A Magic All-European Pension Reform Formula: Selective Comments

*Bernd Marin**

Robert Holzmann has provided an interesting and innovative approach to rapid and comprehensive pension reform in Europe. He shifts the debate beyond the conventional focus on fiscal affordability at the national level toward broader economic and social adjustment needs. And he proposes NDC as an "ideal" approach not just for dealing with a great variety of reform requirements but also for inducing pension harmonization across Europe while allowing for continuous country-specific preferences "and to lead to a political reform movement" toward NDC. This is a strong claim and he puts forward strong and sophisticated arguments in favor, some but not all of them convincing to me. The rationale for much wider domestic reform needs throughout Europe as well as for a move toward a more coordinated Pan-European pension reform are more persuasive than the proposals for its potential structure and transition strategy. While I share the central claim of the paper, which is new and sound, this occasionally is done so for other reasons—starting from other working hypotheses and then coming to other policy conclusions—than the ones put forward by the author, as in the case of atypical employment. At times, additional or other empirical evidence is suggested to strengthen the points, as with exemplifying pension barriers to mobility between the public and private sector. While NDC may be generally close to an "ideal" pension framework, whether the "ideal" NDC as proposed in the Holzmann design is truly "ideal" is still to be explored. Partly, parameters are not yet fully specified, partly risk reinforcement may be more probable than the risk diversification claimed for the Holzmann design of combining pillars. Furthermore, the guaranteed minimum social pension should rather not be conceptualized as a "zero pillar." Crucial dimensions such as disability pensions may be missed. One could rather underline the primacy of political and not just economic desirability, feasibility, and sustainability of NDC. And finally one would stress some of its underestimated comparative advantages, such as its functions of fairness standard, anticorruption device and, as a core component of any pension constitution, its differentiation of welfare trigger, as well as its superior risk management (Gora and Palmer 2003).

Robert Holzmann foresees an increased need, rather than a diminishing one, for rapid and comprehensive pension reform in both current European Union member-states and future accession countries, due to worsening budgetary pressures, socioeconomic changes, and the impact of globalization, all related to societal aging. But expenditure levels are less a reflection of population age structures and aging dynamics than the

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public/private mix of provision, benefit generosity, and the actual retirement age, which is typically low due to disincentives to work. In the future, further increases in longevity, which are likely, together with even modest rises in fertility, which are still below the replacement level, will continue to make for rapid population aging and corresponding increasing old-age dependency ratios. Even if system dependency ratios deteriorate less than old-age dependency ratios, due to reforms and to increased labor force participation of women and middle-aged workers, pension expenditures will rise till around 2040. With reforms, the expenditure increase may be "only" 30 percent, as against the demographically required 70 percent, or a "rough doubling" of expenditures "in a no-reform scenario." Under all circumstances, "a further major increase in pension expenditure can be prevented only if major reforms take place."

While nobody may object to this reasoning and its conclusions, additional forms of empirical evidence supplied to support the cases in point are suggested. Holzmann offers data on public pension expenditure in terms of percent of GDP and projections of old-age dependency till 2050, depicting the great—and increasing—variety within European Union and accession countries. He takes the design flaws of most existing pension schemes for granted: not in need of further documentation. But as the main goal of his chapter is to argue in favor of a reformed NDC system to replace current defined benefit (DB) systems and to push toward a coordinated pension system in Europe, I would like to strengthen his case by providing supplementary calculations.

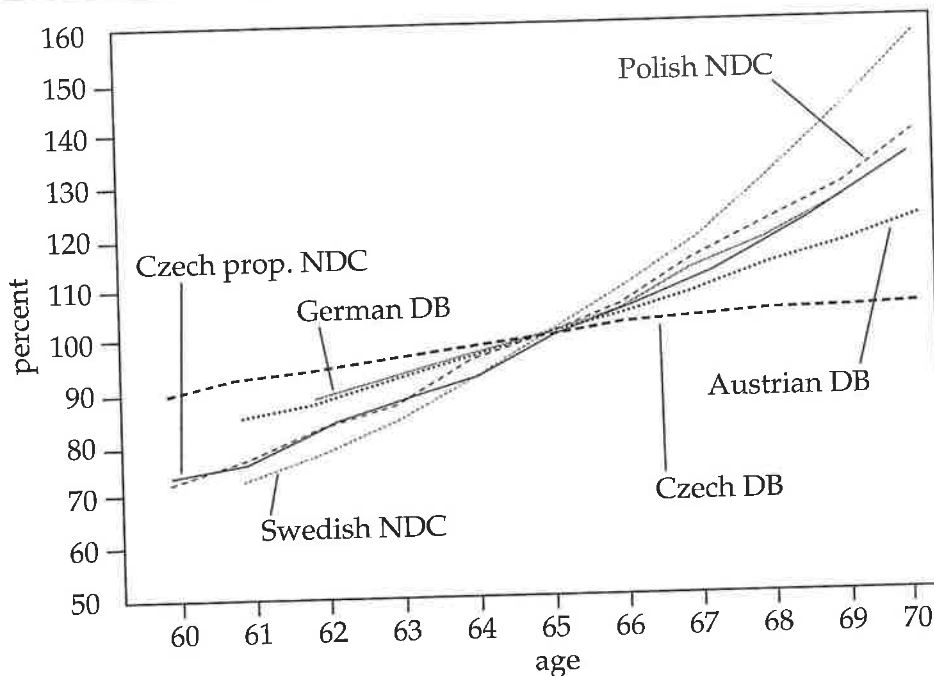
Deeds Defying Words—Reform Flaws Visible through NDC

The approximation offered in this discussion is a comparison of four smaller European countries. Two (Sweden and Poland) adopted NDC schemes when introducing benefit cuts to discourage early labor market exit; two (Austria and the Czech Republic) did not. One big country (Germany) with a reformed DB system holds an intermediate position. The evidence supplied shows quite clearly that all of them have moved in the right direction of increased benefit reductions for pre-retirement—but only NDC pension systems (by using the wage growth rate as notional interest rate) are "quasi-actuarially fair" and neutral to individual preferences. Existing DB arrangements, in contrast, actually continue to strongly subsidize early exit and to heavily penalize working longer (see figure 11.2).

In this way, the governmental rhetoric of praising delayed retirement is undercut by counter-productive measures in the political economy. Words are defied by deeds: only fools willing to sacrifice a painful amount of money—or unable to make the elementary calculation of tangible advantages—will *not* escape the Austrian and Czech labor market at their earliest possible opportunity and convenience. Figure 11.3 shows that benefit rules in these non-NDC systems are detrimental to declared public objectives. The distortion factor is at least 1:2 in Austria and the Czech Republic, and between a third and a half in Germany. In the smaller DB countries, regular voluntary early retirees (that is, not those persons experiencing ill health, disability, unemployment, or another disadvantage) are exempt from more than half of the actuarial losses to be incurred by them (in special categories up to 80 percent). Those working longer than expected, on the other hand, would lose much more than half and up to around six-sevenths (Czech Republic) of the savings generated to the insurance collective.

No surprise, therefore, to find hardly anybody working up until the legal retirement age in such a country and to find less than 3 percent of the working population working to the official working age of 65. Without NDC standards of actuarial neutrality and fairness, neither the amount of distortions and of hidden taxes for younger working generations, nor the fact, so puzzling to policy-makers, as to why their well-intended and supposedly

Figure 11.2. Actuarial Fairness (the Swedish and Polish NDC System) vs. Subsidizing Early Exit and Penalizing Working Longer (the Austrian and Czech DB Systems), as compared to the German DB Intermediate, 2003



Source: Author.

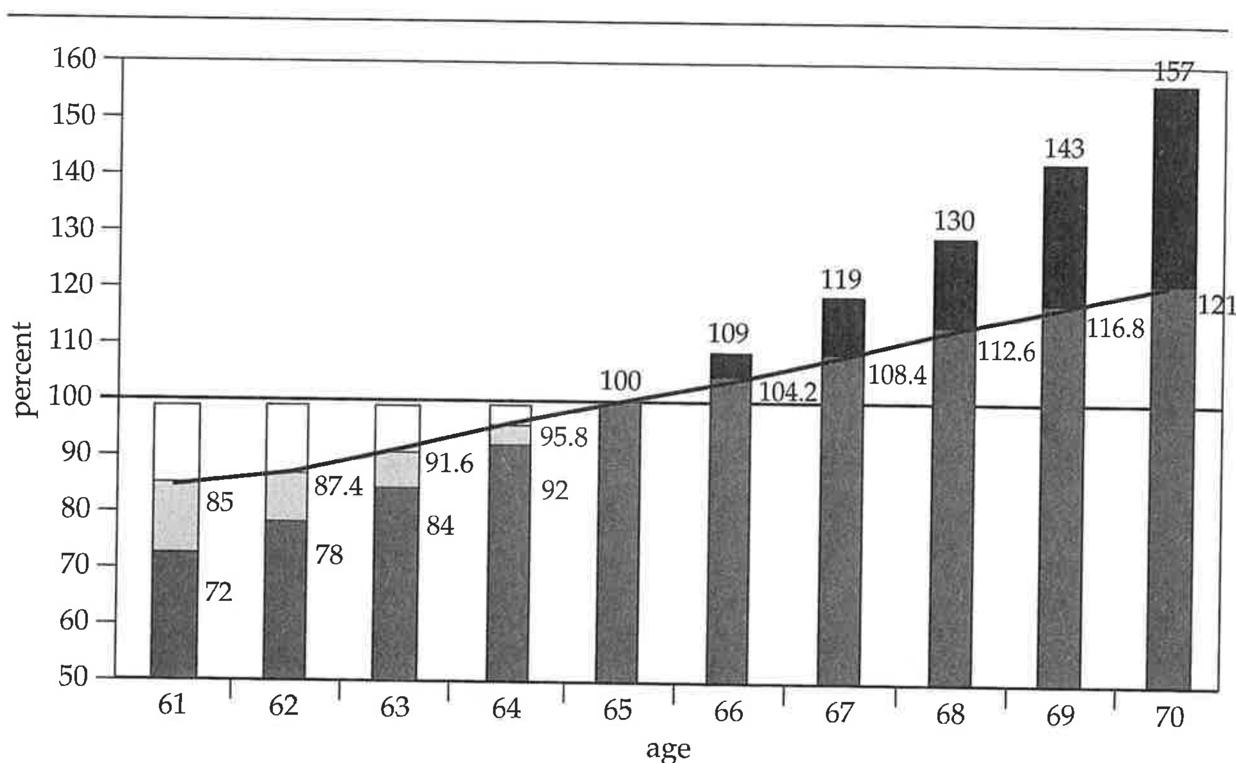
"harsh" reform measures generate opposite effects than the ones intended, could be explained. Recall the reasons for selecting those four smaller countries for paired comparisons. The Czech Republic has the single highest aging dynamics among the future EU-25 countries until 2050. Austria had confronted the single highest pension expenditures worldwide already by 2003 and "as an extreme example, the pension-related deficit amounts to almost 5 percent of GDP." Sweden ages more than a decade earlier than Austria, whereas Poland and the Czech Republic age almost two decades later—but much more rapidly and drastically than Austria and Sweden.

