The Political Economy of Population Aging and Public Policies

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Effects of OECD population aging on:

(1) the timing of pension generosity cutbacks

(2) the general pro-elderly bias of welfare states

(3) pension spending specifically

Vanhuysse, Pieter & Achim Goerres (eds) (2012) *Ageing Populations in Post-Industrial Democracies: Comparative Studies of Policies and Politics*. Abingdon: Routledge/ECPR Studies in European Political Science.

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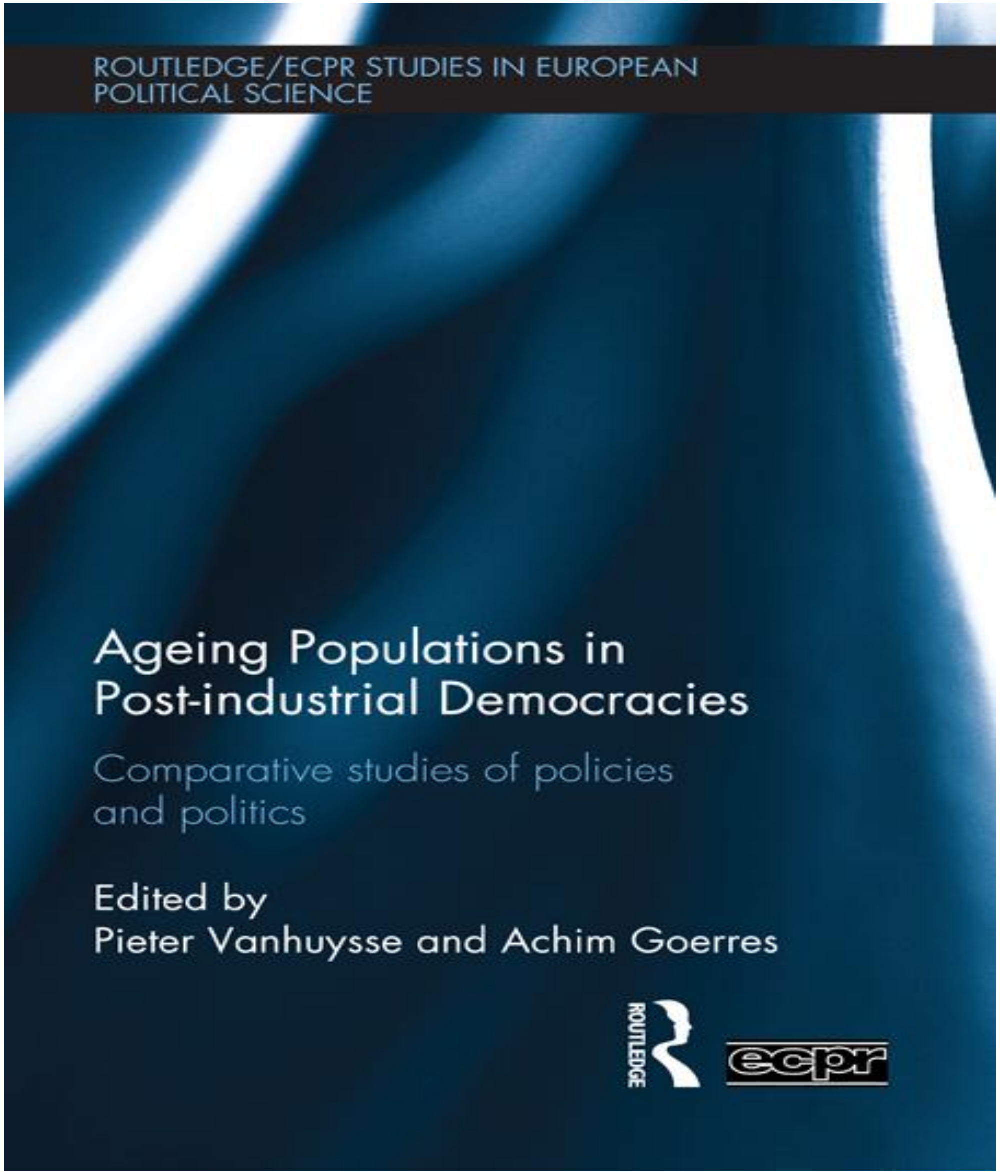
Our editorial introduction, 'Mapping the Field,' at SSRN:
http://ssrn.com/abstract=1799348

Book at Routledge (2012):

http://www.routledge.com/books/details/9780415603829/



1. The Timing of pension generosity cutbacks

Accelerating Smaller Cutbacks to Delay Larger Ones?

