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Report to the Committee on the Budget, U.S. Senate

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ENTITLEMENT REFORM PROCESS

Other Countries' Experiences Provide Useful Insights for the United States

GAO-08-372

January 18, 2008

GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-08-372, a report to the Committee on the Budget, U.S. Senate

ENTITLEMENT REFORM PROCESS:

Other Countries' Experiences Provide Useful Insights for the United States

Why GAO Did This Study

Looking to the future, our nation faces large and growing structural deficits and escalating federal debt due primarily to rising health care costs and known demographic trends. Slowing the growth of entitlements is an essential part of the solution to these challenges.

GAO was asked to identify useful insights from the entitlement reform processes in other countries. Specifically, GAO was asked to analyze (1) other countries' major efforts to reform entitlement programs, (2) the pressure(s) that led countries to undertake the reforms, (3) how reform proposals were developed, and (4) to what extent enacted reforms built in triggers requiring future actions under certain conditions; and where such trigger mechanisms did not exist, whether some adjustments nonetheless occurred.

GAO conducted a literature review focusing on developed, high-income Organisation for Economic Co-Operation and Development (OECD) countries facing similar fiscal challenges. To gain a more in-depth understanding of reform process, GAO selected three efforts for further study: Sweden's pension reform in 1998, Germany's pension reform in 2004, and the Netherlands' disability reform in 2005. For these cases GAO interviewed government officials, reform participants, and experts knowledgeable about the reforms.

GAO is making no new recommendations in this report.

To view the full product, including the scope and methodology, click on GAO-08-372. For more information, contact Susan J. Irving at (202) 512-9142 or irvings@gao.gov.

What GAO Found

Other countries' experiences suggest that reform of entitlement programs is difficult but also possible. Several countries more advanced in population aging and facing greater demographic challenges than ours have successfully undertaken reforms of major entitlement programs. Since the 1980s, almost all of the OECD countries have restructured their public pension programs; disability, unemployment, and other programs have also been reformed. Many reform efforts began or accelerated in an environment of economic and fiscal crisis. Other prompts included longer term concerns about population aging and economic competitiveness, and supranational factors such as a desire to meet the fiscal criteria for entry into the European Union. In many countries, reform occurred despite political processes that made it difficult. Consensus had to be built in coalition governments, and leaders had to work across parties to achieve a broad consensus for reform.

Commissions were generally used to develop proposals, but this was only one stage in the reform process. Leaders needed to define the problem, persuading others that reform was needed and urgent. The challenge was to build a broad coalition to assure the reform's permanency while preserving the main policy initiatives sought in the reform process.

- In some reform efforts political leaders used the "bully pulpit" to educate the public but in some cases commissions also helped. Achieving a broad consensus across parties and groups was key to enacting and sustaining reform.

- Proposals were generally developed by ad hoc commissions established by governments with a strong commitment to reform. Commissions in case study efforts that developed proposals were small, with varying composition. They removed divisive issues from the usual political process, facilitating consultation and negotiation needed to devise a reform package. Commissions also helped to insulate policymakers from political risk.

- Reform processes were generally complex and often conflict-ridden before they ultimately succeeded in enacting legislation. Many reforms were iterative. Following reform enactment, a need for additional changes sometimes emerged.

- In some countries standing commissions were established to monitor pension systems and make recommendations for change. Some recent pension reforms have included mechanisms to automatically adjust benefits if adopted reforms prove insufficient to make programs sustainable.

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United States Government Accountability Office
Washington, DC 20548

January 18, 2008

The Honorable Kent Conrad
Chairman
The Honorable Judd Gregg
Ranking Member
Committee on the Budget
United States Senate

Our nation faces a future fiscal challenge that poses severe and unacceptable risks to the federal budget and our economy. Absent policy change, in the future we face large and growing structural deficits and escalating federal debt due primarily to rising health care costs and known demographic trends. Continuing on this imprudent and unsustainable fiscal path will gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately our national security. Unless action is taken, our current path will increasingly constrain our ability to address emerging and unexpected budgetary needs and increase the burdens that will be faced by our children, grandchildren, and future generations of Americans.

Taken together, Social Security, Medicare, and Medicaid are the major drivers of our future fiscal challenge. While the appropriate level of revenues will be part of the debate about our fiscal future, making no changes to spending on Social Security, Medicare, Medicaid, and other drivers of the long-term fiscal gap would require ever-increasing tax levels—something that seems both inappropriate and implausible. Substantive reform of Social Security and our major health programs remains critical to recapturing our future fiscal flexibility.

Last year several proposals were made to establish special groups to help develop proposals for entitlement reforms to address the long-term fiscal challenge. On September 18, 2007, you jointly introduced a bill to establish a Bipartisan Task Force for Responsible Fiscal Action. Composed of Members of Congress and Administration officials, this group would be asked to make recommendations on how to significantly improve the government's long-term fiscal imbalances.[1] Others have also introduced proposals to establish special groups with similar aims.[2] At the Senate Budget Committee's October 31, 2007, hearing on the Bipartisan Task Force proposal, I testified that this approach offers one potential means to achieve the objective of taking steps to make the tough choices that will be necessary to address the long-term fiscal challenge.[3] As I have noted, revenues will also have to be on the table as we address the long-term fiscal challenge, but slowing the growth of entitlements is a necessary component of the solution. Accordingly, I have called for the establishment of a commission that would address the long-term fiscal challenge by developing proposals to put Social Security on a sustainable path and begin the reform of health care and the tax system.[4]

You asked us to look at entitlement reforms in other countries with an eye to identifying useful insights and possible "lessons learned" from their reform process.

Specifically, you requested that we analyze

(1) other countries' major efforts to reform entitlement programs,

[1]S. 2063 would establish a Bipartisan Task Force for Responsible Fiscal Action. A supermajority approval of the task force's report by 12 of its 16 members is needed for the task force to make recommendations. A companion bill, HR 3655, was introduced in the House of Representatives on September 25, 2007. Securing America's Future Economy Commission Act, or SAFE Commission Act, S. 304, introduced on January 16, 2007, would establish a commission to—among other things—develop legislation to address the imbalance between long-term federal spending commitments and projected revenues. A companion bill, HR 3654, was introduced in the House on September 25, 2007. This proposal would establish a commission composed of 14 Congressional appointees, the Secretary of the Treasury and the Director of the Office of Management and Budget.

[2]On January 22, 2007, Senators Feinstein and Domenici introduced the Social Security and Medicare Solvency Commission Act (S. 355) that would establish the National Commission on Entitlement Solvency to review and report to the President and the Congress on the Social Security and Medicare programs every 5 years with respect to their financial condition and long-term sustainability. On April 24, 2007, Senators Hagel and Webb, and Representatives Tanner and Castle introduced the Comprehensive Entitlement Reform Commission Act of 2007 (S. 1195, HR 2024). On January 16, 2007, Representative McHenry introduced the Commission on Reforming Entitlement (CORE) Spending Act (HR 489).

[3]GAO, *The Long-Term Fiscal Challenge: Comments on the Bipartisan Task Force for Responsible Fiscal Action Act*, GAO-08-238T (Washington, D.C.: Oct. 31, 2007).

[4]See GAO, *A Call for Stewardship: Enhancing the Federal Government's Ability to Address Key Fiscal and Other 21st Century Challenges*, GAO-08-93SP (Washington, D.C.: December 2007).

(2) the pressure(s) that led countries to undertake the reforms,

(3) how reform proposals were developed (the structure or process used—e.g., commissions or special groups within the government), and

(4) to what extent enacted reforms built in triggers requiring future actions under certain conditions; and where such trigger mechanisms did not exist, whether some adjustments nonetheless occurred.

We looked at the reform process in selected developed countries with a focus on instances where the reform process had included commissions or other special groups. We limited our review to developed, high-income Organization for Economic Co-operation and Development (OECD) countries facing similar but even more daunting long-term challenges and demographic changes than the United States. From our literature review we identified instances in other countries where enacted reforms to programs such as pension or other social welfare programs were expected or intended to slow cost growth and increase fiscal sustainability. Although OECD countries have made many reforms to their health care systems since the 1980s, and reform efforts continue, we found no country that has been able to optimize the multiple goals of cost containment, access, and quality over time. Some countries have already undertaken national pension reform efforts to address demographic changes similar to those occurring in the United States, and in a previously issued report we drew lessons from their experiences.[5] Based on this, we selected three reform efforts for further study, including examples of both iterative and noniterative types of process: Sweden's pension reform in 1998; Germany's pension reform in 2004; and the Netherlands' disability reform in 2005. In these three cases we consulted with government officials, reform participants, and others knowledgeable about the specifics of the reform process.

We did not evaluate the effect of reforms on beneficiaries or on program effectiveness. Consideration of any entitlement reform process should not be taken to imply approval of the specifics of any given reform. We limited our review to documents available in English. (For more information on our scope and methodology, see app. I.) We conducted this work in

[5]See GAO, *Social Security Reform: Other Countries' Experiences Provide Lessons for the United States*, GAO-06-126 (Washington, D.C.: Oct. 21, 2005).

accordance with generally accepted government auditing standards from July 2007 through January 2008.

Background

In all countries, entitlement programs such as public pension programs and disability programs are politically sensitive and difficult to change. The hard choices needed to change the path of these programs include trade-offs that are likely to result in redistribution, creating "winners" and "losers." Such choices raise issues of fairness and access, embodying varying views about the appropriate roles of government and individuals in society. Reform may entail short-term sacrifice for long-term gain. Some experts have expressed the view that entitlement reform in the United States faces unique challenges due to the existence of multiple program constituencies combined with a complex legislative process with many hurdles to enactment.

Since the early 1990s, several commissions have been established to develop entitlement reform proposals, and considerable public debate, especially on Social Security reform, has taken place. (See app. II for more information on historical U.S. commissions on entitlement reform.) Both the current President and his predecessor discussed the need for Social Security reform and participated in related town meetings on Social Security, raising public awareness of the need for change. We have developed criteria to help Congress evaluate Social Security reform proposals.[6] These criteria reflect the multiple and conflicting goals that will have to be balanced in any reform package. To date, major structural change to the entitlement programs that drive the long-term fiscal challenge has not been enacted.

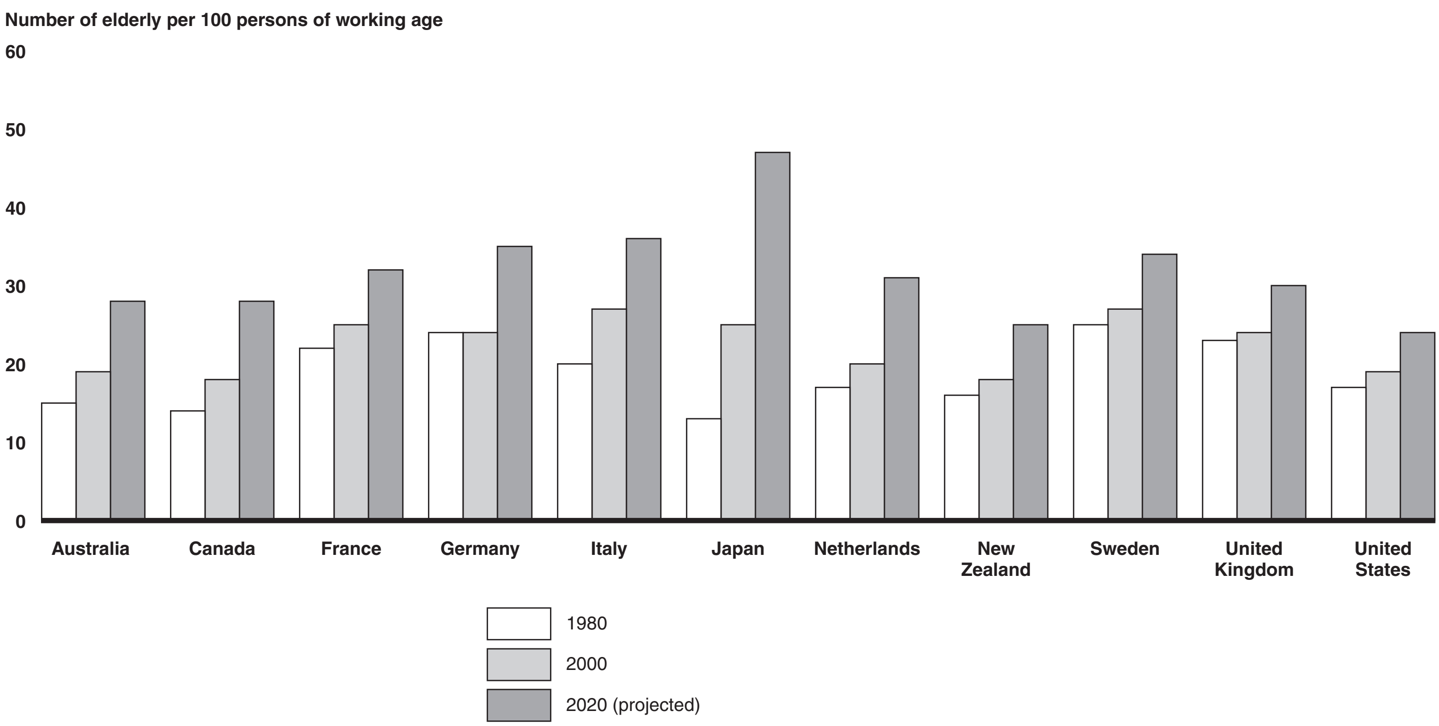
With regard to both Social Security and Medicare, consensus on the need for reform and reform approaches remains elusive. For example, some do not believe fundamental structural change to Social Security is necessary. Among those who have developed proposals, some include individual accounts and others do not. No major changes have been enacted to Social Security since 1983, when reform legislation based on a proposal developed by the Greenspan Commission was enacted in response to a near-term crisis in program financing. In contrast, Medicare has been

[6]See GAO, *Social Security Reform: Analysis of Reform Models Developed by the President's Commission to Strengthen Social Security*, GAO-03-310 (Washington, D.C.: Jan. 15, 2003); *Social Security: Evaluating Reform Proposals*, AIMD/HEHS-00-29 (Washington, D.C.: Nov. 4, 1999); and *Social Security: Criteria for Evaluating Social Security Reform Proposals*, T-HEHS-99-94 (Washington, D.C.: Mar. 25, 1999).

modified frequently, but the most significant change was a 2003 expansion of benefits to include prescription drugs. This step served to significantly increase the fiscal imbalance in the Medicare program.

