Harvard Law School
Federal Budget Policy Seminar

Briefing Paper No. 40

Foreign Entitlement Reform:

Australia, Germany, Japan, New Zealand, and Sweden

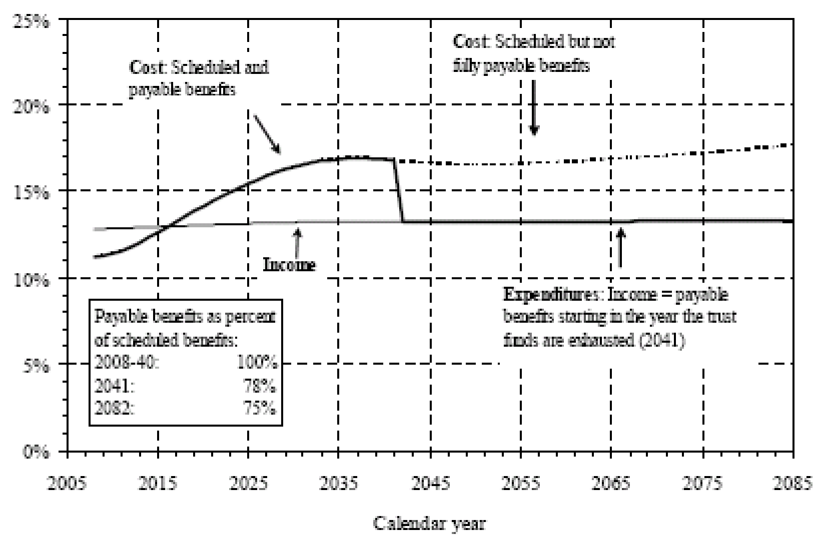
Lee Hochbaum
Brent Lanoue

Submitted: May 13, 2008

I. Introduction

The issue of entitlement reform, particularly as embodied by the social security program, was a major theme of the 2005 State of the Union Address. In the words of President Bush, "[o]ne of America's most important institutions – a symbol of the trust between generations – [is] in need of wise and effective reform."[1] The President then cited a litany of now-familiar statistics: By 2018, the social security system will be expending more than it takes in. In 2027, that yearly deficit will amount to upwards of $200 billion. And by 2042 the entire system will be bankrupt.

Fig. 1: Social Security Income and Cost Rates Under Intermediate Assumptions
[As a percentage of taxable payroll]



Source: THE 2008 ANNUAL REPORT OF THE BD. OF TRUSTEES OF THE FED. OLD-AGE AND SURVIVORS INSURANCE AND FED. DISABILITY INSURANCE TRUST FUNDS (2008) *at 8.*

Yet, despite President Bush's call for reform and the widespread acknowledgement that some action must be taken in order to ensure the program's long-term viability, little if any movement has occurred in the last several years. Clearly, tackling a policy with the scope of social security, and all its constituent interests, is an ambitious project. International experience

[1] President George W. Bush, State of the Union Address (Feb. 1, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/02/20050202-11.html.

suggests, however, that reform need not be an insurmountable hurdle. In the last several decades many OECD countries have successfully reformed politically sensitive entitlement programs, including pension programs.[2] Moreover, they have done so in the face of even greater demographic challenges than those currently faced by the United States.

This Briefing Paper will examine the entitlement reform process in several foreign nations, giving particular attention to pension programs, with the hope of drawing out some useful insights for the U.S. Part II discusses some of the relevant literature on this topic, namely a couple of topical reports issued by the Government Accountability Office ("GAO"). Part III then consists of individual case studies of five nations – Australia, New Zealand, Japan, Sweden, and Germany. For each country, the entitlement reform process is described and analyzed, with the goal of identifying those mechanisms that enabled the transformative process to occur. Part IV offers some concluding thoughts.

II. Overview of Pension Reform in Foreign Countries

Though the processes and outcomes of pension reform have varied widely across nations, the impetuses for reforms have generally been quite similar. In virtually all first-world nations, the main cause of reform has been demographic: longer life spans combined with lower birth rates have led to current or projected drops in the number of workers per retiree, straining pay-as-you-go (PAYG) systems. The United States is in a better demographic position than most countries in this regard, as in many foreign nations the worker-pensioner ratio has already dipped below the 2.9:1 ratio not expected in the U.S. until 2020.[3] In addition to demographic

---

[2] Government Accountability Office, Entitlement Reform Process: Other Countries' Experiences Provide Useful Insights for the United States, GAO-08-372 (January 2008), at 9 [hereinafter GAO 2008].
[3] Government Accountability Office, Social Security Reforms Abroad, GAO-06-126 (October 2005), at 5 – 6 [hereinafter GAO 2005].

challenges, a couple of other common trends have helped to focus political will on the need for entitlement reform. In many countries, including Sweden, Germany, and New Zealand, times of economic and fiscal crisis helped generate the necessary urgency for pension reform. In the 1990s, several European countries, including Italy, the Netherlands, France, and Germany, used European Monetary Union fiscal guidelines as a rationale for pension changes as well.[4] Perhaps unexpectedly, those Organisation for Economic Co-operation and Development ("OECD") countries with the lowest expenditures on retirees reformed roughly as often as those with the highest expenditures.[5]

Typically, reform has been an iterative process, with countries undertaking multiple rounds of adjustments.[6] For example, both Germany and Japan have made a series of changes to their pension system. In the case of Germany, the center-left Social Democrats blocked pension changes in the late 1990s, only to implement more radical changes in 2001. A notable exception to this pattern is Sweden. While the reform process extended at least from the early 1990s through the early part of this decade, during which time the majority coalition in parliament changed, the country's pension reform was largely a single, linear process.

Most countries set up ad-hoc commissions in order to formulate plans to change their pension systems.[7] A smaller number, including Japan and France, have established permanent commissions. These commissions, particularly when they can conduct their deliberations in private, can be less political than normal political forums, such as countries' parliaments. This can allow participants to freely negotiate on sensitive issues, and, when a compromise is reached, to jointly share the credit and blame for the proposals. These commissions can also be useful in

[4] GAO 2008, *supra* note 2,at 15, 17
[5] PENSIONS AT A GLANCE: PUBLIC POLICIES ACROSS OECD COUNTRIES 74 (2007) [hereinafter OECD].
[6] *See* GAO 2008, *supra* note 2, at 18
[7] *Id.*

educating the public about proposed changes. While successful commissions varied in size, most were relatively small. Many have noted that that there is a tradeoff in determining commission size – small commissions can sometimes reach more radical, and therefore beneficial, reforms, but those who are not included early on in the commission's work may be alienated.[8]

Just as there have been a range of reform processes, countries have implemented a variety of reforms, including raising contribution levels, lowering payment levels, or increasing risk (and possibly return levels) to retirees. Most retirement systems rely primarily on worker and employee taxes, but also make liberal use of general revenues. Nearly all determine at least some benefits by work history.[9] The bias has been towards reducing benefits rather than increasing revenue. For example, from 1994 to 2004, in the 21 OECD countries where pension taxes are paid separately from others, the average rate paid went up only 0.1%. However, this may be somewhat misleading, because some countries raised or eliminated caps on their pension taxes and may have increased spending from general revenues.[10] Nonetheless, the clear trend is towards increasing solvency via benefit reductions rather than revenue increases. In the sixteen countries that made major reforms in the last decade, the OECD estimates that they on average cut benefits by 22% for men and 25% for women.[11] This is often done by changing the actuarial formulas determining future benefits, either directly or through methods such as considering lifetime earnings rather than peak-year earnings or reducing annual benefits as life spans

---

[8] *See id.* at 18, 24. An extreme case of the latter mistake may be the 1993/1994 Clinton health care proposal, which was the product of the President's "Task Force on National Health Care Reform." This group consisted primarily of members of the executive branch and was so secretive that a medical group actually had to sue to obtain a membership list and some of its internal documents. *See* Robert Pear, *Judge Rules Government Covered Up Lies on Panel*, N.Y. TIMES, Dec. 19, 1997. Key Democrats, such as Daniel Patrick Moynihan, reacted with hostility when the complicated proposal was released to congress. Michael Kramer, *The Political Interest*, TIME, Jan. 31, 1994.
[9] GAO 2005, *supra* note 3, at 6.
[10] OECD, *supra* note 5, at 66 – 67.
[11] *Id.* at 74.

increase. Some countries also increased penalties for early retirement or raised the normal retirement age.[12]

There has also been a trend towards automatic triggers if the fiscal or demographic outlook worsens. These can come in two major categories. The first are "hard" triggers, which force automatic changes in pension funding. For example, in Sweden, as soon as projections show any future shortfall in the program, benefits for current and future pensioners are immediately cut to bring the system back into balance. Other countries, such as Japan and Germany (which has a hard trigger as well), adopted "soft" triggers. These require that the legislature act in the face of fiscal worsening, but do not mandate a specific outcome.

Some countries, including Sweden, have been developing large reserve funds for years. In contrast, others like Germany have essentially no funds and continue to run primarily PAYG schemes.[13] Countries have built up their funds in a number of ways, such as by adding debt, increasing taxes, or reducing benefits. Those with reserve funds invest them in a variety of assets, including domestic bonds, foreign securities, and domestic securities. While the GAO recommends building up reserve funds, it emphasizes the importance of competent management of such funds. In particular, it considers budget discipline and fund transparency to be vital.[14] Further, the GAO recommends that countries focus on maximizing fund returns with acceptable risk, rather than on goals unrelated to the pension system. The United States takes such an approach, investing the Social Security Trust Fund in low-yield government bonds. A nation that has not always followed this advice is Japan: before reforms in 2001, Japan failed to

---

[12] *See id.* at 56.

[13] To the extent that countries have individual retirement accounts, they are not purely PAYG, even if they have no reserve funds.

[14] GAO 2005, *supra* note 3, at 4. Some countries, including New Zealand and the United States, include pension funds in national debt calculations, while others, such as Sweden, Finland, and Canada do not. *Id.* at 8.

maximize returns by investing reserve funds in infrastructure and other non-pension government priorities.[15]

Many countries have gone to private accounts in recent years. Currently 11 of the 30 OECD countries have mandatory private accounts of some sort, and additional countries, like Germany, have enacted voluntary systems.[16] These proposals have the potential to generate higher rates of returns for participants, especially in countries like the United States where pension funds are currently invested in low-yield domestic bonds. They may also increase future retirees' sense of control and responsibility over their retirement incomes. In addition, by creating individual retirement accounts now, countries with looming entitlement problems may be forced to deal with them earlier, since such accounts generally require countries to increase taxes, lower other pension benefits, or else raise debt. On the other hand, individual retirement accounts often involve high fees, especially for smaller accounts, and also have the potential to generate highly unequal outcomes in the future. Many countries have responded to inequality concerns by either keeping the size of individual accounts small relative to the overall scheme, as has Sweden, or else by guaranteeing minimum rates of return, as has Australia. According to the GAO, these protections may stultify investment options and ultimately yield lower returns.[17]

The GAO draws several lessons for the United States. First, the GAO notes that most countries making sustainable long-term changes have implemented several reforms, not just one or two. Specifically, it finds that successful countries often use individual accounts and automatic features lowering benefits in response to negative demographic changes. However, lowering benefits further may be a greater challenge to the US than in other countries, since it already has a high percentage of retirees living on less than half of median income than other

[15] *Id.* at 18.
[16] OECD, *supra* note 5, at 22
[17] GAO 2005, *supra* note 3, at 4 – 5.

similar countries.[18] Second, the GAO believes a bipartisan approach supported by presidential leadership is essential. Third, it believes commissions are useful.[19] In 1983, Congress enacted the Greenspan Commission's recommendations to raise revenue and lower the costs of Social Security. Since then, however, at least two US commissions have looked at the issue. One did not produce an actionable proposal and seemed to suffer from a lack of presidential leadership. The other likely was doomed from the start by the weakness of its membership and its partisan charter to advocate for private accounts.[20]

Others have identified additional priorities for the United States. The OECD points out that for countries with relatively modest public pensions, such as New Zealand and the United States, increasing private savings rates is essential.[21] Further, there is some evidence that a carefully phased-in program can help in assembling a majority coalition for reform.[22] Finally, many experts have advocated for the U.S. to invest its trust fund in higher yield investments than U.S. Treasury Bonds.[23]

---

[18] *See id.* at 3, 13, 37-38.
[19] GAO 2008, *supra* note 2, at 28 – 29.
[20] *See id.* at 33 – 35.
[21] OECD, *supra* note 5, at 6 – 7.
[22] *See infra* section III.4.
[23] *See*, *e.g.*, Gary Burtless, *The Rationale for Fundamental Pension Reform in the United States and Germany* 13 – 14 (CESifo Working Paper No. 510, 2001), *available at* http://www.cesifo-group.de/portal/page/portal/ifoHome/b-publ/b3publwp/_wp_by_author?p_autor_id=735. Burtless argues that while increasing prefunding is most important, a broader portfolio would enhance returns. *Id.*

III. Case Studies

1. Australia

Table 5: Examples of Adjustments to PAYG Programs, 1970-2004

Country	Increase in contribution rates or coverage	Change in retirement age[a]	Change in years of earnings considered in benefit calculation	Change in indexation for calculation of initial benefit[b]	Change in indexation for benefits during retirement	Economic and demographic adjustment mechanisms	Other decrease in benefits
Australia	None identified	60 to 65 for women	None identified	None identified	None identified	None identified	Means testing reintroduced in mid 1980s

Source: GOVERNMENT ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORMS ABROAD, GAO-06-126 (October 2005) at 45.