The Politics of Timing and Alarm Bells in OECD Pension Generosity Retrenchment

Generosity

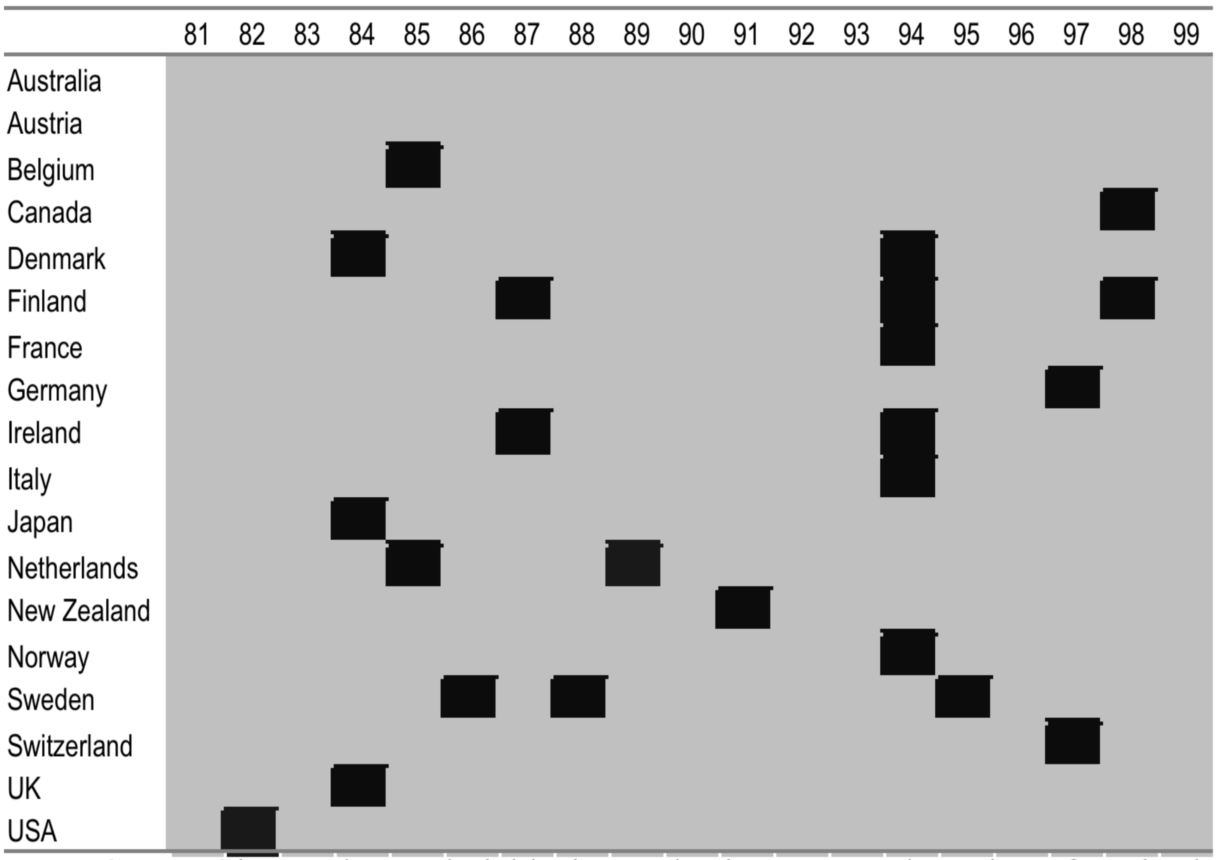
- Scruggs and Allan's (2006) annual *pension generosity scores:* 3 components - average minimum and standard pension replacement rates, number of years needed to qualify for public pensions receipt, take-up rates.
- Event history analysis
- 18 OECD countries, 1981-1999

What are *large v medium* cutbacks?

- We define cutback events as % reversals in the level of the pension generosity index by the amount of *c* within a certain adjustment period by the length of *k*
- If *k*= 3 and *c*= -0.12, the ‚large‘ cutback event dummy has a value of 1 in a given year: i.e. a pension generosity index reduction of at least 12 % occurred within the subsequent three years.
- For 'medium' cutbacks, the event dummy has a value of 1 in a given year when a pension generosity index reduction of between 8 and 12 percent occurred within the subsequent three years (-0.8 > *c* > -0.12).