Challenges posed by the growth path of entitlement spending are not unique to the U.S. Other developed countries have faced and continue to face the challenges of unsustainable social welfare programs including public pensions and health care. Moreover, many developed countries, especially in Western Europe, face more daunting demographic shifts due to population aging than the U.S. Figure 1 shows changes in the elderly dependency ratio–the number of older people relative to those of working age. As figure 1 shows, population aging in France, Germany, Italy, Japan, Sweden, and the United Kingdom is already as advanced today as is projected for the U.S. in 2020.

Figure 1: Elderly Dependency Ratio for Selected High-Income Countries, 1980 to 2020

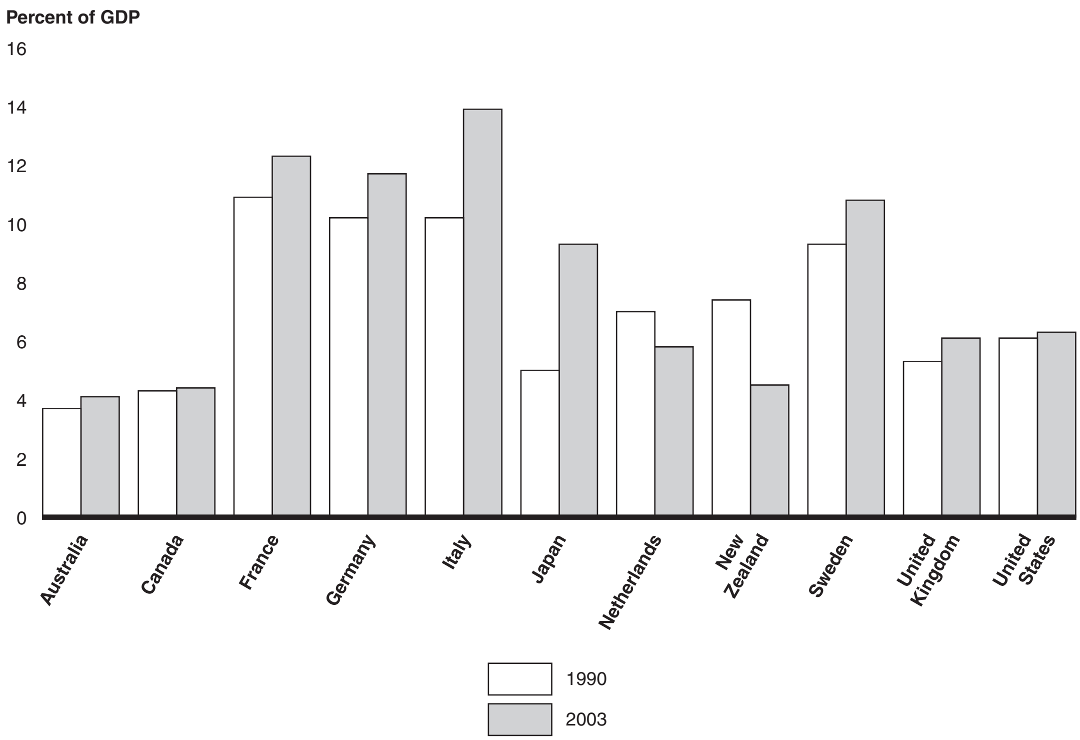


Source: United Nations, *World Population Prospects: The 2006 Revision, and World Urbanization Prospects: The 2005 Revision.*

Note: The number of individuals over age 59 for each 100 persons of working age, defined as age 15 to 59.

Spending on public pensions has presented major challenges in many countries where such spending generally represents a larger share of the total economy than in the U.S. Figure 2 shows this spending as a share of gross domestic product (GDP) in selected high-income countries in 1990 and 2003.

Figure 2: Public Spending on Old-Age and Survivors' Pensions in Selected High-Income Countries, 1990 and 2003



Source: OECD Social Expenditures Database, as shown in *Pensions at a Glance: Public Policies across OECD Countries*, 2007 Edition.

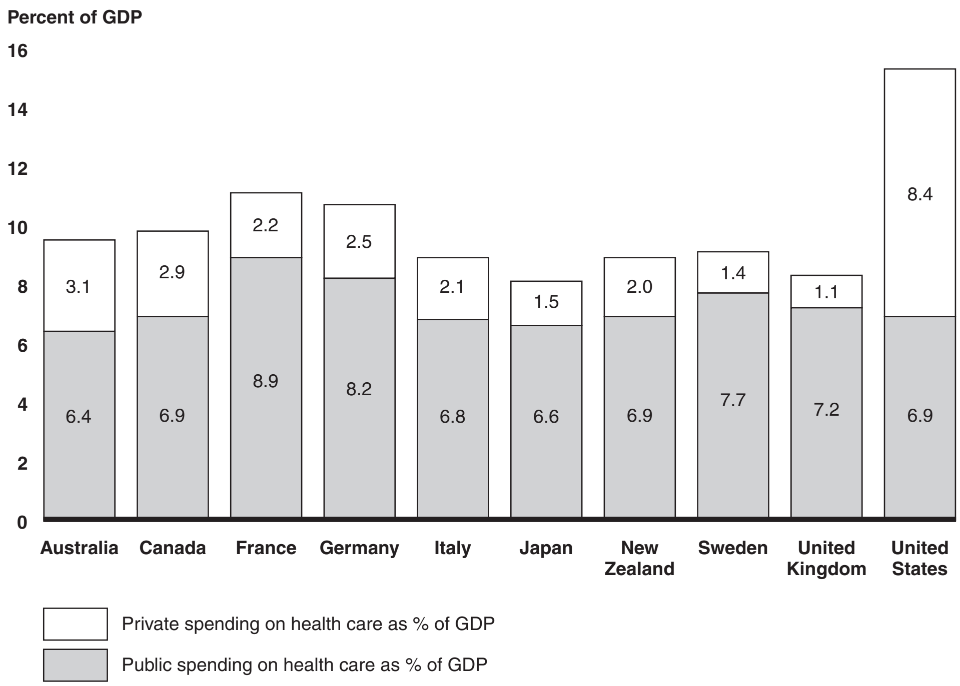
As in the U.S., health care cost growth presents challenges in OECD countries, with total healthcare spending, both public and private, generally rising as a share of GDP in the last 10 years.[7] Although total health care spending in other countries is smaller as a share of the economy than in the United States, a larger share of that spending is public. On average, the public share of health spending in OECD countries was 73 percent in 2005.[8] For example, in 2005 public health spending as a share of GDP in Germany was 8.2 percent, or 77 percent of total health spending; in France 8.9 percent, or 80 percent of total health spending; and in the U.K. 7.2 percent, or 87 percent of total health spending. In the U.S., public health spending was 6.9 percent of GDP, or 45 percent of total health spending in 2005.[9] Figure 3 shows public and private health spending in 2005 for selected countries.

[7]See OECD's *Health at a Glance 2007—OECD Indicators*. See also *European Commission*, *The Impact of Ageing on Public Expenditure: Projections for the EU-25 Member States on Pensions*, *Healthcare*, *Long-Term Care*, *Education and Unemployment Transfers* (2004-50) (European Commission Directorate-General for Economic and Financial Affairs, 2006). According to the European Commission, health care grew faster than GDP in all member countries of the European Union in the 1990s except Finland, Luxembourg, Denmark, and Sweden. In most EU countries spending on health care accounted for a growing share of total public spending in the past several decades, especially in the 1990s.

[8]The public sector continued to be the main source of health financing in all OECD countries in 2005 except Mexico, the United States, and Greece.

[9]Total U.S. health spending was 15.3 percent of GDP in 2005. The relative shares of public and private spending do not reflect government tax subsidies for private health care spending. In the United States, federal revenue losses due to health care-related tax preferences amounted to more than 1.5 percent of U.S. GDP in 2005. As a result, for the U.S., the private share is somewhat overstated and the public support understated. Health tax preferences also exist in some other countries, but information about these preferences is not readily available.

Figure 3: Spending on Health Care as a Percent of GDP for Selected High-Income Countries in 2005



Source: OECD Health Data 2007 database.

Notes:

Public expenditures include those incurred by public funds including state, regional and local government bodies and social security insurances. Private expenditures include out-of-pocket payments, payments by private insurances, charities and for occupational health care. For more information on OECD's methodology, see http://www.ecosante.org/OCDEENG/411000.html

The relative shares of public and private spending do not reflect government tax subsidies for private health care spending. In the United States, federal revenue losses due to health care-related tax preferences amounted to more than 1.5 percent of U.S. GDP in 2005. As a result, for the U.S., the private share is somewhat overstated and the public support understated. Health tax preferences also exist in some other countries, but information about these preferences is not readily available.

Data for Australia and Japan are from 2004. The United Kingdom uses a different methodology to collect their data. Data are not available for the Netherlands after 2002.

Health care cost containment is expected to continue to pose challenges in other countries as well as in the U.S. Projections developed by the Commission of the European Communities show that the management and control of health care spending will be a critical part of overall efforts in European Union (EU) countries to ensure progress towards more sustainable public finances. This is also true outside the EU. For example, in our recent study of accrual budgeting,[10] we found that Australia projects that health care spending will nearly double as a share of GDP by 2046-2047. Similarly, the United Kingdom projects that its health spending will increase from around 7 ½ percent of GDP in 2005-2006 to around 10 percent of GDP by 2055-2056. New Zealand projects a rise in the ratio of health spending to GDP of 6.6 percentage points between 2005 and 2050 resulting in health spending of about 12 percent of GDP.

Results in Brief

Since the 1980s, many OECD countries have enacted reforms to politically sensitive and popular entitlement programs such as public pensions, disability, unemployment, welfare (social assistance), and health care programs. Since the early 1990s, almost all of the 30 OECD countries have restructured their pension programs, with a clear trend toward reduced benefits. Disability benefit reform has also been widely undertaken, with changes made to reduce costs and achieve better integration of the disabled into society. Between 1985 and 2000, 14 OECD countries reduced disability benefits, with the Netherlands undertaking one of the largest reductions as well as policy changes to promote integration of the disabled. Reforms to unemployment programs, with an emphasis on cost containment, took place in several countries in the early 1990s. As in the U.S., growth in spending for public health programs in many counties continues to be a major concern despite efforts to constrain it. In some countries entitlement reform efforts addressed multiple programs simultaneously.

Several kinds of pressures have been cited as prompting entitlement reform efforts. Many reform efforts began or accelerated in an environment of economic and fiscal crisis. In the early 1990s, for example, the Swedish pension reform process took on urgency as Sweden experienced its worst recession since the 1930s. Long-term concerns about population aging and economic competitiveness in an age of globalization also have prompted reforms. Supranational factors, such as a desire to meet the fiscal criteria required for entry into the European Monetary Union, have also been cited as motivating reform.

[10] GAO, *Budget Issues: Accrual Budgeting Useful in Certain Areas but Does Not Provide Sufficient Information for Reporting on Our Nation's Longer-Term Fiscal Challenge*, GAO-08-206 (Washington, D.C.: Dec. 20, 2007).

Reform is difficult. Commissions can help, but they are a tool in a larger process, not a guarantee of reform success.