Among OECD nations, Australia's history of pensions is somewhat unique. Using the terminology of the World Bank, Australia currently has a three-pillar model consisting of (1) an age pension, (2) superannuation, and (3) voluntary savings assisted by tax concessions.[24] However, prior to the reforms of recent decades, Australia's retirement income provision was based almost exclusively on its Age Pension.

Australia's Age Pension is a universal entitlement paid out of general revenues.[25] The rate of payments under the Age Pension is generally set at a minimum of 25% of the average male earnings, but it is also indexed to the consumer price index; coupled with a tax exemption for those for whom the Age Pension is their only stream of income, this can mean a real net replacement rate of 37% of average male earnings.[26] The age pension is means-tested – meaning that benefits decrease relative to the recipient's total assets and other sources of income – but

[24] Peter Whiteford, *Reforming Pensions: the Australian Experience*, in RETHINKING THE WELFARE STATE: THE POLITICAL ECONOMY OF PENSION REFORM 83, 83 (Martin Rein & Winfried Schmahl, eds. 2004).
[25] Hazel Bateman & John Piggott, *Australia's Mandatory Retirement Saving Policy: A View From the New Millennium* (Social Protection Discussion Paper Series No. 0108, 2001) at 4.
[26] *Id.* at 9.

does not take into account employment history.[27] Through the 1980s, the Age Pension was the only government-mandated form of retirement income provision, though approximately 30% of private sector employees also invested in voluntary pension funds.[28]

The movement toward change began in the 1970s, when a government-commissioned study – The Hancock Report of 1976 – recommended adopting a new earnings-related retirement scheme based on those in existence in other OECD nations.[29] While such reforms were not immediately adopted, the issue had gained in salience. In 1983, when the Australian Labor Party came to power, it did so with the support of the labor unions. Prior to the elections, the labor party and the unions had come to an "Accord" which emphasized a consensual approach to economic policy and contemplated reforms to the pension system.[30]

The initial reforms undertaken by the new labor government were fairly conservative in scope. Faced with projected budget deficits in the future, the government made modest changes to the Age Pension, extending the reach of the income test to those over 70 years old and, in 1985, re-introducing the assets test which had earlier been abandoned.[31] The labor party also began to include modest 3% superannuation paid into individual accounts[32] (one-half of a promised six percent increase in compensation) as part of some of its bargaining agreements with public sector employees, and encouraged the private sector to follow suit, but this was neither mandatory nor universal.[33]

---

[27] *Id.* at 4.
[28] *Id.*
[29] *Id.* at 5.
[30] Whiteford, *supra* note 24, at 89.
[31] *Id.* at 85.
[32] Bateman & Piggott, *supra* note 25, at 5.
[33] Testimony of David O. Harris Before the House Ways & Means Cmte. – Subcmte. on Social Security, *Pension Reforms and Ageing Populations: Lessons from Australia* (June 2005), at 2.

As Australia's population grew older during the 1980s, the future of the Age Pension came to be of some concern.[34] It was projected that government payments under the Age Pension would increase from 2.4% of GDP in 1998 to 4.7% by 2050.[35] At the same time, the government was eager to deregulate the economy in order to make Australia more competitive internationally. One way to do this was to institute a mandatory employer-funded superannuation requirement, which would lessen the burden on the government under the Age Pension because more retirees would become ineligible for government-provided benefits under the Age Pension due to the income and assets tests.

In order to successfully legislate its planned superannuation policy, the government needed the support of the labor unions. Specifically, the unions would have to accept superannuation in conjunction with a pause in immediate wage growth. Fortuitously for the government, the unions fell strongly behind the proposed reforms. Two explanations for this phenomenon are presented: First, the unions were eager to extend pension coverage from the white-collar workers (many of whom were covered by voluntary employer-provided pension) to the blue-collar segments. Second, the unions may have seized upon the issue as a mean of increasing their relevance during a period when union membership was declining at a rapid pace.[36]

In 1992, the government passed the Superannuation Guarantee, which required all employers to contribute a percentage of wages to individual employee accounts in a government-registered superannuation fund. The amount prescribed was to grow from an initial ratio of 3%

[34] *Id.* at 2.
[35] Whiteford, *supra* note 24, at 94.
[36] Testimony of David O. Harris, *supra* note 33, at 3.

to 9% by 2002.[37] Certain low-income earners were exempt from contribution, though the government offered co-contribution in some instances. Early withdrawal was severely limited.[38]

The government gained support for this policy by partnering with organized labor, as well as via an extensive advertising and public education campaign run by the Australian Taxation Office that emphasized the benefits of the new reforms for both individuals and the nation as a whole.[39] Given the magnitude of the new policy, the government experienced surprisingly little pushback; many of the larger business were already offering similar benefits on a voluntary basis, and the smaller businesses who argued that the new requirement could undermine their solvency lacked the political capital to mount a successful opposition campaign.[40]

Spurred on by its success, the labor government in 1995 announced a plan to expand the scope of superannuation by requiring employees to contribute an additional 3% of earnings, an amount that would be matched by the government. However, this plan was widely unpopular, and it may have contributed to the election of the rival National Coalition government in 1996.[41] While maintaining the broad outlines of the pension structure in existence when it came into office, the new government took several steps to rein in what it considered to be excesses of the new pension scheme and ensure future fiscal sustainability. The minimum age to qualify for eligibility for the Age Pension was gradually raised to 65 for women (matching the age for men).[42] The minimum age for withdrawing superannuation guarantee benefits was gradually

---

[37] *Id.* at 4.
[38] Bateman & Piggott, *supra* note 25, at 10.
[39] Testimony of David O. Harris, *supra* note 33, at 4.
[40] *Id.* at 5.
[41] Whiteford, *supra* note 24, at 90.
[42] Raymond Harbridge & Prue Bagley, *Social Protection and Labor Market Outcomes in Australia*, in LABOUR MARKET AND SOCIAL PROTECTION REFORMS IN INTERNATIONAL PERSPECTIVE 173, 194 n.17 (Hedva Sarfati & Giuliano Bonoli, eds. 2002

increased from 55 to 60 by 2025.[43] In 1997 and again in 2004, legislation gave employees greater control over choice of superannuation fund, a measure that the government presented as lessening administrative costs.[44] And in 1998 the government took steps to encourage employees to delay retirement by awarding graduated tax concessions, again presumably decreasing the burden on the Age Pension.[45]

Looking back, Australia can be seen as an example of successful change. Today, over 90% of employees are covered by superannuation benefits, and the total amount of superannuation funds held by the 9.2 million workers with accounts is greater than $500 billion, versus $24 billion just fifteen years ago.[46] Institution of mandatory superannuation is expected to save the government 0.3% of GDP in Age Pension benefits yearly by the year 2050. However, the Australian government's accrued unfunded superannuation liability for public sector workers is now the largest liability held by the government. As of May 2007 it stood at AU$103 billion, and is expected to grow to almost AU$150 billion by 2020.[47] The government is paying out AU$4.5 billion a year in unfunded superannuation benefits with general revenue tax funds.[48] To address this projected shortcoming, the Australian government in 2005 created the Future Fund, a privately-managed fund with the purpose of accumulating sufficient assets to fully fund the government's superannuation liabilities by 2020.[49] The Future Fund was initially seeded with funds derived from the Australian government's sale of Telstra, a communications conglomerate. The fund also receives any money from budget surpluses, which in 2007 was

[43] OECD, *supra* note 5, at 99.
[44] Testimony of David O. Harris, *supra* note 33, at 7.
[45] Whiteford, *supra* note 24, at 86.
[46] Testimony of David O. Harris, *supra* note 33, at 6
[47] AUSTRALIA FUTURE FUND, *available at* http://www.futurefund.gov.au/about_the_future_fund/outline.
[48] *Id.*
[49] *Id.*

over AU$10B.[50] While the Future Fund is intended to fully fund the government's superannuation liabilities by 2020, reaching that target is heavily dependent on future projections concerning the rate of growth of invested funds. Small changes in the Fund's return on capital could have large implications for Australia's future unfunded liabilities.[51]

While the Australian experience may offer some insight for American reformers, it should be noted at the outset that the Australian reforms were not necessarily motivated by financial unsustainability. In the words of one observer, "it is difficult to say that the Australian pension system was in crisis in any significant way, or even unsustainable in the long run. . . . Overall, the major motivations for reform were to improve future retirement incomes, to contribute to macroeconomic management of wages growth, and to increase national savings."[52]

Nonetheless, testifying before the United States House of Representatives' Subcommittee on Social Security, financial consultant David O. Harris suggested that the Australian experiences offers several lessons to the U.S. on dealing with aging populations. Harris broke down these lessons into six points:

- partnership with the trade unions;
- incentives for low income workers and the self-employed;
- information and education;
- cost-effective regulation;
- contained administrative costs under the creation of numerous individual retirement accounts; and

---

[50] AUSTRALIA DEPARTMENT OF TREASURY, BUDGET PAPER NO. 1 – BUDGET STRATEGY AND OUTLOOK 2007 – 08, *available at* http://www.aph.gov.au/budget/2007-08/bp1/html/index.htm; *see also* Leslie Nielson and Richard Webb, *The Future Fund* (Parliament of Australia Research Note No. 43 2004 – 05), *available at* http://www.aph.gov.au/Library/Pubs/rn/2004-05/05rn43.htm.
[51] Nielson & Webb, *supra* note 50.
[52] Whiteford, *supra* note 24, at 97.

- persuading all stakeholders that change had to happen and that it was for the benefit of the nation as a whole.[53]

Since Australia addressed its problem essentially by imposing the burden on businesses to increase pension funding, rather than by cutting benefits, gaining the support of the labor movement was especially pivotal. Had Australia instead moved toward cutting existing benefits, such organizations would clearly have been more reticent to throw their weight behind the reforms.

2. New Zealand

Table 5: Examples of Adjustments to PAYG Programs, 1970-2004

Country	Increase in contribution rates or coverage	Change in retirement age[a]	Change in years of earnings considered in benefit calculation	Change in indexation for calculation of initial benefit[b]	Change in indexation for benefits during retirement	Economic and demographic adjustment mechanisms	Other decrease in benefits
New Zealand	No employer/ employee contributions to PAYG	62 to 65	None identified	None identified	None identified	None identified	The link to 80% of average wages (for couple) abolished; relative value is now below 70%

Source: GOVERNMENT ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORMS ABROAD, GAO-06-126 (October 2005) at 49.

