently on the decline while in Poland and in Italy (and possibly in Denmark) there may be a risk of inadequate economic protection in old age in the next two or three decades. Also, in some countries – especially the Netherlands and Switzerland – policy makers have adopted *proactive* reforms in order to address potential problems of adequacy before they materialize, while, in the UK, interventions have been mostly *reactive* in order to tackle existing old age poverty and inadequate income maintenance. Both reactive and, especially, proactive actions are particularly interesting to policy makers in countries where a high risk of inadequate old age protection in the next decades is expected, and especially in 'dis-integrating systems', like Germany, Italy and Poland.

9.2.1 Institutional maladjustment in 'dis-integrating systems'

A preliminary remark is necessary with regard to our choice of labels. As noted above, 'dis-integrating' refers to pension system maladjustment in the light of profound labour market changes and other macro transformations, such as demographic change and increased female labour market participation. It does not mean that the average or standard level of economic protection after retirement will be lower in Germany, Poland and Italy than in the other four countries we analyse. In fact, from the Golden Age to date, the former group of countries has been characterized by higher pension levels – with increasing replacement rates and declining poverty in old age – than most countries with multi-pillar systems, such as the UK, Switzerland, and even Denmark. Nevertheless, the failure to adapt pension arrangements to labour markets characterized by increasing flexibility 'at the margin' – that is, *institutional maladjustment* – is likely to hamper the effective *integration* of non-SER workers. This may lead to inadequate income maintenance after retirement, or even the resurgence of old age poverty. In addition, as described in the previous section, these countries are characterized by comparatively low levels of labour market integration, which further worsens the pension prospects for workers with non-standard employment relationships.

In Germany, Italy and Poland, selective flexibility – through the spread of atypical jobs mostly targeted at new entrants to the labour market (see above Table 3.2) – has been accompanied by a comprehensive restructuring of pension systems, with substantial retrenchment in the first pillar, as well as the initiation of a transition towards a multi-pillar architecture. Crucially, cost containment measures in PAYG schemes have not only reduced the generosity of public pensions, but they have also radically transformed the very nature of the first pension pillar, especially the central goal of contributory schemes: the traditional objective of *income* maintenance after retirement has been replaced by the more limited goal of *status* maintenance. The responsibility for providing adequate income replacement for retired employees has been shifted onto a combination of public and supplementary pensions. Furthermore, the contribution-benefit link has been strengthened in accordance with actuarial principles. Where earnings-related schemes have remained in place – that is, in Germany – the reduction of public pension levels has gone hand in hand with the abolition of several mechanisms for solidarity and redistribution, such as credits for education, pension accrual for recipients of assistance benefits, the revaluation of lower career wages, and so on (cf. Hinrichs, this book). In Italy and Poland, the actuarial logic has been pursued both by shifting to the new NDC (national defined contribution) systems and by introducing supplementary funded DC (defined contribution) schemes. These changes are significant for standard workers but they are particularly detrimental to atypical employees. The more the pension system is actuarially fair the more it mirrors labour market differences, and spells of unemployment or non-employment have a major impact on public as well as supplementary pension levels. This is especially true if retrenchment measures make unemployment benefit systems more exclusive – as has actually happened in these three countries (see above, Section 9.1) – and atypical workers face major obstacles in UI benefit entitlement. Under these conditions, economic insecurity during working age and intermittent attachment to the labour market is likely to lead to economic insecurity after retirement. But the emerging picture is even gloomier given other problems which specifically affect atypical workers. These weaknesses mostly concern coverage – in supplementary pillars but also in the first – and the level of paid contributions in public schemes. Germany displays the most visible gaps in coverage because of her declining share of compulsorily insured workers (from 77.5 per cent in 1991 to around 68 per cent (2009). This is partly the result of the spread of marginal part-time jobs ('mini jobs'), as well as self-employment. By contrast, Italy (the public NDC system) and Poland (both the NDC and DC tiers) ensure coverage for the whole workforce, though some groups of atypical workers are negatively affected by the existence of specific rules, as in the case of Italian economically dependent workers (so called *parasubordinati*) who pay lower contributions into the public pillar scheme. Lower contribution rates mean lower pensions in NDC systems. Against this background, standard replacement rates are hardly realistic, especially for atypical employees in temporary employment. In Germany, 45 years of continuous employment would be necessary to earn a pension replacing 58 per cent of the last net wage in 2049. In Poland the combined gross replacement of NDC (first tier) plus DC (second tier) pensions is slightly more than 60 per cent for a person retiring at 65 with 40 years of contributions. In Italy public pensions are slightly more generous – the gross replacement rate is about 64 per cent in 2040 for a person retiring at the same age and with the same contributory period as in the Polish case above. However, Italian pension levels deteriorate rapidly with shorter contribution periods, for example, retiring with 35 years of contributions means a benefit reduction of about 6 percentage points.