- Before reform can be enacted and implemented, policymakers and the public generally need a shared understanding of the size, scope, and nature of the problem. This understanding can emerge from the work of a commission, as it did in Sweden's pension reform; or from political leaders who define and communicate a problem, as in the Netherlands' disability reform.
- In the three case study reform efforts we reviewed, once reform was on the agenda proposals were developed by commissions—usually small—established by governments with a strong commitment to reform. Although composition and charters varied, leadership was important in these commissions. Standing commissions can also have a role in reform by coordinating stakeholders or by monitoring and providing consultations. Whether ad hoc or standing, commissions or other groups can take divisive and controversial issues out of the usual political process, facilitate the consultation and negotiation necessary for coalition building, and help insulate policymakers from political risks. Reform has also been undertaken without major efforts to build coalitions and reach consensus, but to a lesser extent.
- In the reforms we examined, the process did not proceed in a simple or straightforward manner. Reform processes were generally complex and often conflict-ridden before they ultimately succeeded in enacting legislation.
- Each country's reform process was unique, but some re-adjustment or fine-tuning often occurred over time. In some cases, unexpected challenges emerged as reforms were implemented that required adjustments including due to unintended consequences. In other changes new rounds of reform were enacted as the reform process became iterative.
- Given that there is uncertainty about the future, some reforms foresee that re-adjustment will be necessary and put in mechanisms to do this. Although assuming and structuring an iterative reform process may be politically necessary, this can undermine public trust in a program. Automatic mechanisms (or triggers) have been included in some recent pension reforms including those in Sweden and Germany. These mechanisms require benefit adjustments without policy changes under specified demographic or economic conditions.

Many Countries Have Reformed Entitlement Programs and Reform Efforts Continue

Since the 1980s, many OECD countries have enacted reforms to politically sensitive and popular entitlement programs such as public pensions, disability, unemployment, social welfare (social assistance) programs, and health care. Like the U.S., many other developed countries have experienced and expect to continue to experience a rate of cost growth in their public health programs that exceeds the growth rates of their economies. Unlike the United States, however, many other countries have made major changes to their public pension programs in the last two decades. (For a summary of selected reform efforts, see app. III.)

In the 1980s, some countries sought to address future financial shortfalls in their public pension programs by increasing contributions, but since the early 1990s many pension reform efforts have sought to reduce future public finance commitments. As shown in figure 2, spending on public pensions in some other developed countries is much larger than in the United States. Contribution rates are also higher. In the U.S., contribution rates for Social Security are 12.4 percent of taxable income. In Sweden and Germany, rates in 2006 were over 18 percent; in the Netherlands over 25 percent; and in Italy over 30 percent.[11] Governments have either undertaken far-reaching, structural pension reforms or adopted a series of smaller reforms which, taken together, affect future pension entitlements substantially. Although Sweden undertook a single major overhaul; more typically, several rounds of reform took place as in Italy, France, Germany, and Japan.

Since the early 1990s almost all the 30 OECD countries have made changes to restructure their public pension programs with a clear trend toward reduced benefit promises.[12] In 16 OECD countries that implemented significant reform in the last 10 years, OECD estimates that the benefit promise was reduced by 22 percent.[13] Italy, Sweden, France, Austria, Germany, and Japan reduced replacement rates for workers with average

[11]GAO, *Social Security Reform: Implications of Different Indexing Choices*, GAO-06-804 (Washington, D.C.: Sept. 14, 2006). It is important to note that the structure of public pension programs differs across countries, and hence may not be not strictly comparable. For example, contributions in some cases help finance maternity/paternity and unemployment benefits in addition to old age benefits.

[12]For more information, see OECD, *Pensions at a Glance: Public Policies Across OECD Countries* (OECD, 2007 edition). In our 2005 report, we noted that all OECD countries have made changes to their national pension systems, as did Chile. See GAO-06-126.

[13]For women the reduction was 25 percent.

earnings by at least 6 percent.[14] In assessing future fiscal risk of individual European Union member countries, a 2007 European Commission report cited pension reforms in Italy, Sweden, France, Austria, Denmark, and Germany as having contributed to increased sustainability of public finances.[15]

Efforts to reform pensions are continuing. For example, in France the current government is seeking changes including reductions to pension benefits for certain civil servants; reform of civil service pensions was previously attempted in 1995.[16] The U.K., which restructured its public pension program in the 1980s and has made numerous changes since then, has recently enacted a new major reform following the work of the Turner Commission.[17] Among other changes, this reform combines an increase in the retirement age with higher promised benefits to address an emerging problem of poverty among the elderly. This tension between reducing costs and the need to avoid increasing the number of elderly poor is reflected in the OECD's 2007 report on the status of pension reforms. This report noted that in some countries further reforms are needed to ensure fiscal sustainability while in others previous enacted reforms may have to be revisited given the risk of old-age poverty for low-income workers.

Non-pension social welfare programs have also been subject to change, with many reforms reducing benefits.[18] For example, in 14 of 20 OECD countries changes in disability policy between 1985 and 2000 included reductions in compensation, with the Netherlands undertaking the largest

[14] Gross replacement rate for male workers with average earnings. See table II.1.4 in OECD's 2007 *Pensions at a Glance*. For Sweden the estimated reduction was 17 percent; for Germany, 9 percent.

[15] See European Commission, Directorate-General for Economic and Financial Affairs, *Public Finances in EMU– 2007* (2007).

[16] See Giuliano Bonoli, *The Politics of Pension Reform: Institutions and Policy Change in Western Europe* (Cambridge: Cambridge University Press, 2000).

[17] In its 2007 assessment of the long-term sustainability of public finances in the U.K., the European Commission stated that the U.K.'s proposed reforms to pensions addressed the concern of potentially inadequate provision in the future by strengthening the incentives for private savings for retirement and by increasing provision of public pensions, thus involving a slightly higher increase in public pension expenditure than previously projected; the reform also incorporates a planned gradual increase in the statutory state pension age.

[18] For studies of recent reforms to European entitlement programs, see http://www.ces.fas.harvard.edu/conferences/bismarck/papers.html.

reductions.[19] The Netherlands also undertook the largest policy change with respect to increased integration of disabled people. More recent disability reforms in the Netherlands were cited as contributing to curbing long-term public spending in the European Commission's 2006 report assessing the sustainability of public finances.[20] Since the early 1990s, concerns about cost containment have played a role in reforms of unemployment programs in countries such as Canada, France (2001), and Germany (2003-2005).[21] Reforms of social assistance (welfare) programs were enacted in the Netherlands (2004). Efforts to reform other types of programs continue as well. For example, Sweden is seeking further reform of its sickness benefit, under which general tax revenue and employer and employee contributions pay employees for sick days.[22]

In some countries, reforms sought to make changes to related programs at the same time. For example, the Hartz reforms in Germany integrated unemployment and social assistance. In recent years the Netherlands has undertaken reform of unemployment, social assistance, and health care as well as disability. In Denmark a 2006 comprehensive reform package known as the "Welfare Agreement" included changes to unemployment policy, increases in the retirement age, and provisions for increased investment in education. The Danish government described the Welfare Agreement as part of a national reform strategy building on two decades of reforms and was based in part on the work of a 2003 expert commission.[23]

[19]See OECD, *Transforming Disability Into Ability: Policies to Promote Work and Income Security for Disabled People* (2003), Table 7.1.

[20]European Commission, Directorate-General for Economic and Financial Affairs, *European Economy: The Long-term Sustainability of Public Finance in The European Union* (2006).

[21]See Daniel Clegg, "Unemployment Policy Reform in 'Bismarckian' Welfare States: The Cases of Belgium, France, Germany and the Netherlands," paper prepared for the conference "A Long Goodbye to Bismarck? The Politics of Welfare Reforms in Continental Europe," Minda De Gunzburg Centre for European Studies, Harvard University, June 16 and 17, 2006.

[22]According to Swedish government officials, a negative correlation has existed in recent years between trends in unemployment and sickness receipt. Officials emphasized the importance of looking at the number of all those who are supported by government programs rather than being active in the labor force.

[23]See *Denmark's National Reform Programme: First Progress Report* (October 2006). The European Commission cited the Welfare Agreement in its 2007 assessment of Denmark as a country with low risk with respect to the long-term sustainability of its public finances.

In our 2003 report on strategies to increase labor force participation among older workers, we studied policies in three countries with high levels of older worker participation and recent reforms—Japan, Sweden, and the United Kingdom. All three countries had made changes to their pension systems. Sweden and the United Kingdom had also tightened eligibility requirements for disability insurance to reduce its use as a path to early retirement. Officials in these countries agreed on the need for comprehensive reforms, e.g., changes to national pension reforms should be accompanied by reforms in the employer-provided pension system, in related social insurance programs such as disability, and in labor market policies.[24]

OECD countries have made many reforms to their health care systems since the 1980s, and reform efforts continue.[25] For example, the Netherlands has recently restructured its health system with a stated aim of containing health care cost increases.[26] We found no country that has been able to optimize the multiple goals of cost containment, access, and quality over time. As has been noted by the Deputy Head of OECD's Health Division, the challenge for OECD countries today is how to ensure their health systems will be sustainable given population aging and a rate of health care cost growth faster than the economy.

As in the United States, structural reform of health systems is highly controversial, and the reform process may take time. The 2002 Rurup Commission in Germany was charged with developing recommendations

[24]GAO, *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, GAO-03-307 (Washington, D.C.: Feb. 13, 2003).

[25]According to an OECD official, reforms in OECD countries focused on cost containment in the 1980s; in the 1990s, concerns focused on obtaining value for spending. A 2003 report by the European Council, Committee on Social, Health, and Family Affairs noted that in the 1980s, health care reforms in Western European countries aimed at controlling spending; in the 1990s reforms were concerned with the quality of care and equity of access. For information on countries' health care systems and reforms, see the European Observatory on Health Systems and Policies, WHO European Centre for Health Policy, which publishes Health Systems in Transition (HiT) profiles. These are country-based reports that provide a detailed description of each health care system and of reform and policy initiatives in progress or under development. See http://www.euro.who.int/observatory/ctryinfo/ctryinfo. See also the International Network Health Policy and Reform, which monitors health policy trends and developments in 20 industrialized countries. See http://www.hpm.org/en/index.html.

[26]In 2006. For more information on entitlement reform in the Netherlands, see *The National Reform Programme for the Netherlands: 2005-2008*.

to ensure sustainability for the social insurance system including pensions, health care, and long-term care. Two opposing approaches for health care financing were discussed, but the Commission was unable to reach consensus on a proposal.[27] Reform of the Netherlands health care system in 2006 incorporated some elements similar to recommendations made by a commission that concluded its work almost 20 years earlier.

A Variety of Pressures Have Led to Entitlement Reform in Other Countries

Several kinds of pressures—economic and fiscal crisis, the demographic changes of population aging—have been cited as prompting entitlement reform efforts. In many countries reforms occurred in environments of economic and fiscal crisis. Long-term concerns about population aging and economic competitiveness are commonly cited as prompting reforms, especially of pension programs. Supranational factors such as a desire to meet the fiscal criteria needed for entry into the European Monetary Union have also been cited as constituting pressures for reform.

Many reform efforts began or accelerated in an environment of economic and fiscal crisis.[28] In the early 1990s, for example, the Swedish pension reform process took on urgency as Sweden was experiencing its worst recession since the 1930s, with growing public debt and a devaluation of its currency. A Parliamentary Working Group established by the government in 1991 developed the reform proposal that was ultimately enacted in 1998. Similarly, the 2002 reform effort of the German pension system was triggered by an economic downturn that worsened the program's financial condition and led to the establishment of the Rurup Commission. Although the Commission reached no consensus on health care and long-term care, the pension reforms it recommended were enacted in 2004 and 2007.[29] According to experts, pension reforms in Australia, Canada, Denmark, Finland, Italy, and New Zealand all took place in an environment of economic and fiscal crisis.

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[27]The commission was also unable to reach consensus on a proposal for long-term care.

[28]In the 1980s in some countries, including Canada, Japan and the U.K., pension reforms that reduced benefits and made changes to other entitlement programs took place in a context of deficit reduction efforts. See GAO, *Deficit Reduction: Experiences of Other Nations*, GAO/AIMD-95-30 (Washington, D.C.: Dec. 13, 1994).

[29]The 2002 Rurup Commission's recommendation for a "sustainability factor" was enacted in 2004 and its recommendation for increasing the retirement age was enacted in 2007.

Long-term pressures are also frequently cited as motivating reforms. Our 2005 report found that demographic as well as fiscal factors necessitated pension reform in many countries.[30] With rising longevity and declining birthrates, the number of workers for each retiree is falling in most developed countries, straining the finances of national pension programs, particularly where contributions from current workers fund payments to current beneficiaries. Population aging affects pension programs and projections directly. Swedish and German government officials attributed pension reforms primarily to concerns about the programs' long-term fiscal sustainability. Similarly, according to a Japanese government official, since 1994, projections of Japan's pension program's financial condition have necessitated a series of reforms largely due to further aging of society.[31]

Concerns about competitiveness in an era of globalization combined with current and future population aging are also cited as leading to entitlement reforms and influencing reform options.[32] In the 1980s some pension reforms raised payroll tax contribution rates, but in the 1990s a desire in some countries to keep non-wage labor costs as low as possible tilted options toward benefit reductions. For example, in Germany, avoiding higher payroll tax contribution rates was one concern in their 1990s reforms. Reforms that included benefit reductions and eligibility changes in pension and non-pension social welfare programs, e.g., disability and unemployment, sought to increase labor force participation rates as one response to competitiveness concerns. The European Commission has noted a need to increase employment rates, notably of older workers, as an issue of prime importance in EU countries. The Commission has further noted that in countries where a significant decrease in the benefit ratio, i.e., average pensions over GDP per worker, is projected, raising employment rates of older workers is especially important as this could reduce the risk of possibly inadequate pensions in the future.