All but 2 of 18 countries experienced a medium cut (23)…

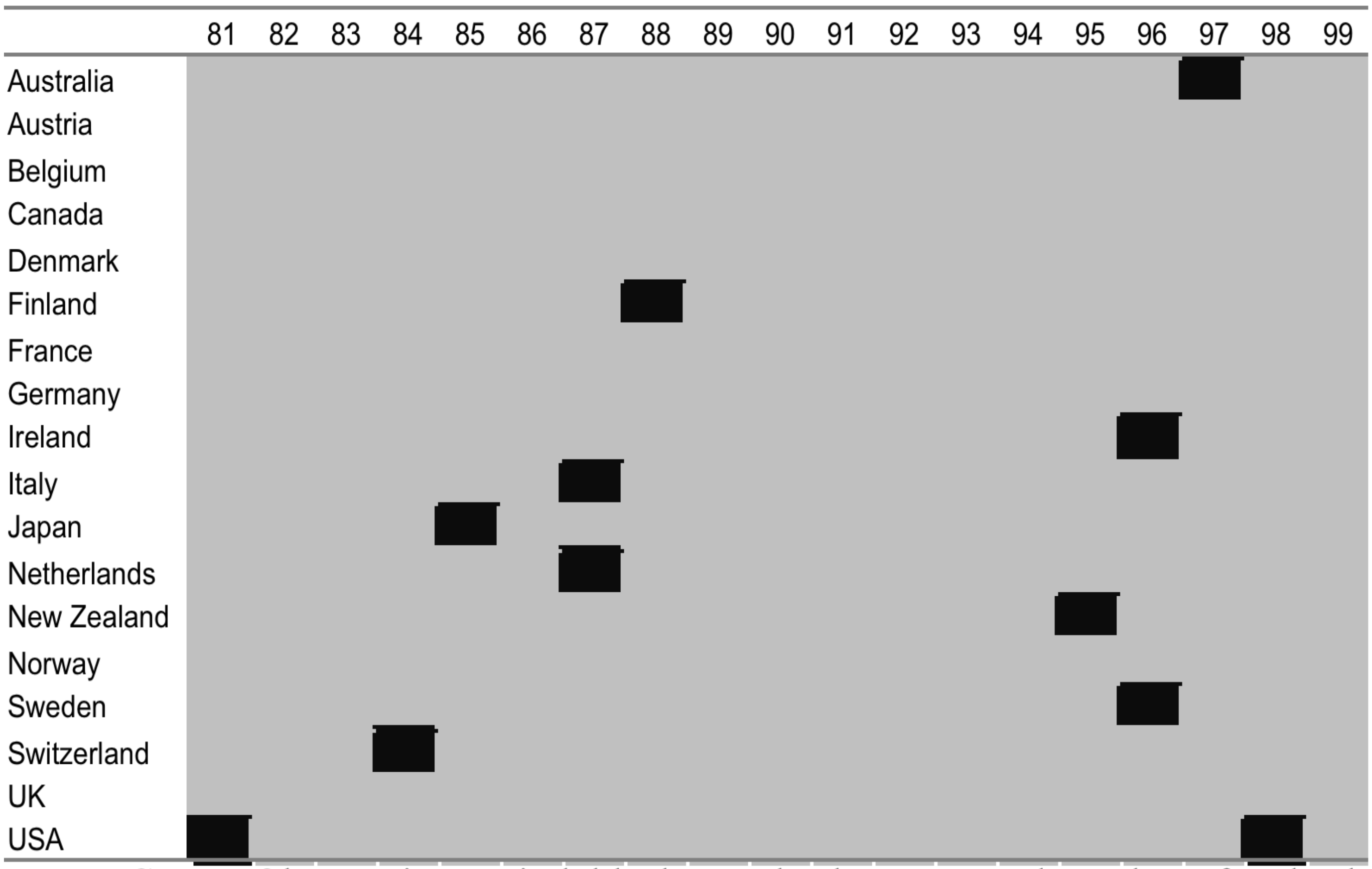
Figure 6.2: ‘Medium’ cutback events in pension generosity by country-years (with k=3 and -0.08 > c > -0.12), 18 OECD countries, 1981-1999



Note: Grey = Observation period, black = cutback event, total number of cut-back events = 23. For a definition of ‘medium’ see text.

… but only half as many had large cutbacks (11)

Figure 6.1: 'Large' cut-back events in pension generosity by country-year (with k=3 and c<-0.12), 18 OECD countries, 1981-1999



Notes: Grey = Observation period, black = cutback event, total number of cutback events = 11. For a definition of 'large' see text.

The ‘new politics’ of pension pain

- Between 1981 and 1999, only AT and AUL experienced NO medium cuts
- 3 countries even implemented 2 medium cutbacks (DK, NL, IL), and 2 countries (SE, FI) implemented 3 such cutbacks.
- On the other hand, large pension generosity cutbacks are much rarer event, occurring once in only half of the countries, and twice in just one single country (USA).