The four countries, therefore, lend themselves to several paired comparisons. Although all those overall tendencies can be seen from the tables provided by Robert Holzmann, I have transformed data on population aging until 2050 into figures displaying the time dimension in a comparative manner. They depict *"l'Europe a plusieurs vitesses"* of aging and reform needs, lags, and peaks. Which country will reach its peak of collective aging when, and how does this compare to European averages and sub-regional aging patterns? (See figures 11.4a, 11.4b, and 11.4c.) Which are the *avant-garde* countries and which are the laggards hit latest by developments and therefore able to learn from the best, brightest and fastest?

Reform Needs Beyond Demography and Budgets

But "even if the budgetary and demographically induced pressures did not exist," Robert Holzmann reasons, "there still would be a major need for most European countries to reform their public pension systems to better align them with socioeconomic changes." Holzmann cites three such changes—"increasing female labor force participation; high divorce rates and changing family structures; and the rise in atypical employment"—and

Figure 11.3. Swedish NDC Actuarial Neutrality vs. Austrian DB, Amount of Labor-depressing Adverse Redistribution, 2003



Source: Marin (2005); author's estimates.

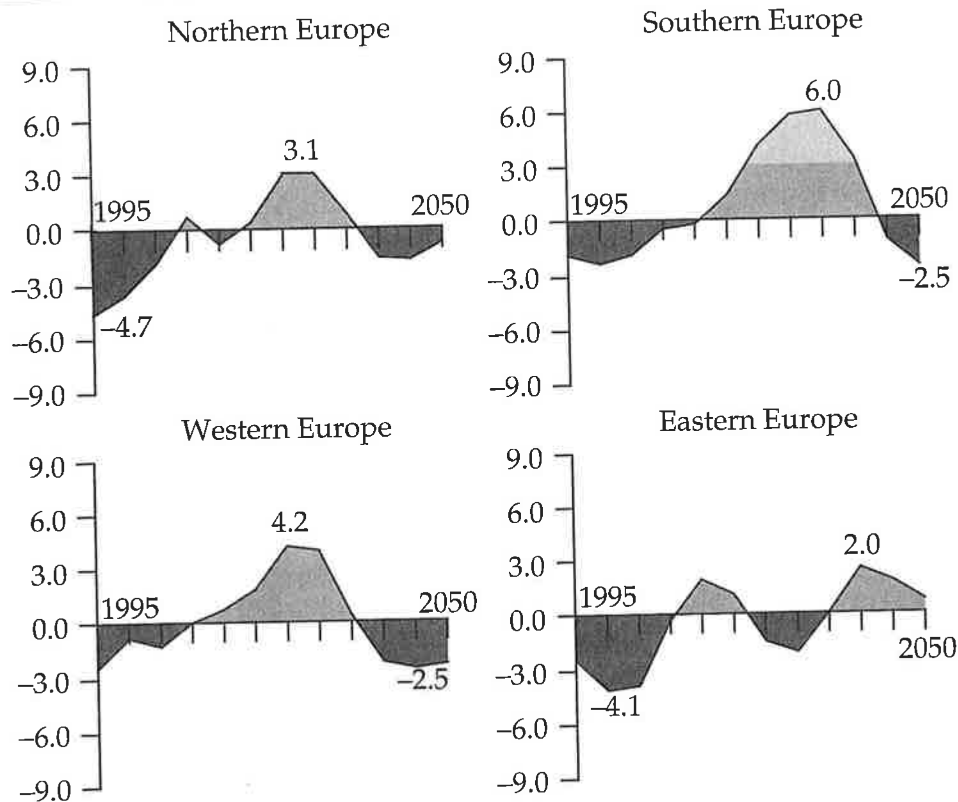
Note: The line across the bars indicates the steepness of the bonus/malus function and its deviation from actuarial neutrality. The light gray difference indicates the amount of subsidies for early retirement, which, perversely, grows with ever earlier retirement in Austria (e.g. 15 percent cuts in Austria compared to 28 percent in Sweden when retiring at age 61). The black color shows the amount of taxing away collective benefits from late retirement (e.g. 12.6 percent instead of 30 percent increments when retiring at age 68, or 21 percent instead of 57 percent higher monthly payments when retiring at age 70). Thus, socially desirable behavior of retiring later is sanctioned or punished in Austria. Harmful early exit behavior, which is strongly supported in Austria but not in Sweden, has led to a striking difference in retirement behavior in the two countries (more than 97 percent of Austrians retire before age 65).

analyzes them. I once again agree with both the diagnosis and the remedies suggested, such as "the individualization of pension rights" to avoid benefit traps for women. But I sometimes do so for other reasons—starting from other working hypotheses and then arriving at other policy conclusions—than the ones put forward by the author.

The Atypically Employed as Winners in Non-NDC-Schemes?

Let me take Holzmann's assertion that "these atypically employed people do not fare well under some pension schemes, which are based on the full-employment fiction. . . . This situation calls for reform (and a stricter contribution-benefit relationship)." This is true, no doubt, as it is general enough—but, therefore, the opposite proposition is equally true, and probably even more frequently true: namely, the atypically employed often fare very well under current pension schemes, despite, or even because, these schemes are based on the fiction of full employment. Just one outstanding example are full-time pension entitlements for predominantly or long-term part-time employees. In table 11.9, I provide a truly

Figure 11.4a. Europe Aging at Multiple Speeds, Lags and Peaks, 1995–2050: Subregional Deviations from All-European Regional Averages (percent)



Source: Prinz and Lutz (1994a, 1994b).

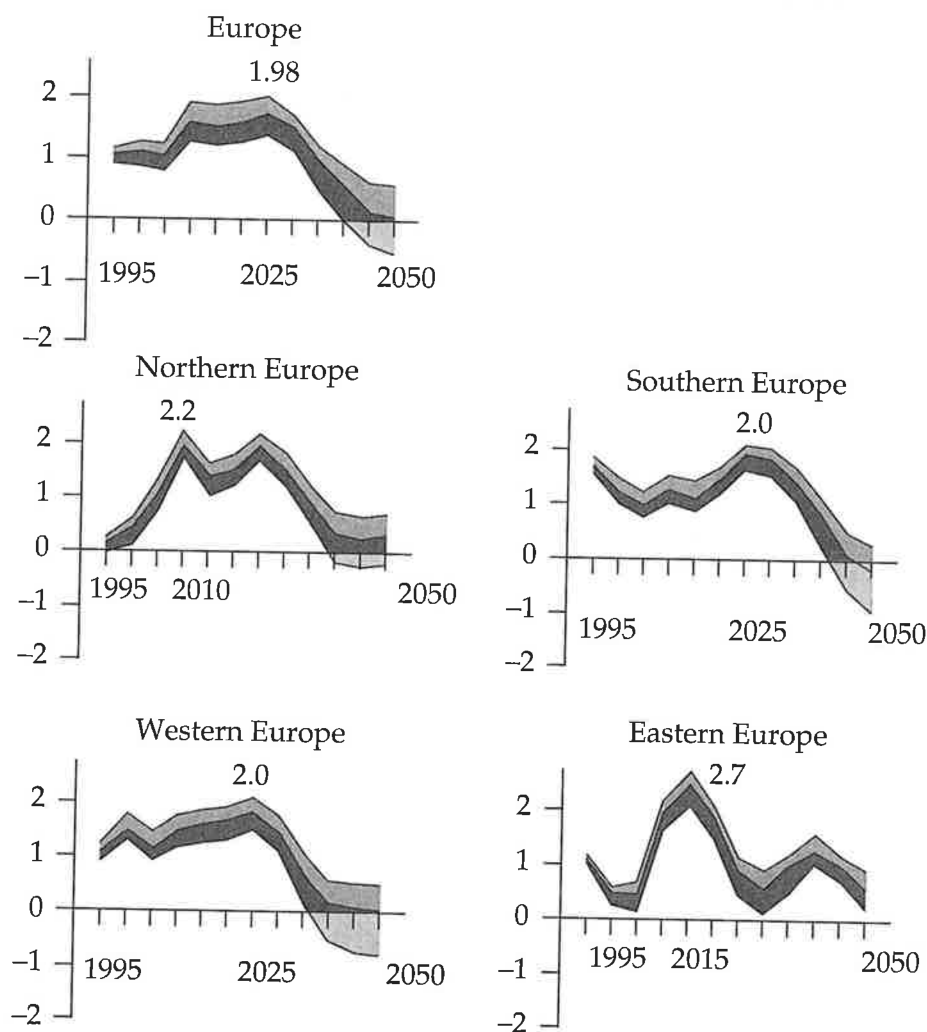
Note: Y-axis values greater than zero are considered above average; those below zero are considered below average.

shocking example of "injustice" and "perverse redistribution" from long-term full-time workers without career development toward part-time employees with good careers (such as female academics). Despite much less than a lifetime working, these part-timers receive between around two and two and a half times higher a lifetime pension in real terms than the simple worker—with identical lifetime contributions.

Such inequities of equal contributions and highly different benefits (and vice versa) within the private market sector may become even more drastic across the private and the public sector boundaries (as will be seen soon), as long as "best years" pension formulas prevail. All systems without a lifetime calculation-base lend themselves to such erratic redistributions in all directions, including frequent perverse redistribution from low-income to wealthy people, which are more able to fiddle the system by superior knowledge and ease of more flexible and well-dosed, opportunistically adjusted labor supply. Vesting periods as entitlements thresholds and other devices may also make for similar advantages. They are often used by self-employed persons and their family members, part-time farmers, railway workers, civil servants, and other special corporatist interest groups, providing them with benefits far above of those of people with equal contributions—and even further above their own contributions.

