Social Security privatization: Lessons from the United Kingdom

Author: John B. Williamson

Chestnut Hill, Mass.: Center for Retirement Research at Boston College, 2000

SOCIAL SECURITY PRIVATIZATION:
LESSONS FROM THE UNITED KINGDOM

John B. Williamson*

CRR WP 2000-10
November 2000

Center for Retirement Research at Boston College
550 Fulton Hall
140 Commonwealth Ave.
Chestnut Hill, MA 02467
Tel: 617-552-1762 Fax: 617-552-1750
http://www.bc.edu/crr

*John B. Williamson is a Professor of Sociology at Boston College. The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) funded as part of the Retirement Research Consortium. The opinions and conclusions are solely those of the author and should not be construed as representing the opinions or policy of SSA or any agency of the Federal Government or the Center for Retirement Research at Boston College. The author wishes to thank Yamil Jaskille, Michele Eickman, and Nicholas Close for their research assistance.

SOCIAL SECURITY PRIVATIZATION:

LESSONS FROM THE UNITED KINGDOM

ABSTRACT: This study draws lessons for the debate about the proposed partial privatization of Social Security in the United States based on evidence from the United Kingdom. The British case suggests that privatization may lead to a reduction in the pension burden on the national budget if combined with substantial cuts in benefits. Such reforms may have positive effects on the economy, but any such benefits would come at the cost of increased inequality and lower pension benefits for many low-wage workers, particularly women. Because Social Security is a path dependent process, policy history differences make it less likely that Americans will easily accept the level of privatization found in Britain.

Any major change in Social Security policy, such as the partial privatization of the program, has the potential to profoundly impact the social welfare and economic well-being of many Americans, particularly the 66% of the elderly for whom Social Security makes up more than half of their annual income (U. S. Social Security Administration, 1997). Given the number of Americans who depend upon Social Security as a major source of retirement income, it makes sense to find out as much as we can about possible consequences, both positive and negative, before even partially privatizing the program. There are a number of ways in which relevant information can be obtained, and each alternative has both strengths and limitations. One alternative is to analyze what has happened in other nations that have much in common with the United States that have partially privatized their pay-as-you-go pension schemes.

Much attention has been given to developments in Chile because it is the nation with by far the longest experience with a privatized social security scheme based on funded personal accounts (Arenas de Mesa & Montecinos, 1999; Edwards, 1998; Huber & Stephens 2000). While developments in Chile offer a number of potential insights relevant to the privatization debate in the United States, Chile differs from the United States in many ways including population, level of economic development, social structure, and cultural background (Williamson, in press). Such differences limit the value of the Chilean experience as a source of information about what would happen were the United States to privatize its Social Security system.

More relevant as models for the United States are privatization reforms that have been introduced in various OECD nations. The most relevant of these nations is the

United Kingdom. While there are other industrial nations (such as Australia and Sweden) that have partially privatized schemes in place(CBO, 1999; Sundén, 2000), Britain is the only G-7 nation that has made the transition from a largely public pay-as-you-go earnings related scheme to a partially privatized alternative with funded individual accounts.

Efforts to generalize to the United States from Britain, Sweden, Australia, or any other OECD country must be carried out with a great deal of caution due to differences between these countries and the United States with respect to program history (e.g., whether or not the country has a long or short history with a wage-related public defined benefit scheme), projected future demographic structure (e.g., the relative proportion of the population that will be elderly 30 or 50 years from now), structural differences related to interest groups (e.g., the influence of labor unions or groups representing the elderly), and differences in cultural values (as reflected in the strength of commitment to social democratic as opposed to neo-liberal policy goals). While it would be a mistake to assume that reforms related to privatization in other nations would have basically the same consequences in the United States as in those nations, it would also be short sighted not to at least take a close look at what has happened in those nations for possible insight about what might happen were the United States to privatize its scheme.

This paper presents an analysis of recent reforms in Britain that have potential implications for the debate over the proposed partial privatization of Social Security in the United States. There are a number of lessons, some supporting privatization and some cautionary, that can be drawn from the British case.

THE PENSION SYSTEM IN THE UNITED KINGDOM

There are many reasons that Britain is relevant as a policy model for the United States. One is that it has more then ten years of experience with pension policy reforms similar to those currently being considered by American policymakers. While the evidence is not all in with respect to the long-term effects of recent British reforms, preliminary evidence is available with respect to some potential strengths and potential problems. Another reason for taking a close look at this case is that Britain is in many ways structurally and culturally similar to the United States (Orszag, 1999). In both countries discourse about social security is dominated by a repositioned center-left and neo-liberalism. Britain has many of the same powerful interest groups and a very similar set of social values including those emphasizing the importance of freedom, autonomy, and individual self-help. Given that Britain has an older age structure than does the United States (Kingson, 1999, Table 2; OECD, 1997), it provides a glimpse of the demographic pressure the United States will be facing several years from now (Weaver, 1998).

Britain introduced its first national pension scheme in 1908, a flat-rate means-tested noncontributory subsistence level pension (Gilbert, 1970, p. 236). In 1925 the means test was dropped and it became contributory (Ogus & Wikeley, 1995, p. 4). The partial privatization of the British national pension system began with legislation enacted in 1959 and implemented in 1961 adding a second-tier earnings-related pension called the "graduated pension." This legislation also gave employers the right to opt-out ("contract-out") of the graduated pension if they provided an alternative private defined benefit occupational pension plan for employees. The graduated pension was designed to provide modest, some would say token, benefits so as not to put pressure on employers to increase benefits provided by existing occupational pension schemes. By keeping the benefits associated with the new public pension alternative low there was little, if any, pressure on employers to increase the benefit levels associated with the occupational pension schemes they had in place (Baldwin, 1990, p. 240).