Historically, New Zealand has been a traditional welfare state, premised on the idea that the state would provide "cradle to the grave" social insurance.[54] However, the nation was forced to reanalyze this philosophy when a period of economic downturn in the 1970s – caused in part

[53] Testimony of David O. Harris, *supra* note 33, at 8.
[54] JAMES ANGRESANO, FRENCH WELFARE STATE REFORM: IDEALISM VERSUS SWEDISH, NEW ZEALAND AND DUTCH PRAGMATISM 93 (2007).

by decreased trade with Great Britain and increasing oil prices[55] – led to rapid inflation and growing unemployment.[56] Higher unemployment in particular caused state spending on entitlements to grow from 15% of GDP in 1970 to 23% by 1984.[57] The government was slow to react to these changes however; the 1977 Pension Act, which implemented a new superannuation scheme paid out of general revenues,[58] actually lowered the pension age from 65 to 60 and eliminated means-testing. As a result, spending on pensions rose from 4% of GDP in 1970 to over 8% in the 1980s.[59]

During the 1980s, New Zealand's economic position became unsustainable. Trade with England, traditionally New Zealand's most important trade partner, had remained depressed due to England's closer ties with the European community.[60] Employment was down, partly as a result of the more generous pensions available. Most importantly, New Zealand had become less competitive on the international market, and its key economic sectors of agricultural and primary good exports were suffering.[61]

Two distinct periods of economic reform followed. The first came under the helm of the Labour Party, which held office from 1984 – 90. Although the Labour Party was not traditionally associated with such reforms, in this case the government was heavily influenced by a prominent Finance Minister and by key officials in the influential Treasury department, traditionally a stepping-stone to higher office.[62] Prompted by the Treasury department, which proposed significantly diminishing the New Zealand government's historically prominent

---

[55] David Knutson, *Welfare Reform in New Zealand: Moving Toward a Work-Based Welfare System* (August 1998), at 16.
[56] ANGRESANO, *supra* note 54, at 94.
[57] *Id.* at 98.
[58] Knutson, *supra* note 55, at 16.
[59] ANGRESANO, *supra* note 54, at 104.
[60] *Id.* at 105.
[61] *Id.* at 96 – 99.
[62] MICHAEL O'BRIEN, POVERTY, POLICY AND THE STATE: THE CHANGING FACE OF SOCIAL SECURITY 148 – 52 (2008).

involvement in economic affairs,[63] as well as by business associations that were increasingly neoliberal,[64] the government set out on a plan of comprehensive market-based reform aimed at liberalizing and privatizing New Zealand's economy in order to retain macroeconomic stability and ensure future international competitiveness.[65] Such radical changes were made possible in part because New Zealand's political system at the time allowed a motivated Prime Minister and Cabinet to push policy quickly through the legislature, in part by taking advantage of urgency procedures which allowed for only limited public consultation.[66]

Despite its willingness to engage in comprehensive economic reform, the Labour Party drew the line at cutting benefits, as it was the party associated with New Zealand's "cradle to the grave" philosophy. The Labour Party's one attempt at reducing benefits – imposing a modest income test on the national pension plan in 1985 – was politically unpopular and later repealed.[67] The combination of economic liberalization and continued high benefits during the 1980s caused unemployment to soar, from 3% in the 1970s to 10% by 1991.[68] Poor economic performance during this time was exacerbated by the Asian Financial Crisis of 1987.[69]

New Zealand's struggling economy led to the 1990 election of the National Party, paving the way for the second period of economic reforms. Although the National Party had in fact campaigned in part on a platform of *increasing* certain entitlement benefits, such a move was rendered infeasible by the exploding budget deficit that it inherited.[70] The National Party was able to make significant reforms to New Zealand's traditional welfare state that the Labour party

---

[63] Knutson, *supra* note 55, at 16 – 17.
[64] O'BRIEN, *supra* note 62, at 148
[65] ANGRESANO, *supra* note 54, at 90 – 95.
[66] Knutson, *supra* note 55, at 17 – 18.
[67] O'BRIEN, *supra* note 62, at 30.
[68] Tim Maloney, *Welfare Reform and Unemployment in New Zealand*, 69 ECONOMICA 273 (2002); *see also* O'BRIEN, *supra* note 62, at 22.
[69] ANGRESANO, *supra* note 54, at 109.
[70] R. Kent Weaver, *New Zealand: The Supreme Political Football* (Ctr. on Retirement Research Working Paper No. 2002-12) at 15.

could not touch for political reasons.[71] Continuing to be influenced by the fiscally conservative Treasury, which itself was influenced by the World Bank and IMF, the National Party announced an "Economic and Social Initiative" intended to fundamentally redesign the welfare state. In the words of a party spokesman:

> The redesign of the welfare state is integral to our strategy for growth. We cannot make economic progress without reforming our social systems, nor can social and economic policy be divorced from one another. The only sustainable welfare state is one that is fair and affordable. Our current system is neither. Real welfare is created by people and families through their own efforts. Our redesigned welfare state will support those efforts and assist those who cannot assist themselves.[72]

With this philosophy in mind, the National Party set out on an ambitious path of entitlement reform. In the 1991 budget, welfare benefits were slashed across the board by 10 to 25%,[73] leading to a substantial decline in unemployment.[74] Between 1992 and 2000, the retirement age was gradually raised from 60 to 65.[75] After returning to power, the Labour Party continued these reforms, raising the pension age to 67 and instituting income-testing,[76] placing further constraints on the ability of citizens to collect welfare,[77] and instituting certain accounting constraints.[78]

With such changes in place, New Zealand had undergone a rapid transformation in entitlement policy, moving away from a comprehensive social insurance regime and toward a

---

[71] ANGRESANO, *supra* note 54, at 110.
[72] *Id.* at 111.
[73] Knutson, *supra* note 55, at 36.
[74] Maloney, *supra* note 68, at 274; *see also* O'BRIEN, *supra* note 62, at 174
[75] ANGRESANO, *supra* note 54, at 111.
[76] Weaver, *supra* note 70, at 14.
[77] Raymond Harbridge & Pat Walsh, *Labour Market Reform in New Zealand*, in LABOUR MARKET AND SOCIAL PROTECTION REFORMS IN INTERNATIONAL PERSPECTIVE 198, 208 (Hedva Sarfati & Giuliano Bonoli, eds. 2002).
[78] Weaver, *supra* note 70, at 46. For instance, the recent Superannuation Fund legislation requires to the government "to state annually whether (and if so, why) they are falling short of a contribution rate that would be sufficient to fund pensions if carried forward on a consistent level-funding basis for forty years." *Id.*

more free-market approach. One area where progress remains to be made is in the realm of pension policy. As one commentator has observed:

> New Zealand, like Australia, entered the 1980s without a mandatory earnings-related pension program. Unlike Australia, however, New Zealand also ended the twentieth century without such a program. Although the New Zealand pension system has been [frequently changed], the basic shape of that program remains very close to what it was two decades ago.[79]

The lack of any pension program beyond the government superannuation fund, which pay out the equivalent of 40% of average earnings as a base rate (indexed to prices but subject to a floor and ceiling),[80] is especially troubling as the population of 65+ in New Zealand is expected to grow from 420,000 in 1996 to 1.15 million by 2051, and the ratio of potential labor force participants to the elderly is expected to drop from 4:1 to 2:1 during that period.[81] With few large businesses and limited tax incentives for occupational pension offerings, less than 15% of private sector workers in New Zealand had personal pension plans as of 2005.[82] Since 1997, New Zealand has considered several new pension programs. A mandatory individual accounts program was put to a national referendum in 1997 and overwhelmingly defeated, and a proposal for a new collective fund by the Labour government in 2001 went nowhere.[83]

In 2007, the New Zealand government introduced a new voluntary pension program called KiwiSaver, in which all workers may contribute 4% or 8% of their salary to government run individual pension accounts. Enrollment is automatic, though workers may elect to opt out. The government incentivizes enrollment by contributing $1000 tax free to all new accounts. Funds are locked in until age 65.[84] This is modeled on Australia's plan, and enrollment has been

[79] *Id.* at 2.
[80] OECD, *supra* note 5, at 162.
[81] Weaver, *supra* note 70, at 3.
[82] Steve Schifferes, *Pension Reform: What Other Countries Do*, BBC NEWS (Nov. 24, 2005).
[83] Weaver, *supra* note 70, at 2.
[84] Schifferes, *supra* note 82.

very high so far. In its first five months of existence, over 300,000 New Zealanders joined the program.[85] There is some talk of making KiwiSaver compulsory in the future, but that remains speculation for the moment.

Like many other nations, it would be easy to point to the economic troubles of the 1970s and 1980s, caused primarily by the increasing competition faced by New Zealand in a globalized economy, as the key prompt toward entitlement reform. And this is certainly true; one observer has noted that:

> [T]he economic reforms were processed on the basis of globalizing the New Zealand economy, that is, opening up the New Zealand economy much more directly, overtly and actively to the influences of the international marketplace. To put this in a slightly different way, one of the major factors shaping the economic changes and shaping current economics policy has been to ensure that the New Zealand economy is both open to international markets and internationally competitive. This globalizing influence and focus has a strong connection with the changes and developments in social policy in New Zealand and more specifically with the reshaping of social security and income support.[86]

However, beyond such obvious factors, there are certain unique characteristics of the New Zealand experience that are relevant to the specific process of reform that the nation experienced. New Zealand's process of reform, perhaps more so than other nation, was motivated in part by the role of a small number of politically influential officials in the Treasury department; that department plays a unique role in New Zealand "as both the central source of policy advice for government and as a clearinghouse for all policy and spending proposals also contribute to centralization of power in New Zealand."[87] Thus, key individuals and political organizations were able to reframe the debate, away from New Zealand's traditional "cradle to

---

[85] *More than 300,000 join KiwiSaver*, NEW ZEALAND HERALD (Dec. 6, 2007).
[86] O'BRIEN, *supra* note 62, at 130.
[87] Weaver, *supra* note 70, at 6.

the grave" social welfare state, and toward a new model that pointed toward dependency on the government as depressing the economy.[88]

It is also important to note the unique positions held by New Zealand's political institutions. At the time that most of the reforms were enacted, the New Zealand government was extraordinary in the extent to which the Prime Minister and Cabinet acting in concert were able to exercise unfettered powers.[89] As one academic found in the context of comparative entitlement reform studies:

> New Zealand's political institutions are extraordinary in the extent to which they concentrate power: no second chamber, no independently-elected executive to veto legislation, no checks on the central government from provinces with autonomous spheres of jurisdiction (as in Canada), no judicial review of legislation, and (prior to 1996) no coalition or minority governments. Indeed, prior to 1996 critics labeled New Zealand an "elected dictatorship" in which governing party elites could force their preferences into policy virtually unchecked. Centralization of power in New Zealand is further enhanced by cabinet dominance over the governing party(ies) caucus.[90]

As a result of such structure, a motivated government was able to push through significant reforms without facing serious pushback from the public or from opposition parties.

Additionally, the overwhelming defeat of a mandatory individual accounts program in the 1997 referendum, coupled with the overwhelming popularity of the KiwiSavers program, characterized by automatic enrollment but with an opt-out provision, suggests that citizens are more apt to accept reforms couched as voluntary, regardless of practical effect.

Finally, Professor of Political Economy James Angresano argues that "reforming an economies' institutions and rules is an iterative process that requires modifications of policies

---

[88] O'BRIEN, *supra* note 62, at 177.
[89] *See* Weaver, *supra* note 70, at 5.
[90] *Id.*

over time."[91] While this is perhaps a truism, it applies with special force to the case of New Zealand, where the economic reforms were first presented by a Labour Party with traditional ties to the welfare state and only then expanded upon by the more conservative National Party.

