Privatization of Social Security in the United Kingdom
warning or exemplar?

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Abstract

This study draws lessons for the debate about the proposed partial privatization of Social Security in the United States based on evidence from the United Kingdom. The British case suggests that privatization may lead to a reduction in the pension burden on the national budget if combined with substantial cuts in benefits. Such reforms may have positive effects on the economy, but any such benefits would come at a price that would include much higher administrative costs, exposure to stock market fluctuations, increased inequality, and potentially lower pension benefits for many low-wage workers, particularly women.

Keywords: Social Security; Privatization; United Kingdom; Reform; Pension policy

1. Introduction

Any major change in Social Security policy, such as the partial privatization of the program, has the potential to profoundly impact the social welfare and economic well-being of many Americans, particularly the 64% of the elderly for whom Social Security makes up more than half of their annual income (U.S. Social Security Administration, 2000). Given the number of Americans who depend upon Social Security as a major source of retirement income, it makes sense to find out as much as we can about possible consequences, both

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positive and negative, before even partially privatizing the program. There are a number of ways in which relevant information can be obtained, and each alternative has both strengths and limitations. One alternative is to analyze what has happened in other nations that have much in common with the United States that have already partially privatized their pay-as-you-go (hereafter PAYG) pension schemes.

Much attention has been given to developments in Chile because it is the nation with by far the longest experience with a privatized Social Security scheme based on funded personal accounts (Arenas de Mesa & Montecinos, 1999; Edwards, 1998; Huber & Stephens, 2000). Developments in Chile offer a number of potential insights relevant to the privatization debate in the United States, but the two nations differ in many ways; for starters, in 1998, the average hourly wage in the manufacturing sector was $2.26 in Chile in contrast to $13.49 in the United States (ILO, 2000). They differ in other ways that have implications for the Social Security base such as level of economic development and labor force structure. They differ in population size, social structure, cultural background, as well as public pension program history, and these differences also limit our ability to generalize to the United States from the Chilean case (Williamson, 2001).

More relevant as models for the United States are privatization reforms that have been introduced in various OECD nations. The most relevant of these nations is the United Kingdom. While there are other industrial nations (such as Australia and Sweden) that have partially privatized schemes in place (CBO, 1999; Sundén, 2000), Britain is the only G-7 nation that has made the transition from a largely public PAYG earnings related scheme to a partially privatized alternative with funded individual accounts. While Britain is particularly relevant as a policy model for the United States, even Britain differs in ways that do have implications for pension policy including differences in program history and labor force structure. Wage rates in these countries were quite similar in 1998, with wages in the manufacturing sector slightly higher in Britain ($15.11/h) than in the United States ($13.49/h) despite a substantially higher GDP/capita for the United States (ILO, 2000).

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

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

There are many reasons that Britain is relevant as a policy model for the United States. One is that it has more than 10 years of experience with pension policy reforms similar to those currently being considered by American policymakers. While the evidence is not all in with respect to the long-term effects of recent British reforms, preliminary evidence is available with respect to some potential strengths and potential problems. Another reason for taking a close look at this case is that Britain is in many ways structurally and culturally similar to the United States (Orszag, 1999). In both countries, discourse about Social Security is dominated by a repositioned center–left and neo-liberalism. Britain has many of the same powerful interest groups and a very similar set of social values including those emphasizing the importance of freedom, autonomy, and individual self-help (Williamson & Pampel, 1993).

Given that Britain has an older age structure than does the United States (Kingson, 1999, Table 2; OECD, 1997), it provides a glimpse of the demographic pressure the United States will be facing several years from now (Weaver, 1998).

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

Legislation enacted in 1975 and implemented in 1978 replaced the graduated pension with the State Earnings Related Pension System (SERPS), which called for much more generous second-tier benefits. This pension was designed to replace approximately 25% of a worker’s pre-retirement wage, based on his or her 20 best years. It too allowed employers to contract-out and substitute their own private pension plans, but the benefits had to be at least equal to the relatively generous benefits provided by SERPS.

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

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

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

Another important provision of the 1986 legislation called for cuts in future SERPS benefits. Under the 1975 legislation, SERPS was to replace 25% of the workers pre-retirement income based on his or her 20 best years. Under the new legislation, the replacement rate would be gradually reduced from 25% to 20% between 1999 and 2009. In addition, this pension would now be based on the worker’s average lifetime earnings.

