

## **Would you Like to Reform the Pension System? The Opinions of European Citizens**

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## **The Opinions of European Citizens**

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### **1. Introduction**

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.<sup>1</sup> Here we focus specifically on the pension system, reporting the results of a questionnaire conducted in Germany and Italy in the Fall 2001. Germany and Italy are particularly interesting countries in this respect because their PAYG pension systems are very generous and provide about 85% of the average retiree's income. Germany has 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: most reform proposals lack a majority and there is limited scope of packaging as reformers rarely support more than one reform option. Later retirement is the easier reform in Italy (where effective retirement age is lower), while opting-out of the PAYG system is popular in Germany, but only if accompanied by mandatory savings of the amounts rebated and with no transition burden. 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.

## **2. 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 during Spring 2000.<sup>2</sup> In addition to the standard set of socio-economic background variables such as age, education, and income, the questionnaire included questions which elicited the 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% higher contributions in order to obtain y% 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 to 80, including 2500 persons both in Germany and in Italy.

### 3. Results

#### a. Are citizens informed?

There is widespread awareness of the unsustainability of the pension system, and of the need to reform it. But at the same time, respondents seem to ignore or under-estimate the cost of the public pension system.

A large fraction of the two populations (85% in Germany and 63% 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 multipillar pension system. In fact, only a very small fraction of the citizens think that “the recent reforms have stabilized the pension system” (Table 1), and 40% think that they were ineffective.

**Table 1. Assessment of Reforms to Date (%)**

The reforms...	Germany	Italy
... have stabilised the system	3.5	10.2
... were just a first step towards stabilisation	50.2	49.4
... were ineffective	40.5	40.4

Source: Author’s calculations based on German-Italian survey

Unsurprisingly, a majority of citizens in both Germany (81 %) and Italy (58 %), 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 understands how a pay-as-you-go (PAYG) system operates (40.5% of the citizens know that their contributions are used "to pay the pensions of current pensioners only", the other 59.5% think that at least some of their contributions go into a fund) or knows the actual costs of the system (less than 20% of employees who pay contributions know the contribution rate approximately, i.e., within the interval of 15-30% of gross earnings in Germany, and 25-40% 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 (Percentages)**

	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

Source: Author's calculations based on German-Italian survey

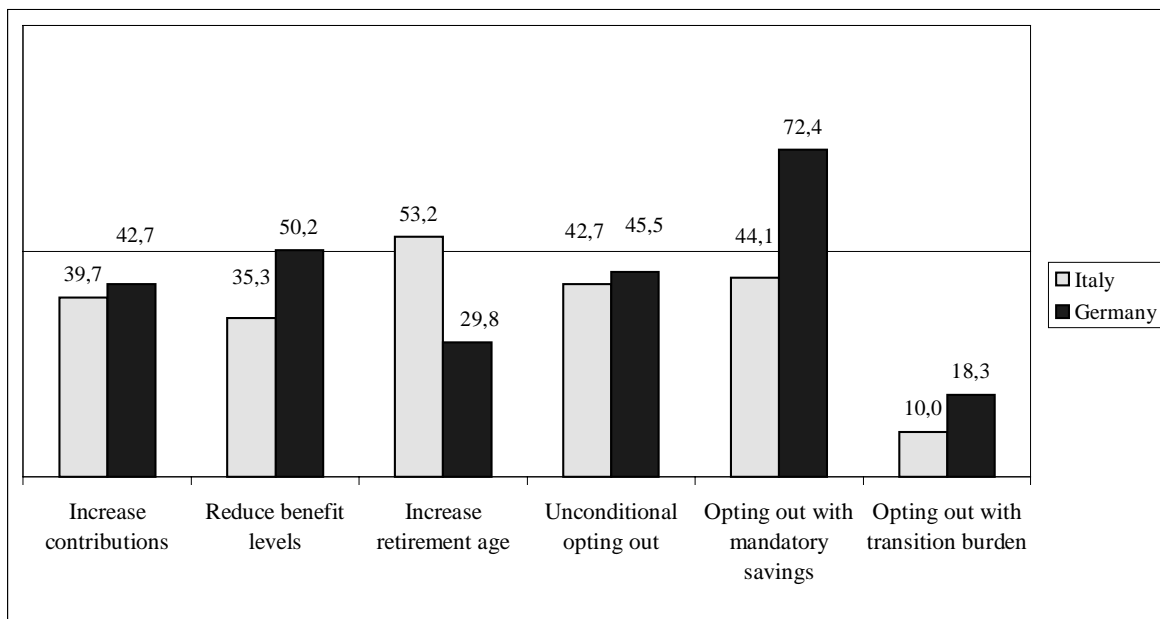
#### **b. Which reform options are more popular?**

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 tradeoff between accepting reform now vs 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% less contributions in exchange for 50% 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% of benefits in the future, but have to pay 50% contributions plus a transition burden.

Realistic pension reform is not a popular business (Figure 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 constrained to save the contributions rebated is surprising but also featured in previous surveys (Boeri, Borsch Supan and Tabellini (2001)). It could reflect time inconsistent (social or individual) preferences – see below.

**Figure 1. Approval of Pension Reform Options (Percentages)**



Source: Author's calculations based on German-Italian survey

Italians and Germans have rather different preferences over the parametric reform options. An increase in retirement age finds 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 the 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 create reform packages?**

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.<sup>3</sup> The patterns of responses by country reveals that those against tend to say no to many reforms, while those in favour tend to approve only one specific reform. This makes it more difficult to reform: not only there is strong opposition on *whether* to reform, but also a division among those in favor on *how* to reform. This is also shown in Table 3, columns 1 and 2, that pools both countries together.<sup>4</sup> Many respondents approve few and oppose many reforms: 24% do not approve any reforms at all (19% say no to all, the difference being those without an opinion); and more than 50% says no to three reforms or more.

