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# Political competition and societal veto players: the politics of pension reform in Southern Europe

*Leandro N. Carrera, Marina Angelaki, Daniel Carolo*

## ABSTRACT

While Southern European countries have pursued a series of pension reforms since the early 1990s, significant variation arises across these experiences. Focusing on the concept of political replacement risk (i.e. the probability of a government being electorally punished for pursuing a given policy) and the changes in the labor movement's organizational structure, this article seeks to elucidate the differences in reform outcomes, ranging from path-breaking ones as in Italy to almost no reform, as in Greece. Our analysis shows that significant reforms are implemented when governments face a high political replacement risk and the labor movement, while still posing a credible threat, has undergone changes in its organizational structure that have weakened its influence over the workforce. By contrast, governments facing a stronger labor movement will generally be less effective at passing significant reforms, unless they can secure a strong support in their rank and file over the necessity to implement reforms, thus lowering the replacement risk.

KEY WORDS • pensions • reform • Southern Europe • political competition • labor movement

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## Introduction

The reform of public pension systems is a top public policy priority for Southern European countries due to rapid population ageing, declining fertility rates and changes in the labor market. In addition, since their creation, public pension systems in Spain, Portugal, Italy and Greece have provided particularly generous benefits and notwithstanding variations, have historically lacked sound management. Since the early 1990s measures adopted in these countries have ranged from null to significant reform. What factors explain such variation in the degree of reform?

The established body of scholarship lacks a clear explanation of the pension reform process in Southern Europe. The pioneering work of Esping-Andersen (1990) made no reference to the welfare regimes of this region, with the exception of Italy classified under the conservative-corporatist model. In the years that followed, the cases of Portugal, Spain, Italy and Greece have increasingly attracted the attention of scholars (Leibfried 1992, Petmesidou 1996, Ferrera 1996, Katrougalos 1996, Bonoli 1997, Katrougalos and Lazarides 2003 and 2008) giving rise to a debate concerning their categorization either as a sub-category of the corporatist model or as a distinct variant. Thus, for some

scholars, Southern European welfare states share common characteristics with the corporatist model such as the high proportion of government spending on old-age pensions, high inequalities, the persistence of poverty and the absence until recently of social minima (Katrougalos 1996, Katrougalos and Lazarides 2003 and 2008). For other scholars, Southern European welfare states have distinctive characteristics that distinguish them from those in other countries; a highly fragmented and corporatist income maintenance system, a low degree of state presence in welfare provision, a strong influence of the Catholic church (with the exception of Greece), the persistence of clientelism and selectivity in the distribution of cash subsidies, the lack of efficient administration and an over-representation of political parties in the mediation of social interests, hindering the formation of consensus (Ferrera 1996).

While this literature provides an overall satisfactory picture of the structure of welfare and pension systems in Southern Europe, it is rather silent about the specific reform mechanisms. Against this background, the aim of this article is to provide a comprehensive approach in understanding how pension reform takes place in Southern European countries by combining key insights of different theories on the politics of pension reform.

We hypothesize that political competition and the labor movement plays a significant role in understanding the mechanisms of pension reform in these countries. Specifically, we argue that it is possible to observe different reform outcomes ranging from null to significant, depending on the level of political competition around the pension reform issue and the particular organizational structure of the labor movement.

### **Towards a common explanation of reform in Southern Europe**

Pension reform has been analyzed by two different strands of literature. A first strand has looked at the role played by international and supranational institutions and their degree of influence over domestic policy makers to adopt reforms. In Europe, this research has led to a well developed literature on the “Europeanization” of pension policy reform (Radaelli 2002, Schmidt 2002, Schmidt and Radaelli 2004). The general conclusion of this literature is that the influence of Europe is

‘cognitive’, in other words ‘indirect’ (Guillén and Pallier 2004). Such cognitive effect is nonetheless important in showing a general EU influence on similar reforms to improve the long-term sustainability of public pension systems. These reforms include, for example, increases in contribution years, increases in the effective retirement age and introduction of complementary occupational and individual pillars. If influence from the EU is indirect, this means that the key mechanisms of pension reform still lie at the domestic level.

In this sense, a second stream in the literature has looked at the role played by political institutions and actors with a capacity to block reforms (veto-actors). In general, this literature has argued that institutions set the strategic context for actors to better achieve their goals (e.g. opposing reforms) by creating or restricting windows of opportunities (veto points). For example, Immergut (1992) emphasized the importance of the centralization and insulation of the executive power from parliamentary and electoral pressures as a precondition for significant reform. Similarly, Bonoli (2001) explains that institutional settings that provide power concentration for the executive and fewer veto points for opponents facilitate reforms. Moreover, he highlights that the impact of political institutions is mediated by electoral results and by the mobilization of strong societal groups like labor unions (Bonoli 2001, 259).

A similar re-adaptation of the institutional and veto player approach has been followed by Anderson et al. (2007). However, they observe that significant reforms have been adopted in recent years in many western European countries with a significant number of veto players. Thus, they argue that the logic of political competition may explain this divergence from the veto point and veto player theory. When the logic of political competition is intense, policy makers will seek a consensus for the reform or they will withdraw their reform proposal. A common example is when the electoral system provides ways for voters potentially affected by the reform in question to vote against the government.

As Anderson et al. (2007, 37) rightly point out the concept of political competition needs further elaboration in order to understand how it plays a key role in explaining episodes of reform. We propose to follow this recommendation as we consider political competition a key component, although not the only one, in explaining reform patterns in Southern European countries.