3. Japan

Table 5: Examples of Adjustments to PAYG Programs, 1970-2004

Country	Increase in contribution rates or coverage	Change in retirement age[a]	Change in years of earnings considered in benefit calculation	Change in indexation for calculation of initial benefit[b]	Change in indexation for benefits during retirement	Economic and demographic adjustment mechanisms	Other decrease in benefits
Japan	17.35% to 18.3% by 2017 government share to increase from one-third to one-half of cost; also extended contributions base to include bonuses (1994)	60 to 65 for men and 59 to 65 for women	25 to 40 in 1986 reform	None identified	Gross wages to net wages (1994), then from wages to prices, then prices less demographic and longevity adjustments projected to be 0.6% and 0.3% per annum	In 2004 legislation introduced automatic adjustment to benefits in response to macroeconomic changes in the working age population and life expectancy	Accrual rate for earnings-related pension from 1% per year to 0.7125%; benefits to be reduced 20% by 2025; increased penalties for early retirement, incentives for later retirement

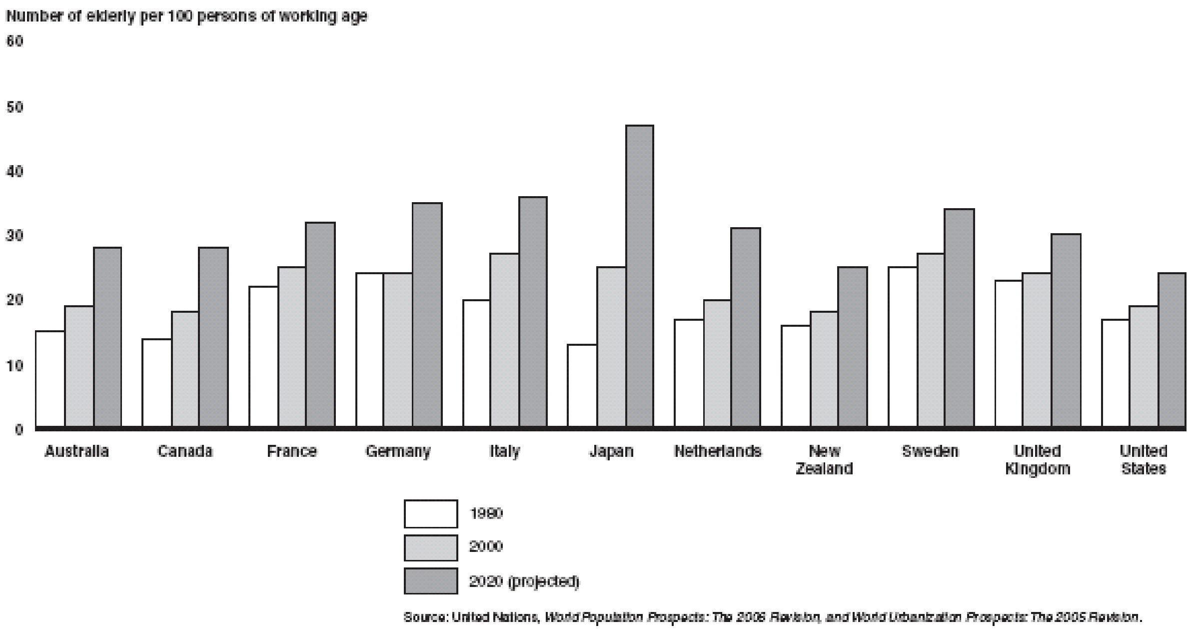
Source: GOVERNMENT ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORMS ABROAD, GAO-06-126 (October 2005) at 48.

The case of Japan is unlike that of the other nations studied for the simple reason that Japan is not a welfare state; expenditures on social-welfare programs in Japan as a percentage of GDP are relatively low compared to other OECD nations.[92] Accordingly, the pressure to reform entitlement in Japan did not result from liberalization policies tied to maintaining global competitiveness. Instead, reforms were forced upon Japan by internal forces, namely the weight of its aging population, as shown in the table below. The issue became extremely salient at the

[91] ANGRESANO, *supra* note 54, at 119.
[92] Toshiaki Tachibanaki, *Social security reform in Japan in the twenty-first century*, in THE ECONOMICS OF SOCIAL SECURITY IN JAPAN 12, 12 – 13 (Toshiaki Tachibankai, ed. 2004).

end of the last century, when the release of projections on Japan's rapidly aging population coincided with a period of general economic malaise.

Fig. 2: Elderly Dependency Ration for Selected High-income Countries, 1980 to 2020[93]



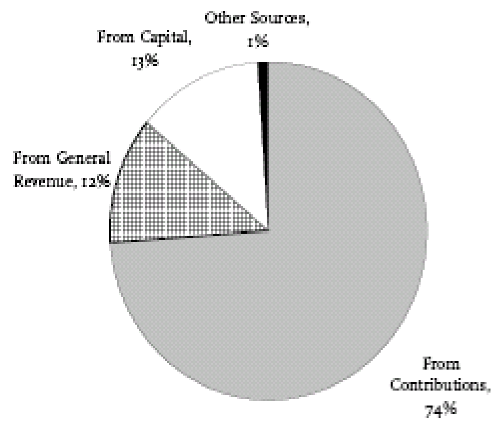
Source: GOVERNMENT ACCOUNTABILITY OFFICE, ENTITLEMENT REFORM PROCESS: OTHER COUNTRIES' EXPERIENCES PROVIDE USEFUL INSIGHTS FOR THE UNITED STATES, GAO-08-372 (January 2008), at 5.

Japan's public pension system has two tiers. The National Pension ("NP") is a mandatory universal flat-rate entitlement that all Japanese workers with a minimum of 25 years of contribution are eligible for. One-third of the NP is financed by general tax revenues, with the other two-thirds coming in the form of contributions.[94] The NP is indexed to prices, and in 2004 paid out at a rate equal to 16% of average wages.[95] The Employees' Pension Insurance ("EPI"), which dates back to legislation adopted in the 1950s, is paid in addition to the NP based upon the employee's contribution history.[96] It is funded primarily out of a 13.58% tax on earnings, split

[93] GAO 2008, *supra* note 2.
[94] Toshiaki Tachibankai, Introduction, in THE ECONOMICS OF SOCIAL SECURITY IN JAPAN 1 (Toshiaki Tachibankai, ed. 2004) at 3.
[95] OECD, *supra* note 5, at 146.
[96] *Id.*

between employers and employees, and supplemented by government reserves.[97] For those eligible for NP only, flat-rate contributions are equivalent to about 3.5% of wages.[98]

Fig. 3 – Revenue Sources for the Public Pension System – NP, EPI (2000)[99]



Source: Bernard H. Casey, *Reforming the Japanese Retirement Income System: A Special Case?*, CTR. FOR RETIREMENT RESEARCH (September 2004) at *6.*

Japan is also unique in that the legislation establishing each pension program also mandates actuarial review, every five years, of the financial status of the public pension and projections for future sustainability.[100] The review process follows several stages, beginning about two years before the report is due to be released. First, the Consultative Committee, run under the auspices of the Ministry of Health and Welfare, and with a membership composed of leading politicians, civil servants, and academics, begins its study and deliberations, leading up to the drafting of a report. Upon completion, the report is published and submitted to the

---

97 Tetsuo Kabe, *Japan's Public Pension Reforms*, INT'L CONF. ON SOCIAL SECURITY REFORM (Feb. 24, 2006) at 5.
98 Bernard H. Casey, *Reforming the Japanese Retirement Income System: A Special Case?*, CTR. FOR RETIREMENT RESEARCH (September 2004) at 5.
99 *Id.* at 6.
100 Kabe, *supra* note 97, at 5.

legislature, which then writes the first draft of the appropriate bill in response. The bill is then sent to the Committee for its opinion before being voted upon by the legislature.[101]

As a result of this process, the reform process has occurred in fairly-regular five-year intervals, as all significant recent reforms have in fact been triggered by the review process.[102] The first of the modern reforms occurred in 1994, when, during a period of recession, the legislature made modest cuts in benefits, instituted a gradual increase in contribution for EPI from its then-level of 11.2%,[103] and increased the eligibility age for NP from 60 to 65.[104] In continuing with the theme of reforms following political change, the 1994 reforms did in fact take place shortly after the political party that had effectively ruled since World War II was replaced by a new legislative coalition; however, it is unclear whether the two events are causally related, given that the reform process was in fact managed mostly by civil servants who served under both regimes.[105]

Within a few years, newly released demographic figures revealed that the situation faced by Japan was much more significant, requiring serious action. The Japanese Ministry of Health, Labour, and Welfare's 1999 actuarial report estimated the present discounted value of future unfunded EPI liabilities at about 90% of GDP.[106] With the goal of ensuring fiscal solvency through the year 2060, the Japanese government in 2000 instituted a series of incremental changes.[107] Most significantly: (1) the retirement age of EPI eligibility was raised from 60 to 65 (for men by 2013; for women by 2018); and (2) the accrual rates for EPI benefits were cut from 0.75% of wages per year worked to 0.7125% (meaning that after the maximum of 40 years of

---

[101] Jean-Francoise Estienne & Kiyoshi Murakami, *The Japanese experience of review and reform of public pension schemes*, in SOCIAL DIALOGUE AND PENSION REFORM 49, 57 – 58 (Emmanuel Reynaud, ed. 2000).
[102] Kabe, *supra* note 97, at 11.
[103] *Id.* at 6.
[104] OECD, *supra* note 5, at 147
[105] Estienne & Murukami, *supra* note 101, at 166.
[106] International Monetary Fund, *Japan: Selected Issues* (IMF Country Report No. 04/247, August 2004), at 52.
[107] Lillian Liu, *Public Pension Reform in Japan*, 63 SOCIAL SECURITY BULLETIN 99, 99 (2000).

contribution, recipients would receive 28.5% of measured wages rather than 30%).[108] The Government Pension Insurance Fund was also created to manage reserves, with a new mandate based on economic expertise and diversification.[109] The legislature considered at the time, but ultimately rejected, a more fundamental restructuring of the pension systems based on a privatization scheme. This decision was based, in part, on popular opinion surveys showing that the wide majority of Japanese workers valued the sense of intergenerational solidarity created by maintaining the status quo.[110]

Despite such fairly significant reforms, demographic information released in 2002 showed that by the year 2025, in order to maintain the system as currently constituted, the contribution rate would have to rise significantly beyond even those increases already undertaken, to a level of 26% of annual wages.[111] Moreover, if further reforms were not undertaken, the assets held by EPI would be exhausted by 2021, and thereafter the pension system would run at a deficit.[112]

Although in the past Japan had always set benefits and then later determined contributions, by the time of the 2004 reforms there was wide concern that following such procedures would lead to an unsustainable level of contributions being required in the future.[113] Accordingly, in 2004 the latest round of reforms adopted a fixed contribution schedule. Essentially, the contribution rate to fund EPI is to rise from 13.58% in 2004 by 0.354% each year until 2017, when it will be fixed thereafter at 18.3%.[114] At the same time, benefits will be correspondingly reduced until the benefits for a standard one-earner family amount to 50.2% of

---

[108] Casey, *supra* note 98, at 8 – 9.
[109] *Id.* at 9.
[110] Liu, *supra* note 107, at 103.
[111] Casey, *supra* note 98, at 9.
[112] Kabe, *supra* note 97, at 9.
[113] Junichi Sakamoto, *Japan's Pension Reform* (World Bank Social Protection Discussion Paper No. 0541, 2005) at 4.
[114] *Id.* at 5.

income (as compared with about 60% at present). A more technical explanation is offered by the International Monetary Fund ("IMF"):

> The reduction [in benefits] will be achieved through a so-called "macroeconomic indexation." A macroeconomic index will be defined every year, reflecting the decline in the number of pension system contributors and the increase of life expectancy. [Japan's Ministry of Health, Labour, and Welfare] estimates that the average annual change of that index will be about 0.9 percent. The initial level of benefits for new retirees will be a function of their average lifetime wages adjusted for the index, and benefits for existing retirees will increase by CPI inflation minus the change in the macroeconomic index (if that is negative, benefits will remain flat). The indexation will be discontinued in 2025—by that time the replacement rate is expected to be down to 50.2 percent.[115]

This indexation method thus takes into account the decrease in the number of contributors and growth in the average life expectancy.