However, other elements must be taken into consideration in order to evaluate the adequacy of income maintenance in old age for non-SER workers. First, actuarially-based systems provide very limited redistribution (if any) and are neutral with respect to income levels. This means that replacement rates must be complemented by information on pension levels in nominal terms. In this respect, for example, analyses have shown that people continuously employed as *parasubordinati* in Italy might well be entitled to old age pensions slightly above the level of social assistance pensions. Neutrality with respect to income levels is also important for part-timers, who are mostly women in all three countries. For them, a replacement rate around 55 per cent might actually correspond to an extremely low pension. Certainly, as mentioned above, adequate income maintenance in these countries should be ensured in future decades by the completion of the transition to a multi-pillar pension system. However, at least in Germany and Italy, atypical workers fare much worse in supplementary pillars than in the first pillar. In both countries, funded pension coverage has increased in the last 10–15 years but it is still limited (Italy) or far from universal (Germany). 'Voluntarism' is the keyword for the development of supplementary schemes but in both Germany and Italy the coverage of funded schemes is also extremely fragmented, and it is generally lower in those sectors (mainly the service sector) where most atypical workers are employed. In addition, atypical workers may find it extremely difficult to contribute to supplementary schemes because of a weaker labour market attachment, lack of resources and regulatory problems (see Jessoula, this book). In this respect, the Polish solution, based on compulsorily funded pensions, is more effective in ensuring (at least) universal coverage of the workforce and providing an encompassing – albeit not generous – system of contribution credits in case of non-employment. Both are favourable elements for employees in atypical jobs. Nevertheless, Poland seems to represent the same syndrome as Italy and Germany because the combined level of NDC and DC pensions is similar to public pension levels in the latter countries. Moreover, the recent frequency of financial crises casts doubt on the economic as well as social and political sustainability of systems that rely heavily on compulsorily participation in funded DC pensions.

In sum, the launch of the transition to a multi-pillar pension system, with the parallel strengthening of the actuarial logic in PAYG as well as in funded schemes, is not a viable approach to de-segment the various kinds of employment status in the labour market. Instead, they reinforce segmentation, even, and mostly fail to integrate atypical workers effectively into systems of income protection in old age. Adequate income maintenance seems actually to be out of reach for a large proportion of those currently employed under atypical conditions. This is mostly due to coverage problems, especially with regard to supplementary pillars and the weakness of redistributive measures in the public schemes. Furthermore, low means-tested pensions undermine the poverty alleviation function in these systems and do not constitute a robust safety net for non-SER workers.