We argue that to understand the impact of political competition on pension reform, it is important to consider the extent to which the stability of government is threatened as a consequence

of coalition partners and voters' views on the reform that is being debated. Thus, in situations where policy makers perceive they will be punished by coalition partners or voters if they pass a given type of reform, they will either seek a consensual proposal or back down from far-reaching reforms for which there is little support. Here, we re-take the political economy concept of "political replacement risk" as key to understand why policy makers may be more or less prone to implement reforms that are political costly.

As Acemoglu and Robinson (2002) elaborate, economic reforms are economically beneficial but politically destabilizing, meaning that an incumbent ruler must balance the incentive to reform against the incentive to keep his position secure (and thus, not being replaced in the next election). In settings marked by low levels of political competition, the latter consideration plays a small role: the incumbent faces little risk of losing power in any case, and is therefore emboldened to undertake unilateral reforms that may help to secure his power. However, when political competition is more intense, the destabilizing effects of economic reforms (and thus the probability of being replaced) weigh more heavily on the incumbents, and will lead policy makers to refrain from unilateral action. We posit that such an approach is particularly useful in understanding the pattern of pension reform in Southern European countries, where pension policy has become a highly contested topic. Policy makers will usually look at the possible reaction of potential "losers" (retirees and workers) and their supporters in Parliament, when having to decide upon the content of reforms. Thus, it can be advanced that, in general, a government facing a low political replacement risk will seek to implement unilateral reform while a weaker one facing a high replacement risk will either back down from reform or seek wide consensus for a significant reform.

However, one additional factor must be taken into consideration in order to understand the full range of possible reform outcomes, namely, the role of the labor movement. Since the late 1960s (in Italy) and since the democratization in mid 1970s (in the case of Portugal, Spain and Greece) the labor movement has become a key veto actor with whom reforms must be negotiated. In these countries, as in other European countries following a corporatist tradition, pensions are seen as "deferred wages" and therefore labor unions will try to bargain hard in order to avoid cuts that will put future and current retirees in a worse off situation. Pierson (1994) has convincingly argued that policymakers may still get labor unions' consent by trying to divide them and weaken them or by compensating them for the potential losses. The latter type of strategy may imply the introduction of

clauses that protect these groups' interests such as lowering the retirement age from what policymakers had originally proposed or excluding some cohorts from being affected by the proposed reforms.

The latter approach has been examined by scholars interested in pension reform in Southern Europe, who have highlighted the re-emergence of new "corporatist" pacts between government, labor and business associations (Rhodes 2001, Rhodes and Natali 2006). For these scholars, the specific preferences of labor unions (i.e. protecting older workers and retirees vis-à-vis young workers) will be critical in understanding the specific concessions that are necessary for their consent. While we agree with this perspective, we argue that it does not fully explain why unions may or may not embark on a negotiation process with government. Some recent industrial relations literature has sought to find an answer to this important question (Royo 2006; Baccaro and Simoni 2008; Baccaro and Lim 2007). The key insight of this literature is that trade unions may provide support for concertation and significant reforms when their power and influence among the workforce has been declining in a recent past due to industrial reconversion processes which, among other things, have led to the closure of large manufacturing industries in favour of small non-unionised ones and increasing labor flexibility. As illustrated by this literature, union membership is seriously affected in these cases and this situation is usually accompanied by a rise of independent issue-specific unions contesting the legitimacy of the traditional labor confederations in firm-level negotiations. Thus, the expectation of this literature is that labor confederations may embark on concertation and significant reforms in order to mitigate their decline at the firm-level and regain wide policy-making influence (Royo 2006, 981; Baccaro and Simoni 2008, 17). In this sense, we advance that the reform of public pension systems may provide a good opportunity to a weakened labor movement to regain wide policy-making influence as union leaders may portray themselves as protecting workers' acquired rights while proposing and supporting measures to ensure the long-term sustainability of the system. By contrast, a relatively stronger labor movement that has not been significantly affected by industrial reconversion processes will adopt a more ideological stance around the pension issue and will not foresee any particular benefit in cooperating with government on a cost-containment reform.

In sum, we argue that the different outcomes of the reform process will depend on the combination of the political replacement risk and the situation of the labor movement. Table 1 below illustrates our expectations distributed along four dimensions. These dimensions should be considered

as “ideal types” in which specific reform cases can be located.

**TABLE. 1. *Expectations on the outcome of pension reforms***

		Situation of the labor movement	
		<i>Strong</i>	<i>Weakened</i>
Political Replacement Risk	<i>Low</i>	Unilateralism; important reform with no exchanges	Moderate reform; few exchanges
	<i>High</i>	Almost no reform; No exchanges	Significant reform; Important exchanges

We expect that a weakened labor movement, whose membership and influence among the workforce has been declining in the recent past, will generally accept to negotiate a reform with government in exchange of concessions for its support. If this is coupled with a government facing a high political replacement risk, with a slim parliamentary support divided around the reform issue, then a significant reform will be negotiated as the government will want to protect itself from the reaction of potential losers and secure political support for addressing the pension reform issue. At the same time, a weakened labor movement will support such significant reform as a way of regaining policy making influence, obtaining some significant concessions and claiming credit for helping to ensure the long term sustainability of the system. By contrast, when the labor movement has remained rather strong in the recent past (especially in some key areas such as the public sector), it will defend the status quo around the pension issue and will not be interested in negotiating a reform. If this situation is coupled with a weak government facing a high political replacement risk, reform attempts will stall or be very minimal. Conversely, a government facing a low political replacement risk with ample parliamentary support will pursue a unilateral approach as it will not see any political gain by including the unions on the reform process.

