

Pension Reforms and the Opinions of European Citizens

By TITO BOERI, AXEL BOERSCH-SUPAN, AND GUIDO TABELLINI*

Most economists would subscribe to the view that the public pay-as-you-go (PAYG) pension systems in many European countries are unsustainable and in need of reform. Yet, such reforms are politically very difficult. A recent line of research has tried to understand the nature of these difficulties by analyzing the citizens' opinions on different aspects of the welfare state and its redistributive programs.¹ Here we focus specifically on the pension system, reporting the results of a survey conducted in Germany and Italy in fall 2001. Germany and Italy are particularly interesting countries in this respect because their PAYG pension systems are very generous and provide about 85 percent of the average retiree's income. Germany carried out a reform in 2001, in between two waves of our survey. Thus, we also have a "natural experiment" to draw upon.

Our questionnaire was designed to shed light on the following issues: Are citizens aware of the unsustainability of the pension system and informed of its costs? Are reforms opposed by a majority or by a powerful minority? Which reform options seem politically more feasible and why? Which groups of citizens are more likely to favor reforms? Do citizens' opinions reflect their economic self-interest, as presumed by the literature on political economics?

Here is what we find. Citizens are aware of unsustainability but lack information about the cost of the PAYG system. The status quo is a majoritarian outcome along many dimensions:

* Boeri and Tabellini: Bocconi University and IGIER, Via Salasco, 5, 20136 Milan, Italy (e-mail: tito.boeri@uni-bocconi.it and guido.tabellini@uni-bocconi.it); Boersch-Supan: University of Mannheim, Germany, and NBER (e-mail: axel@econ.uni-mannheim.de). We are grateful for generous financial support by the European Roundtable of Industrialists, the Land Baden-Wuerttemberg, and the German Insurance Association (GDV), and research grants from Centro Nazionale Ricerche and MURST. Support in designing and organizing the surveys was provided by Fondazione Rodolfo De Benedetti.

¹ See in particular Boeri and Tabellini (1999), Karlyn Bowman (1999), Boeri et al. (2001), and D. Devroye (2001). Alberto Alesina et al. (2001) touch on related issues in their comparison of European and U.S. welfare states.

most reform proposals lack a majority, and reformers rarely support more than one reform option. Later retirement is the easier reform in Italy (where effective retirement age is lower), while lower pensions are more popular in Germany where the effective replacement rate is higher. Preferences over policy options seem to reflect both economic self-interest and one's normative view about the role of the state. Opposition to any reform is high even among those aware of unsustainability. This could be procrastination or selfishness (shifting the burden onto future generations); some answers suggest that the latter could play an important role.

I. The Questionnaire

We designed an identical questionnaire for the two countries, departing from a similar survey which we conducted in France, Germany, Italy, and Spain in winter 2000 (Boeri et al., 2001). In addition to the standard set of socioeconomic background variables such as age, education, and income, the questionnaire included questions that elicited information and the preferences about the current pension systems and potential reform options. We were careful not to ask open questions ("Do you want more benefits?") but posed trade-offs among specific policy options ("Are you willing to pay x -percent higher contributions in order to obtain y -percent higher benefits?") in the tradition of contingent valuation and stated-preference survey techniques. The questionnaire was administered by computer-aided telephone interviews as part of an omnibus survey to a representative sample of the population aged 16–80, including 2,500 persons both in Germany and in Italy.

II. Results

A. Are Citizens Informed?

There is widespread awareness of the unsustainability of the pension system, and of the need to reform it. At the same time, however,

TABLE 1—ASSESSMENT OF REFORMS TO DATE

The reforms ...	Germany	Italy
... have stabilized the system	3.5	10.2
... were just a first step toward stabilization	50.2	49.4
... were ineffective	40.5	40.4

Note: The table reports percentages of respondents who agreed with the statement.

respondents seem to ignore or underestimate the cost of the public pension system.

A large fraction of the two populations (85 percent in Germany and 63 percent in Italy) agree with the statement that “the pension system will face a crisis in the next 10–15 years.” This is in spite of the pension reforms which have taken place in recent years. Italy has experienced three reforms in the last decade (the so-called Dini, Amato, and Prodi reforms), and the German parliament has just approved a transition to a multi-pillar pension system (the so-called Riester reform). In fact, only a very small fraction of the citizens think that “the recent reforms have stabilized the pension system” (Table 1), and 43 percent think that they were ineffective.

Unsurprisingly, a majority of citizens in both Germany (81 percent) and Italy (58 percent) believe that “in the course of the next ten years there will be another pension reform reducing significantly the amounts of public pensions.”