Thus the "stricter contribution-benefit relationship" called for by the author (which, of course, I agree with), would actually make few people better and many people much worse off than they are today—for good reasons of fairness. This is because current distor-

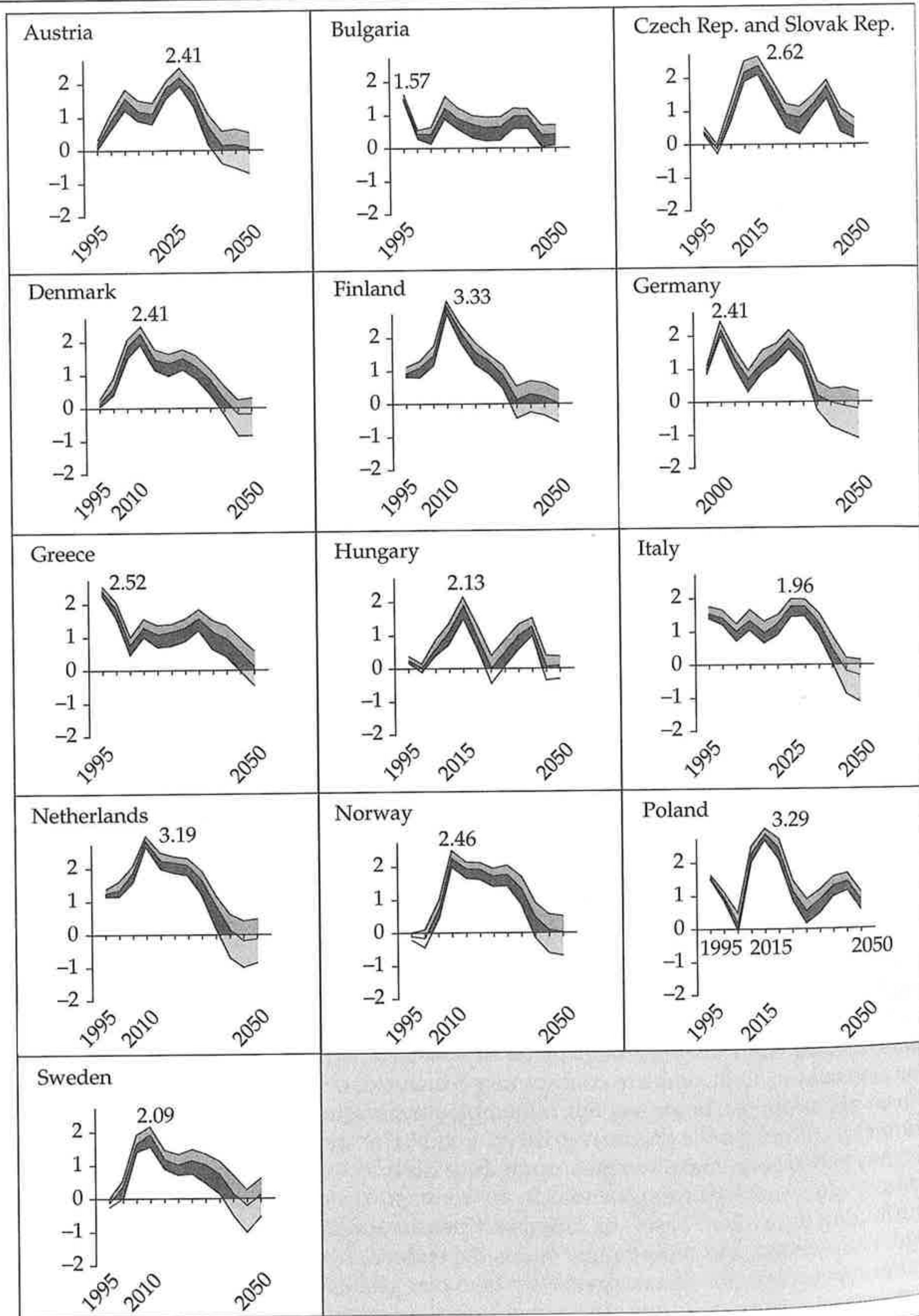
Figure 11.4b. When the Aging Process Will Reach Its Peak: Average Annual Increase of the Population Above Age 60 in Three Scenarios, by European Subregions (percent)



Source: Prinz and Lutz (1994a, 1994b).

tions from defined contribution standards are probably non-accidental, and well-structured by vested interests of atypical employees who typically stand to gain from existing pensions rules. Many "atypical" employees, in particular middle-class preferential part-timers, benefit from them at the expense of low-income people working long hours. In what one could call incomplete contributory Bismarckian insurance systems, DB pension awards are actually "based on the full-employment fiction." But—according to so my counter hypothesis to the one forwarded by Robert Holzmann and many other scholars—this may more often make for their upgrading closer to full-employment or to non-contributory guarantee pension standards. In contrast, their downscaling to a minimum contribution equivalent base—or to indirect pensions rights only, derived through marriage, widowhood and other family status dependencies—is less probable and frequent. And non-contributory systems generally take care of flex-workers through other provisions, moving their pension entitlements above their contribution base.

Figure 11.4c. When the Aging Process Will Reach Its Peak: Average Annual Increase of the Population Above Age 60 in Three Scenarios, by country (percent)



Source: Prinz and Lutz (1994a, 1994b).

Table 11.9. Same Lifetime Contributions, Highly Different Pension Entitlements for Atypically Employed Part-Timers and No-Career Regular Full-Time Employees, Austria, 2003 (euros)

	Part-timer, best years at start of career	*Part-timer, best years at end of career*	*Full-time employee, constantly below average income*
Lifetime contributions, indexed by:			
without any indexation, nominal	50,977	135,182	83,290
notional IRR median income	171,525	175,716	159,884
notional IRR covered wage sum	221,421	187,257	187,823
Nominal lifetime pension, residual life expectancy 24,25 years, calculated by:			
"best 15 years"	551,088	802,744	328,102
lifetime "40 years"	222,274	298,647	237,824
status quo: losses capped at 10%	**495,979**	**722,470**	**295,291**
median income 40 years	324,731	332,665	302,692
wage sum 40 years	419,195	354,516	355,587
Lifetime contributions, indexed by:			
without any indexation, nominal	54,026	135,182	91,743
notional IRR median income	**175,716**	**175,716**	**175,713**
notional IRR covered wage sum	225,944	187,257	207,383
Discounted lifetime pension, residual life expectancy 24, 25 years, discount 3% p.a., calculated by:			
"best 15 years"	399,206	581,504	261,166
lifetime "40 years"	166,111	216,339	190,026
status quo: losses capped at 10%	**359,285**	**523,354**	**235,050**
median income 40 years	**240,982**	**240,981**	**240,978**
wage sum 40 years	309,866	256,810	284,410
Lifetime contributions, indexed by:			
without any indexation, nominal	50,977	143,754	97,825
notional IRR median income	171,525	202,512	187,563
notional IRR covered wage sum	**221,421**	**221,423**	**221,418**
Discounted lifetime pension, residual life expectancy 24,25 years, discount 3% p.a., calculated by:			
"best 15 years"	399,206	581,504	278,102
lifetime "40 years"	161,015	242,015	202,774
status quo: losses capped at 10%	**359,285**	**523,354**	**250,292**
median income 40 years	235,234	277,730	257,228
wage sum 40 years	**303,663**	**303,666**	**303,659**

Source: Calculations by M. Fuchs, European Centre.

Note: The table shows how well atypically employed part-timers can do under current DB pension schemes compared to no-career regular full-time employees. The 9 boldfaced rows in the table indicate both the lifetime contributions indexed by notional IRR median income and notional IRR covered wage sum as well as the nominal and discounted lifetime pensions according to the "status quo: losses capped at 10%," an extended "best 15 plus a few years" combined with undervalued, "unfair" notional IRRs and crippling caps vs. a lifetime calculation base (40 years) with fair IRRs indexed by the median income or the wage sum. Whereas the first option (status quo after the 2003 reform) shows highly unequal (up to 1:2.4) pension entitlements with identical contributions, lifetime calculations with income or wage-sum-based notional IRRs display identical entitlements for identical contributions.

Other Non-Fiscal Reforms Needs Demanding NDC

Both the non-individualization of social rights to health insurance, social insurance, and pensions, as well as all existing deviations of current DB pension schemes from NDC standards of actuarial neutrality and fairness, are costly to society at large and increase public expenditures, Moreover, they tend to benefit those who are *not* most in need of support and targeted for special assistance, but those who are best able to seek the rents implicit in such incomplete arrangements, while taxing those outside the circle of the happy few privileged beneficiaries. NDC allows us to measure existing arrangements serving particular sectional interests at the expense of others against universalistic standards most broadly accepted as reasonable, equitable, and fair.

Another tendency requiring "changes in the way public programs operate, including in the area of pension provision" is increasing international market integration or globalization. It adds further non-fiscal reform needs to the already mentioned socioeconomic changes ignored by most countries that have introduced parametric reform packages during the last decade, exclusively addressed at balancing short- or mid-term fiscal requirements. But open economies will not do well in a globalizing world with social security and public pension systems that "limit if not eliminate" labor mobility between sectors, occupations, and countries. They will not reap the benefits of globalization with pension rules that impede the improvement of financial markets, including a development of portable liquid pension assets from fully funded pillars. And they will not do well with pension arrangements that block life-long learning indispensable for knowledge and skill formation, labor market flexibility, and prolonged activity in the workforce.

Socioeconomic changes, globalization, and societal aging require a reform approach "that must go beyond a parametric adjustment of existing schemes," Holzmann argues, "toward a more actuarial system structure that better links contributions and benefits, more individualization to handle professional and family mobility, and also some funding to allow more individual decision and choices." At this point of reasoning, Holzmann elegantly interweaves the view that more pension reform or "adjustments" are needed with his second core idea: that even with more pension reform, more European coordination is needed. He finally weaves it into the third core assumption or *leitmotiv*: namely, that NDC is "ideal" to make it happen, a cornerstone in the welfare architecture of a "Pan-European pension system."

The Claim for NDC as "Pan-European" Pension System

The most innovative aspect of Holzmann's study is his argument in favor of NDC as responding to "the need for a better coordinated pension system in an integrated Europe." His "Pan-European approach" is not the first, but probably the most encompassing, treatment so far of the proposition to design NDC-type institutions to promote the emergence of an all-European pension system. He rightly deplores the fact that "there is little understanding of and support for a Pan-European approach that should lead to a coordinated pension structure" and wonders why the Commission of the European Union (in contrast to other policy field) does little to overcome the perception of pensions as a strictly national agenda. Can European economic integration truly advance without at least some development toward an all-European pension reform approach?