### The politics of pension reform in Southern Europe

#### *The politics of pension reform in Spain*

The structure of the Spanish pension system as it is now known was laid out in the 1960s and 1970s with two important reform laws.<sup>1</sup> The democratization process that started in 1975 put a special emphasis on expanding social protection to “catch up” with European levels (Guillén and Alvarez 2004). Until the election of the first socialist government in 1982, a series of measures led to a significant expansion of pension coverage (Cruz Roche et al 1985, 200; Guillén 1999, 10). As a consequence, the coverage of the system increased significantly, as well as total expenditure levels, which jumped from 5% of GDP in 1980 to 8,3% in 1982 (MTAS 2001).

The PSOE (socialist) government elected in 1982, which embraced a neoliberal approach of economic adjustment and restrictive monetary policy to achieve macro-economic stabilization, applied a first series of reforms to rein on pension spending. The most important of these measures was the 1985 pension reform law, which was passed after failed negotiations with the labor confederations. The main goal of the law was to reduce fraud levels, especially on disability pensions and to eliminate pensions given under unclear arrangements (Guillén 1999, 9; MTAS 2001, 26). The law introduced important changes to the parameters of the system: fifteen years of contributions required to obtain a pension (previously ten); benefits calculated using the last 8 years of salaries instead of the last two; stricter controls for disability and survivorship pensions; benefits adjusted according to the estimated (and not the past) CPI increase. In 1987, the government passed another crucial law that introduced private pension plans (Chuliá 2007, 530).

The logic of political competition and the increasing weakness of the labor movement created a favorable environment for the government’s unilateral move. The PSOE party had a comfortable majority in the main legislative chamber (the Chamber of Deputies), which would be confirmed in the 1986 general elections. On the labor side, the two main confederations Comisiones Obreras (CCOO) and the Unión General de Trabajadores (UGT) had suffered significant

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<sup>1</sup> These were the 1963 Basic Law of Social Security (*Ley de Bases de la Seguridad Social*) and the 1972 Funding and Improvement Law (*Ley de Financiamiento y Perfeccionamiento*). Both laws reorganised a system composed of different insurance schemes for occupational categories that had existed since the early 1900s.



membership losses during the economic recession of the late 1970s and early 1980s and by the mid 1980s unions found themselves in a weak position in declining industries (Royo 2000, 190). Furthermore, the opening of the Spanish economy set out by the PSOE government forced firms to seek greater flexibility, outsourcing production to small non-unionized firms (Mora 2001,430; Royo 2006, 981). All these developments weakened unions' power, with the net unionization rate declining to 15% of the workforce by 1990 (ILO 1997). Nonetheless, in 1985 labor leaders still adopted an intransigent position. In the view of some scholars, by the mid 1980s labor leaders had not yet realized how much their influence had declined among the workforce in recent years (Royo 2000; Mora 2001).

The recession of the early 1990s led to a significant increase in unemployment, which peaked at 24% in 1994 and had a negative impact on pension contribution levels. In addition, negative demographic trends with declining fertility rates and increasing old-age dependency ratios made necessary a significant reform of the system.

On the political front, the PSOE government was facing increasing competition from the centre-right Partido Popular (PP) since the early 1990s and in the general election of June 1993 it would lose its majority in the Chamber of Deputies, with the PP just 20 seats short of obtaining a majority. As a consequence, the PSOE was forced to form a minority government with the Catalan and Basque nationalists of *Convergència i Unió* (CiU) and *Partido Nacionalista Vasco* (PNV), respectively. The concern expressed by government officials in the following months about the sustainability of the pension system would lead CiU to propose the establishment of a parliamentary commission that would analyze the system's need for reform. The parliamentary commission received the input of specialists from the labor movement, political parties and academics and it concluded its work in March 1995. Shortly after, all parties represented in parliament signed an agreement, the Toledo Pact, which recommended important changes.<sup>2</sup>

As experts and reform participants note, the PSOE's decision to accept an open debate of reform alternatives and not to impose its own view as in 1985 was linked to its political weakness (Lagárez Pérez 2001). Furthermore, PSOE's officials interpreted that the "potential losers" from a

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<sup>2</sup> The recommendations included: reducing the specific privileges for some schemes and gradually reducing them to only two; an increase in the proportionality between contributions and pensions; the financing of non-contributory pensions through taxes; the progressive postponement of the retirement age; etc. See:<http://www.tt.mtas.es/periodico/documentos/Recomen%20Pacto>.

unilateral reform (namely, retirees and workers) would certainly punish them in upcoming elections (as they had done with the PP in the recent 1993 elections) and therefore agreed to negotiate a future reform.<sup>3</sup> For the labor movement, now led by new pragmatic leaders<sup>4</sup> that took note of their relative weakness, with the unionisation rate still at a low 17% of the workforce, this was a good opportunity to negotiate significant reforms and to gain influence over the policy making process.