Legislation enacted in 1975 and implemented in 1978 replaced the graduated pension with the State Earnings Related Pension System (SERPS) which called for much more generous second-tier benefits. This pension was designed to replace approximately 25% of a worker's pre-retirement wage, based on his or her twenty best years. It too allowed employers to contract-out and substitute their own private pension plans, but the benefits had to be at least equal to the relatively generous benefits provided by SERPS (Williamson & Pampel, 1993, pp. 54-55).

In retrospect, the 1959 and 1975 legislation can be viewed as early stages of the privatization of the British pension system, but that is not how the legislation was viewed at the time. The introduction of the graduated pension and subsequently of SERPS represented efforts to supplement existing private pension coverage by adding a public earnings-related scheme for those not covered by existing private schemes (Budd & Campbell, 1998, p. 125).

The Thatcher government came to power in 1979 and encouraged further privatization by making the public scheme less generous and providing increased incentives for workers to move out of SERPS. In 1980 a change was made in the way the first-tier flat-rate pension ("Basic State Pension") was indexed. Indexing had been based on the higher of price increases or wage increases, an approach to indexing that attempts to keep up with long-term increases in the overall standard of living. The 1980 legislation shifted indexing to reflect only increases in prices, a policy assuring that over time the pension would replace an ever decreasing share of pre-retirement income.

A number of major pension policy changes were included in the 1986 Social Security Act and implemented in 1988 (Liu, 1999; Pierson, 1994). One of the most important offered employees the very favorable tax incentives to opt-out of SERPS (or occupational pensions as well) and set up personal retirement savings accounts called Appropriate Personal Pensions (APPs). Workers could select from a very large number of private sector financial service providers (primarily insurance companies, but also other financial institutions such as banks and mutual funds) and a portion of the worker's National Insurance contribution (payroll tax) that had gone to SERPS (or to an occupational pension) could now be sent to a personal account with a provider of the worker's choice. These accounts are similar to IRA accounts in the United States.

Another important provision of the 1986 legislation called for cuts in future SERPS benefits. Under the 1975 legislation SERPS was to replace 25% of the workers pre-retirement income based on his or her 20 best years. Under the new legislation the replacement rate would be gradually reduced from 25 to 20% between 1999 and 2009. In addition this pension would now be based on the worker's average lifetime earnings (a provision that further lowers benefits for many workers, particularly those with irregular work histories, a category that includes many women).

In the 1995 Pensions Act several other reforms were made. One called for gradually increasing the pensionable age for women from 60 to 65 by 2010. Another called for a shift to a less generous formula when computing the worker's original SERPS benefit. Yet another change shifted responsibility of paying for occupational pension price indexing from the government to employers. The net effect of these changes was to further reduce projected future government spending on public pensions.

Most relevant to the current debate in the United States are the personal pensions (APPs) that have been in place since 1988, but there are many other British reforms that are also relevant to this debate. In Britain the private occupational pensions have been part of the national pension program since 1961, and this allows us to analyze the impact of privatization over a much longer period of time.

Britain is currently in the process of making some additional changes in pension policy that will have substantial consequences in the years ahead. As these changes are currently being phased in, it is too soon to draw conclusions about how well they have worked. At the end of 1999 legislation was approved by Parliament calling for the introduction of what are called stakeholders pensions. The Act requires most employers that do not already have occupational pension schemes in place to introduce a new type of occupational pension call the "stakeholder pension." In many ways they will be more like the APPs than like traditional occupational pensions. These pensions will be similar to the APPs in that they will provide individual accounts, but the annual administrative fee will be much lower (1%) and workers will be allowed to transfer between schemes without penalty. They are designed for moderately low-wage workers, a group that often has not had access occupational pension coverage, but unlike traditional occupational pensions very few employers are expected to add a contribution over and above the worker's contribution. These pensions will become available to the public as of April 2001.

A second new pension option is called the State Second Pension. It will start in 2002 (when contributions to SERPS will end). During the first few years it will not be a flat-rate scheme, but it will become a flat-rate scheme in 2007. This second-tier flat-rate pension will eventually replace SERPS. The State Second Pension is designed to meet the needs of workers with low wages and irregular work histories. For this category of workers the new scheme will do a better job of replacing pre-retirement income than would SERPS, particularly given the cuts in SERPS benefits that are being phased in. After 2007 low-wage workers will typically be covered by the original flat-rate first tier Old Age Pension and the flat-rate State Second Pension.

LESSONS FROM THE UNITED KINGDOM

In this section a number of observations (lessons) based on the British experience are presented and where appropriate, generalizations are qualified. Relevant evidence is briefly presented.

If partial privatization is accompanied by substantial cuts in public pension spending, it is likely to have positive long-term consequences for the public pension burden and the national debt. In addition, it may also contribute to economic growth making it easier to pay for the retirement of the boomers. Britain has an older age structure than does the United States and this is likely to continue for the next several decades (Chand & Jaeger, 1996, Table 1). Despite this, the public pension burden (public pension expenditures as a percent of GDP) is projected to decrease from 4.3 in 2000 to 3.4% in 2050 (See Table 1). During the same period the trend for the United States is projected to increase from 4.3 to 7.7%. The projected trend is even more problematic for countries such as Japan (6.5 to 10.7%), Germany (11.1 to 18.7%) and France 12.0 to 21.3%). However, it is important to keep in mind that projections such as these assume no changes in pension policy prior to 2050 (other than those already enacted). It is more reasonable to assume that at least some changes will be made long before 2050 in all of these countries. One reason for the favorable projections with respect to future public pension burden for Britain is the change in indexing for the Basic State Pension introduced in 1980. Also important were the cuts in SERPS benefits implicit in the reforms of 1986 and 1995 (See Table 2).