Budget requirements under a Maastricht fiscal regime, and enhanced labor market flexibility, mobility, and labor supply in aging societies, all demand some convergence in the area of pensions, which crucially affects overall labor supply and employment levels and

consumes up to half of all social expenditures. While migration and regional mobility will remain lower in Europe for a multitude of reasons, mobility is blocked not just across countries and regions, but also between sectors within countries and across professions within the same regions. In contrast to "other economically integrated areas under a common currency (such as Australia, Brazil, Canada, Switzerland, and the United States) . . . the European Union does not have a coordinated—even less a harmonized—pension system." While other states or provinces differ in many things "including income taxes or short-term social benefits . . . they have one thing in common—a public retirement income scheme across states." Even worse, European countries frequently have occupationally fragmented pension systems *within* the same countries, preventing mobility across professions and between the public and the private sector, even within nearby areas.

Barriers to Mobility

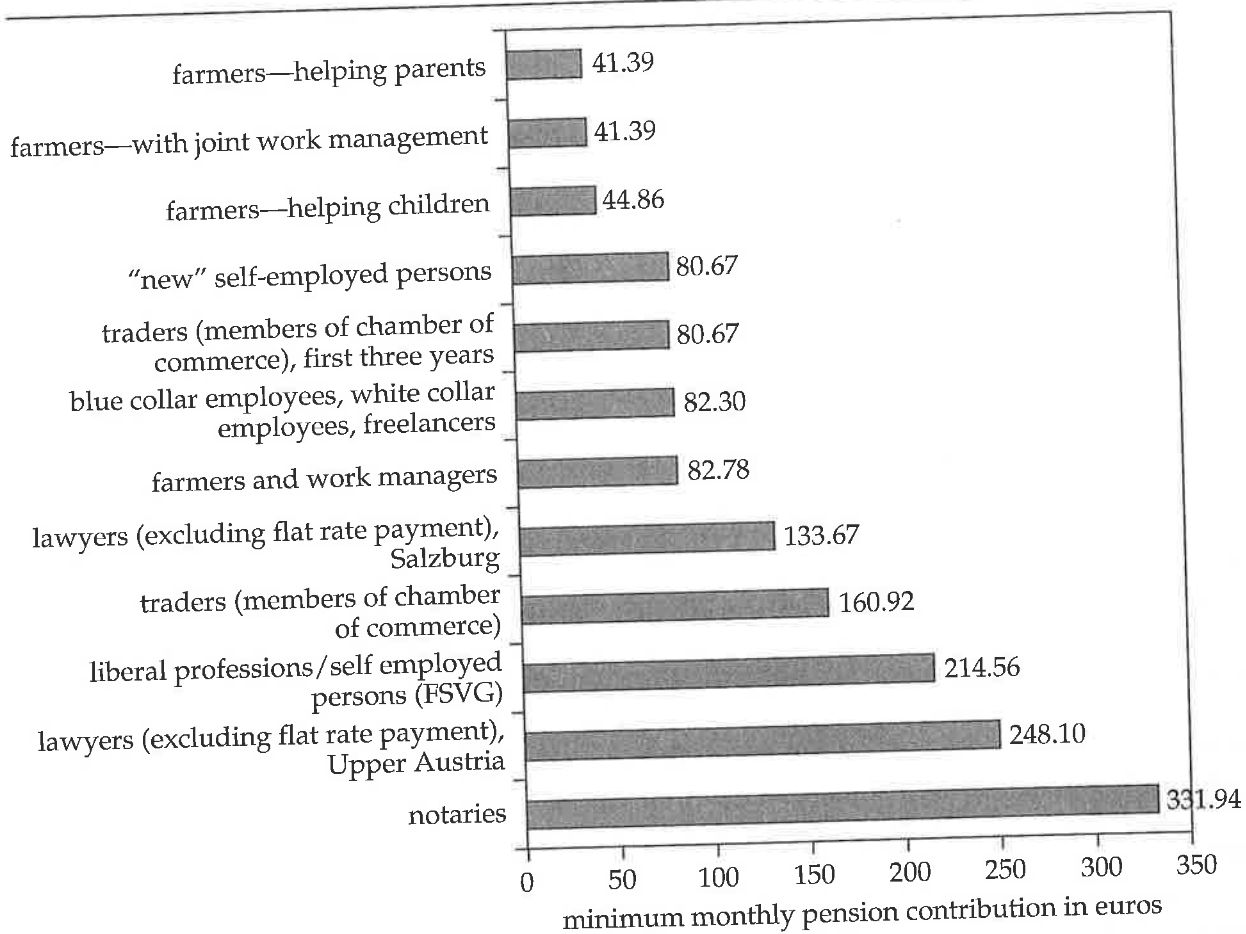
There is nothing to criticize or add to Holzmann's reasoning about barriers to mobility, except perhaps some empirical evidence illustrating the almost incredible extent of barriers to mobility between public and private sector. In a corporatist country like Austria, public sector civil servants receive on average 264 percent of the median retirement income in the private sector (European Centre 2004). Within the same education bracket, public sector workers get up to 44 percent higher lifetime income than private sector employees; the gap decreases as educational attainment increases (Synthesis 2003). Due to a more favorable pension formula, civil servants get around 50 percent higher return on their retirement income—or notional interest rate, in NDC language—for the very same contributions during active life (Marin and Prinz 1999).

To be even more specific: A female civil servant born in 1945 and retiring at age 56.5 in 2002 receives between 46 and 49 percent of her overall lifetime income as old-age pension. With primary education only, her lifetime income (1,926,190 euros) is more than double that of a private sector worker/employee (838,266 euros). Her retirement income (884,318 euros vs. 272,760 euros) is 3.24 times greater. With secondary education, the relationship of lifetime income is 2,408,151 euros, compared to 1,094,097 euros. The retirement income 1,175,108 euros vs. 370,124 euros, or 3.17 times higher (Synthesis 2003).

In many cases, more than 50 percent—or the greater part—of overall lifetime income comes in retirement! Net income of retired civil servants on the regional (*Länder*) or municipal level is rarely below 100 percent of their last (not their average) active income before retirement—and that is around 130 percent of average or calculation base active salary during their working life! In addition, the gap in retirement income between civil servants in the *Länder* or municipalities and that on the federal level in some of the regions may increase up to 43 percent over that of civil servants nationwide by the year 2025 (Marin and Fuchs 2003, table 3/B). And the minimal pension contribution varies up to around 10 times or 1,000 percent between different occupational groups for what may turn out to be the very same monthly retirement income entitlement (Marin and Prinz 1999; see also figure 11.5).

Under such circumstances, how could professional mobility ever take place, except in a unilateral direction toward the public sector? The most telling symptom in this context may be that even among academics, who profit least from these arrangements (and male academics hardly at all), more than 70 percent of university graduates seek public employment as civil servants. Correspondingly, the outflow rates from public sector functions with permanent status (*Pragmatisierung*) is virtually nil—except toward those ever more

Figure 11.5. Corporatist Pension Disharmonies: Cost of Minimum Contribution One Month of Retirement, Austria 2003



Source: Hauptverband, AK department of statistics.

frequent cases of special early retirement arrangements in ever younger age cohorts down to 45 to 55 (*"Lehrermodell"* for all, *"Bundesbediensteten Sozialplangesetz," Berufsunfähigkeit-spensionen in "ausgeglieder-ten Einrichtungen"*). Despite annual decrements of 4 percent (capped at 20 percent)—calculated from a standard retirement age 5 years below that of the private sector—the absolute monthly retirement income usually is still far above of that of an average private sector employee working until the age of 65. It thus provides a frugal early retirement basic income over around 30 to 40 years of further life expectancy. In addition, varying by education but through all education attainment levels, the term of the pensions is several years longer in the public sector. Based on this generous basic income, pensioners may start a second career or undertake rather informal income-gathering activities, but rarely do, as entrepreneurship is neither promoted nor needed for a comfortable third age over decades: more than a quarter of a century on average.

The European Claims for NDC, Continued

Robert Holzmann checks the potential structure of a Pan-European pension system against the (primary and secondary) goals developed by him and his team at the World Bank

(Holzmann, Orenstein, and Rutkowski 2003). A good pension system should "provide adequate, affordable, sustainable, and robust old-age income, while seeking to implement welfare maximizing schemes in a manner appropriate to the individual country." In doing so, it should create economic growth and minimize negative impacts on labor markets and other areas. As "specific objectives of a Pan-European pension system," he also suggests the four criteria of "mobility, national preferences, solidarity, and feasible transition."

These ideal demands on a reformed and coordinated Pan-European pension system are then confronted with three main options for the "potential structures": "a basic pension plus a mandated fully funded pillar (Beveridge for all); an unfounded defined benefit system plus voluntary fully funded pensions (Bismarck for all); and a basic of noncontributory pillar plus an NDC pillar plus a voluntary (or mandated) funded pillar." Holzmann then discusses the main arguments in favor of each option and the difficulties in implementation, the choses the third as superior. The arguments are all in all convincing—apart from some reservations that I note below. NDC is designed as the crucial or first pillar, able to deal optimally with all system objectives and reform needs mentioned—from financial sustainability to all socioeconomic requirements, including divorce, survivorship, mobility across professions and frontiers, and transition issues across member-country groupings.

Holzmann considers coordination among the existing NDC countries, Italy, Latvia, Poland, and Sweden, which have adopted major differences in design and implementation elements, including transition rules, within the same overall NDC scheme. Germany and France are considered "quasi-NDC countries" most easy to transit. Other Bismarckian countries (Austria, Belgium, Czech Republic, Greece, Hungary, Portugal, Spain) may need more time and reform impetus. The greatest difficulty would be transitioning the European outliers with universalistic systems (Denmark, Ireland, the Netherlands, and the United Kingdom). Coordinated portability from/to other European systems may have to be achieved through buy-in options and transfers of the accumulated NDC amount.