The most unique aspect of the Japanese reform model is the statutory requirement that fiscal review be undertaken every five years. Observers have noted that this framework has certain significant strengths:

- it keeps debate over pension policy continuously on the agenda, thereby avoiding any debate over the relevance of carrying out a review;
- flexibility is achieved via a constant search for original solutions; and
- it helps to achieve popular consensus by ensuring that the entire community remains informed.[116]

However, there are also certain drawbacks associated with the process:

- it reinforces bureaucratic power in the reform process; and
- although the public is informed, their input is not necessarily appropriately valued.[117]

---

[115] International Monetary Fund, *supra* note 106, at 54 n.4.
[116] Estienne & Murukami, *supra* note 101, at 61.
[117] *Id.* at 61 – 62.

Cultural factors may also help to explain Japan's repeated success in enacting reforms. As noted above, a strong sense of intergenerational solidarity permeates Japanese society. This is embodied in the fact that a relatively high proportion – over two-thirds – of elderly Japanese live with their children.[118] The strength of intrafamilial relations is important is that it creates a willingness of sacrifice among current payors to fund the benefits of the elderly; at the same time, it potentially lessens the need for immediate reform because a high percentage of the elderly may not depend on government benefits for their sole support.

4. Sweden

Table 5: Examples of Adjustments to PAYG Programs, 1970-2004

Country	Increase in contribution rates or coverage	Change in retirement age[a]	Change in years of earnings considered in benefit calculation	Change in indexation for calculation of initial benefit[b]	Change in indexation for benefits during retirement	Economic and demographic adjustment mechanisms	Other decrease in benefits
Sweden	None identified	Increase from 65 to 66; decrease to 61 with actuarial penalty	None identified	None identified	None identified	NDC reform adjusts benefits to reflect contributions, longevity, and economic performance	None identified

Source: GOVERNMENT ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORMS ABROAD, GAO-06-126 (October 2005) at 50.

Sweden is unusual in having undergone a single, if extended, process of reform. Until the 1990s, Sweden had a similar, though larger, pension system to the United States.[119] Like the United States, Sweden's system had a trust fund but was primarily pay-as-you-go based on prior earnings, with minimum levels of support for indigent workers. Through a collegial multi-partisan process, Sweden overhauled its system, bringing it into long-term solvency. Doing so, it

[118] *See, e.g.*, Diane Rowland, *A Five-Nation Perspective on the Elderly*, HEALTH AFFAIRS 206, 208 (Fall 1992).
[119] Sweden has an 18.5% payroll tax, versus 12.4% in the United States.

primarily did not raise taxes, but rather enacted a series of benefit cuts.[120] It also established a small, mandated individual retirement account scheme. By one estimate, had Sweden not changed its system, by 2025 pensions would have represented 36% of payrolls.[121] Instead, Sweden has gone from what the Heritage Foundation calculated was a shortfall of 200% of GDP in the 1990s to probable long-term surplus.[122] And if the ratio of the present value of the retirement fund plus current and future revenues to current and future pledged benefits were to unexpectedly fall below one, there would be automatic cuts in both current and future benefits.

The overarching impetus for pension reform in Sweden came from projections showing likely future program insolvency. Additionally, in the 1980s the political right put pressure on the governing center-left Social Democrats to show they were serious about pension reform. At the same time, there was an increasing perception that failure to modify program criteria had led to arbitrary under or over-compensation amongst different groups. As a consequence, the Social Democrats appointed a reform commission in 1984.[123] The commission was large and included individuals from parliament, business, labor, and academics. Though in 1990, after six years of deliberation, the commission suggested changes to survivors' pensions, it did not recommend wider reaching reforms because of disagreements and a perception that any crisis in the system

---

[120] Currently Sweden still provides proportionally larger benefits to its pensioners than the United States – take home pension income is 66% of average net working earnings for the median Swedish worker, versus 55% in the United States. OECD, *supra* note 5, at 35. The amount of income replaced by retirement income is commonly called the "replacement rate."

[121] SWEDEN MINISTRY OF HEALTH AND SOCIAL AFFAIRS, FACT SHEET NO. 5 - OLD AGE PENSIONS IN SWEDEN (July 2000), *available at* http://www.sweden.gov.se/content/1/c6/02/46/15/a97e5315.pdf. Other estimates are lower. *See, e.g.*, Annika Sunden, *The Swedish Experience with Pension Reform*, 122 OXFORD REV. ECON. POLICY 133, 136 (2006) (putting the necessary tax at 30% in 2025).

[122] Daniel J. Mitchell and Goran Normann, *Pension Reform in Sweden: Lessons for American Policymakers* (Heritage Foundation Backgrounder No. 1381, 2000), *available at* http://www.heritage.org/Research/SocialSecurity/bg1381.cfm.

[123] Bo Könberg, et. al., *NDC reform in Sweden* in PENSION REFORM: ISSUES AND PROSPECTS FOR NON-FINANCIAL DEFINED CONTRIBUTION (NDC) SCHEMES 449, 451-452 (Robert Holzmann & Edward E. Palmer, eds. 2006).

was 20 to 25 years away.[124] However, the committee did help illuminate many of the weaknesses of the old system.[125]

The demographic projections, and corresponding lack of urgency, changed quickly in the early 1990s. Voters elected a new center-right government committed to reform and the worst economic downturn since the 1930s hit Sweden.[126] Not only was the need for reform clear, but there was somewhat of a consensus that Sweden's tax burden was high enough that reform should come largely from reducing benefits.[127] Sweden's center-right government created a commission with the mandate to redesign the system to be "financially solvent and broadly supported."[128] This time, the commission was quite small. The eight members were comprised of two Social Democrats and one person from each of Sweden's six smaller parties. Six of the eight members were high ranking members of parliament, and one was the Minister of Social Affairs, indicating the power the commission would have in making reforms.[129] Ultimately, representatives from five of the parties representing 85% of Sweden's population, including the Social Democrats, essentially worked amongst themselves to reach an agreement.[130] The private nature of the meetings was justified by the periodic "reference group" meetings with representatives of outside stakeholders such as business and labor.[131] The group started by studying the issue in a non-partisan fashion – only after a thorough examination of the problem did the committee begin to discuss solutions. It first agreed on less contentious issues, such as overall goals for the system, before moving on to the most contentious issue, publicly

[124] GAO 2008, *supra* note 2, at 42.
[125] Könberg, et. al., *supra* note 123, at 451.
[126] OECD, *supra* note 5, at 42; Könberg, et. al., *supra* note 123, at 451.
[127] Agneta Kruse & Ed Palmer, *The New Swedish Pension System – Financial Stability and the Central Government Budget* 18 (Presented at the Urban Institute's International Conference on Social Security Reform, February 24, 2006).
[128] GAO 2008, *supra* note 2, at 42.
[129] Könberg, et. al., *supra* note 123, at 453.
[130] Kruse & Palmer, *supra* note 127, at 18.
[131] GAO 2008, *supra* note 2, at 43.

funded private accounts.[132] Subsequent comments from committee members and the committee's final, far reaching proposal indicated that the committee worked hard to compromise. For example, the left agreed to mandatory retirement accounts, but the right agreed that only a small portion of funding would be directed to that purpose. By 1994 the commission, largely working in private, had agreed to the key elements of the plan. The parliament then overwhelmingly passed the blueprint for the plan, but put off implementing the details, both because some details needed to be worked out and because the Social Democratic Party wanted more time to discuss the facets of the plan internally.[133]

The same year the blueprint was passed, the Social Democrats returned to power at the head of a center left coalition, but the reform process continued. This is perhaps unsurprising, since the five parties at the fore of the original compromise continued to be the large majority of parties in parliament. The Social Democrats resolved all significant internal divisions by 1996. In 1994, the government instituted a second, similar commission to work out the technical aspects needed to fully implement the plan. In 1997 and 1998, the commission's recommendations were adopted by parliament, once again overwhelmingly. The current pension system was now essentially in effect, with the exception of the automatic stabilizer. The second commission developed this portion of the plan, which was adopted in 2001.[134]

The reforms affected all elements of the system significantly, with the exception of the revenue portion. Pension taxes remained at 18.5%, though the income cap, which stood at $46,700 in 2007, was eliminated for employers' portion of the tax.[135] The changes to benefits were much more dramatic. Sixteen percent of the payroll tax is now dedicated to the first pillar

[132] Könberg, et. al., *supra* note 123, at 453-454.
[133] *Id.* at 450.
[134] *Id.* at 449 – 450.
[135] GAO 2005, *supra* note 3, at 42.

of the system: its new notional defined contribution (NDC) system. This functions essentially as a fictional individual retirement account system for workers. Instead of the old system, where the highest fifteen earning years were put into a formula pegged to wage growth, now all of a worker's tax payments are considered notional contributions to his or her own retirement (though most of the money is actually used to pay for current retirees' benefits, with the rest going into Sweden's pension trust fund). Credits are also given based on education, military service, and sickness, which are financed out of the central budget.[136] The contributions then grow according to the country's economic growth and other factors. When a participant begins drawing a pension, the funding level is calculated as an annuity, with increasing life-spans leading to lower payouts. Another important change was to remove the NDC system from the central government's annual budget, making the operation of the program automatic without government intervention.[137]

After additional research, parliament added an automatic trigger to the NDC, which will lower benefits if necessary to keep the system in balance. The payouts to future and current pensioners is automatically reduced if the present value the program's pension fund and revenue falls below the present value of all payments owed. In this way, absent political changes, the system will be perpetually in balance.[138] It appears probable that the automatic adjustment will never come into effect. The Swedish government annually makes pension projections for the next 75 years. For the last two years, of the report's three scenarios – optimistic, base, and pessimistic – only in the pessimistic case will the balancing mechanism be necessary.[139]

---

[136] Kruse & Palmer, *supra* note 127, at 5.
[137] *Id.* at 2.
[138] *See id.* at 6.
[139] THE SWEDISH SOCIAL INSURANCE AGENCY, ORANGE REPORT: ANNUAL REPORT OF THE SWEDISH PENSION SYSTEM 2006, at 26, available at *http://www.fk.se/filer/publikationer/pdf/par06-e.pdf*. Rebalancing in the pessimistic scenario starts in 2013 and occurs frequently thereafter. *See id.*

The second element of the Swedish system remains an automatic benefit to the poor and disabled. However, these have now been transferred to the general revenue fund, and they are now tied to price, not wage, growth.[140] As a result, roughly a third of the pension fund was transferred to general fund coffers in order to help fund the program.[141] While this could obviously have some adverse effect on the general budget, it also makes it more likely the automatic stabilizer will not need to be triggered.[142]

The third element of the new system is a mandatory individual account for every worker. Two-and-one-half percent of the 18.5% payroll tax is automatically put into an individual account. Contributions are capped at incomes 2.8 times the notional defined benefit cap, or three times average workers' earnings.[143] Workers can invest in up to five of roughly 700 government-approved privately operated accounts. Financial institutions cannot market to customers directly – instead there is a nationally approved clearinghouse of information.[144]

The country has experienced some problems with regard to these accounts. While fees are capped, administrative costs still consume roughly 15% of the final value of the funds.[145] Nor are minimum returns guaranteed. And though two-thirds of participants made active account choices in 2000, from 2001-2005, roughly 85% of newly enrolled workers did not pick an account. They instead let their investment fall into the government default account, which

---

[140] OECD ECONOMIC SURVEYS – SWEDEN 15 (July 1999).
[141] Könberg, et. al., *supra* note 123, at 458.
[142] OECD ECONOMIC SURVEYS – SWEDEN 15 (July 1999). Sweden's pension trust fund is off budget, leading to a higher headline level of government debt. In the 1990s the debt was around 75% of GDP, which is relatively high by international standards. It is possible that this high debt level increased the sense of urgency surrounding reforms of all sorts, including pensions.
[143] OECD, *supra* note 5, at 26.
[144] GAO 2005, *supra* note 3, at 27.
[145] GAO 2005, *supra* note 3, at 55. Sunden estimates that the average administrative costs to participants are 0.73%, versus 0.1% in the Thrift Savings Plan, the US Government employee voluntary defined contribution plan. However, the administrative costs for the default government pension are lower than those for plans run by private corporations. Sunden, *supra* note 121, at 142 – 43.