Tables 1 and 2 go about here

The trends evident in Table 1 have implications for the size of the national debt. If no public pension policy changes were made, projections suggest that the national debt in many of these countries would be expected to increase considerably over the next thirty years; but for Britain, in contrast, they suggest that the national debt will decrease dramatically (Enoff & Moffit, 1997, p. 3). While privatization seems likely to keep down the public debt in Britain, the impact on economic growth is less clear. Some experts argue that the privatization will probably enhance economic growth making it easier to support the retirement of the boomers (Thompson, 1999, p. 13), but others question this conclusion (Waine, 1998, p. 162). Whether the British efforts to further privatize pension provision will in the end contribute to greater economic growth depends in part on whether or not it results in a substantial increase in national savings. A substantial increase in national savings would be expected to contribute to economic growth.

Projected cuts in spending on public pensions are likely to result in a reduction in overall government spending (even if we factor in increased spending on means-tested Income Support) contributing to an increase in the public savings rate. However, once the increased regulatory costs and tax losses (due to deferred taxation and the incentive tax rebate for shifting from SERPS to an APP) are factored in, any net increase in savings rate could be modest and largely offset by a reduction in personal savings (Crawford, 1997, p. 39; Schulz, 2000b, p. 95). To the extent this happens, there may be little if any positive impact on economic growth or the size of the overall economy.

Personal pensions (individual retirement savings accounts) may be popular, particularly among younger and more affluent workers. During the first five years or so after they were introduced the APPs were very popular and participation in them grew much more rapidly than had been projected. One explanation as to why they have been so popular is that they are viewed as empowering the individual to make his or her own retirement income decisions and they are also consistent with the value British culture puts on individual self-help (Liu, 1999, p. 24). In recent years the number selecting this option has leveled off at about 20% of those covered by second-tier pensions. This APP option is particularly popular among younger workers. However, the new stakeholder pensions will compete with the APPs for some categories of workers, and over time this is likely to lead to a reduction in the proportion of workers choosing the APP option.

An important reason the APPs were very popular during the early years is that strong economic incentives in the form of tax rebates were provided to get workers to move from SERPS to the APPs (Budd & Campbell, 1998, p. 110). Those electing to move were being subsidized in a big way using general revenues. After the first few years the level of this subsidy was reduced making the APPs less attractive and less popular.

Currently only about 65 to 70% of APP accounts are active Liu, 1999, p. 29). A more serious problem has been the bad publicity the APPs have received linked to the Maxwell affair and the mis-selling scandal in which approximatley 1.5 million workers were sold APPs that were not appropriate for them (Phillipson, 1999). The financial institutions involved have been very slow about investigating and making good on claims in connection with the mis-selling (CBO, 1999, p. 38; Schulz, 2000a, pp. 33-34).

In the aggregate returns on private pensions may be very favorable. Most relevant here is the evidence with respect to the private occupational pensions. One estimate is that between 1986 and 1995 the average yearly rate of return for private pension funds was 13.3%. During this same period average yearly inflation ran 4.6% (Enoff & Moffit 1997, p. 5). As the British stock market performed very well during the 1980s and 1990s (U.S. Bureau of Commerce, 1998, Table 1388), it is easy to see why many workers have opted for private pensions rather than SERPS. Occupational pensions are particularly attractive because employers often add to the employee's contributions boosting the effective first year return on that contribution. In contrast, the changes in SERPS incorporated in the 1986 and 1995 reforms include future benefit cuts (CBO, 1999, p. 36). These cuts result in an implicit reduction in return on contributions currently being made to SERPS.

While the returns for private pension benefits were very strong during the 1980s and 1990s, this was not true during the 1970s, a period when the British stock market generally did not do well. A major drop in the stock market could undercut popular support for personal pensions and defined contribution occupational pensions as well. Some proponents of privatization argue that the increase in income among British pensioners over the past two decades has been due in large measure to the privatization of pensions (Moffit, 1999, p. 3); however, it is of note that similar trends in retirement income have also be observed in the United States which has depended on a public defined benefit scheme during this same period.

A more important consideration is that many British workers who selected the APP option have not realized anywhere near the overall average return for private pension funds. The APPs have a complex set of fees which vary from one financial institution to another in ways that make it difficult for British workers to comparison shop. Many workers shift their assets from on provider to another within the first few years. When they do, the combination of commissions on new contributions, penalties for shifting to another provider, and various flat rate fees greatly reduce returns, particularly for workers who earn low wages and have irregular work histories (CBO, 1999; pp. 39-41; Schulz, 2000b, pp. 99-100).

It is possible to deal with the double-payment problem The British case suggests that it should be possible to finance the transition from a public pay-as-you-go (PAYG) scheme to a largely privatized and prefunded scheme, particularly if some use is made of general revenues (in the form of tax incentives for workers to opt-out of SERPS) and if cuts are made in public pension benefits (Crippen, 1999, p. 6). However, as Myles and Pierson (in press) point out, it would have been much more difficult for the British government to finance the transition had SERPS been a mature earnings-related scheme (such as exists in the United States today) at the time the transition began. In the British case the transition has been made easier because much of the transition had already taken place by the mid-1980s. By then about half of employees were already enrolled in occupational pension schemes that were private sector alternatives to SERPS (Williamson & Pampel, 1993, p. 55). By way of contrast, in the United States almost all workers with employer-provided pensions also participate in the public scheme. This points to a major structural (and policy legacy) difference between Britain and the United States that has implications for the relevance of recent British reforms to the current American debate over Social Security reform.