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

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

Britain is currently in the process of making some additional changes in pension policy that will have substantial consequences in the years ahead. As these changes are currently being phased in, it is too soon to draw conclusions about how well they have worked. In 1999, legislation was approved requiring (as of 2001) most employers without occupational pension schemes in place to introduce a new type of occupational pension called the “stakeholder pension.” In many ways, they are more like the APPs than like traditional occupational pensions. These pensions are similar to the APPs in that they provide individual accounts, but the annual administrative fee is much lower (1%) and workers are allowed to transfer between schemes without penalty. They are designed for moderately low-wage workers, many of whom in the past have not had access occupational pension coverage. But, in contrast to common practice with traditional occupational pensions, very few employers will be adding a contribution over and above the worker’s contribution.
A second new pension option is called the State Second Pension. It will start in 2002 (when contributions to SERPS will end). During the first few years, it will not be a flat-rate scheme, but it will become a flat-rate scheme in 2007. This second-tier flat-rate pension will replace SERPS. The State Second Pension is designed to meet the needs of workers with low wages and irregular work histories. For this category of workers, the new scheme will do a better job of replacing pre-retirement income than does SERPS, particularly given the cuts in SERPS benefits that are being phased in. After 2007, low-wage workers will typically be covered by a combination of the original flat-rate first tier Basic State Pension and the new flat-rate State Second Pension.

3. Lessons from the United Kingdom

In this section, I present, and where appropriate qualify, a number of lessons for policymakers in the United States based on the British experiences. Some are likely to be emphasized by those who favor partial privatization while others are likely to be emphasized by those who opposed the partial privatization of Social Security.

3.1. When partial privatization is accompanied by substantial cuts in public pension spending, there may be a number of positive macroeconomic consequences such as a decrease in the public pension burden and an increase in the rate of economic growth

Britain has an older age structure than does the United States and this is likely to continue for the next several decades (Chand & Jaeger, 1996, Table 1). Despite this, the public pension burden (public pension expenditures as a percent of GDP) is projected to decrease from 4.3% in 2000 to 3.4% in 2050 (see Table 1). During the same period, the trend for the United States is projected to increase from 4.3% to 7.7%. The projected trend is even more problematic for countries such as Japan (6.5–10.7%), Germany (11.1–18.7%), and France (12.0–21.3%). However, it is important to keep in mind that projections such as these assume no changes in pension policy prior to 2050 (other than those already enacted). It is more reasonable to

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<th>Country</th>
<th>Baseline expenditure</th>
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<td>United States</td>
<td>4.5</td>
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<td>Canada</td>
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<td>Sweden</td>
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* Source: Liu (1999, Table 2).
assume that at least some changes will be made long before 2050 in all of these countries. One reason for the favorable projections with respect to future public pension burden for Britain is the change in indexing for the Basic State Pension introduced in 1980. Also important were the cuts in SERPS benefits implicit in the reforms of 1986 and 1995 (see Table 2).

The trends evident in Table 1 also have potential implications for the size of the national debt. However, it is important to note that many factors in addition to pension spending contribute to long-term trends in the national debt. Part of any reduction in the national debt due to less spending on public pensions, is likely to be offset by increases in the national (and local) spending on other programs, particularly those providing means-tested benefits such as rent subsidies, local government tax credits, and income support (welfare). If no public pension policy changes were made, projections suggest that the national debt in many of these countries would be expected to increase considerably over the next 30 years; but for Britain, in contrast, projections suggest that the national debt will decrease dramatically (Enoff & Moffit, 1997).

While privatization seems likely to keep down the public debt in Britain, the impact on economic growth is less clear. Most experts argue that the privatization will probably enhance economic growth making it easier to support the retirement of the boomers (Thompson, 1999), but some do question this conclusion (Waine, 1998).

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

3.2. Personal pensions (individual retirement savings accounts) tend to be popular among younger and more affluent workers, particularly when partially subsidized by the government

During the first 5 years or so after they were introduced, the APPs were very popular and participation in them grew much more rapidly than had been projected. One explanation as to why they were so popular is that they were viewed as empowering the individual to make his or her own retirement income decisions and they were also consistent with the value British

<table>
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<td>Effect of reforms to SERPS (£ billion, 1994–1995 prices)(^a)</td>
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<td>Original regime (1975–1986)</td>
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<td>After 1986 Social Security Act</td>
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<td>After 1995 Pensions Act</td>
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\(^a\) Source: Budd and Campbell (1998, Table 3.5).
culture puts on individual self-help (Liu, 1999). In recent years, the number of workers selecting this option has leveled off at about 20% of those covered by second-tier pensions (Blake, 2001). The APP option is most popular among younger workers. However, the new stakeholder pensions will compete with the APPs for some categories of employees (Ginn & Arber, 2000), and over time this is likely to lead to a reduction in the proportion of workers choosing the APP option.