**Table 3. Multiple Reform Options: Approval and Opposition (Percentages)**

Reforms that:	Increase Sustainability		Shrink Size	
	Approved	Opposed	Approved	Opposed
Number of reform options:				
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



These reform options have very different implications for the extent of intergenerational redistribution. But 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. Only 20% approve more than one reform option, and as many as 37% approve none of them.

**d. What explains individual opinions?**

The evaluation of these reform options reflects one's opinion on the role of the state in caring for the elderly. We asked (i) whether it was right to induce workers to put more emphasis on own provisions for retirement, and (ii) whether private pension systems were deemed as 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. For instance, 85% of those who approve more than one of the three reforms shrinking the size of the PAYG system also respond positively to either (i) or (ii).

But 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. The younger, more educated, richer, males tend to say yes to either (i) or (ii) and to approve more reforms shrinking the size of PAYG; 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 (i) and (ii) and oppose more reforms- see Tables A1 and A2 in the appendix.

Table 4 summarizes the main results of probit regressions of specific reform alternatives against the respondents' characteristics. Columns refer to specific reform alternatives: in the first column, do you prefer lower benefits or later retirement; in the second column, do you prefer lower benefits or higher *future* contributions; in the last column, are you willing to opt out with no transition burden and no mandatory savings. Rows refer to individual features. A + sign means that a variable measuring that feature has a positive and significant (at the 10% level) estimated coefficient in that regression, a - sign indicates a negative and significant estimated coefficient. Full results are shown in the appendix (Table A3).

Two sets of variables appear significant in all regressions: age and education. Older workers oppose any reduction in benefits even if it implies an increase in the future contribution rate, and are less likely to want to opt out. The opposite is true for more educated or more skilled workers. Individual income seems to matter only in the choice of benefits vs 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. Three other variables (not shown in the table) also significantly contribute to explain the opting out responses. Opting out is more popular among those who think a crisis in the PAYG 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).

**Table 4. Reform Alternatives and Individual Characteristics**

	Reduce benefits vs. increase ret. age	Reduce benefits vs. increase fut. contr.	Unconditionally opt out vs. stay in
Age	-	-	-
Male			+
Education or skill	+	+	+
Union member			-
Left wing ideology	+		
Income	+		
Poor region	+		-

Source: See appendix 1 for the results of probit regressions

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 viceversa.

The fear of time inconsistencies may also play some role in shaping the opinions on pension reforms. The expectation of higher returns from private pensions is not correlated with the view that individuals should become more responsible for their retirement: many expect high returns from private pensions but oppose giving more responsibilities to workers. Interestingly, these conflicting opinions are more numerous among those who would opt-out from PAYG only if it is accompanied by mandatory savings.

**e. Why is there so much opposition to reform?**

Respondents are aware of unsustainability. Why don't they want to do 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 imminent crisis of the PAYG, there is overwhelming opposition to further increases in the welfare state (80% 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 privatising social security. They don't. 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 expenses of future generations).

**Table 5**

Employees aware of crisis and wishing to...				
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
<b>% valid votes</b>	<b>20,3</b>	<b>79,7</b>	<b>20,2</b>	<b>79,8</b>

\*Reform options included are Opting Out with Transition Burden, Less Pension, Increase in Retirement Age

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. And indeed, there are more reformers among those who are aware of the crisis and care about young generations (columns 3 and 4 of Table 5).

**f. How popular was 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 reform“ reduced the replacement rate of the public pensions by about 10% 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, Boersch-Supan and Tabellini, 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 visible in the data yet.

In both countries, the impression that there will be a pension crisis in the near future went up; on Germany from 76.8% to 85.2%, and in Italy from 67.5% to 72.7%. However, the Riester reform increased the awareness that dramatic benefit reductions

could be unavoidable (from 69.7% to 80.7%) while in Italy this perception decreased from 62.9% to 57.6%. 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% rather than 59.4% last year want to leave taxes and benefits unchanged, while 35.9% rather than 27.5% want less taxes and less benefits. This did not happen in Italy – actually, the share of respondents favoring the status quo remained unchanged, while there are now more people in favor of a larger welfare state than last year. At the same time, 50.1% of German respondents (still a majority, but less than the 61.3% in last year) want the generational balance between pension recipients vs 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 to 26.5%). We do not observe a similar change in Italy. In this sense, the Riester reform seems to have backfired.

#### **4. Final remarks**

Governments wishing to carry out reforms will have to work hard to highlight the unfairness of the status quo for future generations, and to explain the efficiency benefits of partial privatisation of social security. The Riester 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 involved by various reform options and the redistributions they operate

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<sup>1</sup> See in particular Boeri and Tabellini (1999), Boeri, Boersch Supan and Tabellini (2001), Bowman (1999), Devroye (2001). Alesina and Glaser (2001) touch on related issues in their comparison of European and US welfare states.

<sup>2</sup> Boeri, Boersch-Supan and Tabellini (2001).

<sup>3</sup> Among the opting out proposals, only the one with transition burden really addresses the unsustainability of current policy.

<sup>4</sup> The pattern of how many (as opposed to which) reforms were approved or opposed is very similar in the two countries.