Not all of the lessons from the British case point to the advantages of privatizing public pension systems. There also seem to be a number of costs associated with the shift away from a largely public, defined benefit PAYG scheme toward a much more privatized alternative.

Privatization is likely to increase income inequality. Privatization may be responsible, at least in part, for the sharp increase in pension benefits for those at the upper end of the income scale relative to the more modest gains among those toward the bottom (Budd & Campbell, 1998, pp. 116-117). Over the past twenty years pension income for the top quintile has increased by approximately 70% while for the bottom quintile the increase has been much lower at 38%. The move toward privatization has increased inequality in part as a result of the unequal distribution of privatized pension benefits and in part as a result of the unequal distribution of the burden associated with various cuts in benefits needed to help finance the transition from the PAYG alternative (Phillipson, 1999; Schulz, 2000b).

There is reason to believe that as the cuts in the public system go deeper in the years ahead, the relative position of those toward the bottom of the income distribution will get worse. Middle and upper income workers tend to be covered by occupational and personal pensions. In any given year the bottom 15% or so of workers are excluded from both the first and the second-tier schemes due to their low incomes. If a worker's income falls below the specified level for the year, he or she does not pay into or get credit toward an eventual first or second tier pension for that year. Even the flat rate pension does depend upon the number of years of contribution. As a result at retirement many low-wage workers become eligible for a means-tested subsistence level benefit for the poor called Income Security (soon to be relabeled the Minimum Income Guarantee). Not all 29% of those covered by SERPS have below average incomes, but most do; about 70% of those in SERPS earn less than £10,000 per year while the average income for a male working full times is about £20,000 per year (Budd & Campbell, 1998, p. 102).

Given that workers covered by SERPS tend to be concentrated toward the lower end of the income distribution, as planned cuts in SERPS are phased in there are going to be regressive consequences. The gains in pension income lower-wage workers have experienced in recent years is due in large part to the introduction of SERPS in the late 1970s and the relatively generous pension benefits associated with the program until quite recently. These gains will begin to erode as already legislated cuts are phased in during the years ahead. These cuts are likely to contribute to a trend toward greater income inequality among retirees (Pension Provision Group, 1998).

The projected long-term impact of already enacted cuts in SERPS and the first-tier (Basic State Pension) scheme on the low-wage population has become a concern among British policy makers. The recently enacted State Second Pension represents an effort to blunt the impact of these benefit cuts on low-wage workers (Schulz, 2000b, p. 19).

Privatization is likely to increase gender inequality. In addition to income inequality many of these same policy changes are also likely to increase gender inequality. As women are more likely to be SERPS recipients, in part due to lower incomes then men and in part due to more movement in and out of the labor force, the cuts in SERPS benefits being phased in tend to have a disproportionate impact on women. Women have less access to private pensions than men and they are more adversely affected by the cuts in the first-tier Basic State Pension. They are also more adversely affected by the 1995 legislation equalizing the normal pensionable age by raising the age for women to match men at 65 and a change included in the 1986 legislation calling for a shift from basing benefits on the best 20 years to basing them on lifetime earnings (Ginn & Arber, 1998; Schulz, 2000b).

British workers who earn too little to be eligible for either a first- or second-tier pension benefits will suffer relatively little harm from cuts in SERPS, but this group, which is disproportionately female (Liu, 1999, p. 27), will also fail to benefit from the high long-term returns from private pensions. Over time the gap between this group and those eligible for private pensions is likely to increase and with it the gender gap in retirement income. While the new State Second Pension will not reverse this trend, it will reduce the gap relative to what it would have been in its absence.

Workers who enroll in APPs must buy an annuity at retirement with at least 75% of the assets accumulated in their personal pension fund. While women are better off with this requirement than no requirement of annuitization, some will be less well off than men. A married women whose husband has had a much larger salary over the years may be harmed if he decides to spend the other 25% of his pension in ways that do not benefit her long-term well-being.

Women who are eligible for annuity benefits based on their own work histories end up with lower monthly benefits than men with similar wage histories due to gender differences in life expectancy. They can expect to get the same total return on their annuity investment over a lifetime, but knowledge of this may not be much consolation as they pay their monthly bills. Another potential problem for women is that it is up to the retiree to decide whether to purchase an annuity that includes survivor benefits (Thompson, 1999, p. 13).

Yet another form of inequality that has emerged is between different categories of women. The majority of women who remain in the labor force throughout their working lives, who work full-time, who earn higher wages, and who work for corporations providing occupational pensions find themselves in a very different economic situation in retirement than the majority of women who move in and out of the labor force, who work part-time, who are in lower-paid occupations, and who do not work for organizations providing occupational pensions (Ginn & Arber, 1998).

Policy gains such as decreases in the national debt and the public debt burden may be due more to the cuts in public benefits used to finance the transition than to savings directly linked to privatization itself. For example, one set of projections suggest that the new British APPs are likely to produce a reduction in government spending of £2 billion for the year 2030, but a much greater saving of £33 billion in the same year as a result of the 1980 legislation calling for the introduction a less generous indexing procedure the first-tier pension. As another example, two policy changes were made in 1995, one gradually increasing the pensionable age for women (from 60 to 65) to equal that for men and a second that changes the formula used to compute SERPS benefits based on past earnings making it less generous. Together these changes will save £12 billion in 2030. Workers who retired in 1999 after earning the average wage throughout their lives and who are covered by only the state basic pension and SERPS could expect to have 16% of their pre-retirement wages replaced by the state basic pension and 20% replaced by SERPS for a total of 36%. However, comparable workers retiring in 2030 will find that the Basic State Pension replaces only 10% of pre-retirement wage and that SERPS will replace only 16% for a total of 26% of pre-retirement earnings (Liu, 1999, p. 32). One interpretation of these projections is that the British have in effect asked the disadvantaged, particularly low-wage workers and women, to bear a substantial share of the sacrifices needed to create the nation's rosy future with respect to anticipated reductions in spending on public pensions and the associated reduction in the level of the national debt.