[30]GAO-06-126.

[31]Tetsuo Kabe, "Japan's Public Pension Reforms," Urban Institute International Conference on Social Security Reform, February 24, 2006.

[32]One expert has described these concerns as creating an environment of "permanent austerity." See Paul Pierson, "Coping with Permanent Austerity: Welfare State Restructuring in Affluent Democracies" in *The New Politics of the Welfare State*, ed. Paul Pierson (Oxford: Oxford University Press, 2001).

Supranational factors are also said to have played a part in bringing about entitlement reforms. In some European countries, the desire of some countries to meet fiscal criteria for entry into the European Monetary Union (EMU)[33] has been cited as a factor leading to reforms. For example, Italy's 1992 pension reform was undertaken as the country sought to join the EMU. Entitlement reforms during the 1990s in countries such as Netherlands, France, and Germany have similarly linked to these countries' efforts to meet the fiscal criteria for EMU membership. More recently, the European Commission has encouraged its member countries to adapt their public programs including entitlements such as pensions and health care to be better able to cope with future economic challenges as part of the "Lisbon Strategy" to ensure growth and jobs.[34] Denmark's first progress report on its national reform program, developed as a contribution to the Lisbon Strategy, focuses on its 2006 Welfare Agreement.

Clearly, these various pressures are not mutually exclusive in Europe or elsewhere. For example, according to a Japanese government official, the 1985 pension reform in Japan was introduced as part of a broader fiscal reform in a context of the end of rapid economic growth, growing public debt, and the aging of society. Neither are the pressures sufficient explanations for why some countries enacted reform changes to increase program sustainability while others did not.[35] As a result, according to

[33]An important condition for successfully moving to a single European currency is that economies of the participating countries should converge towards each other and remain healthy. Members of the European Union are expected to avoid excessive budgetary deficits (i.e., above 3 percent) and to ensure their debt to GDP ratio stays within the reference value limit of 60 percent as specified in the Maastricht Treaty. The budgets of EMU countries are monitored annually by the European Commission for compliance with the targets and for the long-term sustainability of their public finances.

[34]Promulgated in 2000 and updated in 2005. The Netherlands' 2007 report on its National Reform Programme can be found at http://ec.europa.eu/growthandjobs/pdf/1206_annual_report_netherlands_en.pdf.

[35]Various explanations have been given of the relationships between prompts and actual reform. Some observers believe that severe economic or budgetary problems are a precondition for countries to undertake reform. Other observers and government officials have noted that an environment of economic or fiscal crisis may facilitate public acceptance and hence enactment of reforms. Conversely, one quantitative study of 57 developed and developing countries has shown that countries with a high public debt to GDP ratio are less likely to privatize their pension programs (at least when pension liabilities are low or moderate). The study attributes a lack of reform in these types of circumstances to an inability to finance the transitional costs associated with moving from a public pay-as-you-go system to a system of fully funded individual accounts.

OECD, some countries' pension systems continue to need a major overhaul.

How Reform Proposals Were Developed in Other Countries

Detailed reform proposals in other countries were generally developed by commissions or other specially established groups.[36] Proposal development, however, is only one stage in what is often a long, difficult, and conflict-ridden process.[37] Before reform can be enacted and implemented, policymakers and the public generally need to have a shared understanding of the size, scope, and nature of the problem. Next, reform options need to be developed, and reform packages that key stakeholders can support need to be negotiated. This stage generally involves dialogue, negotiation, and coalition building to reach a sufficient degree of consensus across political parties and groups in society. Special groups outside the normal political process such as commissions can be used to create a space where the difficult negotiations needed to reach consensus can take place. Such groups can mitigate political risk for reform participants as well as educate the public, creating pressure for change. Finally, a reform package needs to be enacted and implemented in succeeding years. Whatever the reform process, leadership is key at all stages for reform to be enacted and sustained. As one expert has put it,[38] for broad-ranging reform to occur, two conditions must exist: first, the public must believe that change is needed, and second, leadership must be able to transform this perception into an agenda that crystallizes the issues and points to their solution.

[36]According to OECD, most countries set up ad-hoc commissions when pension reform processes are being launched.

[37]On stages of reform, see Mitchell A. Orenstein, "How Politics and Institutions Affect Pension Reform in Three Postcommunist Countries" (Washington, D.C.: World Bank Policy Research Working Paper 2310, March 2000). Orenstein divides the reform process into three stages—commitment building, coalition building, and implementation. The commitment-building phase ends when the government creates a special office or working group with a clear mandate to develop and pursue a single type of pension reform. See also Sarah M. Brooks and R. Kent Weaver, "Lashed to the Mast?: The Politics of Notional Defined Contribution Pension Reforms" (Boston: Center for Retirement Research, January 2005).

[38]See Val Koromzay, "Some Reflections on the Political Economy of Reform," Paper presented at the Conference on Economic Reforms for Europe: Growth Opportunities in an Enlarged European Union. Bratislava, Slovakia, March 18, 2004.

Stage 1 of Reform: Framing the Problem

In reform efforts we examined, various events and actions helped define the size and scope of the problem. In Sweden a commission helped to put pension reform on the agenda. A large and diverse commission worked from 1984 to 1990 without being able to reach consensus on a proposal, but its analyses are credited with having laid the groundwork for later reform, raising public awareness of the problem and leading policymakers to conclude that major structural change was needed. (For more information on the Swedish pension reform, see app. IV.)

It has been noted that the timing of reform depends on political leadership—in the first instance leadership to make clear that there is a crisis. In the Netherlands' long and difficult disability reform process, actions by political leaders defined the problem and communicated its urgency. (For more information on the Netherlands' disability reform, see app. V.)

- **The Netherlands disability reform: the "1 million" measure.** In the early 1990s, government efforts to reform the disability program in the Netherlands and reduce benefits had met with considerable political opposition. Then-Prime Minister Lubbers made a speech in which he declared that if the number of disability claimants exceeded 1 million, he would resign. Analysts, including some who participated in later reform efforts, cited this measure as having re-framed the public discussion about disability. Although this number was never reached, the "1 million" number became a widely accepted symbol of the need for reform in both expert studies and public discussion. This continued to be the case as the number of disability claimants rose and fell throughout the 1990s and into the early 2000s.[39]
- **Netherlands disability reform: televised hearings by the Buurmeijer Parliamentary Commission led to a change in the conversation about disability.** In the mid 1990s, the Buurmeijer Commission, a special parliamentary inquiry chaired by Social Democrat Flip Buurmeijer, investigated the administration[40] of disability by employers and employee groups. According to experts, this kind of

[39]See Sanneke Kuipers, *The Crisis Imperative: Crisis Rhetoric and Welfare State Reform in Belgium and the Netherlands in the Early 1990s* (Amsterdam: Amsterdam University Press, 2006).

[40]The Commission's charter was to investigate the administration of social insurance programs including unemployment.

parliamentary inquiry is rare and considered significant in Dutch politics.[41] The work of the Commission took many months and received widespread public attention through nightly televised hearings. According to experts, this Commission's work had profound effects on the subsequent reform process. The Commission's recommendations influenced later legislation; in the public discussion they raised issues as to whether the program was meeting its goal of serving the truly needy. Ultimately, the reform process in the Netherlands became a conversation about the appropriate roles and responsibilities of government, employers, and employees in society.

- **In Germany Chancellor Schroeder developed a reform agenda he termed "Agenda 2010" that was aimed at modernizing the German social insurance system and labor market.** The Schroeder government established numerous commissions as part of this effort, including the Hartz Commission on unemployment program reform and the Rurup Commission on the sustainable financing of the social insurance system. (For more information on the German pension reform, see app. VI.)

Stage 2: Proposal Development

In the three case study reform efforts we reviewed, once reform was on the agenda, proposals were developed by commissions established by governments with a strong commitment to reform. Commissions served as a venue for negotiation and compromise leading to a reform package. Commissions that developed proposals were generally small, but their composition varied, as did their charters. Within the commissions, leadership was also important. Negotiated behind closed doors, reform packages were presented publicly prior to legislative enactment and sometimes changed following participation in the reform process by other stakeholders. According to OECD, most countries set up ad-hoc commissions when pension reform processes are being launched.

- **Swedish 1991 Parliamentary Working Group**.[42] In Sweden, a small parliamentary working group developed the reform package. This group was chaired by a minister of the center-right government then in power, who had participated in the earlier commission. The group's small size and limitation to political leaders were unusual, as was the exclusion of representatives from employer groups and labor unions. The major parties were represented. In contrast to the earlier 1984 commission, which had been tasked with making program changes within the existing framework, the 1991 group had a broad charter for reform. Between 1991 and 1994, the

[41] Inquiries of this type are customarily used to investigate alleged fraud and abuse or scandal.

[42] Pension reform in Spain also involved the use of a parliamentary working group.

group negotiated the outlines of a major structural pension reform, keeping deliberations within the group.[43] This outline became the basis of legislation enacted in 1998.

- **The 2001 Donner Commission.** In the Netherlands, the Donner Commission crafted a disability reform package that included a recommendation for major structural change. Established by a Minister following many reform changes in the 1990s, the Commission was composed of respected public figures from major parties who were able to negotiate for those parties. Members were not currently active in national politics and not identified with the disability issue. The commission developed a reform proposal in meetings closed to the public and made use of an expert staff. Observers attribute the enactment of reform to the leadership of both the Minister who established the commission and guided its proposal through the legislative process and the Commission chair, Piet Donner.
- **The 2002 Rurup Commission**. This German commission was chartered with developing proposals to make the public pension system, the health care system, and the long-term care social insurance sustainable. The Commission was established by the Social Democratic government of Chancellor Gerhard Schroeder as a means to garner support for reform from both within his party and outside.[44] The Commission was large (26 members), but broke into smaller sub-groups to address the three programs. While it was unable to reach consensus on health care and long-term care, the commission did make recommendations for pension reform. Led by experts, the pension sub-group worked closely with the Commission chair, Bert Rurup, an academic identified with the Social Democratic Party then in power. The Commission's recommendation for a "sustainability factor" in the pension system was enacted in 2004 by the Social Democrats; its recommendation to raise the retirement age was enacted in 2007 by a coalition of Christian Democrats and Social Democrats.

In some reforms, the process of negotiation and proposal development continued after the commission had concluded its work. For example, the Donner Commission's disability reform proposal was reviewed by an

[43]From 1994 to 1998 a second parliamentary group worked out the details of the reform. Following the 1994 elections, in which the Social Democratic party took the majority, the second working group was chaired by a Social Democrat who had played a key role in developing the reform concept put forward by the first working group.

[44]Chancellor Schroeder also established other reform commissions including one on unemployment, the Hartz Commission.

institution representing employer groups, labor unions, and the government. This review, a routine feature in the Dutch legislative process, led to further changes before legislation was enacted.[45] Similarly, according to the Danish government, the 2006 Welfare Agreement was based not only on the recommendations of the Danish Welfare Commission but also on the work of two other groups, the Danish Globalisation Council and a tripartite council of employer, employee (e.g., labor unions), and government representatives.

Although all three case study countries used ad hoc commissions, commissions involved in a reform process can also be standing institutions. Japan used Pension Councils coordinated by a government ministry and composed of representatives of employers' groups, labor unions, academic researchers, and government officials to facilitate pension reforms during the 1990s.[46] Other countries also have standing commissions.[47] Whether ad hoc or standing, commissions or other specially established groups are commonly used to develop reform specifics because they can take divisive and controversial issues out of the usual political process, facilitate consultation and negotiation, and help to insulate policymakers from political risks inherent in supporting a reform package.

Although commissions are a frequently used means to develop proposals, governments have also taken other approaches. In some countries the government developed reforms on a unilateral basis, i.e., without seeking consensus through participation by opposition parties or other stakeholders. Sometimes such efforts succeeded in creating changes; in other cases, they did not. The 1980s pension reform in the U.K. was enacted despite opposition and sustained over time with numerous adjustments.[48] However in France a unilateral approach did not lead to

[45]The Commission had recommended abolishing the benefit for partial disability; the enacted proposal created retained a benefit for partial disability but made this a separate program.

[46]See GAO-03-307.

[47]In France a permanent government commission created in 2000 was tasked with monitoring the retirement system and making recommendations for change based on consultation. This group is composed of members of Parliament, representatives of employer and employee groups, and government officials. According to one expert this council established the concept for the 2003 pension reform.

[48]Some observers have attributed this to the U.K. form of parliamentary government, which provides few hurdles to the exercise of power by a strong majority government.

legislative enactment. A 1995 civil service pension reform effort met with sufficient opposition that it was not enacted. The same thing happened with a 1994 pension reform effort in Italy, which led to a change in government.[49] In other cases, the public was involved in the reform process. Canada's 1997 pension reform included public consultations that highlighted consensus principles for reform. In Japan's 2000 reform, reform alternatives were presented to the public in the early stages of discussion. Indeed, a 2000 study noted that a process involving consultation, negotiation, and public education has been used for pension reform in highly industrialized countries in recent years.[50]

The Process of Reform Is Complex and Not Sequential

In reforms we examined, the reform process as it unfolded did not proceed in a simple or straightforward manner from problem definition to negotiation and consensus-building to enactment. Rather, the reform process at some points seemed more like a zigzag or "two steps forward, one step back" than a straight line.