Political & institutional findings

- Against expectations, number of years left in current electoral term (electioneering thesis) & degree of institutional rigidity in political system (veto point thesis) have no significant effect on timing of cutbacks
- Leftwing party power does not affect timing of pension cuts either way, but rightwing party power significantly and strongly accelerates the implementation of both medium and large cutbacks.
- Partisanship still matters in contemporary welfare politics – for the timing of pension pain

Socio-demographic findings: unemployment

- Higher UE has no significant effect on the timing of large cutbacks (though it points towards delays) but it significantly accelerates the implementation of medium cutbacks
- A similar acceleration effect of unemployment found also as regards cutbacks in general social spending (Tepe & Vanhuysse 2010).

Socio-demogrpahic findings: population aging

- Similar story: higher OADR significantly delays the implementation of *large* cutbacks, while simultaneously accelerating the implementation of *medium* cutbacks.
- ‘Urging incremental action in order to delay radical action’ lines.

Prospect theory explanation?

- At first glance, this appears to support the thesis that governments, while loss averse, may actually take higher risks and impose painful cutbacks when they are in a socio-economic and political context of losing (Kahneman & Tversky 1979, 2000; Vis 2010).
- But it also adds a significant qualifier, in that it indicates that loss frames might make governments more willing to take *minor* risks, but *less* willing to take major risks.

Alarm bells tolling for urgent (*incremental*) action

- We modify the prospect theory prediction: aging populations & rising UE levels today may function as powerful 'alarm bell signals' – heuristics that put policymakers in a 'loss frame' and urge them to take the small risk of incremental retrenchment sooner rather than later ('muddling through').
- But perhaps they do so in order to better be able to delay more radical (and electorally truly risky) retrenchment.
- In contexts of creeping socio-demographic crisis, politicians may thus jump to bite relatively small bullets only in order to delay biting large bullets

Real pension pain

- We have tested relatively ‘tough choice’ political situations in which governments (need to) decide *now* to cut back *now*, that is, over a short time span that allows little, if any, traditional blame avoidance or blame shifting.
- These are different contexts to those where parties can revert to politically more convenient ‘old new politics’ tactics of deciding *now* to cut back *later*, whether by grandfathering clauses implementing cutbacks for future but not currently affected groups, or by ensuring that the true effects of cutbacks kick-in over later years long past the current electoral cycle

2. Population aging and the general pro-elderly bias of welfare states

Elderly Bias, New Social Risks, and Social Spending:

Change and Timing in Eight Programs across Four Worlds of Welfare, 1980-2003

Journal of European Social Policy (with Markus Tepe), paper downloadable at:
http://ssrn.com/abstract=1370004

Six separate welfare programs

Program	OECD Definition	Source
Pension	Old-age – pensions, early retirement pensions, home-help and residential services for the elderly;	OECD (2007)
Incapacity	Incapacity-related benefits – care services, disability benefits, benefits accruing from occupational injury and accident legislation, employee sickness payments	OECD (2007)
Survivors	Survivors pensions and funeral payments	OECD (2007)
Education	Total public spending on education (computed via WDI and OECD data)	Busemeyer (2009)
Health	Health – spending on in- and out-patient care, medical goods, prevention;	OECD (2007)
Family	Family – child allowances and credits, childcare support, income support during leave, sole parent payments;	OECD (2007)
Unempl.	Unemployment – unemployment compensation, severance pay, early retirement for labour market reasons;	OECD (2007)
ALMP	Active labour market policies – Employment services, training youth measures subsidised employment, employment measures for the disabled;	OECD (2007)

Source: OECD (2007) The Social Expenditure database: An Interpretive Guide SOCX 1980-2003 OECD 2007 (see also section 3.1 for more detail)