9.2.2 'Integrated' and 'integrating' systems: proactive and reactive reform strategies

Fully (the Netherlands) and partly (Denmark) *integrated systems,* as well as those that have introduced integrative strategies – that is, *integrating systems* such as Switzerland and the UK – are particularly interesting in the light of the weaknesses that emerged from the analysis of the three countries that had traditionally ensured a medium to high level of old age security by relying on public single-pillar systems. Integrated and integrating systems present multi-pillar pension architectures though of a different type: more inclusive 'universalistic' systems are in place in the Netherlands, in Denmark and in Switzerland, while the UK has been traditionally characterized by a 'liberal' multi-pillar model. As we will see, both the different starting points and specific elements of the multi-pillar pension design in the

Table 9.1 Basic (resource-tested and minimum) retirement benefits as percentage of average gross earnings

Denmark	36
Germany	19
Italy	22
Netherlands	31
Poland	24
Switzerland	24
United Kingdom	28

Source: OECD 2009, p. 65.

four countries, as well as the diverse trajectories towards the integration of atypical workers, lead to cross-national variation in their capacity to guarantee old age security when labour market flexibility is increasing.

First and foremost, (fully and partly) integrated systems such as the Netherlands and Denmark rely on generous basic pensions based on residence (Table 9.1). These schemes are crucial in preventing poverty in old age, especially for workers with interrupted careers or on an atypical contract, as well as women, who mainly work part-time. In this respect, the 1984 reforms in the Netherlands also improved the position of women substantially by individualizing AOW entitlements.

However, integrative measures in the Dutch case were not limited to the basic pension. The interaction of a mature and inclusive multi-pillar pension system and labour market flexibilization (mostly at the margin) has pushed Dutch policy makers into implementing proactive reforms with the aim of ensuring adequate income maintenance in old age for the whole workforce, and preventing inadequate pensions for non-standard workers in the future. Alongside several retrenchment initiatives, and changes in the first as well as in the second occupational pillar (cf. Anderson, this book), a number of measures have been adopted in order to strengthen protection for the most vulnerable groups, by fully integrating part-time and atypical workers into occupational (second pillar) schemes. The length of the vesting period was reduced from 25 years to two months and the portability of accrued rights was guaranteed – a remarkable development given the defined benefits principle which characterizes Dutch occupational pensions. The rules for coordinating the basic pension with supplementary coverage were also modernized: access to occupational pensions was simplified for part-timers, allowing extended coverage, from about 80 per cent to 90 per cent of employees.

In addition, employment policy reforms have helped to improve the situation of atypical employees. The 1996 Equal Treatment Working Hours Act guaranteed the equal treatment of full-time and part-time work in terms of wages and especially occupational pensions, while the 1998 Flexibility and Security Act imposed the automatic conversion of fixed-term contracts into permanent ones after three consecutive fixed-term employment contracts, or if consecutive contracts add up to three years. Against this background, the development of ALMPS and the inclusive nature of the Dutch unemployment benefit system, together with high male and female employment rates, have further favoured full integration of non-SER workers both at working age and after retirement. The main threats to the Dutch system are about the sustainability of pension arrangements in the medium to long term, as well as possible insufficient income maintenance for the (mostly female) workers who have been employed part-time for long periods, because their lower wages translate into lower occupational pensions. Despite these critical elements, the Dutch experience shows that there may be an effective response to the challenge of ensuring adequate economic security in old age 'in a political economy characterized by multi-pillar pension provision and increased labour market flexibility' (Anderson, this book).

Thorough integration is the keyword of Dutch case in a number of dimensions: i) labour market integration through regulatory reform; ii) social protection integration during working age by investing in income security – that is, an inclusive unemployment benefit system – as well as employment security through ALMPS; iii) pension integration in the first pillar, by strengthening redistributive schemes which aim to prevent poverty; and, finally, integration in the second pillar by extending coverage, and coordinating the management of public and occupational pension schemes. As a consequence of these integrated strategies, the Dutch pension systems should be able to provide both poverty prevention and income maintenance to the whole workforce in the next decades, even under changing labour market conditions.