- An important provision of the 1997/1999 pension reform by the Christian Democrats in Germany was revoked by the successor Social Democratic government. This same government subsequently undertook a structural reform in 2001 and in 2002 established the Rurup Commission to address unexpected shortfalls in pension financing.
- In Sweden, following the work of the 1991 group, a second Parliamentary Working Group worked out legislative details of the reform between 1994 and 1998 while leaders of the Social Democratic party worked to persuade opponents within their party on the need for and contours of reform.

Similarly, the activities of consultation, negotiation, and public education may occur at several points in the process, with commissions performing multiple roles. For example, the Danish Welfare Commission both developed recommendations used in the legislative process and educated the public about the need for change. The 2002 Rurup Commission's recommendation to raise the retirement age is said to have led to a controversial public debate, with this change enacted in 2007.

[49] In both cases, subsequent governments returned to the issue and continued to seek reforms.

[50] *Social Dialogue and Pension Reform*, ed. Emmanuel Reynaud (Geneva: ILO, 2000). This 2000 study noted that in contrast to other countries studied (Sweden, Germany, Japan, Italy, and Spain), the will to seek consensus on pension reform was weak in the United Kingdom.

Reform is difficult. Commissions can help, but they are a tool in a larger process, not a guarantee of reform success. For reform changes to be enacted and sustained, a sufficient degree of consensus across the major parties and acceptance by the general public of the need for change must be achieved. Leadership is needed to bring this about. In Sweden and Germany, formal and informal cross-party cooperation was key in moving reform forward; in the Netherlands, disability reforms were enacted by various coalition governments. Consultation took place with key stakeholders either formally or informally.[51] As experts have noted, the tension is to build a broad coalition to assure the permanency of the reform, while preserving the main policy initiatives sought in the reform process.[52]

The Reform Process May Continue Following Enactment of Legislation

Each country's reform process was unique, but some re-adjustment or fine-tuning often occurred over time. In some cases adjustments were needed to address emerging implementation challenges. In other cases change included new rounds of reform as the reform process became iterative. In recent pension reforms, a trend has emerged toward including automatic mechanisms, or triggers, which aim at insulating reforms from policy change. These types of mechanisms are structured to reduce benefits without legislative action under specified circumstances, e.g., if demographic or economic trends prove unexpectedly unfavorable.

As reforms are implemented, unexpected challenges may emerge that call for fine-tuning or other adjustments including due to unintended consequences.

- In Sweden, following the implementation of pension reform, changes to individual account administration have been under discussion. Since account inception, the number of Swedes making active investment choices has dropped, with more people routing their money into the government default option. A government committee has recommended limiting investment options from over 700 accounts to around 200, and

[51] In Orenstein's view, tradeoffs exist across phases of reform in terms of who should be included in the process of proposal development. In his view, the smaller the number of key actors involved in design of reform at the commitment-building phase, the faster and more radical the reform. However, excluding key actors at the commitment-building phase (including those who have the political capacity to hobble or prevent reform) may cause them to mobilize effectively against reform in later phases.

[52] See Brooks and Weaver.

converting the default fund into a fund that adjusts based on an individual's age. To date, no changes have been enacted.

- In the Netherlands, one of the disability reforms sought to provide employers with incentives to limit the number of their employees claiming disability. However, some experts said that in response employers began to seek ways to identify prospective employees who posed a risk of becoming sick or disabled. Legislation was then passed preventing health screenings in the hiring process.
- The United Kingdom experienced substantial difficulties in the 1980s when it implemented its pension reform, in part, by providing too little public education and relying on its already existing regulatory system, which proved to be inadequate. In what has become known as the 'mis-selling' controversy, high-pressure sales tactics were used to persuade individuals, especially older workers, to take up individual accounts when they would more likely have been better off retaining their occupation-based pensions.

As we noted in our report on other countries' pension reforms,[53] the extent to which new provisions are implemented, administered, and explained to the public may affect the outcome of the reform.

In some cases the need to revisit is anticipated and initial legislation provides for some form of periodic re-visiting under specified circumstances. For example, Germany and Japan established "soft" triggers as part of their pension reforms. The 2001 German reform included a requirement that if projections did not meet specified thresholds for maximum expected contribution rates or minimum replacement rates in the future, government action would need to be taken. Triggered in 2002, this mechanism led to the establishment of the Rurup Commission. A similar mechanism in Japan requiring an examination every 5 years of its pension program's sustainability led to additional rounds of reform.[54] Other countries also have established institutions to monitor pension fiscal sustainability and in some cases are tasked with recommending adjustments as appropriate.

[53]GAO-06-126.

[54]Other countries also have similar mechanisms. Canadian pension reform includes a re-visiting under specified circumstances as evaluated by their Chief Actuary. According to one expert, Canada's mechanism is not expected to be triggered. In France, an advisory council was created in 2000 to monitor the French retirement system and to put forward recommendations for public policy concerning retirement. The council includes members of Parliament, representatives of employer and employee groups, experts, and representatives of the state.

Reform processes can be described as one-time “big bang” reforms as in Sweden; more commonly, reforms are iterative as in the Netherlands disability reform or German pension reform. In our work on other countries’ pension reforms, we noted that, in almost every country we studied, debate continued about alternatives for additional reform measures even after initial changes were enacted. It is clearly not a process that ends with one reform, and it often requires more than one type of reform. An iterative process can be understood as reflecting the difficulties posed by reform of popular and politically sensitive programs.

Some have pointed out that frequent changes may have a downside. Some officials we spoke with noted that although an iterative process may be politically necessary, constant re-opening of issues is not ideal. In some cases where several rounds of reforms occurred, frequent changes to pension systems created public mistrust. For example, in Japan noncompliance with the system became an issue in the public debate in the early 2000s following a series of pension reforms driven by rapid population aging. Swedish officials said that achieving a consensus on a reform that would be politically sustainable was one reason that the reform process took so long.

Because reform is so difficult, a major goal is to have a reform that will last. Given that there is uncertainty about the future, some pension reforms include mechanisms to reduce benefits (and in some cases also increase revenues) without intervention by policymakers. In 2001 as part of its reform changes Sweden enacted an automatic balancing mechanism to adjust benefits if other reform changes prove insufficient to keep the pension program in fiscal balance.[55] The automatic balance mechanism is a kind of “hard trigger” that comes into play under specified circumstances.[56] Following Sweden’s lead, several other countries have adopted similar types of mechanisms, and these mechanisms are considered an emerging trend in pension reform.[57] Germany’s 2004 pension reform included a

[55]Sweden’s reform also included a notional defined contribution (NDC) system for its pay-as-you-go defined benefit pension. This system automatically adjusts initial benefits to changes in longevity. Other countries including Italy have also adopted NDC systems as part of reform.

[56]See our discussion of “hard” and “soft” triggers in *Mandatory Spending: Using Budget Triggers to Constrain Growth*, GAO-06-276 (Washington, D.C.: Jan. 31, 2006).

[57]See Rudolph G. Penner and C. Eugene Steuerle, *Stabilizing Future Fiscal Policy: It’s Time to Pull the Trigger* (Washington, D. C.: The Urban Institute, Aug. 2007).

"sustainability factor" as recommended by the Rurup Commission. The sustainability factor automatically adjusts benefits based on the number of workers to beneficiaries. Pension reforms in Japan, Italy,[58] Canada and other countries have also included automatic adjustment mechanisms. An aim of this type of mechanism is to insulate reforms from future legislative changes, thereby increasing trust in program sustainability and compliance with the system. In addition, experts have noted that such mechanisms could mitigate political risk for policymakers in the event reductions are triggered.

The effects of such mechanisms generally remain to be seen.[59] In Japan, a mechanism adopted in 2004 to limit increases in contribution rates has been triggered. According to one expert, the result has been accepted by the public following a painful public debate.

Experts have expressed differing views concerning these types of mechanisms as used in pension reforms. Some have expressed the view that automatic mechanisms may be the best approach to slowing cost growth in the entitlement programs driving the long-term fiscal challenge. Others have noted that mechanisms could be subject to erosion should they be triggered and the required benefit reductions prove politically unacceptable.[60] Those who support the concept of automatic mechanisms note that in this event legislators always have the option of suspending the mechanism and are unlikely to raise benefits above the levels that would

[58]Italy has established a body tasked with monitoring pension finances and making the calculations that determine the notional defined contribution adjustment; the government and others have to agree on the adjustment.

[59]One expert has noted that a shift to price-indexation of initial pension benefits in the U.K. reform of the 1980s was the first use of an automatic mechanism to adjust benefits. Over time this mechanism reduced benefits such that elderly poverty became an issue in the United Kingdom. Recent reforms include a modification to the 1980s formula. See Richard Jackson, "The 'State of the Art' in Entitlement Reform: Lessons from Abroad," *Facing Facts Quarterly*, Vol. II, No. 1 (Washington, D.C.: Concord Coalition, Winter 2006). Jackson describes the U.K. change as a "blunt instrument" in comparison with recent NDC systems.

[60]Brooks and Weaver have expressed the view that NDC-based reforms are likely to work best in countries that have the political capacity to achieve and sustain broad political agreement and the administrative capacity to produce independent forecasts of economic and demographic trends and complete and accurate records of earnings, as well as the capacity to ensure compliance and adequate understanding on the part of employers and employees. NDC-based reforms are less likely to work well where these capacities are lacking.

have been the case had the mechanism never been activated. In any case, triggers may make it more difficult to ignore that a problem exists.[61]

Implications for the United States

The experiences of other countries suggest that while reform is difficult, it is also possible. Countries more advanced in population aging and facing greater demographic challenges than ours have undertaken reforms of major entitlement programs. In many countries, reform occurred despite political processes that made it difficult. Consensus had to be built in coalition governments, and leaders had to work across parties to achieve a broad consensus for reform. Nonetheless, politically sensitive and popular programs such as public pensions were reformed including those which were (and are) more generous to individuals and constituted a larger share of their economy than is the case in the U.S.

The experiences of other countries also underline that for reform to be enacted and sustained, it needs broad-based support that reaches across parties and groups. In the U.S. this means that reform will need to be done on a broad bipartisan basis. For reform to be sustained, a broad public consensus must be reached on the need for reform.

Other countries' reform processes show that at all points in the process leadership will be needed to create and sustain consensus. In other countries leaders undertook many actions to begin the reform process and move it forward to enactment and implementation. Leaders framed the problem in new ways, persuaded the public and other policymakers that reform was necessary and urgent, established commissions to develop reform packages, and worked to build coalitions to support reform. Throughout the process, leaders had to negotiate tensions between the need to build broad coalitions while maintaining reform goals. In the U.S., presidential leadership will be key if reform is to happen.

As in the 1983 reform of Social Security, other countries' experiences show that commissions can be a useful tool. Commissions in other

[61]In 1983, a "hard" trigger was added to Social Security. Under current law, Social Security benefits for the elderly and disabled are updated annually by the change in inflation as measured by the Consumer Price Index. Should the trust fund ratio of payable benefits to reserves fall below a specified level, however, the annual update is to be the lower of price or wage change. The "triggering" trust fund percentage was 15 percent through 1988 and 20 percent for 1989 and later (42 U.S.C. §415(i)). To date, trust fund ratios have remained above the threshold.

countries moved reform forward by educating the public and also provided a forum for developing reform packages. Commissions we studied often met out of the public eye, thereby facilitating discussions and negotiations that could then be supported by all those involved. Establishing a commission, however, does not guarantee that a reform package that can gain consensus will be developed. While commissions can help, they are not a substitute for leadership or political will.

Other countries' experiences show that for reform to occur, certain elements must fall into place. For reform to occur and be sustained, the public and policymakers in other countries were ultimately persuaded that reform was necessary and urgent. Coalitions were built to support reform, and a package that could gain support and a broad consensus was negotiated and enacted. For reforms to be enacted and be sustained by future governments, the involvement of major stakeholders whose support was necessary for the success of the reform was needed, whether through membership in the commission or through some other means. How this happened differed from country to country—each country's process was unique. Taken as a whole, reform processes were generally complex and often conflict-ridden before they ultimately succeeded in enacting legislation.

One conclusion is that it is hard to know—before legislation is actually enacted—how close any given process is to reaching its culmination. In the U.S., past commissions and other public discussions on entitlement reform have laid groundwork for reform even while appearing to "fail," e.g., no reform was enacted. For Social Security reform in this country, options have been developed, and policymakers have had the opportunity to learn from past initiatives that did not gain consensus. Public debate has been ongoing for some time, with considerable and growing public awareness that Social Security and Medicare are unsustainable. While no one can know what needs to happen next, given leadership committed to reform, it is possible that our reform process could be further along than it may seem.

We are sending copies of this report to interested parties. Copies will also be made available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov. This report was done under the direction of Susan J. Irving, Director of Federal Budget Analysis, Strategic Issues, who may be reached at (202) 512-9142 if you have any questions about this report. Contact points for our Offices of Congressional Relations or Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed on appendix VII.