<u>The Elderly/Non-elderly spending share</u>

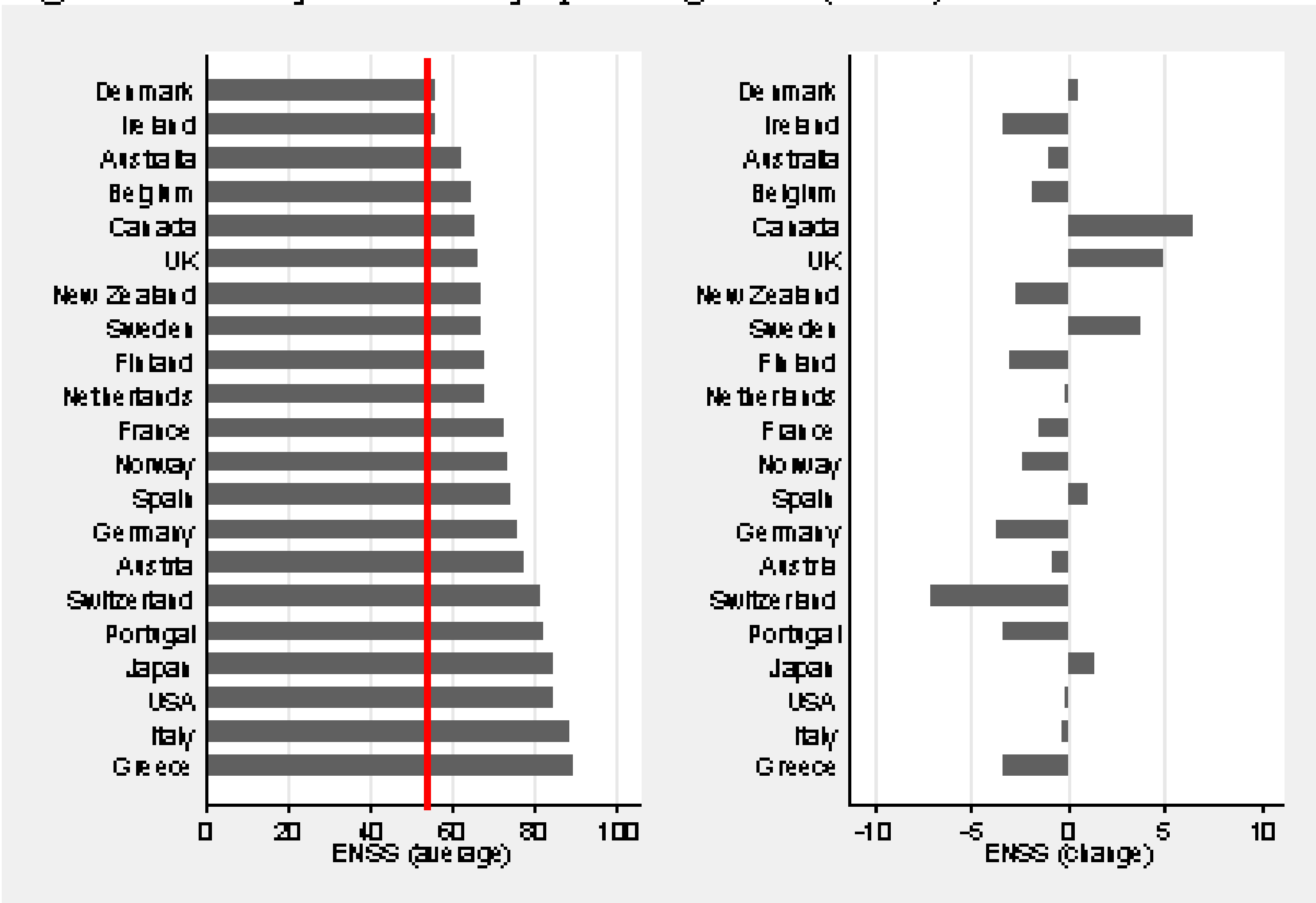
- How does population aging affect all sorts of <u>pro-elderly</u> programs within larger 6-program welfare states? (Lynch 2001; 2006; Pampel 1994; Esping-Andersen and Sarasa 2002)

$$ENSS_{i,t} = \left(\frac{Pensions_{i,t} + Survival_{i,t}}{Pensions_{i,t} + Survival_{i,t} + Incapacity_{i,t} + Family_{i,t} = ALMP_{i,t} + Unemployment_{i,t}} \right) * 100$$

H1: ***ENSS* increases with a larger share of elderly voters**

The ENSS

Figure 1. Elderly/non-elderly spending share (*ENSS*)



Note: Averages refer to 1980 to 2003. Change refers to differences between the last (1998-03) and the second (1986-91) period.

<u>Fixed-effect and between-effect findings</u>

- <u>*Within* countries</u>, *ODR* decreases incapacity program spending & increases pension expenditure (~ Breyer and Craig 1997; Castles 2004; Disney 2007; Pampel and Williamson 1989).

- *ODR* has positive effect on *ENSS*

→ **<u>Support for H1</u>**

- <u>*Between* countries</u>, *ODR* decreases incapacity program spending & increases pension expenditure (~ Breyer and Craig 1997; Castles 2004; Disney 2007; Pampel and Williamson 1989).

- But *ODR* has no effect on *ENSS*

→ **<u>No support for H1</u>**

3. Population aging and public pension spending

Are Aging OECD Welfare States on the Path to Gerontocracy?

Evidence from 18 Democracies, 1980-2002

Journal of Public Policy (with Markus Tepe), paper downloadable at:
http://ssrn.com/abstract=1225672

Motivation

- How has population aging affected public pension effort in the OECD?