invests primarily in global equities.[146] According to a recent study, 60% of Swedes rate their understanding of the pension system as either "poor" or "very poor."[147]

In Sweden's reformed system, workers can retire as early as 61, but there are strong financial incentives to work longer. First, the longer one works, the more they contribute to the NDC and therefore the larger their pension. Second, since the annuity is calculated based on life expectancy at retirement, the longer one waits to retire, the higher benefits will be.[148] The effects on yearly pensions are dramatic – for example, currently if one retires at 67 rather than 65, his/her annual pension will be 20% higher.[149] Third, after turning 61, workers can draw a quarter, half, or three-quarters pension, providing a potential way to continue working at reduced hours and salary.[150] As a result, Sweden is expected to continue to have high labor force participation rates among workers in their 60s.[151] However, it is unlikely for the foreseeable future that labor force participation will rise above age 67, since most collective bargaining agreements mandate retirement at that age.[152]

While satisfaction with the new system runs high, there have been some modest calls for additional reform. Most tend to relate to improving educational outreach for the individual accounts, as well as reducing the number of investment options.[153] An additional government commission has studied this issue and recommended a reduction to 20 available accounts, but

---

[146] GAO 2005, *supra* note 3, at 26; Könberg, et. al., *supra* note 123, at 459.
[147] GAO 2008, *supra* note 2, at 45.
[148] *See* Kruse & Palmer, *supra* note 127, at 6. The standard retirement age was recently raised from 65 to 66, slightly lowering the annuity Swedes will receive at any given age. GAO 2005, *supra* note 3, at 50. It is worth noting, however, that the government need not raise the retirement age further, except to the extent that it encourages liberalization of negotiated private sector retirement ages; increasing life spans will lower annuity payments, encouraging Swedes to work slightly longer in order to obtain the same benefit.
[149] Könberg, et. al., *supra* note 123, at 462.
[150] GOVERNMENT ACCOUNTABILITY OFFICE, OLDER WORKERS: POLICIES OF OTHER NATIONS TO INCREASE LABOR FORCE PARTICIPATION, GAO-03-307 (February 2003), at 39.
[151] *Id.* at 3. Average retirement age, while still higher than most countries in the mid-1990s, had declined from an average of about 67 in 1965 to 62 in the mid-1990s. Rates have stabilized since then. See Sunden, *supra* note 121, at 36.
[152] Könberg, et. al., *supra* note 123, at 462.
[153] GAO 2008, *supra* note 2, at 24 – 25.

thus far parliament has not acted on the issue. Further, some suggest that the government default fund should be a lifecycle fund, making appropriate portfolio changes as individual workers age. Another potential challenge is pensions for low income workers. The OECD notes that since the benefit plan for indigent citizens is tied to price rather than wage growth, which may require an adjustment. Otherwise, in 45 years indigent pensioners are expected to receive just 14% of average earnings in Sweden, which is below any other OECD nation's poor-pensioner rate and less than half of Sweden's current 34% rate.[154]

Nonetheless, Sweden's reforms seem to be regarded as among the most successful any country has undertaken. The trust fund is 24% of GDP, almost proportionally double to the United States' Social Security Trust Fund.[155] Further, the OECD calculates that Sweden has gone from promising its pensioners 78.9% of their gross earning to promising 62.1% post reform, which is still above the rate in many countries.[156] As a result, public spending on pensions would at most need to only modestly increase over the coming decades, from 10.6% of GDP to 11.2%, despite a population that is aging more rapidly than the United States.[157] The program is in actuarial balance, and there appear to be no significant efforts on either the left or the right to change the core elements of the program – 10 years after the reforms were first accepted in 1994, the same five dominant parties were still broadly supportive of the scheme. As a political advisor in Sweden's Finance Ministry wrote, while, "in theory, a simple majority could change [the pension system]… in practice, that is extremely unlikely to happen."[158]

[154] OECD, *supra* note 5, at 27, 30.
[155] GAO 2005, *supra* note 3, at 17.
[156] OECD, *supra* note 5, at 66.
[157] Kruse & Palmer, *supra* note 127, at 1.
[158] Email from Björn Wretfeldt, Political Advisor, Swedish Ministry of Finance, to Brent Lanoue (May 9, 2008) (on file with authors).

Sweden's experience provides several lessons for the United States. The private nature of the 1994 commission's deliberations, its small size, and its politically powerful membership were all probably critical to its success. The agreement of such a high percentage of parties, and the decisive action by parliament shortly afterwards, were likely important to stymieing opposition, though it is not obvious how such a consensus can be replicated in the United States political system, which is dominated by two parties. Some have also cited the existence of a fairly large public pension fund as making the compromise more palatable.[159]

One researcher places special significance on the way the program was phased in as an explanation for why such a difficult reform may have been passed.[160] The old retirement scheme was preserved for people born before 1938, who were 57 or older in 1994. The new scheme was phased in for citizens born between 1937 and 1954. For example, workers born in 1938 have 4/5$^{\text{ths}}$ of their benefit determined by the old rules, and 1/5$^{\text{th}}$ determined by the new criteria. For each birth year afterwards, an additional 1/20$^{\text{th}}$ of workers' pensions are determined by the new system, such that for those born in 1953, 19/20$^{\text{ths}}$ of benefits will be determined by the new system. This allowed for the plan to be appealing to a majority of society. For workers deriving most or all of their benefit from the old system, the plan was beneficial because it appeared to lock in their high level of benefits by making the overall system solvent. The plan was also beneficial to younger voters, since they were relieved of most of the burden of paying taxes for a system likely not sustainable in the long term. Together these voters made up a larger percentage of the electorate than workers in the middle who were probably harmed by the plan.

---

[159] Kruse & Palmer, *supra* note 127, at 18.

[160] *See* Agneta Kruse, *Political Economy and Pensions in Ageing Societies – a Note on How an "Impossible" Reform was Implemented in Sweden* (Department of Economics, Lund University Working Paper No. 05-035, 2005), *available at* http://www.nek.lu.se/publications/workpap/Papers/WP05_35.pdf.

Many details of the Swedish plan are also well thought out and may have led to greater acceptance amongst the public. For example, Sweden provides flexibility in determining retirement age but strong incentives to retire later. This allows individual choice while ensuring high rates of labor force participation among older workers. And since its sustainability factor is triggered when the long term fiscal outlook becomes even slightly negative, any downward adjustments in pensions may be gradual enough to ensure continued political acceptance.

5. Germany

Table 5: Examples of Adjustments to PAYG Programs, 1970-2004

Country	Increase in contribution rates or coverage	Change in retirement age[a]	Change in years of earnings considered in benefit calculation	Change in indexation for calculation of initial benefit[b]	Change in indexation for benefits during retirement	Economic and demographic adjustment mechanisms	Other decrease in benefits
Germany	Successive increases, e.g., 1991 increase of 2.5% and 1.7% in 1994; upper earnings limit indexed to wages	60 to 65 for women by 2004	None identified	None identified	From gross to net wages, then prices	Point system for calculating earnings-related benefits in supplementary schemes, including a demographic factor	Adopted penalties for early retirement and incentives for later retirement

Source: GOVERNMENT ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORMS ABROAD, GAO-06-126 (October 2005) at 47.

Like Sweden, Germany first initiated reforms in response to a worsening demographic outlook, starting in the 1980s.[161] But unlike Sweden, it has undergone a series of discrete reforms, rather than one continuous process. The center-right government raised revenues in the early 1990s, in part in response to East-German reintegration and economic downturn. In 1997, the government passed more controversial measures reducing benefits, which the opposition

[161] In the late 1980s, it was estimated that Germany's payroll tax would have to increase from under 20% to 40% in 2035 in order to maintain the current benefit structure. Axel H. Börsch-Supan et al., *How an Unfunded Pension System looks like Defined Benefits but works like Defined Contributions: The German Pension System* 5 – 6 (SonderForschungsBereich Working Paper No. 07-09, 2007), *available at* http://www.sfb504.uni-mannheim.de/publications/dp07-09.pdf.

Social Democratic Party (SPD) blocked. The SPD later enacted stronger measures than the 1997 reforms two years after returning to power in 1999, lowering benefits. Subsequently, the automatic government review forced by a soft trigger led to additional reforms in 2004 and 2007. Since 1989 Germany has both raised revenues and reduced promised benefits. It has an automatic trigger that could lower benefits further. Germany currently levels a 19.5% payroll tax for pensions, which will rise to 22% by 2030.[162] However, this higher tax rate than the United States is almost entirely the result of demographic and program design differences rather than higher benefits. For example, the current median net wage replacement rate is 57% versus 55% in the United States, and it will likely fall further.[163] It is not clear whether the system will require additional changes to stay solvent.

In response to worsening demographic projections, in 1989 Germany's center-right Christina Democratic Union (CDU) led-government enacted multiple reforms, which went into effect in 1992. The government raised the payroll tax, increased the normal retirement age from 63 to 65, and enacted actuarially calculated early retirement penalties for those drawing a pension before 65. It also changed the replacement rate calculation to net rather than gross, which implied lower future payouts because of likely additional tax increases.[164] The CDU passed these changes in positive economic conditions. However, the combination of the reintegration of large numbers of poorer East-Germans in 1989 and a severe economic downturn in 1992 – 93 led both to a bleaker long-term outlook for the solvency of the program, as well as

[162] OECD, *supra* note 5, at 127.
[163] *Id.* at 35.
[164] *See* Börsch-Supan et al., *supra* note 161, at 6.

more general fears about business competitiveness. The government responded by increasing contribution rates again, for a cumulative increase of 4.2% since the late 1980s.[165]

However, competitiveness and solvency concerns remained. These concerns were further stoked by Germany's entrance in to the European Monetary union, which imposed fiscal discipline targets. These led the government to propose somewhat more radical reforms in 1997. The changes brought women and unemployed people, whose previous retirement age was 60, in line with the employed male retirement age of 65 and limited unemployment compensation eligibility.[166] Further, it reduced pension replacement rates in line with expected demographic changes. Nonetheless, competitiveness concerns remained at the center of the political debate.

In 1998, Gerhard Schroeder's SPD was decisively elected to office, promising to reinvigorate Germany's international competitiveness by shrinking the welfare state. However, it had also promised not to lower pensions and owed its election in large part to union support. As a result, it reversed the 1997 change in pension calculations. But it did not overturn the retirement age change, likely in part because the change was only to be phased in over an extended period, culminating in 2017. Therefore, the public did not seem to notice.[167]

However, a difficult economic situation once again made the pension outlook bleaker, forcing the government into action. In 2001, the government implemented more radical reforms than Kohl's had been in 1997.[168] Ironically, Labor Minister Walter Riester, an ex-union leader, led the effort, proposing to include mandatory individual retirement accounts as part of the changes. However, Riester was forced to make the accounts a voluntary add-on, rather than

---

[165] GAO 2005, *supra* note 3, at 40, 47. The government also indexed the income cap, which was $77,300 in 2005, to wages.
[166] *See* Börsch-Supan et al., *supra* note 161, at 7.
[167] *Id.*
[168] GAO 2008, *supra* note 2, at 57.

mandatory carve out, after workers and rank-and-file members of the SPD protested.[169] One expert implies that not even the voluntary individual scheme would have passed had stocks not performed well and Sweden's recent reforms not occurred.[170] The cost containment provisions, including potentially reduced future benefits, were enough to ensure CDU support.