In debating the transition issues in introducing such a potential structure of a Pan-European pension system, Robert Holzmann has no illusions, either about the speed or about the actors involved. "An approach initiated and led by the EU Commission" he considers "possible but not likely"; I would argue that is it impossible given the current interpretation of the subsidiarity principle with regard to pensions. This may also explain that "there are no visible efforts by the Commission to take such a lead," even if "the necessity for a more rapid and a more comprehensive reform" is seen. Also, the method of open coordination "is unlikely to lead to rapid national reforms—and even less to create a Pan-European reform vision." He does not expect a great deal from country competition as various countries adopt reformed pensions systems it is "again possible, and a bit more likely, but not sufficiently rapid. Even if carried out, the outcome might be sub-optimal." Apart from the great time lags in a copy-cat world where countries learn from one another through imitation, institutional transfers will probably remain restricted—and may themselves not yet "ensure sufficient consistency of approaches across countries to provide the needed mobility of the workforce in Europe."

Consequently, the only somewhat realistic perspective for Holzmann is a "cross-country approach led by governments," for instance, through the EU's Economic Policy Committee, should it take a broader view on aging issues. But the coalition to promote "a better coordinated, Pan-European pension system is quite likely the task of academics and research institutions, examined and supported by the EPC or similar core groups, and at some moment in the future espoused by a charismatic European politician as a reform champion. Perhaps this will happen after the first main asymmetric shock hits euroland."

I wish one could be more optimistic on that last point than the author. But perhaps Robert Holzmann's expectations already express the maximum feasible optimism in a Europe simultaneously growing together and drifting apart in many social policy areas, including pensions.

If "No System is Politically Foolproof," Not Even NDC, Is the "Ideal" NDC Truly "Ideal"?

Whether the very design of the "ideal NDC" in the Holzmann model—and the mix of pillars as such—is actually ideal must remain unanswered for the first and probably for the second query. The postulated mix of the model proposes the "structure of a (mandated) first pillar NDC plan, a (voluntary or mandated, if so desired) funded pillar with occupational and individual retirement plans, and a basic pillar of social/non-contributory pensions that provides minimum income support for the very vulnerable elderly." This, in my view, is preferable to the older World Bank perspective of suggesting a combination of mandatory DB-PAYG with a mandatory fully funded DC (corporate or individual) private pillar and a voluntary fully funded DC (corporate or individual) private pillar. But there are also disadvantages, such as potentially fewer synergies in risk spreading, as will be seen in the next section. And whether the better mix proposed now is the best or "ideal" one is not easy to prove. The first step would be to demonstrate the crucial first NDC pillar as optimally designed.

Generally, NDC may be close to an "ideal" pension framework, and thus the "basic structure of ideal NDC" as the core component of the overall combination is designed optimally almost by definition. But specifically, Robert Holzmann leaves actually open almost all parameters to be specified for an "ideal NDC." He neither specifies his choice of an ideal notional interest rate ("the discussion about the (most) appropriate . . . choice is far from over"), nor that of the remaining life expectancy, the indexation of benefits, the reserve fund to be created, or the amount of redistribution and the transition rules to new NDC benefits. Given the fact that all four European countries that have introduced NDC systems (Italy, Latvia, Poland, and Sweden) use different notional interest rates, different ways to determine the residual life expectancy, and different transition rules, some well-reasoned specificity in parameter choice for an "ideal" system would have been expected. But the only specific choice Holzmann makes is advocating a minimum eligibility age to a zero pillar pension that "may have to be conditioned on higher ages (say 70 onward)."

He carefully outlines the issues at stake with any one choice taken, and the non-trivial "technicalities" involved in opting, for instance, for aggregated wage growth rates or for per capita wage growth. The same applies to choices between cross-section life expectancies and estimated cohort expectancies, between price indexation and revaluation beyond price adjustments, or between a top-down and a bottom-up approach in transitioning from DB-PAYG to NDC. Holzmann weighs the pros and cons, the contexts, and follow-up problems of any single choice taken without opting for a preferred one. This is legitimate and academic prudence, but may be somewhat disappointing to readers expecting policy conclusions from a policy expert directing an intergovernmental economic and social policy institution. This even more so as we can see a risk of gradual erosion of NDC rules over time, from Latin America to Latvia. If *no* system is politically foolproof—not even NDC is a panacea, as Holzmann convincingly demonstrates—we may expect some more specific suggestions about how precisely to avoid choices that may turn out to be more foolish or less rational than intended.

Risk Reinforcement Instead of Risk Diversification by the Holzmann Design of the "Ideal" NDC-Mix?

As an "ideal" mix of pension systems around the core NDC pillar, Holzmann proposes combining this basic unfunded pillar with a supplementary funded scheme and with a social pension, unfunded as well. Whereas the crucial first NDC pillar and the social pension pillar or non-contributory pension (as a kind of fall-back device "for the elderly poor") are both PAYG and mandated, the funded pillar—the second or third—is now proposed to be voluntary. Still, it will have to play an important role in a future "more coordinated but not harmonized Pan-European pension system," where national "differences would still exist," but where "their mobility-reducing effects . . . can be limited with a strong (voluntary or mandated) funded pillar." Apart from facilitating "Pan-European mobility," the funded pillar is meant to allow further "consumption smoothing beyond NDC benefits" and "according to individual preferences" without distorting labor supply and saving decisions; "to support retirement flexibility in an aging society"; and to acheive "risk diversification."

Holzmann argues that "as funded and unfunded pillars have a different exposure to economic, demographic, and political risks, and as their rates of return are little correlated, diversifying pension benefits from two pillars is welfare enhancing." No doubt that it is welfare enhancing for globetrotting professionals like those assembled in Sandhamn: currently constrained by a conspicuous and hardly understandable lack of pension portability, great uncertainties about future entitlements, and significant retirement income losses from mobility. It thus, probably serves the great majority of internationally mobile experts at the Sandhamn conference very well. Actually, many of us, despite being specialists in international pension issues, cannot more than very vaguely if at all envisage the kind and amount of retirement income to be expected from a diversity of institutions in a variety of countries. Whether similar welfare gains from combining NDC with a funded DC pillar can be expected by broader middle classes and lower-income strata is still to be seen.

Again, Holzmann's argument holds in principle. But there usually is a much stronger complementarity of respective strengths and weaknesses between a traditional unfunded DB and a fully funded DC system (the previous World Bank priority mix) than between a funded DC and a formally "unfunded" but quasi-funded NDC scheme. As the last combination basically introduces the logic, structures, and processes of private funded DC schemes within public PAYGO systems, synergies of supplementing the other system get lost. By implication, at least two groups of persons may find themselves in more difficult situations than before. Both of them belong to the large section of the population losing through a "quasi-actuarially fair" NDC system because they before have unduly benefited from DB schemes far above their contribution base.

The first group is those in principle able to compensate for the expected losses in pension income. They may do so by investing significantly in a voluntary second or third pillar of a funded pension: for instance, by converting their severance payment claims into an old-age provision. But the new funded pillar is meant to be DC as well, simple in design (to avoid disappointing take-up rates such as with the German *Altersvermögensgesetz* or *Riester-Rente*), and voluntary: three design elements with which I agree. But being voluntary also implies that people free to choose may choose as well *not* to take care of their supplementary old-age provision—or not take care of it sufficiently.

Empirical evidence suggests that this is exactly what we have to expect, at least for some mid-term transition period. The majority of people are not fully aware of their "pension income gap." Those who are do only about a third of the savings they themselves consider necessary. The Sandhamn conference has provided additional evidence of incomplete information, lack of interest, severely limited rationality—and subjective preferences for DB schemes. Annika Sundén (chapter 13, this volume) shows that even for the comparatively well-informed participants in the Swedish system, less than half of them had looked at the benefit projection. They have less self-reported "good knowledge" in 2003 than they had in 2001 when NDC was started, and they show a relapse in most basic knowledge ("all years count") from 50 percent in the year 2000 to 38 percent in 2003. Low-income and younger participants are less likely to look at information at all. In the United States, workers generally lack knowledge about social security benefits, and those who depend most on them are least informed. In Michael Orszag's unpublished presentation to the Sandhamn conference, on which this book is based, he shows that people are generally more satisfied with quality of information in DB systems than in DC systems. Thus, combining two DC schemes will obviously reinforce subjective feelings of uncertainty and information deficiency.

As a consequence, even those who make provisions and voluntarily contribute to a funded DC scheme may at times find themselves with significant and unexpected real losses; and will always find themselves with the double uncertainty of two DC schemes and somewhat unpredictable annuities. Again, Mike Orszag has calculated the "loss in retirement income" in Europe and the United States from 2000 to 2003 as ranging from more than 15 to 25 percent for those who invested in half equity and from more than 40 to more than 50 percent for those who invested in all equity for the funded pillar. The index of all active funds in the Swedish PPM has gone down between the starting period in spring 2001 to 88 percent (spring 2002) and to 63 percent in spring 2003. The Swedish PPM is the Premium Pension system, with a contribution rate of 2.5 percent which accrues a capital-market-determined rate of return. The PPM complements the unfunded (first) pillar with a contribution rate of 16 percent in addition to a minimum "guarantee pension" which provides a basic safety net for those aged 65 and above. The corresponding share of Swedes opting for actively managing their premium pension capital has declined from 67 percent initially to over 14 percent last year to 8 percent in the first half of 2003, the third year of falling stock markets (Casey 2003).

While fluctuations of NDC and funded DC schemes may be independent from each other, co-variation of volatility and thus risk reinforcement cannot be excluded, either. There are many scenarios where risks accumulate or even interact instead of cancelling one another smoothly. For many people, not only getting much lower pension but getting much less predictable retirement income from more sources than before may be the most probable outcome. This may still be meaningful from an overall welfare perspective, but it certainly is in sharp contrast to the hyper-stability of DB final salary pension rights for, say, civil servants in many countries today. It will therefore inevitably be perceived as deterioration over time, even if the final result may be equal to or even better than the *status quo ante*. In Germany, for instance, the *Gesetzliche Rentenversicherung* plus 4 percent savings qua *Riester-Rente* may generate a higher gross replacement income with anything higher than the projected 4 percent annual rate of return on financial markets—nominally (Börsch-Supan and Wilke, 2003, figure 13).

But it will take time to find out what is actually going to happen—and how people actually perceive what is going to happen under uncertainty. Welfare and old-age security must not only be provided, they must also seen to be provided, to be accepted as "good enough," if not "best" a practice or "ideal" pension arrangement.