The newly elected PP government in May 1996, which defeated the PSOE but struggled to form a coalition with CiU, PNV and Coalición Canaria (CC), was in charge of negotiating a reform following the recommendations of the Toledo Pact. Conscious of its compromised political support, but also of the necessity to implement important reforms to ensure the long term sustainability of the system, the PP government negotiated a reform with the social partners that included some significant cost-containment measures: gradual increase in the number of years used to calculate the pension benefit from 8 to 15, penalty for early retirement, reduction in the number of occupational schemes and annual adjustment of benefits according to wages' evolution. In exchange for accepting these measures, the labor movement obtained important concessions that aimed at improving the situation of the less advantaged, measures that, in the union's eyes, would help them to improve their stance vis-à-vis a broad range of workers. These included improvement in the poorest widows' and orphans' pensions, no penalty for early retirement when due to long unemployment and an increase in the age limit to receive orphan survivorship pensions.

In sum, in 1995 a government facing a high political replacement risk over the pension reform issue and a labor movement that realized its relative weakness and the need to gain policy making influence agreed on a far-reaching reform that entailed significant labor concessions. By contrast, the reforms of 2001 and 2006 have been led by governments (PP and PSOE respectively) enjoying a low political replacement risk with ample legislative majorities; thus, even though reforms have been negotiated with the social partners they have tended to be limited in scope.

### *The politics of pension reform in Portugal*

The Portuguese pension system was institutionalized as a corporatist system in 1935, during the

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<sup>3</sup> Interview with former Director of the Social Security Secretary and former key negotiator of the Toledo Pact in 1995, Jose Panizo Robles. Madrid 2006.

<sup>4</sup> In 1994 the legendary UGT leader Nicolás Redondo was replaced by Cándido Méndez. CCOO's general secretary, Antonio Gutiérrez together with Méndez favoured a pro dialogue approach with the government.

*Estado Novo* regime. However, the first Social Security framework law was passed only in 1984 (Law 28/84), after the democratic transition, with the support of the two major parties PS (Socialist) and PSD (Social Democrat).

The labor movement has generally played an important role in pension reform negotiations. The Portuguese labor movement is split between the communist CGTP and the socialist UGT. Even though affiliation levels are rather low in the private sector they are significantly higher in the public sector (Dornelas, forthcoming). Furthermore, industrial reconversion processes have not affected the Portuguese labor market in the same way as in Italy and Spain. For example, temporary employment has hovered around 13% of the workforce in the 1990s while in Spain it has peaked above 40% over the same period (Richards and Polavieja 1997, 13-23; Bover, García Perea and Portugal, 1997, 16-17). Different estimates of the net union density provide figures of around 20% to 25% of the workforce (OECD 2009a; Bover, García Perea and Portugal, 1997, 16-17). Moreover, the unionization rate is particularly high in railways, banking, insurance, transport, and public companies (Bover, García Perea, and Portugal 1997, 14). Thus, the Portuguese labor movement has remained in a position of relative strength in the last twenty years. Consequently, in the different reform processes it has generally adopted a more ideological point of view and has generally opposed reforms or provided its consent only to minor measures that did not affect the current benefits of older workers and pensioners.

The first social security reform occurred in 2000, during the PS government, which had only a single majority in parliament. The reform was discussed with the parliamentary parties, where each one presented its reform proposal and with the labor movement. However, facing a high political replacement risk given its slim majority and the opposition of the labor movement to significant change, only a parametric reform was passed including limited measures to improve the long-term sustainability of the system. Based on an expert panel report on pension reform, the possibility of a contributory upper ceiling (“plafonamento”) was introduced, nonetheless dependent on specific conditions. In the view of some observers, this “light” reform was a result of a consensus strategy followed by the government (Chuliá and Asensio 2007, 644). We would only contend that such a “consensus” approach may be explained by the high political replacement risk faced by the government.

In 2002, a new government led by a coalition of the social democratic (PSD) and the

conservative party (CDS/PP) pushed for a new reform. The significant difference with the 2000 reform was the political determination to introduce the social security contributory upper ceiling (“plafonamento”), which would mean the introduction of a voluntary private pension system, as a supplement to the public one (Law 32/2002).

However, the two labor union confederations decided to oppose the reform, claiming that the “plafonamento” was a government attempt to dismantle the public pension system. The government was also unable to secure strong support among its coalition partners. The outcome was still another parametric reform that did not affect the structure of the system significantly. The “plafonamento” was included but was subject to a further legal requirement that was not implemented because the President dissolved the parliament (Chuliá and Asensio 2007, 650).

The political crisis of 2005 and the advent of a new socialist government enjoying, for the first time since democratization, an absolute majority in parliament, set the tone for a new reform of the public pension system. The reform aimed to ensure the system’s sustainability, while responding to reports and recommendations from the OECD and the European Commission. Enjoying a low political replacement risk, unlike in the aforementioned reforms, the government pushed for the most significant pension reform to date.

In effect, the 2007 reform (Law n.º 4/2007) abandoned the controversial second pillar issue, but placed emphasis on reducing the generosity of the pension benefits for new generations. The reform also introduced a new benefit formula (actuarial) and a sustainability factor (pension penalty or retirement age improvement) to index pension benefits to life-expectancy variation, thus helping to secure the long-term sustainability of the system (OECD 2009b). The social democrat UGT ended up supporting the measures because it judged them necessary to ensure the sustainability of the system; meanwhile, CGTP rejected the reform on the grounds of defending alternative ways of financing for social security, such as a new taxation on companies profits instead of cuts in pension values.