The perception of a pension crisis is stronger among those who are informed about how the pension system works (Table 2). However, only a minority of respondents understand how a pay-as-you-go (PAYG) system operates (40.5 percent of the citizens know that their contributions are used “to pay the pensions of current pensioners only”; the other 59.5 percent think that at least some of their contributions go into a fund) or know the actual costs of the system (less than 20 percent of employees who pay contributions know the overall contribution rate approximately, i.e., within the interval of 15–30 percent of gross earnings in Germany, and 25–40 percent in Italy). Regression results show that the perception of an impending crisis of the pension system is more or less evenly spread among employees.

TABLE 2—INFORMATION AND PERCEPTION OF PENSION CRISIS

Respondents	Understood PAYG system		Knew PAYG contribution rate	
	Yes	No	Yes	No
Total	40.5	59.5	18.3	81.7
Pension crisis	84.1	80.7	85.3	79.2

Note: The table reports percentages of the total number of respondents and of those who agree with the statement that “the pension system will face a crisis in the next 10–15 years.”

B. Which Reform Options Are More Popular?

We confronted currently working individuals with several pension-reform options. Three questions offered to change the main parameters of the PAYG system (higher contributions, lower benefits, later retirement), emphasizing the intertemporal trade-off between accepting reform now versus having to raise the contributions later. For instance: “Would you accept an increase in the retirement age if this would mean that the future contributions to public pensions could remain constant?” We also proposed an explicit transition to a multi-pillar system in three variants: an unconditional opting-out proposal, in which employees could choose to pay 50 percent less contributions in exchange for 50 percent less benefits in the future; the same opting-out proposal conditional on putting the saved contributions in a retirement savings account; and an asymmetric opting-out proposal, in which employees would receive only 50 percent of benefits in the future, but have to pay 50 percent contributions plus a transition burden.

Realistic pension reform is not a popular business (Fig. 1). No opting-out variant finds a majority in Italy. Opting out is very popular in Germany, but only if it requires mandatory savings and does not involve a transition burden. The latter is unrealistic, and mandatory saving plans were dropped from the current “Riester Reform” in Germany.

The finding that individuals are much more willing to opt out if they are constrained to save the contributions rebated is surprising but also featured in previous surveys (Boeri et al., 2001).

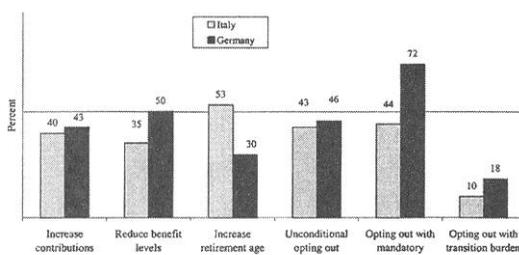


FIGURE 1. APPROVAL OF PENSION-REFORM OPTIONS (PERCENTAGES)

Note: The horizontal line indicates 50 percent.

It could reflect time-inconsistent (social or individual) preferences (see below).

Italians and Germans have rather different preferences over the parametric reform options. An increase in retirement age is preferred by a majority in Italy, where the effective retirement age is lower, but it is the least attractive change for German workers. In turn, a reduction in the benefit level of public pensions finds a slim majority in Germany, where the effective replacement level is higher, but it is the most disliked option among Italian workers. The differences between Germany and Italy are therefore in line with where a reform may hurt least.

C. Is It Possible To Bundle Reforms?

How many reform options are approved/opposed by the same individual? Do the same individuals approve/oppose all reforms, or is there also disagreement over how to reform?

Consider the four pension reform options addressing the unsustainability of current policy: opting-out with transition burden, higher retirement age, lower benefit level, and higher contributions.² The patterns of responses by country reveal that those against tend to say no to many reforms, while those in favor tend to approve only one specific reform. This makes it more difficult to reform: not only is there strong opposition on *whether* to reform, but also a division among those in favor on *how* to reform. This is also shown in columns (i) and

² Among the opting-out proposals, only the one with transition burden really addresses the unsustainability of current policy.

TABLE 3—MULTIPLE REFORM OPTIONS: APPROVAL AND OPPOSITION (PERCENTAGES)

Number of reform options	Reforms that:			
	Increase sustainability ^a		Shrink size ^b	
	(i) Approved	(ii) Opposed	(iii) Approved	(iv) Opposed
0	23.7	2.4	37.1	5.1
1	36.8	15.5	41.8	26.6
2	27.6	30.6	18.7	38.8
3	11.0	32.3	2.5	29.7
4	1.0	19.2	—	—
Total	100	100	100	100

^a Lower benefits, later retirement, opting out with transition burden, higher contributions.