A Guaranteed Minimum Social Pension is Needed, Not a "Zero-Pillar"

This applies even more so to persons on a minimum social assistance or old-age provision for the elderly poor, who may have been fewer before reforms, or not so poor under a no-reform scenario. In OECD countries, old-age poverty fell for decades until about the mid-1990s, although it was still higher than average among the population above 65, and in particular the population over 75 (Förster 2004). Reforms will most probably reverse the past trend "of the increasing material well-being of the elderly population" and this turn-around has already been observed (Förster 2004). In an accession country like Hungary, for instance, around 150,000 more elderly poor in need of social assistance are expected as a consequence of reform, which is yet far from introducing an NDC scheme (see Marin, Stefanits, and Tarcali 2001).

Holzmann recognizes clearly that "having under the new structure a quasi-actuarial NDC system as first pillar and actuarial funded second and third pillars tends to increase the efficiency in the labor market but reduces the redistribution of income toward the poor" and therefore requires minimum benefits. "Income support for the very vulnerable elderly to prevent old-age poverty is part of the adequacy objectives of any pensions system.' Consequently, he unequivocally calls for "a strengthened social or non-contributory pension in EU member-countries" necessary to counter-balance increasing "vulnerability of the elderly as aging progresses. He argues that "with incomplete and perhaps falling coverage under earnings-related schemes, one can conjecture that poverty incidence will increase as the increase in life expectancy continues." Let us not forget that more than the increase in residual life expectancy, it was and is the increase in survival rates to pension age that determines the pension load. Those survival rates rose from around 15 percent at Bismarck times in the 1870s to over about two-thirds in the post-war period to 90 percent today. Again, who would not share both the diagnoses provided and the normative and policy conclusions drawn in accordance with "the solidarity objectives of the European Union"?

Two main questions remain. First, "how such a strengthened social pension pillar should be structured"? Second, as I added in my original comment on the Holzmann paper, "why should the guaranteed minimum social pension be conceptualized as—and initially even called—a 'zero-pillar'"? Holzmann's response to the second query was to fully accept the objection "and to do away with the, perhaps, questionable notion" but not "with the proposed concept." He thus changed "the language around the zero pillar" into "social pension pillar" or "non-contributory pension," which signals rather a tribute to political etiquette or correctness—and less a rethinking of the real implications of semantic choices.

Before returning to this issue, I accept that his answers to the first query, his own, are all specific enough and satisfying. He opts for a minimum pension under the NDC system in addition to a social pillar in order to "strengthen incentives for formal labor force participation." But he sees that this also requires eligibility restrictions "in order not to contradict the neutrality objective of the NDC structure with regard to the individual retirement decision." Again, I tend to partly agree with the philosophy as well as with the measures proposed. "For example, while allowing individuals to retire from the age of, say, 60 onward, it may have to be required to have a minimum accumulated notional amount equivalent to 100+ percent of the minimum pension or else the need to reach the standard retirement age of, say, 67 (which is increased with a rise in life expectancy). Second, coordinating a minimum NDC pension with a social pension with regard to labor market incentives requires different eligibility criteria (such as some kind of means or affluence testing of the

social pillar), different amounts, or different eligibility ages—or some combination of these. Finally, eligibility for a social pension may have to be conditioned on higher ages (say 70 onward), but means-testing may be kept light . . ."

Still, Holzmann himself seems to be skeptic about the persuasiveness of his overall proposal: "How much national preferences such a social pension pillar would be able to exhibit . . . is open for discussion. . . ." This obviously needs more debate—and research. In this context, let me raise a few basic queries without having precise answers. Did not the very name of "zero pillar" originally disclose a preference for a residual conception of sheer poverty relief instead of a broader conception of welfare? Why not adopt the United Nations philosophy, as formulated from the time of the "Guiding Principles for Social Developmental Welfare Policies and Programmes in the Near Future" to the follow-up documents of the World Summit for Social Development (WSSD) 1995? Why not replace a concept of welfare as minority concern, program of poverty relief, and social control of those "living on welfare" by a more encompassing, comprehensive, and universal policy concern meant to "serve to raise the level of living of the widest possible sections of the population" (UN Guiding Principles; see European Centre 1993, pp. 212, 213 ff.)? Should guarantees regarding old-age pensions be restricted to protecting the marginal and vulnerable instead of more universal minimal standards of human well-being and social integration? Is protecting and compensating the most needy a sufficient complement to counting on self-help for all others, or may a strategy of enabling also require supporting those who generally take care of themselves—and assisting those who care for others?

Are no other forms of minimum income guarantees and non-contributory social rights qua redistribution conceivable, desirable, or even preferable? How does which kind of coverage of unemployment and periods of illness, disability, military service, and family-related time off, such as maternity leave or care leave, supplement insufficient earnings-related NDC claims to a decent minimum income guarantee? As they add up to several years, and frequently more than a decade of absenteeism from work during working life (Marin 2000), they may better assist consumption smoothing and provide more targeted, social policy goal-oriented support beyond poverty relief and to equal opportunities than a social pension. Generous cash contributions for non-contributory periods (related to unemployment, sickness, disability, military service, family-related time-off such as maternity leave, care leave, etc.) may supplement insufficient earnings-related NDC accumulations much better than unconditional basic social pensions, achieving a decent minimum benefit level and at the same time providing better incentives. This, at least, is my major hypothesis. Why should social pensions be means-tested and restricted to "the vulnerable elderly" and thus to the very margins of society, instead of being non-contributory universal grants available to specific categories of people, such as (working or lone) parents, caregivers, or the disabled?

In short: why, after all, should the social underpinning of NDC cum voluntary funded pillar be conceptualized as if it still were what it is not any longer called: namely, a "zero" pillar? Did "zero pillar" not imply unintentionally but tellingly that getting something for nothing (or at least for less than one's contribution equivalent) may end up with getting next to nothing ("zero") for something (a tax-financed primary social policy goal "pillar," withering away with other "national preferences")? Why not conceive the social safety net below the mix of mandated NDC and a supplementary voluntary funded scheme as a "grounding," a basic pension guarantee—as much a core component as the crucial NDC—and not as a "zero pillar," which may crack just when most needed? But I have to agree with Robert Holzmann's rejoinder in a personal communication to this critique that my "grandiose 'pension guarantee' sounds fine but is not fully thought through with regard

incentives provided" and still "rather fluffy." Indeed, much more work needs to be done on the synchronization of minimum NDC pension, social pension, and the non-contributory supplements to regular earnings-related NDC schemes for social policy goals on work-, family- and health-related interruptions of working life—open to everybody in need and not just to the poor.

Disability Welfare: A Most Relevant Lacuna

One crucial aspect of the pension *problematique* in general, and of massive pre-retirement as probably its single most important determinant in particular, that is completely ignored in the Holzmann model is disability pensions. (For recent publications, see OECD 2003; Prinz 2003; Marin and Prinz 2003; and Marin, Prinz, and Queisser 2004). This is even more surprising in view of two trends: first, the uncontrollable spending dynamics on disability policies during the last few decades; and second, its foreseeable future aggravation. With coverage and replacement rates of monthly pension incomes probably falling, as well as with retirement age rising under earnings-related schemes, one can assume that the propensity to exit early from the labor market via disability pension claims may increase. But can an "ideal" Pan-European pension pillar mix formula even be conceived without some solution to one of the major causes of early retirement, if massive early retirement itself is one of the major causes of unsustainable pension dynamics today? In addition to fiscal unsustainability, in several European economies with high non-employment rates, disability pensions play a major role in depressing labor force participation.

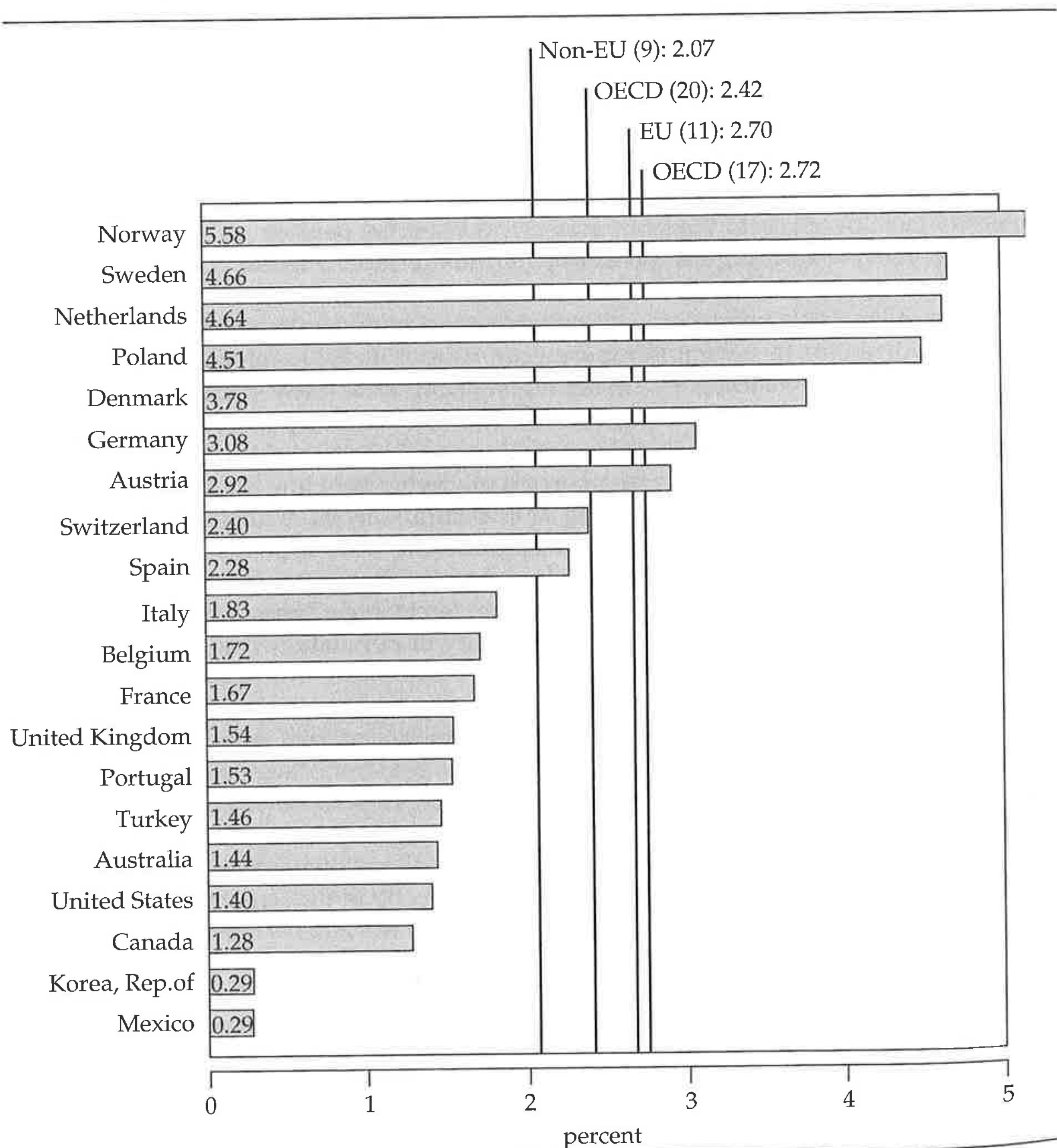
Some facts and trends are puzzling indeed: How can invalidity pensions for the working age population significantly increase with improved health and higher disability-free life expectancy, compression and postponement of morbidity? How is a steep rise in incapacity rates in working age possible along with a simultaneous reduction of chronic and occupational diseases, accidents, and work injuries—and with less exposure to infectious and contagious diseases (some of which have virtually disappeared) and to dust and to hazardous substances such as asbestos and other carcinogens? How can disability pensions in working age rise with a decline in disability of population groups of higher risk such as the elderly beyond working age 65?