The reforms changed the scheme from a U.S.-style PAYG system, into a multipillar one. The new structure is composed of the following four parts: a modified PAYG pensions scheme based on earnings, which is closer to Sweden's NDC scheme than a traditional PAYG program; inducements to occupational pensions; the voluntary private pensions mentioned above (frequently called "Riester Pensions"); and a new minimum scheme distinct from the basic social pension available to all citizens.[171] The voluntary PAYG scheme is supported by direct subsidies and tax advantages, especially for the poor and parents.[172] The plan allows workers to invest via private financial institutions. The contracts are regulated in several ways, and investors are guaranteed upon retirement to receive at least their nominal contribution.[173] The changes also encouraged savings in occupational retirement accounts through tax incentives and other rule changes, though such pensions remain small.[174]

While it is not clear whether the plan will be entirely successful, it is intended to be solvent while meeting payment and benefit targets. PAYG pensions will be gradually reduced through the new formula. The net average replacement rate target has been lowered from 70% to

---

[169] *Economic Reforms Approved*, FACTS ON FILE WORLD NEWS DIGEST, July 8, 1999, at 494 A1.
[170] GAO 2008, *supra* note 2, at 57 – 58. The overall proposal continued to be quite controversial, especially within the unions and the SPD itself. *See, e.g.*, *German Reforms Strongly Resisted*, THE IRISH TIMES, August 25, 1999, at 17.
[171] GAO 2008, *supra* note 2, at 57. Benefits for poorer retirees are now 15% than those available to younger indigents. Börsch-Supan et al., *supra* note 161, at 13.
[172] Börsch-Supan et al., *supra* note 161, at 8. The typical Riester Pension provides a direct subsidy and provides tax benefits similar to a traditional IRA – contributions are only taxed at the time of withdrawal, thus both deferring tax costs and presumably creating savings via the progressive nature of the tax system. *See id*. at 12.
[173] Some have criticized the program's limitation of investment options to only those that provide an annuity upon retirement, excluding more varied strategies, like pre-paying for a nursing home. *Id*. at 11.
[174] *Id.* at 12-13.

67%.[175] But assumed in the replacement rate target is that workers will invest 4% of their gross earnings, meaning that the real replacement for the PAYG scheme should decline by about 10%.[176] On the revenue side, Germany wants its payments for PAYG to be no more than 20% in 2020 and 22% in 2030 and thereafter.[177] Built into this long term plan in the 2001 reforms was a soft trigger, which required the government to take some form of action if contribution and replacement rate targets appeared in danger of not being met. This provision was triggered faster than expected, during the financial crisis of 2002 – 03.[178]

In the elections of late 2002, Gerhard Schroeder's coalition government narrowly clung to power, as voters showed their dissatisfaction with the economy. Shortly after the election, the soft trigger led Schroeder to create an ad hoc commission, the Rurup Commission, to make reform proposals on pension sustainability, health insurance, and long-term care proposals. Some saw the commission as an important tool to legitimize future reforms, since the governing coalition was smaller, and the CDU dominated the upper house of parliament.[179] Further, the economic crisis was more acute than the one facing the 2001 reformers. That, along with the changes already made in 2001, appears to have opened up greater possibilities for the commission.[180] The Rurup Commission was large, with 26 members drawn from various parts of society, including unions, business groups, and lower level government officials.[181] Its members were placed in one of three subcommittees, which did most of the substantive work.

---

[175] This number is higher than the OECD and others' estimates for Germany's average net replacement rates because the German government calculates its rate from a hypothetical average worker who is employed for 45 years, whereas in reality the average pensioner works fewer years than that. Holger Bonin, *Will it Last? An Assessment of the 2001 German Pension Reform* 5 (IZA Discussion Paper No. 343, 2001), *available at* http://ftp.iza.org/dp343.pdf.
[176] Börsch-Supan et al., *supra* note 161, at 8. For more explanation of the formula, see *id.* at 10.
[177] Even before the 2002 – 03 downturn, one expert's estimation was that the plan would require a peak tax rate of 23.3% by 2035. Bonin, *supra* note 175, at 8.
[178] GAO 2008, *supra* note 2, at 58.
[179] *Id.* at 58 – 59.
[180] Börsch-Supan et al., *supra* note 161, at 16.
[181] GAO 2008, *supra* note 2, at 58.

The pensions group seemed less polarized and publicized less of its internal deliberations than the other two subcommittees, which may have ultimately helped it to be the only subcommittee to produce firm recommendations. In addition, observers credit the commission's public educational efforts before and during the reforms with helping the public understand the meaning and importance of the changes.[182] The proposals became law quickly after being announced in 2004.

The changes tweaked the 2001 reforms in a few ways. The first change is the introduction of a new automatic stabilizer, the "sustainability factor," to the calculations determining PAYG pension benefits. Pensions for both current and future pensioners are now calculated by multiplying the number of work points an employee has earned over the course of his or her career by a pension point value. This point value is modified yearly based on net wage growth and the sustainability factor, which is based on the retiree/worker ratio. While this has already eliminated benefit increases, benefits cannot decrease in nominal terms. The OECD estimates that in the long run the increase in pensions will be 18% less than the increase in wage growth.[183] As in other countries, this reform is designed to depoliticize the issue and minimize the need for future political interventions.[184] The second change was the addition of another soft automatic mechanism – the government must report every four years on whether the target replacement rates for 2020 and 2030 are at risk and propose remedies, if necessary. Third, the law changed the private pension plan to encourage more participation by making a larger number of people eligible for government subsidies. Fourth, participants in the system now receive a detailed annual mailing explaining their personal pension position, and financial institutions must

[182] *Id.* at 59.
[183] OECD, *supra* note 5, at 127.
[184] GAO 2008, *supra* note 2, at 58.

meet stringent disclosure standards before enrolling new pensioners.[185] As with Sweden, the 2001 and 2004 reforms can be seen as changing the system from defined benefits to defined contributions, though because of the floor on benefit reductions it is arguably closer to defined benefits than Sweden.[186]

The only element of the Rurup Commission's pension recommendations not passed in 2004, increases in the retirement age, was enacted in 2007. The normal retirement age increased from 65 to 67. Many consider this to be the commission's most unpopular proposal. Because of this and the lack of urgency of the proposal – the 24 year implementation period would have started in 2011 – the Schroeder government deferred action.[187] Elections in 2005 resulted in government of national unity led by the center-right Angela Merkel, which may have enabled the parties to enact the measure by allowing them to share the political blame.[188] Surprisingly, however, the new government chose to speed up the implementation to be completed in 2019 rather than 2035. This is the most recent significant change Germany has made. Though there have been a long string of sometimes complicated reforms, for the last 15 years a series of governments have tried to explain the demographic and economic challenges facing Germany, leading to greater public acceptance of the changes than there might have been otherwise.[189]

These reforms in the aggregate have put Germany on better fiscal footing. In addition to having raised revenue, the OECD calculates that Germany has gone from promising its pensioners 48.7% of their gross earning to promising 39.9% post reform.[190] However, while German officials believe the recent reforms, coupled with planned tax increases, will be

---

[185] *Id.* at 59.
[186] See Börsch-Supan et al., *supra* note 161, at 20 – 21, for the perspective that Germany is actually more of a pure defined contribution system, because the demographic portion of the formula is used yearly to calculate benefits, rather than existing as a failsafe, as in Sweden.
[187] *Id.* at 19; GAO 2008, *supra* note 2, at 60-61.
[188] GAO 2008, *supra* note 2, at 61.
[189] *Id.*
[190] OECD, *supra* note 5, at 66.

sufficient, not all experts agree.[191] Germany continues to face a difficult demographic profile[192] and, since the 1960s, has not had a pension trust fund of significance.[193]

Of particular concern is how many workers will use the voluntary retirement accounts, since government projections assume all but the indigent will invest 4% of their income in the accounts. In 2005, 20% of workers used Riester pensions, but the number is steeply increasing, as are other private savings plans. According to one estimate, 80% of German households will have a sufficient private pension to meet a net replacement rate of 55 – 60% in the future.[194] However, this is uncertain, and several factors might depress participation, including inertia, fear of poor investment returns, and mixed incentives for the poor.[195] But possibly the biggest gap in the incentives is for lower middle class workers, who are not poor enough to qualify for additional subsidies but not wealthy enough to derive significant tax savings.[196] Ultimately, this may lead to low-income individuals retiring with insufficient pensions.[197] In addition, as in Sweden, due to regulations, administrative costs are higher than in comparable higher plans.[198]

There have been further actual and proposed small scale revisions of the system in 2008, some of which may push the system away from greater solvency. On one hand, the Bundesbank has recommended increasing the retirement age again, from 67 to 68. Parliament has yet to act on this.[199] On the other hand, after Germany's pension formula provided zero nominal increases from 2004 – 06 and only a half percent nominal increase in 2007, parliament has overridden the

[191] GAO 2008, *supra* note 2, at 61.
[192] *See* figure 2, *supra* at 21.
[193] Börsch-Supan et al., *supra* note 161, at 14.
[194] *Id.* at 13 – 16.
[195] The more indigent workers earn from private investments, the more they lose in guaranteed government benefits. GAO 2008, *supra* note 2, at 61. However, the government provides extra subsides to the poor to invest.
[196] Börsch-Supan et al., *supra* note 161, at 13 – 14.
[197] GAO 2008, *supra* note 2, at 61.
[198] One study suggested they would erode 20% of the value of the funds, versus 10% in comparable private plans. Börsch-Supan et al., *supra* note 161, at 14 (citing Siftung Warentest, RISTER-RENTENVERSICHERUNGEN: DIE LUCKE SCHLIEBEN (FINANCZtest 2002)).
[199] *Oldies with Muscle: Growing Fears about the Political Power of Pensioners*, 387 ECONOMIST 1, 70 (Apr. 26, 2008).

formula. Pensions would have risen by another half percent this year, but instead will increase of 1.1% in July, 2008 and 2% in 2009. Both of these nominal increases are still decreases in real terms. While this change will be paid for by a brief delay in scheduled tax decreases, and the government has pledged to revert to the prior formula in 2012 – 13, some worry that modifying the formula now could lead to additional interference in the future.[200] Also concerning is that currently all of Germany's political parties support higher spending, with the exception of the opposition Free Democrats, which hold less than 10% of the Bundestag's seats.[201] Likewise, 90% of German voters supported the benefit increase or thought it was not large enough, suggesting that perhaps public acceptance of the long term plan is weak.[202]

There are also proposals for a more substantial basic pension for poorer workers.[203] None of Germany's recent reforms have significantly changed the social insurance scheme for the elderly poor, who currently make just a fraction more than younger poorer retirees. Currently, the poor are entitled to benefits worth 19.3% of average earnings.[204] The Bundestag has not seriously considered any plans, however.

While it appears that even without further cost-increasing changes the German system will require greater reforms than Social Security in the United States, it still provides several potential lessons in reform. For example, the Rurup Commission's lack of partisanship and low profile deliberations provide an additional example of a successful commission, as does its work educating the public. In addition, like Sweden, it appears that phasing in changes may have helped Germany in some circumstances. Specifically, that in 1998 the SPD repealed indexation changes, but retained very slowly phased retirement age changes without public notice suggests

---

[200] *Id.*
[201] Judy Dempsey, *Conservatives in Germany Join Spending Bandwagon*, INT'L HERALD TRIB., Apr. 22, 2008, at 10.
[202] Oldies with Muscle, *supra* note 199.
[203] *Id.*
[204] OECD, *supra* note 5, at 127.

the effectiveness of this strategy.[205] Germany's recent experience counsels caution in enacting reforms. They need to be ones the public will continue to accept as they are implemented.

IV. Conclusion

The reform efforts detailed above have generally been quite successful in drastically reducing, and even eliminating, projected accounting shortcomings in each nation's public pension programs. While the deficit of the U.S. social security program is projected to run at 1.1% of GDP for the indefinite future,[206] nations such as Australia, Japan, and Sweden have, at least according to current government projections, entirely eliminated any future deficits.[207] Germany has experienced tremendous progress as well, though its deficit will likely run above the U.S. level without further tax increases and benefit cuts.[208]

Given such success, it is useful to consider what strategies and conditions that have played roles in reform efforts abroad might be successfully applied in the U.S. First, many countries, Sweden and Japan in particular, have made effective use of commissions in order to create a depoliticized, private forum for negotiating often painful but necessary solutions. These same commissions have often been instrumental in educating the public as well. Second, a poor economy has often led to significant long-term reforms, as in countries such as New Zealand.