An important reason the APPs were very popular during the early years is that a strong financial incentive (in the form of a 2% government contribution) was provided to get workers to move from SERPS to the APPs (Blake, 2001). Those electing to move were being subsidized in a big way using general revenues. After the first few years, the level of this subsidy was reduced making the APPs less attractive and less popular. Currently, only about 65 to 70% of APP accounts are active (Liu, 1999). A more serious problem has been the bad publicity the APPs have received linked to the mis-selling scandal in which approximately 1.5 million workers were sold APPs that were not appropriate for them (Phillipson, 1999). The financial institutions involved have also been very slow about investigating and making good on claims in connection with the mis-selling (CBO, 1999; Schulz, 2000a).

3.3. In the aggregate long-run returns on private pensions tend to be very favorable

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

More relevant to the debate in the United States is the evidence with respect to those in private pension schemes covered by APPs. Many of these workers have not realized anywhere near the overall average return for private pension funds. The APPs have a complex set of fees, which vary from one financial institution to another in ways that make it difficult for British workers to comparison shop. Many workers shift their assets from one provider to another within the first few years. When they do, the combination of commissions on new contributions, penalties for shifting to another provider, and various flat rate fees greatly reduce returns, particularly for workers who earn low wages and have irregular work histories (CBO, 1999; Schulz, 2000b).

3.4. Partial privatization tends to increase income inequality

Privatization may be responsible, at least in part, for the sharp increase in pension benefits for those at the upper end of the income scale relative to the more modest gains among those toward the bottom (Budd & Campbell, 1998; Ginn & Arber, 1999). Over the past 20 years,
pension income for the top quintile has increased by approximately 70%, while for the bottom quintile the increase has been much lower at 38%. The move toward privatization has increased inequality in part as a result of the unequal distribution of privatized pension benefits and in part as a result of the unequal distribution of the burden associated with various cuts in benefits needed to help finance the transition from the PAYG alternative (Phillipson, 1999; Schulz, 2000b).

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

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

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

In Britain as in the United States the extent of dependence on public pension benefits increases as income level decreases. Among the aged, 15% of the income of the highest income decile is derived from public pensions in contrast to 66% for those in the fifth decile and 85% for those in the lowest decile. For the United States, the corresponding figures are 19%, 66%, and 70% (Smeeding, 2001). These data suggest that the elderly poor in Britain are currently somewhat more dependent on the public pension system for support than are the elderly poor in the United States.

3.5. Privatization tends to increase gender inequality

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

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

Women who become eligible for APP annuity benefits often end up with lower monthly benefits than men who have accumulated the same amount in their retirement accounts. The reason is that contributions over the required minimum are subjected to gender specific mortality tables (Ginn & Arber, 1999). Women can expect to get the same total return on their annuity investment over a lifetime, but knowledge of this may not be much consolation as they pay their monthly bills. Another potential problem for married women is that it is up to the retiree to decide whether to purchase an annuity that includes survivor benefits (Thompson, 1999).

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

3.6. Policy gains such as a decrease in the national debt or in the public debt burden may in the end be due more to associated cuts in public benefits than to savings directly linked to privatization itself

For example, one set of projections suggest that the new British APPs are likely to produce a reduction in government spending of £2 billion for the year 2030, but these projections point to a much greater saving of £33 billion in the same year as a result of the 1980 legislation calling for the introduction a less generous indexing procedure the first-tier pension. Workers who retired in 1999 after earning the average wage throughout their lives and who are covered by only the state basic pension and SERPS could expect to have 16% of their pre-retirement wages replaced by the state basic pension and 20% replaced by SERPS for a total of 36%. However, comparable workers retiring in 2030 will find that the Basic State Pension replaces only 10% of pre-retirement wage and that SERPS will replace only 16% for a total of 26% of pre-retirement earnings (Liu, 1999). One interpretation of these projections is that the British have in effect asked the disadvantaged, particularly low-wage workers and women, to bear a substantial share of the sacrifices needed to create the nation’s
rosy future with respect to anticipated reductions in spending on public pensions and the associated reduction in the level of the national debt.