David M. Walker
Comptroller General of the United States

Appendix I: Scope and Methodology

To develop criteria for "major entitlement reforms" and to select case studies and reform efforts for further review, we conducted a literature review and consulted with experts.

We reviewed GAO reports on other countries' entitlement reforms for pension programs, labor market reforms, and disability reforms; OECD reports on pension reforms, disability reforms, and long-term care reforms; the WHO Health Care in Transition country profiles; International Monetary Fund country profiles and studies of health care reforms by the International Network Health Policy & Reform, which monitors health policy trends and developments in 20 industrialized countries. We reviewed materials from a 2007 OECD conference of budget officials from several OECD countries involved in budgeting for entitlement programs and concerned about the future cost implications of these programs.

- We reviewed papers from a 2006 conference on entitlement reforms and reform process in European countries including reforms to pensions, unemployment, and health care programs.
- We analyzed OECD information on pension reforms to identify countries that had made the largest reductions in benefit promises. We reviewed the 2005/06 and 2007 sustainability assessments made by the European Commission of EU for the sustainability of public finances in those countries, focusing on countries where risk assessments indicated that entitlement reforms had improved sustainability.
- We consulted with the staff responsible for the GAO reports on international entitlement reform and with OECD officials responsible for pension reform and health care. We also consulted with an OECD official who had convened a conference on budgeting for entitlement reforms and with an academic expert on budgeting and public policy.

Although OECD countries have made many reforms to their health care systems since the 1980s, and reform efforts continue, we found no country that has been able to optimize the multiple goals of cost containment, access, and quality over time. Some countries have already undertaken national pension reform efforts to address demographic changes similar to those occurring in the United States, and in a previously issued report we drew lessons from their experiences.

Based on these reviews and consultations we narrowed our focus to highly developed, relatively affluent OECD countries on the grounds that these countries were more likely to have similar types of political pressures to the U.S., but even more daunting long-term challenges and demographic changes. We further limited our review to reforms enacted within the last

10 years that had aimed at slowing cost growth and increasing fiscal sustainability. Finally, we selected the following reform efforts for further review: pension reform in Sweden, Germany, Japan, Italy, France, U.K., and Canada; disability reform in the Netherlands; and reform of social programs in Denmark.

To understand how reform proposals were developed and to understand the dynamics of entitlement reform, we reviewed political science literature on reform process in various countries including theoretical studies of the stages of reform. We also reviewed studies from experts including researchers at the Center for Strategic & International Studies (CSIS), the Urban Institute, the International Labour Office (ILO), and the Center for Retirement Research.

To analyze how reform proposals were developed and to supplement our analysis of the other objectives, we selected three reform efforts for more in-depth review. In selecting reform efforts we took into account information from the literature review and recommendations by the experts we consulted. We selected reform efforts representing a range of approaches to reform process including whether any mechanisms for revisiting changes or triggers were built into the reform. Each of the reform efforts selected had included one or more commissions or other specially established groups.

- Sweden's pension reform was an example of a major reform that has been sustained without further structural change following a long process.
- Germany's pension reform was an example of an iterative process over an extended period of time and also an example of a process that included a trigger requiring actions under specified circumstances in its reforms.
- The Netherlands' disability reform was an example of an iterative process of reform of a non-pension program and as an example of entitlement reform in a country that has undertaken reform of multiple entitlements in recent years.

In these countries we interviewed government officials knowledgeable about the reform process, at least one commission participant or commission staffer, and independent experts.

We did not evaluate the effect of reforms on beneficiaries or on program effectiveness. Consideration of any entitlement reform process should not be taken to imply approval of the specifics of any given reform. We limited our review to documents available in English.

Appendix II: Summary of Selected U.S. Commissions

	Greenspan Social Security 1983	Kerrey-Danforth Bipartisan Commission on Entitlement and Tax Reform 1994	Breaux-Thomas Commission on the Future of Medicare 1998	Bush Committee to Strengthen Social Security 2001	9/11 Commission 2002	Mack-Breaux Tax Reform 2005
Statutory basis?	No; Executive order but agreement by the Congress	No; Executive order	Yes; Balanced Budget Act 1997	No; Executive order	Yes; Pub. L. No.107-306	No; Executive order
Imminent crisis or other action-forcing event?	Yes	No	No	No	Yes	No
Presidential leadership and commitment to success of effort?	Yes	No	No; President strongly disagreed with proposed recommendations	Yes	Partial	No
Within the general charter was scope broad or restricted (and how)?	Broad	Broad; entitlement spending and tax reform	Broad	Restricted; had to include individual accounts	Broad	Restricted; required revenue neutrality and keeping incentives for homeownership and charitable giving, and encouraging savings; required to consider equity and simplicity too
Number of commissioners (No. of current elected federal officials / No. of others)	15 (7/8); 4 Senators, 3 House Representatives, 8 non-elected (included 2 former Members of Congress; also insurance, labor, business representatives)	32 (22/10)	17 (9/8)	16 (0/16); Included 3 former Members of Congress	10 (0/10)	9 (0/9); Chair and Vice-Chair were former Senators; 1 former House Representative on panel; also included 4 professors and 2 “tax practitioners”

	Greenspan Social Security 1983	Kerrey-Danforth Bipartisan Commission on Entitlement and Tax Reform 1994	Breaux-Thomas Commission on the Future of Medicare 1998	Bush Committee to Strengthen Social Security 2001	9/11 Commission 2002	Mack-Breaux Tax Reform 2005
Appointments by both President and Congress?	Yes; 5 by President, 5 by Senate, and 5 by House	No; presidential appointments only	Yes; 1 of 17 (Chair) by both President and Congress; 4 others by President; others by congressional leadership (Republicans appointed 4 each house and Democrats 2 each house) = 8 by each party	No; presidential appointments only	Yes; 1 by President (Chair); 1 by Senate Minority Leader with House Minority Leader consult (Vice-Chair); 2 ea. by Senate Majority Leader and House Speaker; 2 each by Senate and House Minority Leaders	No; presidential appointments only
Bipartisan?	Yes	Yes; of the 22 Members of Congress, 11 Democrats and 11 Republicans	Yes	Yes; 8 Republicans and 8 Democrats	Yes	Yes
Co-chairs?	No	Yes, functionally; technically Chair and Vice-Chair	Yes, functionally; technically Breaux = Chair; Thomas = "Administrative Chair"	Yes	Yes, functionally; technically Chair and Vice-Chair	Yes
Open/transparent process including public hearings?	Yes; but found way to do smaller conversations	Yes; all meetings and hearings were televised on C-SPAN. All commission documents, transcripts and reports made public on a CD.	Yes	Yes	Yes	Yes
Commission resulted in report?	Yes	Yes; failed to reach consensus on specific recommendations	No; proposed recommendations failed to gain required 11 votes	Yes	Yes	Yes
(month, year issued)	(Jan. 1983)	(Jan. 1995)		(Dec. 2001)	(July 2004)	(Nov. 2005)

	Greenspan Social Security 1983	Kerrey-Danforth Bipartisan Commission on Entitlement and Tax Reform 1994	Breaux-Thomas Commission on the Future of Medicare 1998	Bush Committee to Strengthen Social Security 2001	9/11 Commission 2002	Mack-Breaux Tax Reform 2005
Report set forth specific, actionable recommendations?	Yes	No; but recommended 5 broad principles for crafting “solutions to our fiscal problems”	N/A	Report set forth 3 reform models	Yes	Yes
Under establishment of Commission was action required by the President or Congress? Or were there other action-forcing provisions?	No	No	No	No	No; recommended actions to both but not required	No; recommended actions to President but not required
Did President / Congress take required action or some other responsive action?	Yes	No	N/A	No	Yes – many were enacted	No
Other relevant information		Interim report widely respected; source for much of what is said today	Outlook for Medicare appeared to improve while Commission met	Limit on scope and conditions for membership perceived as having negative impact on acceptance of analyses—even those not related to specific individual account issue; Democrats appointed not viewed as representative of party point of view		Commission viewed report as starting point for congressional consideration of tax reform; no action yet

Source: GAO analysis.

Appendix III: Summary of Selected Reform Efforts

	Sweden	Japan	Germany
Most recent reform	Pension reform: Passed in 1994, details passed in 1998; implemented in 1999; automatic stabilizer in 2001.	Pension reform: 2004.	Pension reform: 2004. Retirement age: 2007.
Pressure(s) for reform	Aging population; predictions that the system was unsustainable in the mid-1980s; a recession in the early 1990s.	Population aging; statutory requirements for periodic monitoring.	Population aging; high non-wage labor costs; economic downturn.
Reform history	Process that led to reform began in 1984.	Beginning in 1985, pensions have been reformed multiple times due to population aging and lower economic growth rates with the goal of achieving fiscal sustainability.	Incremental reforms began to be implemented in 1992 under the Kohl government.
Commission(s) or other institutional prompts	Swedish government appointed a commission to study pension system in 1984, which met through 1990; a parliamentary working group met from 1991 to 1994 to create legislation; another parliamentary group focusing on implementation details met from 1994 to 1998.	National Pension Council: a standing government commission.	German government appointed a commission in 2002 following an economic downturn and financial crisis in the public pension system—and a 2001 law required the government to take action when projections were unfavorable.

Netherlands	Canada	United Kingdom	Italy	France
Disability reform: 2005.	Pension reform: 1998.	Pension reform: 2007.	Pension reform: 2004.	Pension reform: 2003.
High number of beneficiaries; population aging.	Primarily financial pressures: • declining economic conditions. • declining demographic conditions. • increase in disability benefit use. • benefit increases from the 1970s; also, in 1993, pension assets were not enough to pay benefits (benefits funded by collecting provinces' debt to pension plan).	Growing levels of pensioner poverty.	Population aging; economic crisis in early 1990s; meeting Maastricht criteria for entry into European Monetary Union.	Deficit in the pension system and unfavorable projections for the future solvency of the system.
Many reforms and changes to the system since the 1980s.	Pension reform in Canada is difficult, and thus uncommon, because it requires consent from the provinces.	Pension system changes had been common in the UK and have been seen as unilaterally driven by government in power; recent reform included public outreach.	Reform efforts began in 1992 and continued through the decade. These efforts were met with controversy, including strikes and protests.	Reform of public pensions in 1993 stemmed from discussions in the mid-1980s. Attempt at reform of civil service pensions in 1995 was met with strikes and ultimately failed. 2003 reform is seen as the beginning of a series of reforms.
Parliamentary committee investigated disability administration in 1993 leading to greater public awareness; the government appointed a commission in 2000; its recommendations were deliberated by a standing body with representatives from government, employers, and employee groups; reform passed in 2005	No commission or special group was used. Reform was based upon negotiations with Ministry of Finance and provincial ministers along with information collected from town hall meetings.	An independent government commission.	Italy has a standing commission to monitor expenditures. This commission is not seen as having prompted 2004 reform.	Pension Advisory Council was created in 2000. This is a standing body.

	Sweden	Japan	Germany
Composition of commission/ special group(s)	1984 commission included experts, political party representatives, unions, business organizations, and government officials. The 1991 group had 8 members representing the parties in power; 6 of them were Parliament Members. The 1994 group had 8 members from the parties that agreed to the reform; 4 were current Parliament Members, 1 was a former Member.	Government assessment begins with pension experts from Ministry of Health and Welfare. They consult with National Pension Council (which includes business groups, trade unions, and pension experts) along with political parties.	Pension reform was handled by a subset of 26-member commission; this commission included academic experts, officials from lower levels of government, employer and union representatives.
Parameters of commission/ study group	1984 commission was tasked with examining the challenges of the old system, and making recommendations within the old system's framework. The 1991 group was tasked with creating legislative proposals for a system that is fiscally and politically sustainable in the long term.	Standing commission required to provide input to Ministry of Health and Welfare's assessment of financial outlook every 5 years and assist in developing reforms if necessary	The Rurup Commission was tasked to make recommendations on ways to achieve sustainability in the pension system, within the parameters established in 2001—payroll tax at no more than 20% up to 2020 and no more than 22% to 2030; replacement at no less than 67% of average net earnings.

Netherlands	Canada	United Kingdom	Italy	France
1993 committee: Members of Parliament from multiple parties. 2000 commission: Five representatives of large political parties (not from parliament), one independent expert, and one civil servant.	N/A	Three members and a small secretariat. One member from private sector, one from unions, one academic expert.	Not applicable for this reform.	Includes representation from government, labor, business, and elderly interest groups.
Goal of recent reform was to decrease share of population receiving disability—to increase size of labor force.	N/A	Commission charged with looking at level of pensions, level of pension savings, level of other savings among pensioners, and to make recommendations based upon these findings; commission produced three reports.	Not applicable for this reform.	Purpose of council is to monitor French retirement and put forth recommendations based upon negotiations with involved partners.

Source: GAO.

Appendix IV: Pension Reform in Sweden

Reform Overview: Significance of the Reform

Sweden's pension reform, a complete overhaul enacted in 1998, restructured a pension system that was the hallmark of the Swedish social welfare system and a result of political conflict in the 1950s. The reform's novelty is evident in its employment of a notional defined contribution approach to the pay-as-you-go benefit component and an automatic balance mechanism.[1] In addition to the substantive reform, the process that facilitated the changes is also noteworthy, namely the lengthy period of deliberations that ultimately reconciled disparate interests and gathered strong support in Parliament.