^b Lower benefits, later retirement, opting out with transition burden.

(ii) of Table 3, which pools both countries together.

Many respondents approve few and oppose many reforms: 24 percent do not approve of any reforms at all (19 percent say no to all, the difference being those without an opinion); and more than 50 percent say no to three reforms or more.

These reform options have very different implications for the extent of intergenerational redistribution. Opposition to reform is even higher if we neglect the option of higher contributions, restricting attention to the three reforms that reduce the size of the PAYG system: lower benefits, later retirement, and opting out with transition burden. This is shown in the last two columns of Table 3. Less than 22 percent of respondents approve of more than one reform option, and 37 percent approve of none of them.

D. What Explains Individual Opinions?

The evaluation of these reform options reflects opinions on the role of the state in caring for the elderly. We asked (a) whether it was right to induce workers to put more emphasis on self provisions for retirement, and (b) whether private pension systems were deemed to be more advantageous than the PAYG system. Those who answered positively to these two questions were also much more likely to favor reforms shrinking the PAYG system. For instance, 85 percent of those who approve of more than one of the three reforms shrinking the

TABLE 4—OPPOSITION TO REFORM
AND INDIVIDUAL CHARACTERISTICS

Variable	Probit		Ordered probit	
	(i) Coefficient	(ii) SE	(iii) Coefficient	(iv) SE
Young	-0.32	0.07	-0.14	0.07
Old	0.24	0.06	0.23	0.10
Male	-0.24	0.05	0.01	0.06
Compulsory	0.09	0.06	0.17	0.08
University degree	-0.02	0.07	-0.16	0.08
Union	0.12	0.06	-0.01	0.07
Left	0.20	0.07	0.007	0.08
Right	0.03	0.09	-0.21	0.11
Rich	-0.18	0.07	-0.02	0.07
Poor	0.21	0.06	0.04	0.09
Unskilled	0.11	0.08	0.34	0.12
Crisis	-0.38	0.06	-0.08	0.09
Private returns			-0.22	0.07
Poor region	0.14	0.05	0.16	0.07
Italy	0.14	0.07	-0.21	0.08
Number of observations:	3,049		1,275	
Pseudo R ² :	0.0619		0.0213	

Notes: The dependent variable of the binary probit model is whether respondents are *against* putting more emphasis on self provision for retirement *and* think that private pensions are not more advantageous than public pensions. The dependent variable of the ordered probit model is whether there is opposition to none, one, two or all of the following reforms proposals: (1) opting out with transition burden, (2) higher retirement age, and (3) lower benefit level.

size of the PAYG system also respond positively to either (a) or (b).

Individual features such as age, income, and education play an important role in shaping both the general view on the role of the state and the evaluation of these reform options. Table 4 reports the results of probit and ordered probit regressions (boldface fonts indicate significance at the 10-percent confidence level). The younger, more-educated, and richer males tend to say yes to either (a) or (b) [columns (i) and (ii) in Table 4] and to approve of more reforms shrinking the size of the PAYG system [columns (iii) and (iv) in Table 4]. Union members, residents of poor regions (the Italian South and East Germany), and those with a left-wing ideology tend to say no to both (a) and (b) and oppose more reforms.³

³ The explanatory variables are dummy variables taking a value of 1 if the individual possesses that attribute, 0 otherwise.

We also estimated probit regressions of specific reform alternatives against the respondents' characteristics (results are available online).⁴ Two sets of variables appear significant in most regressions: age and education (or skill level). Younger workers, and more-educated or more-skilled workers, are less likely to oppose any specific reform. Individual income seems to matter only in the choice of benefits versus retirement age, with richer individuals more willing to accept lower benefits. Having a left-wing ideology or being a member of a union only plays a limited role. Opting-out is more popular among those who think a crisis in the PAYG system is imminent, who expect higher returns from private pensions, and who are under a defined-contribution system (the new PAYG regime in Italy only applies to younger generations; older workers are still under a defined benefit PAYG system).

Altogether, these results suggest that preferences reflect the economic interests of individuals, as presumed by the theoretical literature on political economics. There is also a subtle interaction between economic self-interest and one's general view of the role of the state. Economic self-interest is correlated with the view about what is right or wrong. Those who say that it is right for the state to take care of the elderly are also more likely to benefit from it (the older, the less educated, the poorer), and vice versa.