- Prior findings until the mid-1990s: ODR (or % elderly) generally tends to increase <u>overall</u> pension expenditure per GDP (Pampel & Williamson 1989, Lindert 1996, Breyer & Craig 1997, Tabellini 2000; Castles 2004;Disney 2007)

- **H1: <u>Size</u> of public pensions <u>as % of GDP</u> will increase with ODR, also with most recent data**

Problem

- Finding on spending/GDP does not discriminate well against alternative explanations (e.g. social planner; benevolent dictator,…)
- Gerontocracy theories really predict that population aging leads to more generous **individual pension benefits**.
- How does aging effect the **generosity** of public pensions ?

“Elderly Power” theories

(Persson & Tabellini 2000; Sinn & Uebelmesser 2002; IMF 2004)

- The elderly want larger public pensions, as they internalize mainly benefits and not costs of higher contribution rates.
- Once the elderly are in or approach majority, pension politics are locked-in in favor of elderly.
- **H2: The generosity of public pensions *increases* with larger ODR**

Elderly power alarmism

- Howker & Malik (2010) ***Jilted Generation: How Britain Has Bankrupted its Youth***
- Beckett (2010) ***What Did the Baby Boomers Ever Do for Us?***
- Berry *(2012)* ***The Rise of Gerontocracy?***
- Kotlikoff & Burns (2004; 2012) ***The Coming Generational Storm/ The Clash of Generations***

• Roman Herzog (2008): 'we are seeing a **foretaste of a pensioner democracy**… It could end up in a situation where **older generations plunder the younger** ones'

“Elderly Power” alarmism

- Kotlikoff & Burns (2004): in the USA, a 'coming generational storm' will have arrived by 2030.

- IMF (2004): year when 50+ voters will be 50.1% of all : **The Last Train For Pension Reform Departs In…:**
  - 2019 for Denmark, Greece, Italy, Norway, Portugal, Sweden
  - 2015 for US, Germany, France
  - 2012 for Finland, Switzerland

“Elderly Power” alarmism

- Sinn & Uebelmesser (2002) beginning of 2010s = 'Germany's *last chance* for a partial transition to a funded pension system. *Thereafter, the country will effectively be a gerontocracy*.'

- Sinn (2005): ‘*Europe is gradually being transformed into a gerontocracy in which the old rule the roost.* Even today no party can dare act against the interests of pensioners. This trend will be consolidated in the future.’

“Elderly Power” alarmism

Sinn (2005): ‘Europe’s fun society is aging…fast. …. Hordes of pensioners, using the income received from the European pay-as-you-go pension systems, cruise the seven seas on luxury liners and jet off to the remotest beaches of our planet. The pay-as-you-go pension systems have made Europeans world champions in tourism and created a breathtaking infrastructure with seaside resorts and leisure centres from the Canaries to the Maldives and the beautiful Pacific Islands.’

“Fiscal Leakage” theories

(Razin et al 1992; Breyer & Stolte 2001; Razin & Sadka 2007)

- Population aging reduces RR from PAYG
- Current young expect smaller pension benefit for themselves than they are paying to the current old.
- As long the young hold a majority, this may lead them to vote for lower pension benefits.
- **H3: The generosity of public pensions *decreases* with larger ODR**

Increasing perceptions of intergenerational injustice

Sabbagh & Vanhuysse (2010) study of 2000+ university students in 8 countries

1. Higher support *in principle* for young-to-old transfers in social-democratic & conservative welfare states than in liberal & radical-Antipodean ones.

2. Students everywhere perceive adults and even more the young as more strongly under-rewarded *in practice* than the elderly, most so in the conservative regime.

Approach

- Cross-sectional time-series
- **Two dependent variables**:

  1. Pension exp. per GDP

  2. Pension exp. per elderly

- **Main independent variables**: *ODR* (65+/15-64); *50+ Ratio* (50+/20-49); *ODR 20 Year Difference*
- *Economic controls*: GDP growth, Interest rate
- *Labor market controls*: Female and elderly participation rates
- *Political & Institutional controls*: Leftwing gov; Welfare regime; Coalition Strength

<u>Baseline effects: *Population aging*</u>

- Population aging (ODR65+ & ODR55+) has <u>positive</u> effect on pension program size (*macro*), but a <u>negative</u> effect on pension spending per elderly (*micro*)

Support for H1 & H3; Reject H2

→ **"Smaller slices - out of larger cakes"**

- ODR-20 (expected pop aging) behaves differently

Baseline effects: *Time period*

- Coefficients for most recent periods negative: increased retrenchment in recent years, as compared to early & mid-1980s.
- Period effect systematically larger (program size) or at least as large (spending per elderly) for 1996-2003, as compared to 1988-1995.