As a result of the reforms, Sweden's pension system changed from a traditional pay-as-you-go defined benefit plan, like the U.S. Social Security program, to a system where participants' benefits are more closely related to their contributions.[2] Like its predecessor, the new system uses pay-as-you-go financing; however, the former benefit scheme was replaced with notional and individual accounts whose balances are based primarily on work-related contributions, and a guaranteed minimum pension for low-income individuals (see table 1).[3] Credits for child care, education, military service, and sickness also contribute to an individual's pension rights. The system relies on a reserve fund for financing during periods of economic or demographic changes that cause increased pension liabilities.[4] If liabilities exceed the reserve fund, a balancing mechanism will temporarily adjust indexation of benefits and interest rates on the notional accounts, thus preventing contribution rate increases.

[1]Although the balance mechanism was mentioned in the 1998 reform legislation, it was not formalized until additional legislation was passed in 2001. Pay-as-you-go pension systems use contributions from current workers to fund current beneficiaries.

[2]For further discussion of the programmatic changes to Sweden's pension system, see GAO, *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, GAO-03-307 (Washington, D.C.: Feb. 13, 2003).

[3]Notional accounts hold contributions and investment earnings, but exist only on the books of the managing institution. At retirement, the accumulated notional capital in each account is converted to a stream of pension payments using a formula based on factors such as life expectancy at retirement.

[4]The fund is the difference between contributions and expenditures in the pension system. The fund can include investments in any capital market instrument that is quoted and marketable, but the fund is subject to several restrictions on the allocation of the investments. From 1999 to 2001, the fund was used to help ease the transition to the new system. In the future, the fund will help finance pensions for baby boomers.

Table 1: Sweden's Public Pension System, Pre- and Post-Reform

	Pre-reform	Current system
Benefits and Structure	• Flat rate universal benefit, established in 1913. • Earnings-related benefit, established in 1960. Payouts calculated based on an individual's 15 highest earning years. Supplements were available for low-income individuals.	• Notional accounts — payouts that are based on credits from payroll contributions and credits from eligible nonwork periods. • Mandatory individual accounts. • Guaranteed minimum benefit for low-income individuals.
Financing	• Approximately 19 percent payroll tax on employers. • General tax revenue supported the universal benefit.	• Employers and employees pay equally into an 18.5 percent tax on earnings; 16 percent goes to notional accounts, and 2.5 percent goes to individual accounts. • General tax revenue supports the guaranteed minimum benefit and nonwork credits for notional accounts.

Source: GAO analysis.

Note: Employees only pay on earnings up to the pension ceiling, while employers pay on all earnings.

Origins of Reform

By the mid-1980s, the actuarial predictions showed that the old system was financially unsustainable. Accordingly, Swedes were losing faith in the system. Demographic changes, increased longevity and an aging population soon eligible for benefits, threatened to strain the system. In 1980, 21.9 percent of Swedes were age 60 or older, compared with 15.6 percent in the U.S.

Other considerations also played a role in reform. The benefit formula had an "inequitable and unsystematic relationship" between benefits and contributions according to one government official, implying that decreased work did not necessarily mean reduced benefits. Furthermore, the income ceiling for benefits was indexed to consumer prices, meaning that as more people earned wages above the ceiling, the earnings-related benefit would eventually become a flat rate.

Even before the reform effort of the 1990s, the contributory pension system had been a focus for political conflict. The system, which was enacted by a Social Democrat Parliament in 1960, was only gradually accepted by non-Socialist parties.[5] After an oil crisis in 1979, the non-Socialist Parliament unilaterally attempted to remove energy prices from the pension benefit indexation formula. The effort failed and the Social Democrats campaigned on the issue and regained control of Parliament in 1982. Once in power, the Social Democrats changed the index formula but

[5]Social Democrats are a left-of-center party generally aligned with the interests of labor.

did not initiate other reforms, causing non-Socialists to believe the Social Democrats abandoned their reform intentions.

The Reform Process

In 1984 the Social Democratic government appointed a pension committee tasked with examining the challenges of the system, and proposing reforms within the existing framework.[6] The committee's membership was typical of a Swedish Parliamentary commission: it was large and included representatives from political parties, unions, employers, experts, and government. The committee's deliberations lasted six years, culminating in a report that proposed changes to survivors' pensions, but not an overall reform (see fig. 4). According to one expert, the report said the financial problems would not peak until about 2010-2015 and therefore reform was not an immediate need.

By the early 1990s, Sweden experienced its most serious recession since the 1930s, marked by an increased deficit, high unemployment, near failure of several major banks, and a devaluation of the currency. Starting in 1990, Sweden's budget surplus became a deficit, leading to a dramatic escalation in government debt. The recession served as the final spur for pension reform, making the issue a high priority in 1991 for the newly elected center-right coalition in Parliament, who appointed a working group on pensions.

This group was tasked with producing proposals for a new pension system that would be financially solvent and broadly supported. Unlike the 1984 committee, the working group was small, consisting of two Social Democrats and a representative from each of the six other parties in Parliament at the time; everyone but the chairman and one of the working group members were Members of Parliament.[7] The small size of the group was the result of a decision by the chairman, who also wrote the group's directives. The chairman was the Minister of Social Affairs at the time, and a former member of the 1984 committee. According to a government official, it is unusual for a minister to chair a working group, but it showed the importance of the reform. The exclusion of interest groups such as labor unions was justified by the work of the 1984 committee, who laid the

[6] One academic expert told us he believed the Social Democrats tried to "bury" the issue in the committee.

[7] Although seven parties were represented, five parties constituted an "inner circle" that negotiated the substantial reform elements, and later were the supporters of the reform.

reform's foundation by highlighting financial problems, leaving reform negotiations to the politicians, according to an expert. Despite their lack of direct participation, interest groups had close ties to the parties and participated in occasional meetings of special groups known as reference groups.

Prior to negotiating specific compromises, the working group came to an agreement on broad principles, according to a group member. To prevent the endless introduction of new debates, members agreed to reach consensus before they consulted with nonmembers. An expert and a working group member described the members as "social engineers" who possessed the leadership, knowledge, and personal dynamics necessary to produce legislation. During negotiations, both the majority coalition and the Social Democrat opposition adjusted their preferred reform models in exchange for preservation of their overall goals. For example, the Social Democrats agreed to incorporate individual accounts into the system—an inclusion important to conservatives—but Social Democrats advanced their views by insisting that the accounts be kept to a relatively small portion, 2.5 percent, of benefits. The strength of the Social Democrats as the opposition party permitted responsibility for legislative outcomes to be diffused between both the majority and the opposition, according to an academic expert; each party could cite the other as the force necessitating unpopular concessions. The deliberations resulted in a consensus and a proposal outlining principles for reform.

A majority of Parliament —five parties representing about 85 percent of the electorate—passed the principles in 1994 just prior to an election. However, the legislation did not contain specific legal provisions and therefore only served as a guide for future legislation. Due to the relatively early agreement on the reform principles and small size of the group, the opportunity for interest groups and politicians to muster strong opposition or support was limited, according to a working group member. Reform debates were not public, a condition that prompted some criticism of the process.

To formulate the details of the reform, a second working group, composed of representatives from the five parties who supported the reform, convened later that year following the return of the Social Democrats to a majority in Parliament.[8] As with the 1991 working group, there was little

[8] The implementation group was chaired by a Social Democrat who was instrumental in developing the reform proposal in the 1991 group.

public discussion of the 1994 group's deliberations. During this period, however, Social Democrat leaders faced opposition to the reforms within their party, as some members believed the reforms veered too far from the existing system the Social Democrats created. Party officials had to persuade members to support the reforms, holding lengthy discussions. Additionally, it took time to work with the Ministry of Finance, which did not have a direct role in the proposal's formation. During these negotiations, Sweden's National Insurance Board—the government agency responsible for administering pensions at the time—began preparing for implementing the reforms. In June 1998, Parliament passed the finalized legislation. One group member told us that it was significant that the bulk of the reform was accomplished all at once. Unlike incremental reforms, one set of changes helps to reduce the public's uncertainty and ensure the trust and security that is vital for social insurance schemes, according to one expert. To introduce the reforms to the public, the government launched a three year information campaign, which included media outreach and mailings of individual benefit projections. Payments under the new system began with retirees born after 1937, who receive benefits from both the old and new systems.[9]

Post-Reform Implementation and Adjustments

Although the bulk of the reform was enacted in 1998, the government faced challenges with implementation and ensuring the political insulation and fiscal stability of the system. Because the new system is still influenced by demographics, it was necessary to introduce an automatic balancing mechanism to assure the system's stability, a part of the system discussed in the 1990s, but not enacted until technical details were resolved in legislation passed in 2001. The mechanism was intended to help protect the system from political recalibration during system imbalances by automatically activating when necessary and therefore minimizing intervention from Parliament.

The Swedish government also sought to refine the administration of individual accounts. A committee was established in 2004 to evaluate program guidance, clarity of investment options, system costs, and the possibility of including life annuities in addition to the unit-linked funds already being offered. The committee report showed that the number of

[9] Individuals born between 1938 and 1953 will receive adjusted benefits from both systems, and individuals born after 1954 will receive pensions based completely on the new system. Individuals born before 1938 receive benefits based on the old system.

Swedes making active investment choices has dropped since the accounts' inception, with more people routing their money into the default option offered by the government. In addition to proposing steps to reduce administrative costs, the committee recommended limiting investment options from over 700 accounts to around 200, and converting the default fund into a fund that adjusts based on an individual's age. To date, the government has not implemented any changes.[10]

Legacy of the Reform

The reforms enacted in Sweden highlight the importance of coupling universally acknowledged problem definitions with knowledgeable leadership in order to pass reform. Specifically, the analysis performed by the 1984 pension committee, a large group with broad membership, set the stage for the legislative negotiations in the 1990s, according to an expert. Economic conditions and eroded confidence in the old pension system helped activate those deliberations in the 1990s. The 1991 working group, which had the necessary social engineering skills and knowledge, used the projections of program fiscal unsustainability to craft a major structural reform that was agreeable to a strong majority of Parliament. Although also a criticism, the autonomy of the 1991 working group and its small size decreased the potential opportunities for derailing the legislation and helped build consensus across party lines, according to one expert.

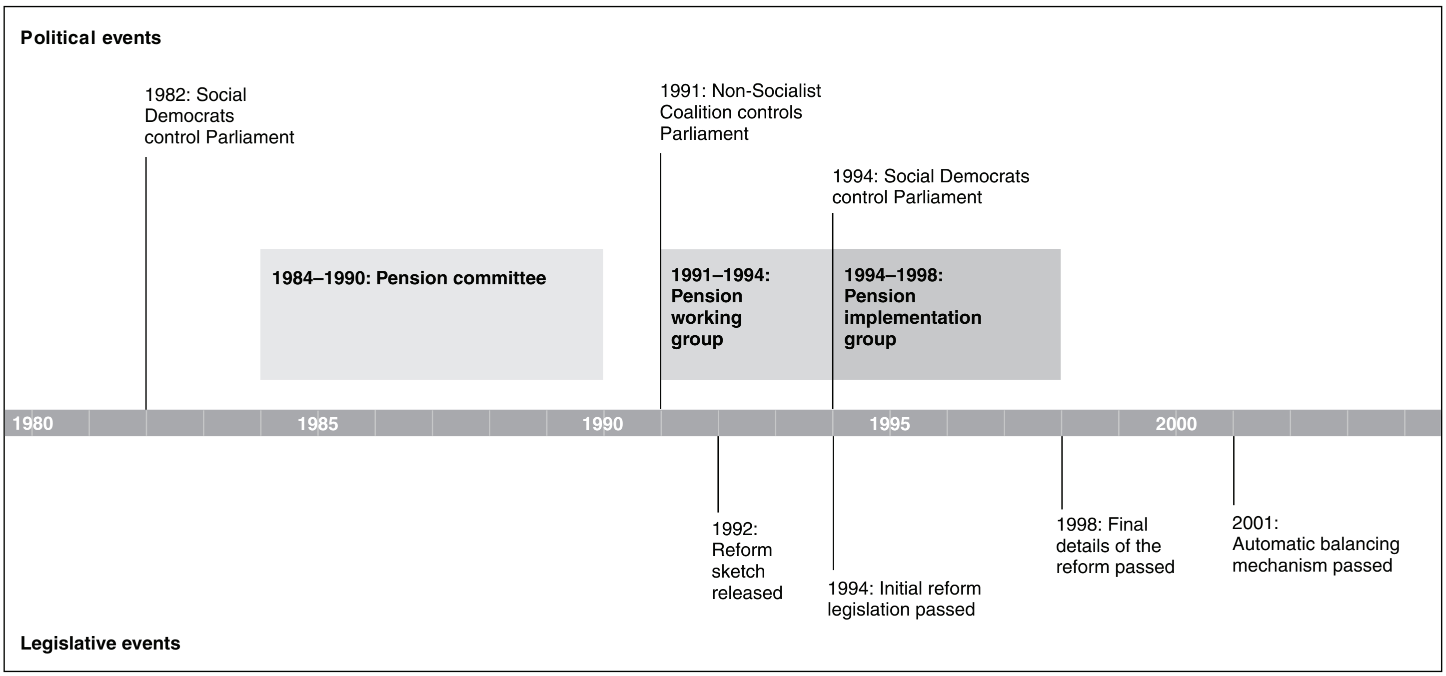
The result of the two decade and multi tier process was a complete reconstruction of the pension system, designed with the aim of insulating it from the temptation of constant political fine-tuning. As the reforms are gradually phased in, the Swedish public's true grasp and support of the changes remains to be seen. Government survey data from the early 2000s suggests the public's understanding of the reform is not high, despite outreach efforts.[11] Although some criticism exists of the reform, officials and experts believe it has public support and will be sustained. Another government official stated that people who currently oppose the system tend to base their opinions on politics and not because of lost benefits. One result of the reform, according to a government official and member

[10] In the fall of 2006, after the committee released its report in 2005, Sweden's government changed from Social Democrat control, to a center-right coalition government.