The administrative costs associated with a personal pension program are turning out to be much higher than originally anticipated. During the early years the claim was that the administrative costs associated with the APPs were relatively low. But more recently it has become increasingly clear that the administrative costs are relatively high and certainly a lot higher than had been thought. One estimate is that it costs up to 20% of the value of yearly contributions to administer the personal pensions as opposed to approximately 1% for SERPS (Crawford, 1997, p. 42). Another way to describe the cost of administering personal pensions is to say that when all fees, commissions, and other administrative costs are taken into consideration the cost to the account of the average worker runs somewhere between 1.5% (CBO, 1999, p 39) and 2.5% (Chapman, 1998, p. 88) of the assets in that account per year. Due to the way charges are assessed the actual administrative charges tend to be lower for those who make regular and large contributions and higher for those who make smaller and more irregular contributions, particularly those who stop making contributions altogether (Blake, 1995; Liu, 1999, p. 36). These fees and the resulting impact on net returns are particularly problematic for women (Ward, 1996, pp. 43-44, 83-84). A number of factors have contributed to the high administrative expenses. The need to service a large number of small inactive accounts has driven up administrative costs as has the increase in time needed to respond to more elaborate regulatory procedures called for in the 1995 legislation in response to the mis-selling scandal.

In Britain SERPS has very low administrative costs as does the Social Security system in the United States. The British occupational pensions have higher administrative costs, but it is the APPs that have the highest administrative costs. In the long-run such costs reduce net returns on investments, but as long as the stock market is moving up rapidly, as it did during the 1980s and 1990s, these costs get less attention than they otherwise would. However, the impact of these fees on the accounts of low-wage workers with irregular work histories has not gone unnoticed. It is a major reason that the stakeholder pension was created with a 1% limit on the administrative annual fee.

Private pensions plans need close supervision and tight regulation. Britain has faced a number of scandals associated with the move toward privatization. The most serious is what is described as the "mis-selling scandal." During the early 1990s it was common for the sales representative of various financial organizations marketing APPs to misrepresent their products (Orszag, 1999). By statute they were required to ask a number of questions to make sure the product they were selling made good economic sense for the client. Many failed to do so. In their drive to maximize sales commissions and sign up as many people as possible, they successfully urged a number of workers already enrolled in generous occupational schemes (with employers making substantial contributions to their pensions) to shift to the less favored APP alternative, a product designed primarily for those not covered by generous occupational schemes (Stecklow & Calian, 1998). Such shifts were particularly problematic when the worker was close to retirement and was hit with a substantial reduction in occupational pension benefits due to moving out of the scheme prior to retirement (Blake, 1995, p. 208). These sales representative often failed to fully inform clients about the implications of the change they were making and sometimes presented them with misleading statistics about fund performance. This scandal became public in 1993 and in 1995 legislation was enacted calling for tighter regulation and requiring the pension industry to compensate those who had been harmed as a result of the mis-selling. There seem to be disagreements among experts as to how many of the 1.5 million affected workers ended up with serious pension losses. Most commentators (e.g., Phillipson, 1999; Stevenson, 1998; Waine, 1998, p. 164) argue that there were substantial losses for many workers; but some (e.g., Lilley, 1999, p. 3) take issue with such claims. There is evidence suggesting that some of the practices associated with the mis-selling scandal continue albeit at a lower level (Orszag, 1999; Schulz, 2000a, p. 34).

A second scandal was linked to actions by Robert Maxwell and his close associates. He was a major publishing magnate and his empire was under starting to fall appart. As part of an effort to restore solvency to his organization approximately £450 million was taken from the occupational pension funds for approximately 30,000 employees (Lilley, 1999, p. 3; Poortvliet & Laine, 1995, p. 75). Exactly what happened was never clear as this behavior did not come to light until his sudden and somewhat mysterious death in 1991. Much of the pension fun money was eventually recovered, so that workers involved will receive their full pension benefits. However, the Maxwell affair and the mis-selling scandal have made it clear that much closer regulation is needed. As noted earlier this in turn has increased the cost of administering private pensions (Schulz, 2000b, p. 95).

UNRESOLVED QUESTIONS ABOUT RECENT BRITISH REFORMS

A full assessment of the British APPs will not be possible for another few decades, until those who are currently in their 20s retire, and a full assessment of the new stakeholder pension and the new State Second Pension will take even longer because they are not as yet fully implemented However, it will be very instructive to policymakers in the United States to follow these pension-related developments in Britain in the years ahead. There are a number of important, but as yet unanswered questions keep in mind as we follow these developments.

Is the partial privatization of the public pensions in Britain only a first step toward full privatization. One concern among many analysts in the United States is that even a modest step in the direction of privatization today will end up being the first step toward full privatization a few years from now. Developments in Britain may shed light on this question. In connection with the 1997 general election the Conservative Party did propose what amounted to full privatization the pension system including the first-tier

Basic State Pension (Waine, 1998, p. 157). As it turned out they lost the election and the Labour Party is not at present proposing to do the same. But it is possible that this proposal will be brought up again by the Conservative Party the next time it is in power, and even the Labour party has decided to phase out SERPS and put greater emphasis on privatized alternatives.