---

[205] *See* Börsch-Supan et al., *supra* note 161, at 7.
[206] THE 2008 ANNUAL REPORT OF THE BD. OF TRUSTEES OF THE FED. OLD-AGE AND SURVIVORS INSURANCE AND FED. DISABILITY INSURANCE TRUST FUNDS (2008), at 62
[207] However, note that such projections, even when backed up by forceful trigger mechanisms, may not fully ensure fiscal sustainability. For instance, while Japan's indexing mechanism is supposed to guarantee future solvency, its success depends in part on returns generated by Japan's reserve funds, which are used to supplement contributed monies. *See, e.g.*, International Monetary Fund, *supra* note 106, at 54 (noting possible 2% of GDP deficit for Japan's pension program in the year 2050, despite recent reforms). The same applies for Australia. *See supra* at 12.
[208] Direct comparisons of New Zealand's pre-reform position relative to the United States' current position are difficult to draw due to the varying nature of each country's funding mechanisms. While the United States' social security program is intended to be internally funded via a dedicated trust fund, New Zealand funds its main retiree entitlements out of general tax revenues. Thus, it cannot technically be said that New Zealand's pension program was ever suffering from a long-term projected deficit, only that the amount of government expenditures on that front would have to increase as a percentage of GDP.

While downturns may make pension reforms seem especially necessary in countries, like Germany, which have larger pension systems perceived to be a drag on business efficiency, the increasing fears of global competitiveness that have accompanied the current economic problems faced by the United States suggest that now may be a good opportunity to fix Social Security. Third, persistence is critical. In all of the countries studied here, reform has come as a result of several years of effort. Even in Sweden, which had essentially a single reform process, no changes were made until two commissions had spent a decade working on the issue, and even then it took another seven years until all key reforms were implemented.

The record of success and failure of reform in the United States seems to support these observations as well. Of the commissions in the U.S. that have studied social security reform in the last three decades, the only successful one, the Greenspan Commission, is the only one that found a way to conduct at least some of its business behind closed doors. It also was convened in the early 1980s, a time of poor economic growth.

Unfortunately, politicians from the United States on both sides of the political spectrum have failed to properly address the issue in recent years. While President Bush has raised the issue of reform, he has done so in an overtly partisan way, demanding that individual accounts be the center-piece of any reform plan. This is opposite of the approach of successful countries like Sweden, where politicians first worked to find common ground before addressing the politicized issue of reform. Congressional Democrats have also failed in recent years, refusing to push for a less partisan reform process or indeed any reforms at all. Yet, despite the failure to make any notable progress in recent years, the United States remains in a favorable position relative to other pre-reform nations due to its relatively good demographics and sizeable trust fund. While changes to make the Social Security system solvent in the long-term may prove may prove moderately difficult, international experience demonstrates that they are clearly attainable.

TABLE 1

Net Replacement Rates (percent of income) at Multiples of Mean Income

Country	0.5	0.75	1	0.75	2
Australia	83.5	66.2	56.4	46.1	40.8
Germany	53.4	56.6	58.0	59.2	44.4
Japan	52.5	43.5	39.2	34.3	31.3
New Zealand	81.4	54.9	41.7	29.4	23.2
Sweden	66.2	69.2	64.0	71.9	73.9
United States	67.4	58.0	52.4	47.9	43.2
OECD	83.8	74.0	70.1	65.4	60.7

Source: PENSIONS AT A GLANCE: PUBLIC POLICIES ACROSS OECD COUNTRIES 35 (2007).

TABLE 2

Selected Net Replacement Rates (percent of income), Contribution Rates (payroll tax percentage, dedicated pension taxes only), and annual contribution ceilings (U.S. Dollars)

Country	Median: pre-reform	Median: post-reform	Pension contribution rates: 1994	Pension contribution rates: 2004	Annual contribution ceiling: 2005
Australia*		61.7	Private only		87,900
Germany	75.9	57.3	19.2	19.5	77,300
Japan	49.4	41.5	16.5	13.9	67,500
New Zealand*		48.6	General revenue only		N/A
Sweden	81	66.2	19.1	18.9	46,700^
United States*		55.3	12.4	12.4	90,000
OECD		72.1	19.9	20	

Sources: PENSIONS AT A GLANCE: PUBLIC POLICIES ACROSS OECD COUNTRIES 35, 63, 101, 127, 149, 164 (2007); GOVERNMENT ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORMS ABROAD, GAO-06-126 40-44 (October 2005).

* The OECD did not calculate pre-reform net pension replacement levels for these countries.
^ Sweden's cap applies only to employees. Employers' payments are not capped.

TABLE 3

Pension spending as a percentage of GDP

Country	Projected Increase in Pension Spending: 2000 to 2050	Funding for Pensions: 2000	Projected Funding for Pensions: 2050
Australia	1.6	3.0	4.6
Germany	5.0	11.8	16.9
Japan	0.6	7.9	8.5
New Zealand	5.7	4.8	10.5
Sweden*	1.6	9.2	10.8
United States	1.8	4.4	6.2

Source: GOVERNMENT ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORMS ABROAD, GAO-06-126 40 – 44 (October 2005).

* Sweden's calculations assume that the sustainability factor is not triggered.

SELECTED BIBILIOGRAPHY

JAMES ANGRESANO, FRENCH WELFARE STATE REFORM: IDEALISM VERSUS SWEDISH, NEW ZEALAND AND DUTCH PRAGMATISM (2007).

AUSTRALIA DEPARTMENT OF TREASURY, BUDGET PAPER NO. 1 – BUDGET STRATEGY AND OUTLOOK 2007 – 08, *available at* http://www.aph.gov.au/budget/2007-08/bp1/html/index.htm.

Hazel Bateman & John Piggott, *Australia's Mandatory Retirement Saving Policy: A View From the New Millennium* (Social Protection Discussion Paper Series No. 0108, 2001).

Holger Bonin, *Will it Last? An Assessment of the 2001 German Pension Reform* 5 (IZA Discussion Paper No. 343, 2001), *available at* http://ftp.iza.org/dp343.pdf.

Axel H. Börsch-Supan et al., *How an Unfunded Pension System looks like Defined Benefits but works like Defined Contributions: The German Pension System* (SonderForschungsBereich working paper No. 07-09, 2007), *available at* http://www.sfb504.uni-mannheim.de/publications/dp07-09.pdf.

Gary Burtless, *The Rationale for Fundamental Pension Reform in the United States and Germany* (CESifo Working Paper No. 510, 2001), *available at* http://www.cesifo-group.de/portal/page/portal/ifoHome/b-publ/b3publwp/_wp_by_author?p_autor_id=735.

Bernard H. Casey, *Reforming the Japanese Retirement Income System: A Special Case?*, CTR. FOR RETIREMENT RESEARCH (September 2004).

Jean-Francoise Estienne & Kiyoshi Murakami, *The Japanese experience of review and reform of public pension schemes*, in SOCIAL DIALOGUE AND PENSION REFORM 49 (Emmanuel Reynaud, ed. 2000).

GOVERNMENT ACCOUNTABILITY OFFICE, ENTITLEMENT REFORM PROCESS: OTHER COUNTRIES' EXPERIENCES PROVIDE USEFUL INSIGHTS FOR THE UNITED STATES, GAO-08-372 (January 2008).

GOVERNMENT ACCOUNTABILITY OFFICE, OLDER WORKERS: POLICIES OF OTHER NATIONS TO INCREASE LABOR FORCE PARTICIPATION, GAO-03-307 (February 2003).

GOVERNMENT ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORMS ABROAD, GAO-06-126 (October 2005).

Raymond Harbridge & Prue Bagley, *Social Protection and Labor Market Outcomes in Australia*, in LABOUR MARKET AND SOCIAL PROTECTION REFORMS IN INTERNATIONAL PERSPECTIVE 173 (Hedva Sarfati & Giuliano Bonoli, eds. 2002).

Raymond Harbridge & Pat Walsh, *Labour Market Reform in New Zealand*, in LABOUR MARKET AND SOCIAL PROTECTION REFORMS IN INTERNATIONAL PERSPECTIVE 198 (Hedva Sarfati & Giuliano Bonoli, eds. 2002).

Testimony of David O. Harris Before the House Ways & Means Cmte. – Subcmte. on Social Security, *Pension Reforms and Ageing Populations: Lessons from Australia* (June 2005).

Bo Könberg, et al., *NDC reform in Sweden* in PENSION REFORM: ISSUES AND PROSPECTS FOR NON-FINANCIAL DEFINED CONTRIBUTION (NDC) SCHEMES 449 (Robert Holzmann & Edward E. Palmer, eds. 2006).

Agneta Kruse, *Political economy and pensions in ageing societies – a note on how an "impossible" reform was Implemented in Sweden* (Department of Economics, Lund University working paper No. 05-035 2005), *available at* http://www.nek.lu.se/publications/workpap/Papers/WP05_35.pdf.

Agneta Kruse & Ed Palmer, *The New Swedish Pension System – Financial Stability and the Central Government Budget* (Presented at the Urban Institute's International Conference on Social Security Reform, February 24, 2006).

David Knutson, *Welfare Reform in New Zealand: Moving Toward a Work-Based Welfare System* (August 1998).

International Monetary Fund, *Japan: Selected Issues* (IMF Country Report No. 04/247, August 2004).

Lillian Liu, *Public Pension Reform in Japan*, 63 SOCIAL SECURITY BULLETIN 99 (2000).

Tim Maloney, *Welfare Reform and Unemployment in New Zealand*, 69 ECONOMICA 273 (2002).

Daniel J. Mitchell and Goran Normann, *Pension Reform in Sweden: Lessons for American Policymakers* (Heritage Foundation Backgrounder No. 1381, 2000), *available at* http://www.heritage.org/Research/SocialSecurity/bg1381.cfm.

Leslie Nielson and Richard Webb, *The Future Fund* (Parliament of Australia Research Note No. 43 2004 – 05), *available at* http://www.aph.gov.au/Library/Pubs/rn/2004-05/05rn43.htm.

OECD ECONOMIC SURVEYS – SWEDEN (July 1999).

MICHAEL O'BRIEN, POVERTY, POLICY AND THE STATE: THE CHANGING FACE OF SOCIAL SECURITY (2008).

Oldies with Muscle: Growing Fears about the Political Power of Pensioners, 387 ECONOMIST 1, 70 (April 26, 2008).

PENSIONS AT A GLANCE: PUBLIC POLICIES ACROSS OECD COUNTRIES (2007).

Diane Rowland, *A Five-Nation Perspective on the Elderly*, HEALTH AFFAIRS 206, 208 (Fall 1992).

Junichi Sakamoto, *Japan's Pension Reform* (World Bank Social Protection Discussion Paper No. 0541, 2005).

SWEDEN MINISTRY OF HEALTH AND SOCIAL AFFAIRS, FACT SHEET NO. 5 - OLD AGE PENSIONS IN SWEDEN (July 2000), *available at* http://www.sweden.gov.se/content/1/c6/02/46/15/a97e5315.pdf.

THE SWEDISH SOCIAL INSURANCE AGENCY, ORANGE REPORT: ANNUAL REPORT OF THE SWEDISH PENSION SYSTEM 2006, available at *http://www.fk.se/filer/publikationer/pdf/par06-e.pdf*.

Toshiaki Tachibanaki, *Social security reform in Japan in the twenty-first century*, in THE ECONOMICS OF SOCIAL SECURITY IN JAPAN 12 (Toshiaki Tachibanaki, ed. 2004).

THE 2008 ANNUAL REPORT OF THE BD. OF TRUSTEES OF THE FED. OLD-AGE AND SURVIVORS INSURANCE AND FED. DISABILITY INSURANCE TRUST FUNDS (2008).

R. Kent Weaver, *New Zealand: The Supreme Political Football* (Ctr. on Retirement Research Working Paper No. 2002-12).

Peter Whiteford, *Reforming Pensions: the Australian Experience*, in RETHINKING THE WELFARE STATE: THE POLITICAL ECONOMY OF PENSION REFORM 83 (Martin Rein & Winfried Schmahl, eds. 2004).