It is of interest to note, however, that the reform was achieved because the government, negotiating from a strong position given its parliamentary majority, decided to adopt a mostly unilateral approach. Nonetheless, it was careful not to push for the introduction of a second pillar, obtaining union support for a significant cut in future pension values, which could increase the risk of poverty for pensioners. Thus, the system remains fully public having strengthened its financial sustainability, yet at the expense of adequacy.

In understanding the role of the labor movement, we interpret that unions have acted as self interested actors (Natali and Rhodes 2005). Thus, the UGT support for the 2007 reform could be achieved by the maintenance of its institutional role in the management of the public pension system, avoiding the introduction of the second pillar. Being in a position of relative strength, labor unions in Portugal have had a strategy of defending their own institutional interests and protecting members, passing the reform costs to future generations, instead of considering the reform process as an opportunity to solve the current inequalities of the pension system.

As our analysis shows, contrary to Spain and Italy, Portuguese governments have never been able to achieve broad social pacts to reform the public pension system. A relatively strong labor movement (particularly in some key sectors) and governments generally facing a high political replacement risk over the pension issue have generally led to no significant reform. This could explain why the reform progress has been so poor until 2007.

#### *The politics of pension reform in Italy*

The main feature in the evolution of the Italian public pension system since the post-war was its use as a clientelistic tool by governments (Regini and Regonini 1981, Ferrera 1997). The extremely generous provisions of the system coupled with economic and demographic developments in the 1980s and early 1990s made the public pension system financially unsustainable and determined the need for significant reform.

During the 1980s, several attempts to introduce cost-containment measures were proposed. However, all of these attempts failed due to the high political replacement risk faced by weak governments usually relying on broad coalitions of five parties, with the Christian Democratic Party as a pivot point (Ferrera and Jessoula 2007).<sup>5</sup> In addition, a relatively strong labor movement would pursue an ideological stance on the pension issue and reject negotiating any cost-containment reform with government.

Political and economic developments in the early 1990s made reform more likely to occur. 1992 would be a particularly difficult year for the Italian economy as economic growth plummeted

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<sup>5</sup> Even moderate reforms including the unification of the different schemes, retirement age increase and harmonization of rules for seniority pensions, such as the 1980 Scotti, the 1984 Cristofori, and the 1987 Formica proposals, were blocked in the Chamber of Deputies and/or were followed by the fall of governments.

while unemployment stayed above 11%. On the political side, the repercussions of the major corruption scandal known as “Mani Pulite” would bring down the DC-PS government and a caretaker technocratic government was put in place in June 1992 led by former treasury minister Giuliano Amato.<sup>6</sup>

In addition to the logic of political competition, the situation of the labor movement would be critical to understand the outcomes of the different reforms adopted since the 1990s. During the 1980s, Italian unions started to suffer losses in active workers’ membership levels due to changes in firms’ organizational structure and relocation of production abroad, while rival radical unions emerged (Baccaro and Locke 1998 11, Piore and Sabel 1984). As a consequence, union density decreased from 49% in 1980 to 38% in 1991 and the weight of retirees within the three main labor confederations increased. Therefore, since the 1990s, labor confederations would acknowledge the need for a significant reform of the pension system to ensure its sustainability and regain some policy making influence, but they would negotiate important concessions to protect the situation of older workers and retirees.

Already in his inauguration speech, Prime Minister Amato stated that “a major reform of Italy’s public finances, while painful, is necessary and it will have the pension system as a central component” (*La Stampa*, July 1st 1992). Conscious of his weak parliamentary support due to the government’s caretaker nature, but also aware of the necessity to adopt measures to reduce the public deficit, to which the pension system contributed heavily, the Amato government proposed and successfully implemented a reform. The measures included increasing the minimum contribution years for obtaining a seniority pension in the public sector to 35 years; the increase from 15 to 20 years required to receive an old-age pension and the calculation of pension benefits according to average life-time earnings for new entrants to the labor market.<sup>7</sup> In passing this reform, however, the government had to give important concessions to the labor movement to secure its acquiescence.<sup>8</sup>

In 1994, the newly elected Berlusconi government proposed significant reforms that

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<sup>6</sup> As some observers point out, Amato, together with former central bankers like Carlo Azeglio Ciampi and Lamberto Dini, was part of the group of technocrats that since the 1980s were convinced about the necessity of implementing major reforms in Italy’s public finances (Natali 2004, Radaelli 2002).

<sup>7</sup> As an outcome of the reform, private voluntary pension plans were authorized in 1993 through a special decree law.

<sup>8</sup> The concessions were related to: 1) a reduction of the number of years to obtain a seniority pension from 40 years, as initially proposed, to 35 years; 2) the calculation of pension benefits according to life-time earnings only for new entrants to the labor market; 3) the respect of pension rights for current retirees. See Cazzola (1995, p. 55)

generated opposition from the labor movement and political opponents.<sup>9</sup> The measures would also spark resistance within Berlusconi's heterogeneous government coalition (Natali 2004, 1090). After massive labor demonstrations, the government decided to withdraw the reform proposal and it resigned in December 1994. A caretaker government was then formed with former finance minister Lamberto Dini as Prime Minister. In the negotiations to form government, a fixed schedule for the reform of the pension system was agreed among the Northern League and the center-left parties (Natali 2004, 1090).