What will be the long-term distributional consequences of recent reforms that have been made? What will the implications turn out to be for women and for low-wage workers? It is clear from the change in structure that there has been and will continue to be an increase in the degree of inequality, but that leaves open what will happen to the absolute standard of living for those in the bottom half of the income distribution. There may not be much change for the very poor, those who have earned too little over the years to be covered by either the first or second tier of the current system. But it will be of interest to keep track of what happens to the bottom 30% or so of workers who are eligible for second-tier pensions, those who currently depend for the most part on SERPS and the Basic State Pension. One recent study found that between 1979 and 1993 the average income among pensioners increased more for the higher income groups than for lower income groups, but that it did increase for all income groups (Budd & Campbell, 1998, pp. 116-17.). While the study does not make clear how much of the observed trend was due to privatization, it does suggest that privatization has not adversely impacted the real incomes of low-income pensioners. However, this may change as benefit cuts already legislated take effect in the years ahead.

In Britain as in the United States women's retirement income tends to be lower due in part to lower wages and in part to more movement in and out of the labor force

(Davis & Ward, 1992, Chapter 2; Schulz, 2000a, pp. 5-7). Thus the fate of British women will be in part be linked to the fate of the lower-wage workers more generally. But there has been another recent change that may also have important long-term distributional consequences for women. In the Pensions Act of 1995 there is a provision making it possible for a divorce court to earmark a portion of a worker's pension for a former spouse with the transfer taking place when the worker retires (Waine, 1998, p. 164). This is a reform that will, no doubt, help improve the retirement incomes of women. In the past, pension rights were rarely taken into consideration as part of divorce proceedings.

Will the public remain silent as already enacted changes are phased in? It is striking how little public opposition there has been to rather deep cuts in future pension benefits that have been enacted since 1980. One reason may be that much of the legislation calls for changes that phase in cuts gradually over many years. Another reason may be that only about 29% of British workers are enrolled in SERPS and the Basic State Pension is so small that most British workers do not expect to depend upon it as a major source of retirement income. But we may see an emergence of public opposition to recent changes a few decades from now after the long-term consequences of these deep cuts become more obvious. Efforts are being made to call the long-term implications of already enacted policy changes to the attention of the general public in an effort to mobilize the public to reverse those changes. See, for example, Ward (1996). The new Stakeholder Pension and the new State Second Pension do represent at least modest concessions to those calling attention to the plight of low-wage workers, particularly the plight projected for the decades ahead.

How will the public respond if Britain goes through a prolonged decline in

financial markets? The private pension funds (both occupational and personal) have been doing well in recent years due to the generally strong performance of the British stock market But what is going to happen if market trends change. It is now clear how much decline or how many years of decline the public will tolerate without demanding some form of government supplementation or compensation. It is also not clear at this point which categories of the population will bear the brunt of any such market declines. While it is likely that those near the poverty line will have their standards of living most threatened, the full distributional consequences of a major or prolonged decline remain to be determined.

DISCUSSION AND CONCLUSIONS

While the British personal pensions (APPs) have only been in place since 1988, the national pension system has been partially privatized much longer. Thus, while what we can learn from this case about the long-term consequences of the personal pensions is somewhat limited, we can learn something about the long-term consequences of partial-privatization due to the presence of partial-privatization linked to occupational pensions for about 40 years. Although it will be a few more decades before we can draw firm conclusions as to how well the APPs provide for different categories of workers, we are in a position to draw at least some conclusions based on the British experience that are relevant to the debate in the United States over the proposed partial privatization of Social Security.

In recent years we have seen the emergence of what could become a worldwide trend in national pension policy, a trend away from the PAYG defined benefit schemes and a corresponding trend toward greater emphasis on funded defined contribution schemes. A number of structural, cultural, and ideological factors have played a role in shaping the policies that have emerged.

Some structural factors have been present in most if not all of the nations that have shifted from PAYG defined benefit schemes to schemes that depend all or in part on a funded defined contribution component. All of these countries have been finding it more difficult to provide promised pension benefits as their PAYG systems have matured and as their populations have aged. Policymakers in many nations have become concerned about projected demographic trends pointing to a rapid graying of the age structure over the next few decades. A factor that has received less attention, but is also important in many of these counties, is concern about the maintenance of international competitiveness. Policymakers in affluent nations such as Sweden and Germany have become aware that they cannot ignore the impact of rapidly expanding welfare state spending on the nation's competitiveness in international markets. Related to this are the fiscal constraints placed on nations that have become members of the European Union. Member nations must constrain the potentially inflationary impact of an overly generous old-age pension scheme.

A structural factor of particular relevance for the present analysis is program history. As Myles and Pierson (in press) point out, pension policy can be viewed as a "path dependent" process. While many social processes do follow the convergence model suggested by neo-classical economics, this is not necessarily the case with pension policy. Once a nation gets well along on path as has the United States with its mature and well institutionalized public PAYG defined benefit, it is much more difficult to shift to a largely privatized funded alternative similar to what presently exists in Britain. The shift in the direction of a highly privatized scheme was much easier to make in Britain in part because the nation's earnings related pension scheme (SERPS) had been in place for so few years.