In Hungary, for instance, the majority of all new pensioners exit to retirement via invalidity (Marin, Stefanits, and Tarcali 2001, figure 2). In Austria, every second man retires during working age as disabled and the numbers climb to up to two out of three farmers or three out of four blue collar workers. For the age cohorts 55/56 years, invalidity pensions have increased by 555(!) percent in less than two decades. Despite many other avenues for early retirement, in the age group 60 to 64 years, 40 percent of males have an invalidity pension. For the OECD, the average is 23 percent. In the Netherlands, which has one of the world's most advanced medical and health care systems, almost 1 million persons of working age are on disability pension benefits; overall, invalidity recipiency rates have increased 86 percent between 1980 and 1997. In the United Kingdom, without any evidence of deterioration in health, government spending for sickness and disability has quadrupled over the past two decades, and 40 percent of working-age recipients of state benefits now claim sickness and disability compensation.

Correspondingly, the general slowing down of the rate of welfare expenditure expansion (social spending roughly doubled between 1960 and 1980 and has increased around 20 percent since) has affected disability pensions less than any other social expenditure. Extension of programs, number of beneficiaries, and amount of expenditures for disability have steadily increased for about 35 years, even if one controls for the changing age structure of

societies. Periodic efforts at retrenchment (in the mid-1970s and 1990s) have succeeded in slowing down recipiency growth rates, but never the growth of beneficiaries as such; the stock of benefit recipients remained high, and the inflow rates much higher than outflow. As a consequence, even disability pension expenditures have begun to show reduced inflow rates: that is, continuing though slower expansion dynamics. But overall cost containment

Figure 11.6. Variation in Public Expenditure for Disability Related Programs (percentage of GDP)



Source: Marin and Prinz (2003, p. 36).

Note: All disability-related programmes include broad disability benefits and employment-related programs for disabled people. OECD (17) excludes Republic of Korea, Mexico, and Turkey. The vertical lines in the graph indicate mean.

will be a core challenge in the years to come—more than in any other social policy field.

Expansion of disability pensions over the last decades has become uncontrollable (figure 11.6). Social expenditures on disability now total several times the social costs of unemployment, even under adverse conditions of very high unemployment rates. In 19 out of 20 OECD countries investigated, disability costs were significantly higher than the costs for unemployment. On average, they were more than double the costs (2.17 times). In Norway, they are up to 11.9 times the unemployment costs. Public expenditures go up to 5.58 percent of GDP, and are 2.72 in OECD-17 and 2.70 in EU-11 countries. Still, high costs do not guarantee good targeting. A recent OECD report (2003) shows that a clear majority of severely disabled people, most in need of support, are not awarded a disability benefit,

Figure 11.7. Disability Status of Disability Benefit Recipients

not disabled: EU (10): 34.4 | OECD (14): 31.0
moderately disabled: EU (10): 31.2 | OECD (14): 36.2
severely disabled: EU (10): 34.4 | OECD (14): 32.7

Country	not disabled	moderately disabled	severely disabled
Mexico	91.4	8.6	
Sweden	48.9	20.0	31.0
United States	46.7	26.6	26.7
Italy	43.9	25.9	30.3
Belgium	43.4	31.8	24.8
United Kingdom	43.3	28.8	27.8
France	33.3	25.4	41.2
Netherlands	30.6	36.2	33.2
Switzerland	29.8	70.2	
Portugal	28.6	27.5	44.0
Norway	28.4	30.4	41.2
Austria	27.7	38.3	34.0
Denmark	26.2	43.6	30.2
Spain	18.3	34.5	47.1
Australia	15.2	45.0	39.8
Korea, Rep. of		93.4	6.6

100 80 60 40 20 0 20 40 60 80 100
percent

Source: Marin and Prinz (2003, p. 57).

Note: For Mexico and Switzerland, "severe" and "moderate" are one number. Mexico and Switzerland are excluded in the OECD average. The vertical lines in the graph indicate mean.

whereas more than 40 percent of disability pension recipients are self-declared non-disabled (figure 11.7). Scarce funds are thus wasted either on non-deserving persons, often neither poor nor needy, or on persons in need but deserving and being better helped by forms of support other than disability pensions. The European underemployment malaise seems to have shifted from mass unemployment to a massive non-employment, of which widespread invalidity has become a major current.

Above the age of 50, in particular, the relationship between unemployed and economically inactive persons, many of them on disability benefits, is now 1:8. During working age, Europeans are outside the labor force for between 10 years (men) and 22 years (women), of which the average person is likely to be unemployed or on job search for not more than two years. Thus unemployment (while still quite high) is becoming a minor problem as against overall non-employment. Whereas one-in-five adult men of working age is now outside the labor force and another one-in-ten-to-twelve is not working because of unemployment, male unemployed are less than a third of the male non-employed in Europe today. The proportion of women outside the labor force is six times greater than the proportion unemployed.

Obviously, invalidity pensions account for only one faction, though an important and growing one, of overall growing non-employment of adult Europeans of working age. And labor market hypotheses for explaining the rise of disability pensions are all the more plausible, as demographic explanations play no role for the working age population. All medical experts agree that there is no increase in the prevalence of invalidity and, therefore, no medical or epidemiological explanation for this steep increase in invalidity pensions and invalidity expenditures. Aarts, Burkhauser, and De Jong (1996) refer to a quantitative study of determinants of change in disability recipiency shares in the Netherlands in the 1980s (Aarts and de Jong 1992). They concluded that only a third of the variance in inflow into disability status is explained by medical factors. Two thirds is explained by non-medical determinants, above all benefit generosity and unemployment rates.

The Policy Shift Needed on Disability Pensions

Disability pensions seem to have become a kind of garbage can social welfare category. It probably will continue to depress labor force participation above the age of the median voter—around 45 years already, today. Thus it will contribute to aggravating fiscal pressures rather than to maintaining or restoring stability and long-term sustainable social policy. This *malaise* requires a paradigmatic turnaround in framing the social policy issue at stake. The very expansion of disability pensions cannot be seen any longer as a sign of more overall welfare and well-being of disabled people or "elderly" unemployed of middle age, but rather as an administrative incapacity to provide welfare and cater it well enough to the persons with impairments in need. In short, disability welfare extension is a potential welfare failure, rather than an unquestionable welfare and social policy success.

As with spending on unemployment, hospitals, prisons, and pharmaceuticals, more spending on sickness, accidents, work injuries, and disabilities or early retirement invalidity may signal less welfare for each disabled person and for society at large. Yet the failure of disability pension policies is not at all accidental but an inevitable byproduct, an unintended but unavoidable consequence, of a purposeful and successful social compensation policy. Compensation produces income security for persons with assumed health-related restrictions on earnings without a corresponding level of integration offers and activation demands. In all modern European welfare states, the main determinants of public spend-