E. Why Is There So Much Opposition to Reform?

Respondents are aware of unsustainability. Why are they opposed to doing something about it? Other parts of the questionnaire can shed light on this issue. Individuals were asked whether they oppose further increases in the size of the welfare state (i.e., an "increase of pensions and transfers to households" obtained by "raising taxes and compulsory contributions"). Among those who also expect an

Young (old) means less than 35 (more than 54) years old. Private returns means that the individual believes that the private system is more advantageous than the PAYG system. Crisis means that the individual expects an imminent crisis in the PAYG system. Compulsory means that the individual attained only the primary level of education.

⁴ URL: <www.frdp.org>

TABLE 5—EMPLOYEES AWARE OF CRISIS AND WISHING TO INCREASE THE WELFARE STATE OR REALLOCATE TRANSFERS

Yes to:	Increase the welfare state		Redistribute to young	
	Yes	No	Yes	No
0 reforms	38.0	37.1	17.8	23.2
All 3 reforms	3.0	2.8	2.5	0.8
Percentage of valid votes	20.3	79.7	20.2	79.8

Note: Reform options included are opting-out with transition burden, less pension, and increase in retirement age.

imminent crisis of the PAYG system, there is overwhelming opposition to further increases in the welfare state (80 percent oppose further increases; see the last row of Table 5). Given that these same individuals believe that pension promises cannot be met without increasing taxes and contributions, they should consistently support reforms reducing benefits, increasing retirement age, and partly privatizing social security. They do not. As shown in the first two columns of Table 5, the approval rate of these three reforms is the same irrespective of whether or not one opposes further expansions of the welfare state. There are two possible interpretations of this finding: procrastination (time-inconsistent preferences) or intergenerational selfishness (current workers really want to gain at the expense of future generations).

To try and discriminate between procrastination and selfishness, individuals were also asked whether they favor a reallocation of transfers (i.e., “should the state allocate less resources to pensions and more to unemployed or young jobseekers?”). The answers indicate that selfishness plays an important role. As shown in the last row of Table 5, only one out of five respondents who are aware of the crisis are also altruistic with respect to intergenerational redistribution. Indeed, there are more reformers among those who are aware of the crisis and care about young generations (last two columns of Table 5).

F. *How Popular Is the German Pension Reform?*

The pension reform in Germany sheds more light on the nature of the opposition described above. This controversial so-called “Riester re-

form” reduced the replacement rate of the public pensions by about 10 percent starting in year 2011 and introduced a small, voluntary but tax-advantaged funded pillar from January 2002 on. It was approved by Parliament in January 2001, just in between this survey and our earlier survey (Boeri et al., 2001), in which we asked many of the same questions. Since no further reform took place in Italy during this time, our two surveys permit a “difference-in-difference” approach for the questions posed in this paper. Of course, other events took place in both countries, diluting the pure experimental character. Moreover, many of the impacts will be medium- or even long-term and are not yet visible in the data.

In both countries, the impression that there will be a pension crisis in the near future went up: in Germany from 76.8 percent to 85.2 percent, and in Italy from 67.5 percent to 72.7 percent. However, the Riester reform increased the awareness that dramatic benefit reductions could be unavoidable (from 69.7 percent to 80.7 percent), while in Italy this perception decreased from 62.9 percent to 57.6 percent. This is an interesting result: the Riester reform obviously succeeded in conveying the message that there is an end to pension generosity.

The Riester reform did reduce the status quo bias. In Germany, only 51.3 percent (rather than 59.4 percent in the previous survey year) want to leave taxes and benefits unchanged, while 35.9 percent (rather than 27.5 percent) want less taxes and less benefits. This did not happen in Italy: the share of respondents favoring the status quo remained unchanged, while more people were in favor of a larger welfare state than in the previous survey year. At the same time, 50.1 percent of German respondents (still a majority, but less than the 61.3 percent in the previous year) want the generational balance between pension recipients versus young and unemployed unchanged—but almost all of that change went into an increase in favor of pensions and against unemployment (up from 16.8 percent to 26.5 percent). We do not observe a similar change in Italy. In this sense, the Riester reform seems to have backfired.

III. Final Remarks

Governments wishing to carry out reforms will have to work hard to highlight the unfair-

ness of the status quo for future generations, and to explain the efficiency benefits of partial privatization of social security. The Riestler reform seems rather unsuccessful on both accounts: it made people aware of what they might lose, but not of the potential gains. As perceptions of what is right and wrong appear to be strongly correlated with self-interest, there can be synergies in highlighting individual advantages associated with various reform options and the redistributions they propose.

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