Conscious of the existing risk of replacement if a reform was not achieved and of the pressing need to implement a significant reform to reduce deficit levels to help Italy to qualify for the last stage of the EMU, the government sought collaboration from the labor movement. In turn, a weakened labor movement saw this as an opportunity to regain policy influence and actively negotiated and proposed measures (Natali 2007, 161). Both government and social partners adopted a discourse strategy that stressed the necessity of passing a reform to improve the fairness of the system and save it from bankruptcy, while agreeing on measures that would reduce the replacement rate of the system significantly.<sup>10</sup> In exchange for their consent, the main concessions given to the labor movement centered upon the cohorts to be affected by the new system (Rhodes and Natali 2006; Jessoula and Alti 2006). In the end, it was agreed that the system would entirely apply only to new entrants and that workers with at least 18 years of contributions would retire according to the rules of the old system. Those with less than 18 years of contributions would have their pensions calculated on a pro-rata basis: until 1995 according to the old system and after 1996 according to the new one. A further significant reform was negotiated by the Prodi government in 1997, which reduced the transition time to the new system. The replacement risk for the Prodi government was also significantly high, as it relied on a fragile coalition that would be forced to resign less than a year later by a party of its own coalition (Baccaro and Simoni 2008, 15). Furthermore, the government badly needed the reform to reduce budget levels further and help Italy qualify for the EMU.

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<sup>9</sup> The reforms included the following points: a) increasing the retirement age by one year every 18 months and not every two years as agreed in the Amato reform; b) the indexation of pension benefits according to the expected increase in CPI and not according to the actual CPI evolution; c) a reduction in the calculation of the pension benefits by 1,75% per year of contribution for every worker with 15 years of seniority or higher. See Castellino 1995.

<sup>10</sup> A new formula for the calculation of benefits was introduced, based on a worker's full contribution history. In this new "Notional Defined Contribution" system current contributions are still used to pay current retirees but workers' contributions are registered in virtual or "notional" accounts. The accounts indexed every year and the total accumulated is used at retirement to calculate the pension benefit adjusted by life expectancy. See Börsch-Supan (2003).

In 2004, the Berlusconi government, relying on its parliamentary majority, implemented a reform that still needed to be negotiated with the unions after their opposition to the initial plans of proceeding without consulting them. The reform was moderate in scope and included some concessions to the labor movement; the government's initial plan of reducing employers' contributions was eliminated and the use of the *Treatamento Fine Rapporto* (TFR) for supplementary funds was based on the 'silenzio/assenzo' mechanism.<sup>11</sup> The reform also included a 'jump' (*scalone*) in the minimum retirement age from 2008 to 60 years old and at least 35 years of contributions. Finally, in 2007, the Prodi government passed another moderate reform that replaced the scheme of the *scalone* introduced by the Berlusconi reform for a new "quota" system that mixes age and the years of contributions. In practice, this reform implies a very gradual increase of the retirement age from 58 in 2008 to 61 in 2013 (*Eironline* 4<sup>th</sup> March 2008). The reform was mainly negotiated with the government's coalition partners although it received the consent of the social partners in the end.

In both the 2004 and 2007 cases it is possible to observe governments enjoying a lower political replacement risk than those in the 1990s. In this situation, politicians were not pressed to include the labor movement in far-reaching consensual reforms. Not surprisingly, the outcomes were moderate reforms.

#### *The politics of pension reform in Greece*

The history of social security in Greece can be traced back to the late 19th century with the emergence of the first social security funds. The development of the Greek welfare state is nonetheless linked to the restoration of democracy in 1974 and in particular to the advent of the centre-left (PASOK) to power in 1981 leading to the expansion of social policies, also interpreted as a catch-up process with its European partners (Sakellariopoulos 2007). However, this increase exceeded the economy's capacity causing concerns about its long term financial sustainability (Guillén & Matsaganis 2000, Katrougalos 1996, Papadimitriou 2001).

The first reform initiatives were introduced in the early 1990s by the centre-right government

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<sup>11</sup> The TFR is an end of service allowance set aside by the employer and paid as a lump sum of money upon retirement. The new law stipulates that employees will have up to six months since being hired to decide whether they want to perceive the TFR at the end of their employment or if they want to transfer it to private pension plans. In case of no decision ("silence") the TFR will be transferred to the company closed occupational fund. If such alternative does not exist, the money will be transferred to the INPS.



of Nea Dimokratia (ND) in a context of severe economic crisis. The case for reform was built on the grounds of containing the soaring costs of pensions (equal to 15% of GDP and amounting to almost half of the overall budget deficit) supporting macroeconomic adjustment, while giving the system some “breathing space” in order to arrive at a consensus as to the basic characteristics of the new one (Matsaganis 2006). The key provisions of Law 1902/1990 entailed increases in contributions, introduction of contributions for civil servants, tightening of eligibility rules for disability pensions, increases in the pensionable age and changes in the calculation of pensions. Meanwhile, key aspects of Law 2084/1992 entailed the unification of pension rights and a further reduction in the generosity of pension benefits for new entrants to the labor market.

Overall, the legislative framework fell short of initial expectations aspiring to the gradual introduction of a multi-pillar system by retaining the system’s original structure in order to minimize the political cost (Sakellariopoulos and Economou 2006). As argued by Venieris (2006, 77) “reforms came too late and achieved too little”. Reform initiatives were limited to “housekeeping measures”, lacking a long term perspective and leaving the structural deficiencies of the system untouched (Featherstone 2005, Featherstone et al 2001).