→**“The new political economy of pensions”**

Determinants of pension expenditure as a percentage of GDP

	Model 1 Random	Model 2 Fixed	Model 3 Fixed	Model 4 Fixed	Model 5 Fixed	Model 6 Fixed
GDP/capita (log)	0.79	0.97	-0.55	0.72	1.8	1.81
GDP growth	-0.43***	-0.45***	-0.39***	-0.48***	-0.51***	-0.50***
	[0.1]	[0.1]	[0.1]	[0.1]	[0.1]	[0.1]
Interest rate	-0.16**	-0.16*	-0.16**	-0.18*	-0.19*	-0.21**
	[0.07]	[0.08]	[0.07]	[0.09]	[0.09]	[0.1]
Inflation rate	0.12	0.12	0.19**	0.12	0.093	0.072
	[0.08]	[0.09]	[0.09]	[0.09]	[0.06]	[0.1]
ODR	0.13*	0.093			0.088*	0.12*
	[0.07]	[0.07]			[0.05]	[0.07]
1988-1995	-0.026	-0.074	1.46*	0.11	-0.87	-0.93
	[0.6]	[0.8]	[0.8]	[0.8]	[0.7]	[0.8]
1996-2002	-0.38	-0.44	2.47*	-0.21	-1.18	-1.8
	[0.9]	[1.3]	[1.4]	[1.3]	[1.2]	[1.4]
55plus ratio				0.031		
				[0.03]		
Elderly workers part.					-0.13***	
					[0.03]	
Female part.						0.0006
						[0.03]

Determinants of **real pension expenditure per elderly person**

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
	Random	Fixed	Fixed	Fixed	Fixed	Fixed
GDP/cap (log)	0.2	0.16	0.12	0.29	0.034	-0.012
	[0.5]	[0.4]	[0.5]	[0.4]	[0.3]	[0.4]
GDP growth	-0.074***	-0.073***	-0.037	-0.065**	-0.069**	-0.073**
	[0.03]	[0.03]	[0.03]	[0.03]	[0.03]	[0.03]
Interest rate	-0.038*	-0.036	-0.030*	-0.029	-0.027	-0.034
	[0.02]	[0.02]	[0.02]	[0.02]	[0.02]	[0.02]
Inflation rate	0.027	0.028	0.026	0.024	0.034*	0.028
	[0.02]	[0.02]	[0.02]	[0.02]	[0.02]	[0.02]
ODR	-0.039	-0.039**			-0.047***	-0.043***
	[0.02]	[0.01]			[0.01]	[0.01]
1988-1995	-0.37*	-0.35**	-0.37*	-0.43***	-0.24	-0.26
	[0.2]	[0.2]	[0.2]	[0.2]	[0.2]	[0.2]
1996-2002	-0.34	-0.31	-0.35	-0.41	-0.044	-0.16
	[0.3]	[0.2]	[0.4]	[0.3]	[0.3]	[0.3]
55plus ratio				-0.015**		
				[0.007]		
Elderly workers part.					-0.020*	
					[0.010]	
Female part.						0.0045

Politics: *coalition and ideology*

- ***Coalition Type*** **:** weaker government coalitions actually reduce program size (large & sig.); effect on benefit generosity smaller

- ***Left/rightwing power*** no sign. effect: the **waning of partisanship**

<u>Institutions: *welfare regime type*</u>

- Baseline *ODR* findings are confirmed in the institutional models, but once we control for welfare regime type, *ODR* loses statistical significance

- Both social-democratic and liberal regimes cut back program size

→ **Institutional set-up of welfare regimes is a core causal factor behind pension effort, independently of population ageing as such**

The influence of politics and institutions

	Pension exp. as % of GDP			Real pen. exp. per elderly		
	Model 7 Fixed	Model 8 Between	Model 9 Between	Model 7 Fixed	Model 8 Between	Model 9 Between
GDP/cap (log)	1.76	-3.44	-3.73	0.3	-0.084	-1.96
	[1.8]	[3.9]	[3.9]	[0.4]	[6.1]	[6.3]
GDP growth	-0.48***	-0.79	-0.79	-0.077**	-0.45	-0.27
	[0.1]	[0.6]	[0.6]	[0.03]	[1.0]	[1.0]
Interest rate	-0.16*	0.057	-0.0031	-0.038*	-0.53	-0.39
	[0.08]	[0.5]	[0.5]	[0.02]	[0.9]	[0.8]
Inflation rate	0.073	0.56	0.65	0.02	-0.55	-0.5
	[0.08]	[0.7]	[0.7]	[0.02]	[1.1]	[1.2]
ODR	**0.098**	**0.26**	**0.22**	**-0.039****	**0.14**	**-0.088**
	[0.07]	[0.2]	[0.2]	[0.02]	[0.3]	[0.3]
1988-1995	**-0.58**			**-0.43****		
	[1.0]			[0.2]		
1996-2002	**-1.04**			**-0.41**		
	[1.5]			[0.3]		
Gov. coal.type	**-0.43***			**-0.071**		
	[0.2]			[0.06]		
Liberal regime			**-3.43****			**0.0004**
			[1.4]			[2.3]
Soc-dem reg.			**-2.88***			**3.24**