3.7. The administrative costs associated with a personal pensions program tend to be high, particularly when there are a large number of small accounts

During the early years, the claim was that the administrative costs associated with the APPs were relatively low. But, more recently, it has become increasingly clear that the administrative costs are relatively high and certainly a lot higher than had been thought. One estimate is that it costs up to 20% of the value of yearly contributions to administer the personal pensions as opposed to approximately 1% for SERPS (Crawford, 1997), which is close to the estimates of between 1% and 2% for the Social Security program in the United States (Diamond, 1996; Williamson, 1997). Another way to describe the cost of administering personal pensions is to say that when all fees, commissions, and other administrative costs are taken into consideration the cost to the account of the average worker runs somewhere between 1.5% (CBO, 1999) and 2.5% (Chapman, 1998) of the assets in that account per year. Due to the way charges are assessed, the actual administrative fees tend to be lower for those who make regular and large contributions with no change in pension fund management provider and often much higher for those who frequently shift between alternative pension fund management providers or make smaller or more irregular contributions, including those who stop making contributions altogether after a few months or years (Blake, 1995; Liu, 1999). These fees and the resulting impact on net returns are particularly problematic for women (Ginn & Arber, 2000; Ward, 1996). A number of factors have contributed to the high administrative expenses. The need to service a large number of small inactive accounts has driven up administrative costs as has the increase in time needed to respond to more elaborate regulatory procedures called for in the 1995 legislation in response to the mis-selling scandal.

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

A few years ago the Advisory Council on Social Security (1997) made estimates as to the amount by which the cost of administering the American Social Security system would increase were each of three different reform proposals adopted. One proposal, the Maintain Benefits (MB) plan, called for investing up to 40% of the Social Security trust fund in private sector equity markets without the introduction of individual accounts. A second approach, the Personal Security Account (PSA) plan, called for the diversion of 5 percentage points of the employee’s 6.2% share of the payroll tax into an individual savings account to be managed by one of many alternative private sector money management organizations. The third approach, the Individual Accounts (IA) plan, called for the creation of individual accounts financed by a
1.6 percentage point increase in the payroll tax. In this last case, the government would manage the money and there would be a relatively small number of investment choices. The Advisory Council on Social Security estimated that the increase the Social Security administrative cost would be 0.005% per year for the MB plan, by 0.105% for the IA plan, and by 1.00% for the PSA plan. The PSA accounts, the most expensive of these three alternatives, would be similar to the British APPs.

3.8. Private pensions plans need close supervision and tight regulation

Britain has faced a number of scandals associated with the move toward privatization. The most serious is what is described as the “mis-selling scandal.” During the early 1990s, it was common for the sales representative of various financial organizations marketing APPs to misrepresent their products (Orszag, 1999). By statute, they were required to ask a number of questions to make sure the product they were selling made good economic sense for the client. Many failed to do so. In their drive to maximize sales commissions and sign up as many people as possible, they successfully urged a number of workers already enrolled in generous occupational schemes (with employers making substantial contributions to their pensions) to shift to the less favored APP alternative, a product designed primarily for those not covered by generous occupational schemes (Stecklow & Calian, 1998). Such shifts were particularly problematic when the worker was close to retirement and was hit with a substantial reduction in occupational pension benefits due to the back-loaded benefit structure for many of these occupational pensions (Blake, 1995).

There was also evidence of mis-selling to many who would have been better off had they remained with SERPS, including many women part time and low-wage workers more generally (Ginn & Arber, 2000). These sales representatives often failed to fully inform clients about the implications of the change they were making and sometimes presented them with misleading statistics about fund performance.

The mis-selling scandal became public in 1993 and by 1995 legislation was enacted calling for tighter regulation and requiring the pension industry to compensate those who had been harmed as a result of the mis-selling. There seem to be disagreements among experts as to how many of the 1.5 million affected workers ended up with serious pension losses. Most commentators (e.g., Phillipson, 1999; Stevenson, 1998; Waine, 1998) argue that there were substantial losses for many workers; but some (e.g., Lilley, 1999) take issue with such claims. There is evidence suggesting that some of the practices associated with the mis-selling scandal continue albeit at a lower level (Orszag, 1999; Schulz, 2000a).

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

4. Discussion and conclusions

In 1980 Britain became the first industrial nation to begin shifting away from unfunded state provision in favor of funded private provision (Blake, 2001). While the British APPs have been in place for less than 15 years, the national pension system has been partially privatized for a much longer period of time. Although it will be many years before we can draw firm conclusions as to how well the APPs provide for different categories of workers, we are in a position to draw at least some tentative conclusions based on the British experience that are relevant to the debate in the United States over the proposed partial privatization of Social Security.

While privatized accounts may have positive consequences for the overall economy, in the long-run any such benefits could turn out to be quite modest. Although shifting from the more redistributive approach implicit in most PAYG public defined benefit schemes to a less redistributive scheme that includes a defined contribution individual accounts component is likely to have at least some positive consequences for the overall economy, and in some cases for the average worker as well, any such benefits will come at a price. As noted earlier, evidence from the British case suggests that such a shift in pension policy is likely to be associated with an increase in income inequality, an increase in gender inequality, and a possible increase in poverty rates among the elderly.