The Danish experience shows many commonalities with the Dutch, although the Danish story is less about effective adaptation to profound labour market changes, mainly because flexibility has not advanced that far in Denmark, except for the increase in part-time employment. As mentioned above, the first-pillar basic pension leads to low levels of old age poverty. In addition, ATP (the labour market supplementary pension scheme) delivers low benefits that are nonetheless important to workers with low incomes and fragmented careers (see Ploug, this book). As for income maintenance, the extended coverage of collectively agreed occupational pension schemes – that is, about 85–90 per cent of employees – ensures that most future retirees will rely on a combination of public and supplementary old age benefits, and part-timers will enjoy the same social protection rights as full-time employees. Moreover, the well-known Danish flexicurity model guarantees a high level of integration, both in the labour market and in the unemployment benefit system. Nevertheless, the Danish case raises some concerns due to several features of its multi-pillar pension model. First, exclusive reliance on collective agreements for the establishment of occupational pension schemes ensures very high but still not universal coverage and low-skilled workers on temporary jobs tend to be excluded. Also, occupational pensions are of the DC type: this not only implies that financial risk is borne by those insured but also that career interruptions directly translate into lower benefits due to the absence of compensatory solidarity measures, such as contributions credits in case of unemployment, sickness or maternity. Finally, and even more important, a government-appointed commission has recently revealed that for those retiring before 2050 the contribution rate in occupational schemes is, on average, too low (see Ploug, this book). Accordingly, the commission has proposed the introduction of an additional complusory and funded pension arrangement covering all workers, with a contribution rate of 6 per cent of income. Clearly this would favour workers with low incomes and non-standard employment careers. However, if the proposed measure is not implemented there is a risk of inadequate income maintenance, especially for the limited share of fixed-term workers as well as for the much larger group of part-timers.

In the last two cases, Switzerland and the UK, policy makers have begun the process of adapting multi-pillar pension systems to flexible labour markets with distinctive features: there is a very high proportion of atypical workers in Switzerland and a very limited diffusion of fixed-term contracts in the UK. In both countries, the reforms – beginning in the mid-1980s in Switzerland and the mid-1990s in the UK – included two fundamental elements: i) more redistribution and generosity in the first public pillar; and ii) actions aimed at extending the coverage of supplementary pillars, particularly for atypical workers. The 1995 AHV/AVS reform of the first pillar in Switzerland has substantially equalized pension entitlements for men and women by introducing so-called 'pension splitting' between spouses and introducing contribution credits for child-rearing. This reform was adopted in the context of increasing female, mostly part-time, employment and higher divorce rates. In addition, the increase in means-tested pension supplements (1985, 1996) has strongly enhanced the poverty prevention capacity of public pension schemes (see Häusermann and Schwander, this book). In a similar vein, in the UK, New Labour has introduced reforms of the traditional basic state pension, with the introduction of new schemes such as the Minimum Income Guarantee (1999) and the Pension Credit (2003), the replacement of SERPS with the more redistributive State Second Pension (2002), and the implementation of a more comprehensive system of contribution credits (in case of caring activities and unemployment). These measures have significantly increased the generosity of public schemes for low wage earners, thus improving the status of atypical workers, at least in terms of poverty alleviation (see Natali, this book). As a result, 1.8 million pensioners – 1.3 million of whom are women – have been lifted out of absolute poverty. Furthermore, the 2007 Pension Act implemented a package of interventions that should be particularly effective in enhancing the old age security for women with interrupted careers, as well as that of low income earners.

Efforts to adjust pension arrangements to a flexible labour market have also focused on supplementary funded schemes. Important measures have been adopted, although several problems remain. In Switzerland, the 1994 reform allowed full portability of earned entitlements, while the 2003 reform took an important step towards improved integration of part-time workers in the second pillar by modifying the rules that link AHV/AVS and supplementary pensions (the so-called, 'coordination deduction'). Finally, in 2008 supplementary pensions coverage for fixed-term employees was improved by allowing the accumulation of different insurance periods if fixed or short-term workers are employed several times in a row by the same employer on short-term contracts (see Hāusermann and Schwander, this book). In spite of the several *integrative* reforms that have started to adjust the three-pillar system to changed labour market conditions, atypical work remains a major source of risk of inadequate income in old age. In defined contribution systems, broader supplementary pension coverage does not necessarily lead to adequate pension levels. Weak attachment to the labour market and low earnings are, and will remain, the main determinants of insufficient second-pillar pension accumulation. The Swiss trajectory in providing economic security in old age for today's insecure workers can thus be described in terms of the *incomplete adaptation* of pension arrangements to a still highly flexible but also more segmented labour market.