Conclusions

- **The continuing primacy of 'thick politics'**:
  - *Partisan* politics waning, but 'world of welfare' shapes extent to which numerical pressures are translated into policy outcomes.
  - Institutional variables receive little attention in political economy models with median voter assumptions, but they crucially mediate how absolute voter numbers influence pension effort

Conclusions

→ Even in fast-aging democracies, larger pensioner weight does not automatically lead to expansion of either program size or benefit generosity

→ **It is the logic of *contrasting fiscal-electoral straitjackets, not (yet?) gerontocracy*, which rules supreme in the political economy of pensions today**

Forthcoming by European Centre on LTC

What to find?

- Demography
- Social connectedness
- Income and housing situation
- Health status, risk factors and prevention
- Informal care
- Migrant care work
- Long-term care services
- Expenditure on long-term care

Where and when?

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The draft publication is presented at the UNECE Ministerial Conference on Ageing in Vienna and the pdf of the final publication, as well as the underlying data, will soon be made available for free download at the webpage of the institutions involved.

Look out for further information at:

http://www.euro.centre.org/

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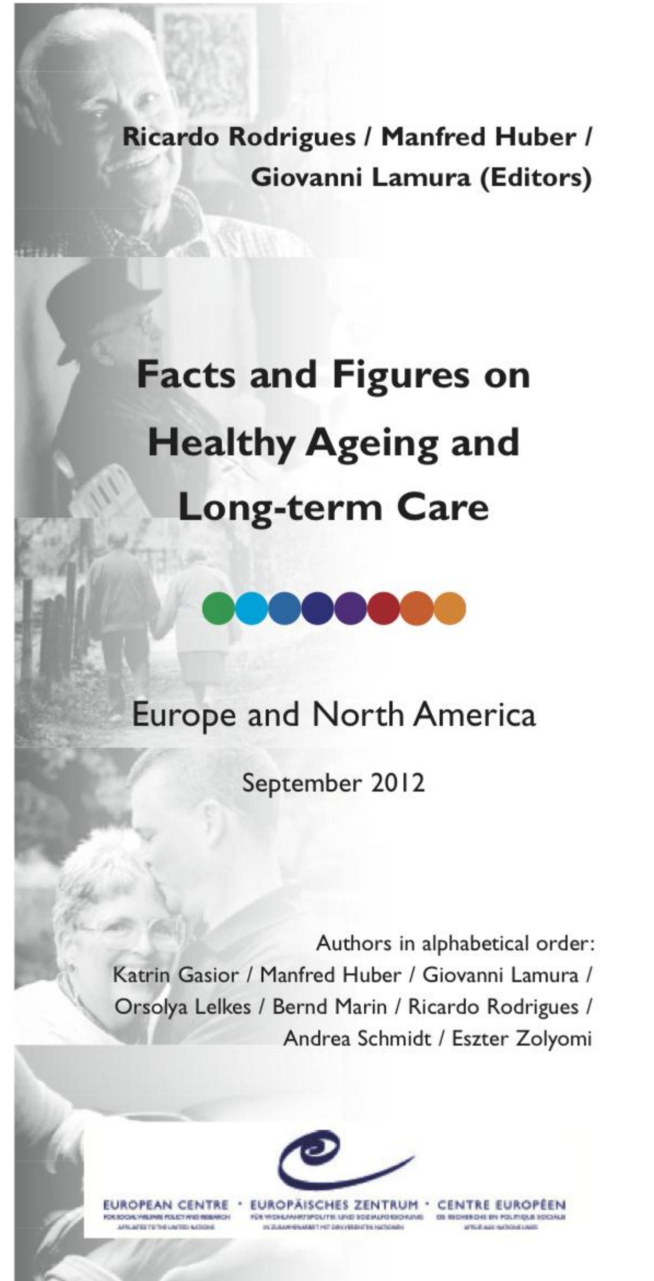
* The findings, interpretations and conclusions expressed in this publication are entirely those of the author and should not be attributed in any manner whatsoever to the World Health Organization.



Thank you.

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