One concern among many analysts in the United States is that even a modest step in the direction of privatization will end up being the first step toward full privatization a few years from now. Developments in Britain may shed light on this question. Privatization did begin on a modest scale during the early 1960s. The rate of privatization accelerated during the 1980s and early 1990s (Ginn & Arber, 2000). Then, in the 1997 general election, the Conservative Party did propose what amounted to full privatization the pension system including the first-tier Basic State Pension (Waine, 1998, p. 157). As it turned out, they lost the election and the Labour Party is not proposing to do the same, but it has decided to phase out SERPS and put greater emphasis on privatized alternatives.

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

In recent years, we have seen the emergence of what may become a worldwide trend in national pension policy, a trend away from the PAYG defined benefit schemes and a corresponding trend toward greater emphasis on funded defined contribution schemes (Ginn
Arber, 2000; Williamson, 2001). A number of structural and cultural factors have played a role in shaping the policy changes that have emerged in recent years. Some structural factors have been present in most if not all of the nations that have shifted from PAYG defined benefit schemes to schemes that depend all or in part on a funded defined contribution component. All of these countries have been finding it more difficult to provide promised pension benefits as their PAYG systems have matured and as their populations have aged. Policymakers in many nations have become concerned about projected demographic trends pointing to a rapid graying of the age structure over the next few decades.

In recent years, much attention has also been given to the impact of globalization and concerns about maintenance of competitiveness in international markets (for summaries of the arguments, see Hinrichs, 2000; Pierson, 2001; Schwartz, 2001). Policymakers in Britain and in other OECD nations have become aware that they cannot ignore the impact of rapidly expanding welfare state spending on the nation’s competitiveness in international markets. Related to this are the fiscal constraints placed on nations that are members of the European Union (Rhodes, 1997). Member nations must constrain the potentially inflationary impact of an overly generous old-age pension scheme.

A structural factor of particular relevance for the present analysis is program history. Pension policy can be viewed as a “path dependent” process (Hinrichs, 2000; Myles & Pierson, 2001). While many social processes do follow the convergence model suggested by neo-classical economics, this is not necessarily the case with pension policy. Once a nation gets well along a policy path as has the United States with its mature and well institutionalized public PAYG defined benefit scheme, it becomes difficult to make a major shift of direction to a largely privatized funded alternative. Such a shift is easier to make, both economically and politically, in a nation such as Britain that has a short history with a PAYG public defined benefit earnings-related pension scheme.

Cultural factors have played an important role in many OECD nations. For example, both Sweden and Britain have made moves in the direction of privatization, but differences in their political cultures are reflected in the very different models that have emerged. Sweden is a nation that has long been committed to a set of communitarian values that emphasize egalitarian welfare state goals such as minimizing the extent of both relative and absolute poverty. In Britain, in contrast, there is less of a cultural commitment to these solidaristic goals and a greater commitment to values that emphasize the importance of individual responsibility and self-help. In Britain the move toward privatization is being carried out via a set of policies that will cut benefits to many low-wage workers. Most policy analysts argue that over time the new policies will further reduce the extent of income redistribution, increase income inequality, and increase the proportion of the elderly dependent upon means-tested benefits (Cutler & Waine, 1999; Schulz, 2000a). Recent policy changes in Sweden have produced a pension system that is less redistributive than the scheme it replaces, but it is still much more redistributive than the British scheme.

It is generally agreed that Britain and the United States are culturally more similar than the United States and Sweden. Ideologically, the United States is closer to the neo-liberalism of Britain than to the more egalitarian social democratic orientation of Sweden. This line of
analysis can be used to argue that the largely privatized British pension model may be culturally and ideologically more acceptable to Americans than the Swedish model.

To push this argument one step further recall that egalitarian Sweden has also recently taken some major steps in the direction of privatization. Swedish workers are now required to contributed 2.5% of their wages to funded individual retirement savings accounts very similar to those currently being proposed for the United States (Sundén, 2000). This Swedish evidence bolsters the potential relevance of the British trend toward privatization to the current debate over the proposed partial privatization of Social Security in the United States. It does so by calling into question efforts to down play the relevance of the British case based on path dependence arguments that emphasize differences between the United States and Britain in program history with respect to PAYG earnings-related pensions. Sweden has introduced funded individual accounts despite its long history with public PAYG earnings-related pensions.

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