Table 9.2 Main issues of concern of Europeans (by country), 2006

	Germany	**Italy**	**Poland**	**UK**	**Denmark**	**Netherlands**
Pensions	43%	29%	39%	25%	10%	10%
Unemployment	47%	34%	53%	13%	3%	5%

Source: Adapted from European Commission – Eurobarometer 2007, pp. 45–6.

In recent years, UK policy makers have also extended the traditionally patchy coverage of funded pensions. Fragmented supplementary coverage is particularly detrimental to atypical workers – both part-time and fixed-term – who are usually employed in sectors where the provision of supplementary pension schemes by employers is generally limited. By introducing a system of personal accounts based on the auto-enrolment mechanism, the 2008 Pension Act aimed to tackle these shortcomings. It should contribute to maximizing the coverage of supplementary schemes, especially for lower earners. As a result, and in contrast to *dis*-integrating systems, the income security gap between standard and atypical workers – as well as between male and female employees – is expected to diminish in the next decades in the UK even though overall pension levels will remain comparatively low.

To conclude, it is interesting to notice that in the countries belonging to both 'integrated' and 'integrating' system clusters, pensions – as well as unemployment – are relatively minor issues of concern for the population (Table 9.2).

9.3 Conclusions

This volume has shown that tensions are likely to emerge from the encounter of labour market and employment policy models with institutional architectures for old age protection. The effective integration of pensions with increasingly flexible post-industrial labour markets represents a major challenge which may require encompassing institutional adaptation in order to ensure economic security for the elderly.

However, cross-national variation is also evident and the countries analysed in this book have been clustered in three groups which present a different capacity to provide poverty alleviation and income maintenance after retirement, especially to non-SER workers. The first group comprises 'integrated systems' – the Netherlands and to a lesser extent Denmark – which have been able to address the tension between labour market flexibility and pension reforms effectively by integrating atypical employees, both in the labour market and the pension system. Other countries – Switzerland and the UK – have started to implement integrative measures with the aim of adapting their multi-pillar pension systems to flexible labour markets. We have labelled them 'integrating systems': positive results have been achieved so far with respect to the poverty prevention objective but adequate income maintenance for employees with atypical employment careers still has to be reached and further measures have to be adopted for this purpose. In the first two groups, incomplete or full adaptation was achieved through interventions in the different pension pillars and reforms aimed to counterbalance increased labour market flexibility with more employment and income security during working age. By contrast, the task seems to be more challenging in '*dis*-integrating systems', characterized by institutional maladjustment of the labour market and pensions arrangements, which may lead to inadequate old age protection for non-standard workers. For countries like Germany, Italy and Poland – which used to ensure a high level of old age security – an articulated and wide-ranging process of institutional adaptation seems to be necessary, involving a revision of current labour market institutions and the redesign of their pension systems. In the latter field, the new 'post-industrial pension contract' should not only include the completion of the transition to a multi-pillar system, with particular attention to the coverage of workers on non-standard (namely fixed-term) jobs as well as the full portability of supplementary pension rights. Also regulatory changes and an increased reliance on new principles and instruments, such as the strengthening of (means-tested or more universalistic) redistributive measures, are crucial for effective economic security in old age.

Note

1. The survey allowed multiple answers, therefore the total is not 100 per cent.

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Note: References to tables and figures are written in bold type.