Cultural factors have played an important role in many of these countries. Both Sweden and Britain have made dramatic moves in the direction of privatization, but differences in their political cultures are reflected the very different models that have emerged. Sweden is a nation that has long been committed to a set of communitarian values that emphasize egalitarian welfare state goals such as minimizing the extent of both relative and absolute poverty. There is a reluctance to make policy changes that are expected to substantially increase the incidence of poverty or the extent of inequality. While recent changes in Sweden, including the introduction of individual funded accounts and the much larger individual unfunded "notional" accounts will increase the level of inequality in Sweden, the increase will be modest by comparison with the trend in Britain. One reason is that the notional accounts include a mechanism to give pension credit for time spent in such activities as providing cargiving to young children or sick parents (Sundén, 2000).

In Britain, in contrast, there is less of a cultural commitment to these solidaristic goals and a greater commitment to values that emphasize the importance of individual responsibility and self-help. In Britain the move toward privatization is being carried out via a set of policies that will cut benefits to many low-wage workers. Most policy analysts argue that over time the new policies will reduce the extent of income redistribution, increase income inequality, and increase the proportion of the elderly dependent upon means-tested benefits (Cutler & Waine, 1999; Schulz, 2000a, pp. 17-18).

Ideology is also playing an important role in the transformation of national pension policy. In recent years the neoliberal ideology of the free market and market solutions to policy needs has been gaining a great deal of momentum. This ideology calls for a shift in the locus of responsibility for social provision, from the state to the individual. The collapse of the communist regimes in Eastern Europe and the subsequent difficulty many of these nations have had in adapting to a market economy have contributed to a discrediting of not only socialism, but also of generous welfare states more generally. Generous defined benefit public pension systems and other generous health and social welfare programs are increasingly being viewed as providing an unacceptable burden on the state. The solution to the problem of social provision according to neoliberal ideology is to make the individual and individual family increasingly responsible. The goal is to shift much of the risk from the state to the individual. In today's world markets it is becoming increasingly difficult for governments to finance expensive pension systems. The neoliberal ideology of the market offers what looks like a solution, a policy move to partial or the full privatization of national pension systems. How well this alternative approach will work in the long run remains to be seen, but in the short run it is looking attractive to policymakers in an increasing number of nations.

The personal retirement savings accounts are also likely to be less attractive to women than to men. The reason is that women tend to earn substantially less then men and they also tend to spend fewer years in covered employment. The result is that more women can expect to receive the guaranteed minimum pension when they retire. In Britain these considerations lead many low-income women to opt for the public SERPS scheme rather than the individual accounts alternative (Schulz, 2000a).

While privatized accounts may have positive consequences for the overall economy, in the long-run any such benefits could turn out to be quite modest. While a shift from the more redistributive approach implicit in most public defined benefit schemes in favor of less redistributive defined contribution schemes based on individual accounts is likely to have at least some positive consequences for the overall economy, and in some cases for the average worker as well, those benefits will come at a price. There is at least suggestive evidence that such a shift in pension policy is likely to be associated with an increase in income inequality, an increase in gender inequality, and maybe an increase in poverty rates among the elderly as well. To date there has been no systematic effort to assess let alone factor in the long-term economic costs of the trend toward greater inequality taking place in Britain.

One of the most important unresolved questions at this point is how patient the public will be when their individual retirement savings accounts are subjected to the consequences of prolonged declines in financial markets. After a few nations have gone through such periods, the consequences of the decision to shift the financial risk from the state to the individual will come to be much more clearly understood by the general public. While the British case does highlight the link between privatization and increased risk for workers, to date the issue of market risk has not received much attention, due in part to the generally favorable rates of return for financial markets during the 1980s and 1990s.

REFERENCES

Arenas de Mesa, A., & Montecinos, V. (1999). The privatization of social security and women's welfare: Gender effects of the Chilean reform. *Latin American Research Review, 34* (3), 7-37.

Baldwin, P. (1990). *The Politics of Social Solidarity: Class Bases of the European Welfare State 1875-1975*. Cambridge: Cambridge University Press.

Blake, D. (1995). *Pension schemes and pension funds in the United Kingdom*. Oxford,UK: Clarendon Press.

Budd, A., & Campbell, N. (1998). The roles of the public and private sectors in the U.K. pension system. In M. Feldstein (Ed.), *Privatizing Social Security* (pp. 99-127). Chicago: University of Chicago Press.

Chand, S. K., & Jaeger, A. (1996, December). *Aging Populations and Public Pension Schemes*. (Occasional Paper No. 147). Washington, DC: International Monetary Fund.

Chapman, J. (1998, November). Pension plans made easy. *Money Management*, p. 88.

Congressional Budget Office (CBO) (1999, January). *Social Security Privatization: Experiences Abroad.* Washington DC: Congressional Budget Office.

Crawford, M. (1997) The big pensions lie. *New Economy, 4* (1): 38-44.

Crippen, D. L. (1999, February 11). Social Security privatization: Experiences abroad. Testimony before the Committee on Ways and Means, U.S. House of Representatives.

Davies, B. & Ward, S. (1992). *Women and Personal Pensions*. London: Her Majesty's Stationery Office.

Edwards, S. (1998). The Chilean pension reform: A Pioneering program. In M. Feldstein (Ed.), *Privatizing Social Security* (pp. 33-57). Chicago: University of Chicago Press.

Enoff, L. D., & Moffit, R. E. (1997, August 6). *Social Security Privatization in Britain: Key Lessons for America's Reformers*. (Backgrounder No. 1133). Washington, DC: The Heritage Foundation.

Gilbert, B. B. (1970). *British Social Policy 1914-1939*. Ithaca, NY: Cornell University Press.

Ginn, J., & Arber, S. (1998, August). *Prospects for women's pensions: The impact of privatization*. Paper presented at the annual meeting of the American Sociological Association, San Francisco, CA.