In understanding the reform outcome one should take into consideration that ND was faced with a high political replacement risk; its “frail” parliamentary majority of just one seat, coupled with the opposition of some of its members to certain provisions, resulted in the watering-down of its initial proposals. In addition, the government was faced with a labor movement<sup>12</sup> that opposed the reforms on ideological grounds and organized major strikes on both occasions in an attempt to defend the interests of their members. This ultimately forced the government to adopt a “blame avoidance strategy” by passing the cost either to the less privileged funds (e.g. the IKA, covering mostly private sector employees) or to future generations, while introducing only minor cuts to the “special” funds of public sector enterprises (Matsaganis 2006).

The centre-left government (PASOK) elected in 1993 based its election campaign on the need for a new social contract; yet pension reform reappeared on the political agenda only after the 2000 elections. PASOK’s new mandate, coupled with the pressure exercised by the EU, strengthened

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<sup>12</sup> The General Confederation of Workers (GSEE) represents the private and the broader public sector, while the Civil Servants’ Confederation (ADEDY) represents the public servants. While overall union density is around 30% (close to the European average, yet declining) the significant differences between the two sectors constitutes a “Greek paradox” (Kouzis 2005).

the case for reform (Featherstone 2005, 736). Projections of the Economic Policy Committee (EPC) estimated in particular that the old age dependency ratio would rise to 54% by 2050 (from 26% in 2000) causing a significant increase in public pension expenditure as they would almost double from 12,6% of GDP in 2000 to 24,8% in 2050 (EPC 2001). In addition to sustainability problems, the issue of adequacy and the need to tackle the system's fragmentation and legislative complexity were also highlighted as important challenges (Council EU 2003, 113-114).

The 2001 proposal comprised measures that would strengthen the system's viability, tackle its inequalities and limit fragmentation without affecting its PAYG character. Nonetheless, the proposal was perceived as extremely harsh by the trade unions, generating massive demonstrations and general strikes (Sakellariopoulos and Angelaki 2007).

It should be noted that in Greece, declining union density does not seem to affect their mobilising capacity which remains considerable (Seferiades 1999). On the contrary, certain mobilizations (such as the strikes organized against the 2001 pension reform) have been marked by high participation levels (Kouzis 2005). Moreover, research has shown that despite labor market changes, union density, although in decline since the mid 1990s, has remained rather high, at around 27% by 2004, with unionization rate reaching 90% in certain cases such as state banks and enterprises (Kouzis 2005; Matsaganis 2007, 542-543). It is precisely these sectors which have usually strongly opposed cost-containment reforms.

Within a climate of severe opposition and facing a high political replacement, the government withdrew its proposal and called for a renewed social dialogue (*Eironline* 28<sup>th</sup> May 2001). The failed reform attempt entailed a heavy cost for the government as it aggravated conflicts within PASOK, affected the PM's popularity, increased mistrust towards the government (the latter considered as an important factor that contributed to PASOK's subsequent electoral defeat) and widened the gap with the trade unions who considered the government's retreat as their victory (Sakellariopoulos and Angelaki 2007).

Following lengthy consultations with the social partners and a radical reformulation of the 2001 proposals, a new reform was approved in 2002. The novel characteristic of Law 3029/2002 is the introduction of funded pension schemes presented as an element that would add flexibility to the system (MEF/MLSS, 2002). As argued by Sotiropoulos (2004, 277) the introduction of funded schemes can be considered as a hesitant step towards a multi-pillar pension system. However the

gradual transformation of auxiliary funds into funded occupational schemes managed by the social partners has not been realized, while the four occupational funds that have been established are limited to the provision of either lump sum payments or health benefits (Romanias 2006, 356). Studies by the trade unions' Labor Institute have also questioned the extent to which the annual state's supplement provided to IKA is able to guarantee its long-term sustainability, especially when the government is not upholding to its part of the agreement (Robolis et al. 2007). While the successful outcome of the 2002 reform stands in sharp contrast to the 2001 experience the consensual approach adopted undermined its effectiveness (Council EU 2003, Featherstone and Papadimitriou 2007).

Following the 2004 elections and the advent of ND in power, the launch of a social dialogue process was announced on several occasions. However, initiatives were undertaken only after the party's second electoral victory in 2007 leading to a "slim" parliamentary majority. While doubts were raised concerning the social dialogue that took place, Law 3655/2008 was finally voted in March 2008. The law is divided in two parts; the first deals with organizational and administrative aspects (entailing measures targeting the unification and merging of funds, expecting to limit the number of pension schemes from 155 to 13), while the second contains measures aimed at the rationalization of specific provisions. The reform initiative was justified by reference to the need to limit the system's fragmentation and tackle the negative demographic prospects. The unification and merging of funds is undoubtedly an important step contributing to the system's rationalization, however as merged funds retain their original provisions, serious concerns are raised about the extent to which the new legislation contributes to the system's rationalization and the enhancement of its efficiency (INE 2009). In parallel, given the absence of actuarial studies, doubts have also been raised regarding the extent at which the measures enacted are well grounded (Angelopoulou 2008).

Guillén and Petmesidou (2007) interpret ND's reluctance during its first term in office (2004-2007) as an attempt to buy time and find a more suitable moment for the introduction of a reform that, in their opinion, would entail the strengthening of the second and third pillars. The outcome has fallen short of expectations, as the 2008 law is limited to the restructuring of the first pillar. At the same time the EU and the OECD have already stressed the need to adopt new cost-containment measures (Council EU 2009, OECD 2009c).