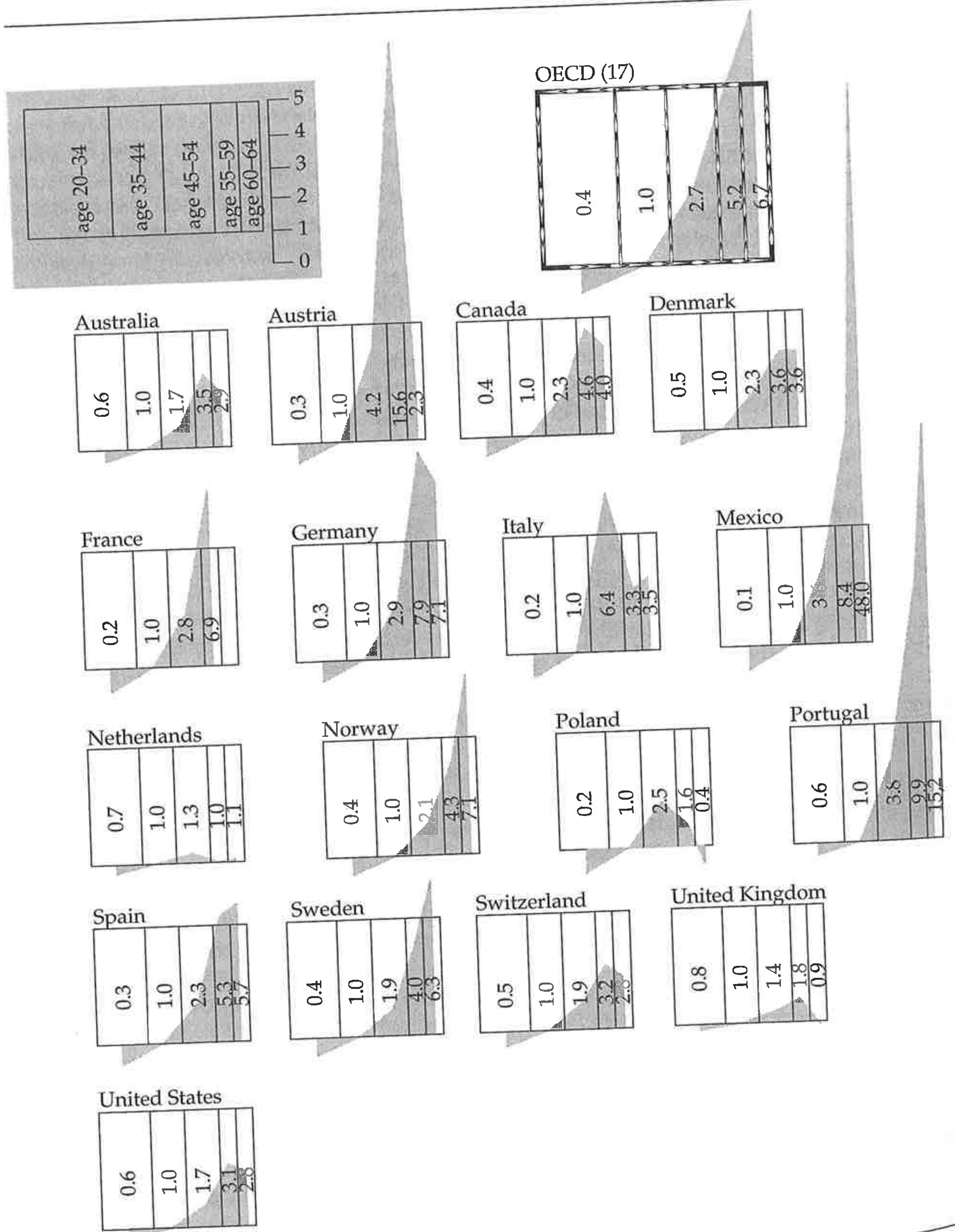
ing are not revenue but entitlements to welfare benefits. But in contrast to transfers—for instance, for unemployment, social assistance programs, or even old-age pensions—spending on invalidity pensions and disability benefits cannot easily be changed and adapted even over mid-term periods. Disability pensions lend themselves to the temptation of political rent-seeking and manipulation, to using pre-retirement and invalidity pensions schemes for facilitating industrial restructuring or for hiding unemployment, for getting votes instead of making welfare schemes compatible with standards of fairness, competitive requirements, and long-term affordability. Disability pensions allow for trading short-term political popularity for long-term sustainability. Easier access to early retirement, broader coverage, more generous replacement income, more relaxed screening of eligibility and assessment of claims buy immediate satisfaction of interest groups and voters. The fiscal burdens of unfunded liabilities are shifted unto later generations of working populations, without easily discernible relationship with the goodies distributed in earlier periods (for this and the following, see de Jong 2003).

But in contrast to political leniency with respect to regular old-age security, thoughtless generosity regarding disability pensions changes the behavior not only of current invalidity beneficiaries; it also adversely affects the behavior of potential claimants: non-disabled employees, their employers, and social administrators, and all other interest groups as well. As with sickness and health insurance, moral hazard in disability welfare may become contagious, spreading over to others, demoralizing previously innocent bystanders watching what they may consider malingering at their own expense by free-riding recipients. They may possibly give in to the temptation to use incapacity schemes that are an easier and cheaper way to deploy surplus workforce than regular dismissals. Enterprises frequently find themselves in the paradoxical situation of complaining about a rise of non-wage labor costs, which they themselves have previously produced by abusing pre-retirement and invalidity pensions schemes to offload large proportions of middle-aged workers at public expense.

Currently, disability policies award many more people permanent pensions than they place in rehabilitation or employment programs, with much higher costs for social exclusion. They are not able to create employment through activating programs. Everywhere, they systematically exclude exactly those persons most in need for occupational reinsertion—those above 45 years of age where inflow rates are highest—from return to work programs, creating a great age-mismatch between disability inflow and vocational rehabilitation offer. Thus, they are completely writing off broad middle-aged cohorts of persons with partial impairments and whole generations of so called elderly workers that have gone through longer spells of unemployment. They invite massive claims for invalidity pensions and illness-related pre-retirement for ever younger cohorts and frequently even grant early retirement under false disability label. Large country differences are not even well documented, nor understood (figure 11.8).

Disability policies have led to a situation where invalidity expenditures and non-employment costs for disabled people within generally more healthy populations greatly exceed the expenditures for unemployment. These policies have led to an acceptance of widespread paid non-employment of employable persons with (partial) disabilities. They take it for granted that extremely low outflow rates for even partial disability tend to make invalidity benefits, once granted, a lifelong welfare dependency. They even tend to channel social problems of long-term unemployment, social assistance, and non-employment through the invalidity track, thus making disability a major entrapment for surplus labor populations. They thereby not just misallocate resources at a grand scale but misdirect and reduce energies and work capacities at large. They demoralize and misguide disabled and non-disabled citizens alike—to the extent these mismatches become widely visible and

Figure 11.8. Country Differences in Age-specific Inflow Rates (ratio of age-specific inflow rates over age group 35–44, 1999)



Source: Marin and Prinz (2003, p. 74).

Note: Data for Canada, France, Italy, and Spain cover contributory programs only rather than both programs.

publicly debated—corrupt norms of solidarity and reciprocity by inviting opportunistic behavior and widespread abuse of social rights, and threaten to undermine the legitimacy of welfare entitlements and pension arrangements altogether.

As a consequence, the radically ambiguous paradigm shift that has occurred during the last decades must be followed-up by a shift toward a more coherent employment-oriented equal opportunity model (OECD 2003; Marin, Prinz, and Queisser 2004). What is crucial is that the normalization and mainstreaming of disability inherent in the social model finally moves away from modeling disability benefits primarily according to a lifelong retirement pension scheme without return option, and move it instead more toward job search, job return, and other (re-)start or unemployment programs.

The Primacy of Political Desirability, Feasibility, and Sustainability of NDC: Its Underestimated Comparative Advantages

For all those reasons, introducing NDC as a core component within an overall Pan-European pension package or combination of multiple pillars should be argued both in political and economic terms. The mix Holzmann proposes has "an NDC model at its core and supplementary funded pensions and social pensions at its wings." It is a mix of mandatory and voluntary, of unfunded and funded, of public and private, occupational and individual retirement plans, of contributory earnings-related and non-contributory minimum income support. It will have to be argued convincingly—and that, in the last resort, is politically. When taking recourse to economic reasoning and formulated in its very framework, efficiency arguments are necessary, but not sufficient, whereas fairness and equity issues building on optimal efficiency are most important.

Policy conclusions follow this diagnosis. In order to win broader popular support for NDC schemes, their underestimated comparative advantages and *political assets* should be clearly presented.

- *NDC as a fairness standard, anti-corruption device, and promoter of pension literacy:* NDC sets broadly shared standards of fairness, as actuarial fairness may be the minimum common denominator, apart from and compatible with remaining ideological cleavages in matters of social justice. NDC thus makes explicit hidden or perverse redistributions, as well as implicit taxes for the benefit of special privileged sectional or particular interests, and discloses the true beneficiaries of pension arrangements and reform measures, as opposed to claimed beneficiaries. It makes people think in terms of lifetime contributions, lifetime incomes, annuities, and lifetime pension entitlements in relation to flexibly chosen retirement ages, as against monthly replacement rates to final or previous incomes. It induces thinking in terms of choices, trade-offs, and budget and other constraints, thereby living up to the requirements of modern pension systems, and generating pension literacy (against all well-known reasons for limited knowledge). It may unblock reforms and build political consensus on required adjustment options in situations where the current system is widely seen as unjust, but lack of credibility to continue with parametric reforms is difficult to overcome.
- *NDC as a functional differentiation of welfare trigger:* NDC allows for functionally differentiating old-age security from disability benefits, health or accident insurance, social assistance, unemployment benefits, survivor's income support, and other family policy measures such as child care credits, anti-poverty measures, and all minimum or basic income guarantees. While these and other social policy fields remain strongly interrelated, only functional differentiation and correspondingly separate

flows of resources permit transparent and politically defendable forms of redistribution. It also allows for autonomy and self-referentiality of the social security pensions system comparable to that of the central banks, the judiciary and court system, science and research, the market economy, and the political system. This system needs its own specialized language, vocabulary (translating all DB problems into NDC language), taxonomy, and framing. But finally, it makes for a "difference in philosophy, not just vocabulary" (Lindbeck 2003b). It is not an "autopilot" system (Monika Queisser, chapter 12, this volume), but helps safely navigate long distances (even with controlled naps or nodding off occasionally). And it eliminates the need for constant nerveracking, costly, and conflicting parametric reform maneuvers (for example, 35 since 1993 in Austria; 50 between 1963 and 1995 in Sweden).

- *NDC as better risk management:* As Gora and Palmer (2003) have shown convincingly, NDC is a superior form of risk management and risk diversification compared to all other pension paradigms. Of course, NDC faces the same macroeconomic and somewhat less demographic risks as all other systems. But compared to public defined benefit systems, it is much less exposed to political manipulation—and not at all subject to opportunistic behavior and moral hazard. It does not create overshooting expectations and no promises will ever be broken; it even depends less on good forecasts. And in contrast to financial defined contribution accounting systems, it is unexposed to financial market fluctuations. There are advantageous NDC features, but not all of them are inherent in NDC; rather, the tangible advantages are in political realities more than in design or superior formula. NDC is inevitably "underresearched" because of its newness, but it is not "oversold" (Diamond 2003) as long as it does not claim conceptual instead of practical and political superiority.
- *NDC as a core component of any pension constitution and autonomy:* NDC's comparative advantages in handling risk exposure—compared to DB-PAYG systems and financial DC systems—make NDC the single most powerful candidate for a core component of any pension mix and pension constitution. The "wings" making this rare bird fly best are still under construction and testing. But the NDC corpus as a PAYG lifetime saving scheme could help to turn an implicit and frequently heavily distorted generation compact into an explicit generation contract, providing fairness and equity within and between generations. It does not yet solve the transition legacy problem of how to handle overhang liabilities (which in Japan amounts to 95 percent of all excess liabilities; see Takayama, chapter 24, this volume) and how to share the legacy costs over generations. But in preventing future excess liabilities, NDC can help overcome system imbalances and correct a prevailing sense of opaqueness and injustice that so far have been the major obstacles to pension reform. It may still not yet be a magic Pan-European pension reform and coordination formula. But it may come close to an optimal device in that there are no better ones around. And trying to become the best workable pension arrangement, not only in Europe, may make NDC come close to the "ideal" self-binding mechanism claimed for by Robert Holzmann.

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