Huber, E. & Stephens, J. D. (2000). *The political economy of pension reform: Latin America in comparative perspective.* (Occasional Paper 7). Geneva: United Nations Research Institute for Social Development (UNRISD).

Kingson, E. (1999, February 11). Hearing on Social Security reform lessons learned in other countries. Testimony before the Committee on Ways and Means, U.S. House of Representatives.

Lilley, P. (1999, March 2). *Social security reforms in Britain: The principles of effective privatization*. (Backgrounder No. 1259). Washington, DC: The Heritage Foundation.

Liu, L. (1999). "Retirement income security in the United Kingdom." *Social Security Bulletin, 62* (1), 23-46.

Mesa-Lago, C. (1997). Comparative analysis of structural pension reforms in eight Latin

American countries: description, evaluation, and lessons. In M. H. Pearce, (Ed.), *Capitalization: a Bolivian model of social and economic reform*. (pp. 381-461). Miami: North South Center, University of Miami.

Moffit, R. E. (1999, February 12). *Learning from Britain's next step in privatizing social security benefits.* (Backgrounder No. 1251). Washington, DC: The Heritage Foundation.

Myles, J., & Pierson, P. (in press). The comparative political economy of pension reform. In P. Pierson (Ed.), The New Politics of the Welfare Sate. New York: Oxford University Press.

Ogus, A. I. & Wikeley, N. J. (1995). *The Law of Social Security,* 4th edition. London: Butterworths.

Organization for Economic Cooperation and Development (OECD). (1997). *Ageing in OECD* countries. Paris: OECD.

Orszag, P. (1999, February 11). Individual accounts in the United Kingdom: Lessons for the United States. Testimony before the Ways and Means Committee, U.S. House of Representatives.

Pension Provision Group. (1998). *We all need pensions: The prospects for pension provision*. London: Her Majesty's Stationery Office.

Phillipson, C. (1999, November). *Inequality, pensions, and social exclusion in the UK: Current trends and policy options*. Paper presented at the annual meeting of the Gerontological Society of America, San Francisco, CA.

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

Poortvliet, W. G., & Laine, T. P. (1995). A Global Trend: Privatization and Reform of Social Security Pension Plans. *Benefits Quarterly, 11* (3), 63-84.

Schulz, J. H. (2000a). *Older women and private pensions in the United Kingdom*. Waltham, MA: National Center on Women and Aging, Heller School, Brandeis University.

Schulz, J. H. (2000b). The risks of pension privatization in Britain. *Challenge, 43* (1), pp. 93-104.

Stecklow, S., & Calian, S. (1998, August 10). Financial flop: Social Security Switch in U.K. is disastrous; a caution to the U.S.? *The Wall Stree Journal*, pp. A1, A8.

Stevenson, R. W. (1998, July 19). Britons govern their own retirements. *New York Times*, p. 6.

Sundén, A. (2000). *How will Sweden's new pension system work?*" (Issue Brief No. 3). Chestnut Hill, MA: Center for Retirement Research, Boston College.

Thompson, L. H. (1999). Administering individual accounts in social security: The role of values and objectives in shaping options. (Occasional Paper No. 1). Washington, DC: Urban Institute.

U.S. Bureau of Commerce. (1998). *Statistical abstract of the United States*, 118th ed. Washington, DC: U.S. Government Printing Office.

U.S. Social Security Administration. (1997). *Social security programs throughout the world–1997*. Washington, DC: U. S. Government Printing Office.

Waine, B. (1998). Paying for pensions. In Helen Jones and Susanne MacGregor (Eds.), Social issues and party politics (pp. 155-167). London: Routledge.

Ward, P. R. (1996). *The Great British Pensions Robbery: Your future income* (2nd ed.).

Preston, UK: Waterfall Book.

Weaver, R. K. (1998). Insights from social security reform abroad. In R. D. Arnold, M. J.Graetz, & A. H. Munnell (Eds.), Framing the Social Security Debate. Washington, DC: National Academy of Social Insurance.

Williamson, J. B. (in press). Privatizing public pension systems: lessons from Latin America. *Journal of Aging Studies*.

Williamson, J. B. and Pampel, F. C. (1993). *Old-Age Security in Comparative Perspective.* New York: Oxford University Press.

Table 1

Public Pension Expenditure as Percent of Gross Domestic Product

Country	Baseline Expenditure 1990	Projections 1995	2000	2010	2030	2050
United States	4.5	4.4	4.3	4.2	7.4	7.7
Japan	5.0	5.7	6.5	7.5	8.9	10.7
Germany	8.9	10.0	11.1	11.0	18.4	18.7
France	11.9	12.5	12.0	12.6	19.4	21.3
Italy	13.9	16.0	17.1	15.2	23.3	25.7
United Kingdom	4.2	4.4	4.3	4.6	4.7	3.4
Canada	3.8	4.4	4.5	4.9	7.5	7.1
Sweden	7.0	8.5	8.2	8.1	9.2	7.4

Source : Liu (1999, Table 2)

Table 2

Effect of Reforms to SERPS (£ Billion, 1994-95 Prices)

	1994-95	2000-01	2010-11	2020-21	2030-31
Original regime (1975-86)	**1.8**	**4.2**	**12.0**	**25.0**	**41.0**
After 1986 Soc. Security Act	**1.8**	**4.2**	**9.2**	**14.5**	**18.7**
After 1995 Pensions Act	**1.8**	**4.2**	**8.4**	**10.9**	**12.0**

Source : Budd and Campbell (1998, Table 3.5)