Overall, the lack of institutionalized relations between the government and the trade unions

along with the bias of representation in the latter, leads to the reproduction of the system's status quo and to the protection of the acquired rights of a minority of over-protected workers (Sakellaropoulos and Angelaki 2007, Matsaganis 2007). These factors account for the poor reform results in the Greece.

#### 4

### **Discussion and Conclusions**

The four countries under study have engaged since the early 1990s in a series of reforms that, in general, have resulted in the reduction of the generosity of the public pension pillar following stronger actuarial principles, the promotion of supplementary pension provision and the introduction of minimum income schemes that were until recently absent from these countries (Greece still being an exception). While reforms have been enacted following a series of socio-economic pressures that have placed significant strain (albeit to varying degrees) on the future financial sustainability of public pension systems, the four countries display different reform records. In particular, while Italy has enacted more path-breaking reform followed by Spain, reform has only recently progressed in Portugal, while it has largely stalled in Greece.

We argued that the political replacement risk faced by the government as well as the situation of the labor movement, constitute the core factors accounting for the divergent outcomes observed in the countries under study. The political replacement risk (see Table 1) can be either low or high depending on the support in parliament and the extent to which members of government perceive that they will be punished by voters in future elections due to their stance over the reform issue. The labor movement can be categorized as strong or weakened. The first category applies to a situation in which the union density has remained high, especially in some key sectors such as the public or the banking sector. The second category refers to a situation in which, due to industrial reconversion processes, the union density has declined significantly in the recent past, generally accompanied by a rise in independent unions and temporary non-unionized employment. We advanced that, given this latter situation, trade unions would be willing to negotiate a significant reform with government in order to regain policy making influence. However, we also hypothesized that only weak governments

facing a high political replacement risk would be willing to include the unions in devising such far-reaching reforms. Table 2, following the structure of Table 1, displays the full range of our expected dimensions together with each country reform.

**TABLE. 2. Distribution of the cases of reform**

		Situation of the labor movement	
		<i>Strong</i>	<i>Weakened</i>
<b>Political Replacement Risk</b>	<i>Low</i>	<i>Unilateralism; important reform with no exchanges</i> Spain 1985 Portugal 2007	<i>Moderate reform; few exchanges</i> Italy 2004, 2007 Spain 2001,2006
	<i>High</i>	<i>Almost no reform; No exchanges</i> Italy 1980s Portugal 2000, 2002 Greece	<i>Significant reform; Important exchanges</i> Italy 1992, 1995, 1997 Spain 1996 Spain 2010?

As we originally predicted, the cases of broad and significant reforms took place when there was a combination of a weakened labor movement, although still retaining a significant mobilization capacity, and a government facing a high political replacement risk. Italy during the 1990s and Spain in 1996 illustrate this situation. In both countries, the labor movement suffered significant membership losses and the emergence of rival unions that threatened their influence. Governments facing a high political replacement risk in both countries decided to embark the labor movement on negotiating significant reforms. Labor leaders accepted to cooperate as they saw in the negotiation the opportunity to regain policy making influence, obtaining significant concessions in exchange for their consent. In Italy, the Amato and Dini governments faced a high political replacement risk due to their caretaker nature. The critical condition of the system and the necessity for a significant reform to put public finances in order added to the high political replacement risk situation. The weak 1997 Prodi government underwent the same situation, and the necessity of implementing further reforms to help Italy qualify to the latter stage of EMU added to the high political replacement risk. In Spain, the 1996

Aznar government also faced a high political replacement risk due to its weak parliamentary support. In all the cases, political leaders saw the convenience of negotiating with the labor movement in order to achieve significant reforms. As of this writing, the Zapatero government has also unveiled the necessity of a new significant reform to tackle the impact of the economic downturn. Weakened by the impact of the economic recession, it seems likely that the government will need to negotiate broad reforms with the social partners (*ABC*, 2010).

Our analysis has also shown that when Spanish and Italian governments have faced a rather low political replacement risk because of enjoying more solid parliamentary majorities, the outcome of the reform has been rather modest. This has been the case of the Berlusconi and Prodi governments in 2004 and 2007 and the Aznar and Zapatero governments in 2001 and 2006.

The labor movement in Portugal and Greece has remained rather strong when compared to those of Spain and Italy. Moreover, it has remained particularly strong in key sectors of the economy such as the banking and the public sector. Therefore, labor leaders in these countries have never seen the necessity to negotiate significant reforms with government as a way of regaining influence. In this situation, governments facing a high political replacement risk because of their weak political support have passed very minimal reforms. This has been the case of Greece during the period under analysis and also of Portugal in 2000 and 2002. Only the emergence of a strong government, as in Portugal in 2005, has been able to break the inertia, implementing the most significant reform to date.

The comparison of the cases has also illuminated some areas that deserve further research. For example, the cases of significant reform that were widely negotiated with the social partners, as in Italy in the 1990s and Spain in 1996, mixed significant retrenchment with concessions, providing evidence of the multidimensionality of the policy space (Häusermann 2009). In both countries, by combining retrenchment and expansion measures, policy makers were able to achieve a significant departure from the status quo. The use of discourse to legitimate retrenchment has also been significant, and constitutes another aspect to be researched in further studies of policy change (Schmidt 2002).

In sum, our comparative analysis has provided new insights to understand the degree of pension reform across Southern European countries and has shown the way in which the specific interplay of political institutions and societal veto actors affect the outcome. In so doing, we have provided new empirical evidence on how reform proceeds in this region and we have contributed to

the comparative literature on pension reform.

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