[11] According to an official from Sweden's National Insurance Board, about 3 percent of Swedes report their knowledge of the pension system as "very good," and about one-third say their knowledge is "good" while about 50 percent reports that their knowledge is poor and 10 percent that their knowledge is very poor.

of the working group, is that young Swedes who previously had no confidence in the system now believe they will receive a small pension. The complete impact of the reforms and any potential need for reexamination will be more evident as the phase-in of the system is more complete and baby boomers begin collecting benefits.

Figure 4: Key Events in Sweden's Pension Reform, 1982 through 2001



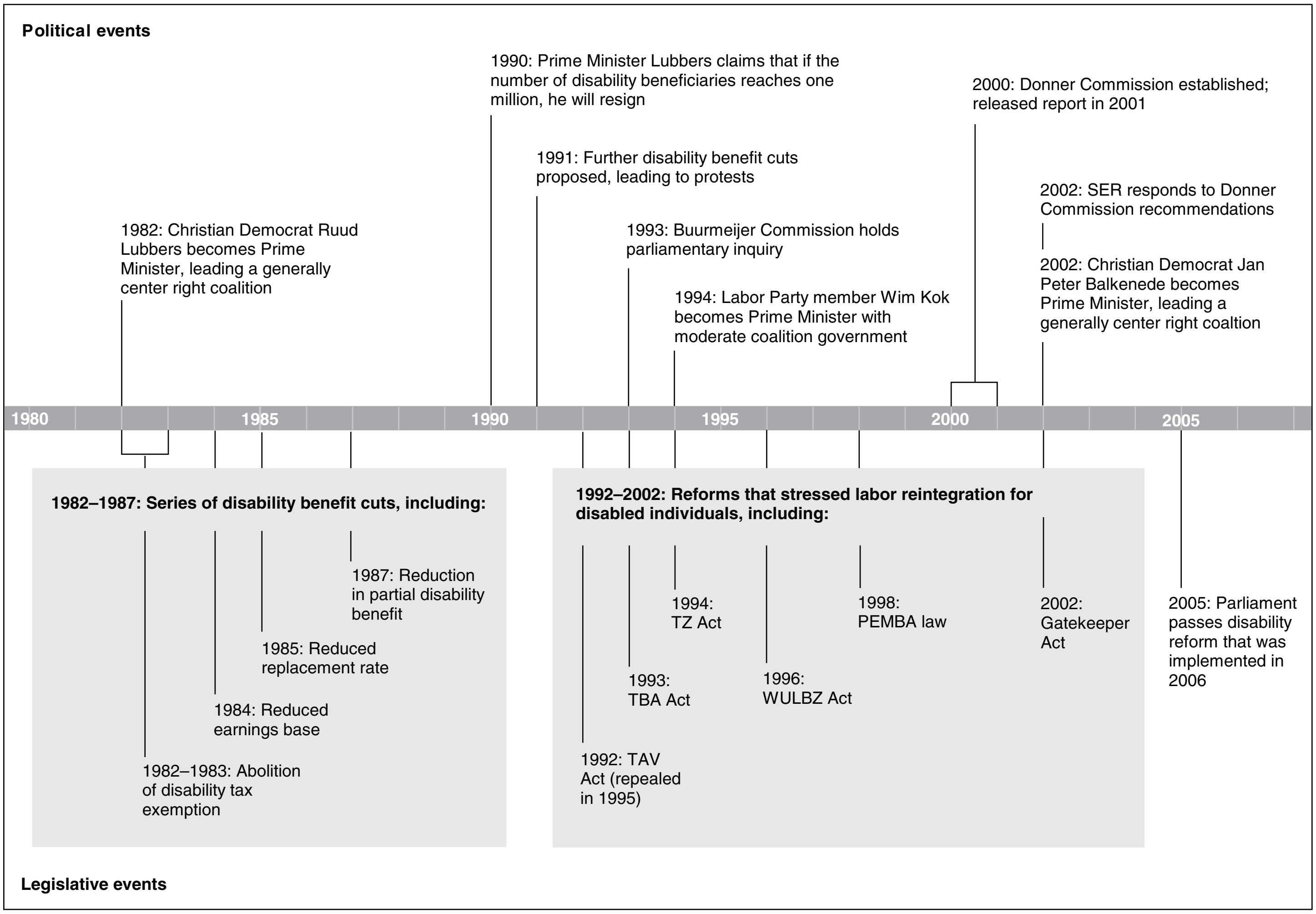
Source: GAO analysis.

Appendix V: Disability Reform in the Netherlands

Reform Overview: Significance of the Reform

Since 1967, the disability program in the Netherlands has had a broad definition of "disability" that included partial disability benefits. This broad definition opened the disability system to high levels of use. For most of the 1980s, 1990s and the first half of this decade, the proportion of the labor force on long-term disability was over 10 percent. Because there was broad support for the program and disabled individuals in general, reforming the disability system was politically difficult. The disability program had been a source of national pride for the Netherlands, referred to as the "crown jewel" of its social programs. After multiple attempts at reforming the system, a structural reform of the program was implemented in 2006 that is seen as significant by government officials and experts. The process leading to the reform was long and difficult, requiring many attempts at reform and a shift in public perception of the disability program. Figure 5 illustrates the key events that occurred in this reform process.

Figure 5: Key Events in the Netherlands Disability Reform Process



Source: GAO analysis.

Disability in the Netherlands Differs from that in the United States

The Netherlands disability system differs significantly from disability programs in the United States and other countries. The disability program in the Netherlands differs from Disability Insurance (DI) in the United States in the following ways:

- **The Netherlands provides a "partial disability" benefit.** Individuals in the Netherlands can claim a benefit if one is "partially" disabled, meaning that those who can still work and those who are still working can receive benefits if working at a reduced capacity.[1] Partial disability is rated on a percentage basis; before 2006, beneficiaries had to be at least 15 percent disabled to receive the benefit. No partial disability benefit exists in the United States. In the United States, for a person to receive DI benefits, the impairment must be of such severity that not only is the person unable to do previous work but, considering his or her age, education, and work experience, is unable to do any other kind of substantial work that exists in the national economy.

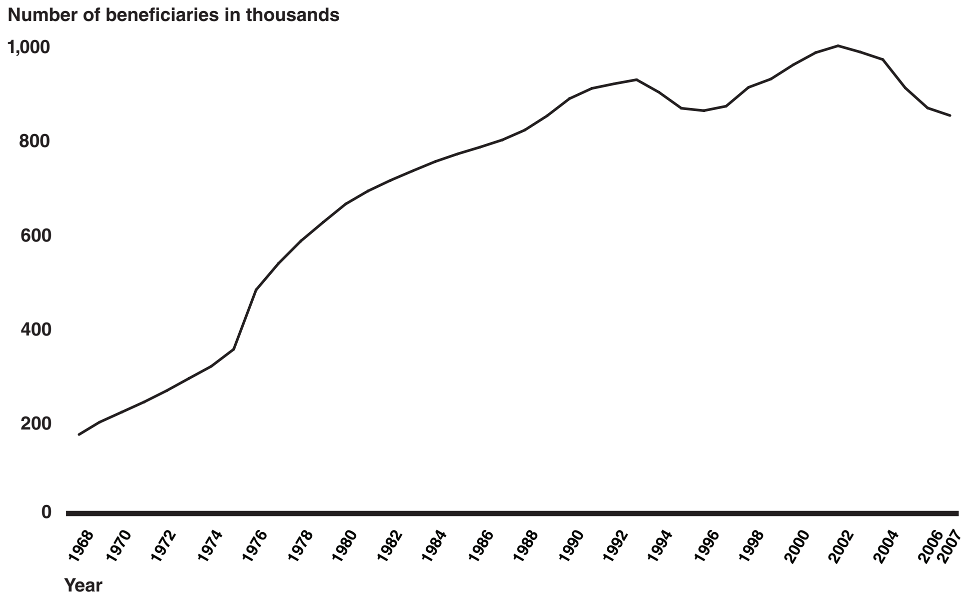
- **There is virtually no waiting period for receiving benefits in the Netherlands.**
  While a claimant in the Netherlands does not qualify for the disability program at first, he or she immediately qualifies for benefits under employer financed "sickness insurance" for up to 2 years. In the United States, one must have or expect to have a disabling condition for at least 1 year and there is a mandated 5 month waiting period before receiving benefits.

- **The disability program was originally administered by employer and labor groups in the Netherlands until the mid-1990s.**
  In contrast, U.S. disability benefits are administered by the government.

Figure 6 shows the number of disability beneficiaries for each year since the beginning of the disability program. Over this time, the number of beneficiaries has generally increased. In the 1990s after a period of decreasing beneficiaries, the number once again went up.

[1]This benefit is less than the benefit one would receive if one qualified for full disability benefits.

Figure 6: Disability Beneficiaries in the Netherlands: 1968 through 2007



Source: GAO analysis of data from the Netherlands Ministry of Social Affairs and Employment.

Origins and History of Reform

Number of those receiving disability increased in the 1980s and remained high despite benefit reductions

Following a recession in the late 1970s, the Netherlands had an increased rate of unemployment. Individuals—if they qualified—started to claim disability benefits instead of unemployment benefits because disability provided a more desirable benefit. For some, the benefit facilitated early retirement. As the economy improved, however, similarly high levels of disability beneficiaries continued. The government believed that this was too costly and, if similar levels of disability receipt continued, costs would continue to rise.

Reform of the disability system began in the 1980s and early efforts focused on reducing disability benefits to reduce costs. These reforms included ending tax exemptions for the disabled, a 10 percent reduction in the disability benefit's replacement rate, and a decrease in the earnings base (which is used to calculate disability benefits). While the amount paid for individual benefits decreased, government data show that the number of beneficiaries increased in this decade.

Policy reform in 1990s focused on return-to-work measures as public perceptions of the program changed

The number of people on disability continued to be high during the 1990s, with studies showing that the disability system was used as an option for early retirement and unemployment ("stress" was also cited as a reason for receiving disability benefits). Concerns about the effect of population aging also created pressure for change, as this could lead to even more use of the disability program.

A change in policy reform from benefit reductions to return-to-work provisions was accompanied by political events that helped to change public perception of the disability system and made the public more amenable to reform.

In 1990, Prime Minister Ruud Lubbers (a Christian Democrat who served as Prime Minister from 1982 through 1994) stated that the Netherlands was "sick" and threatened to resign if the number of those in the disability program in the Netherlands reached 1 million. Experts agreed that 1million was an arbitrary number, but it became an accepted measure of the need for reform. While this threshold was never surpassed, his statement generated public interest and concern over the disability program, and the "1 million" measure continued to shape discussion of the program past Prime Minister Lubbers' tenure. Throughout the 1990s and beyond, experts noted that whenever the number on disability approached 1 million, public discussion of the disability system increased.

In 1991, major retrenchments of the disability program were proposed by the governing coalition, a combination of the center-right Christian Democratic party and the center-left Social Democratic party. These proposals were met with disfavor, leading to large protests. According to experts, the governing coalition was threatened with a loss of power and did not follow through with the proposed reforms. One expert said that this series of events was the catalyst for a shift in focus on the part of the government to reforming the administration of the disability system instead of a further reduction in benefits.

In 1993, a special parliamentary commission known as the Buurmeijer Commission had an impact on public perceptions of the disability program. The Buurmeijer Commission was a parliamentary group that held hearings on social insurance programs[2] including the disability program. The chair was Flip Buurmeijer, a Social Democratic member of Parliament. The commission led to policy recommendations, but experts say that its most important legacy was informing the public and changing its perception of the disability system. The hearings exposed fraud and abuse in the disability program and showed the public how both employer and employee interests benefited from misuse of the disability benefit. One expert said that the commission identified this moral hazard, which convinced the public that change was needed.

The commission had several features that experts said gave it the power to change public opinion. First, parliamentary commissions are a rarity in Dutch government, used primarily to investigate scandals and thus significant attention was paid to the disability hearings. Second, the hearings were broadcast on national television and viewed by many, creating public awareness of fraud in the disability system.

Following the Buurmeijer Commission, reforms were implemented to address the disability system's problems. Several laws were passed in the 1990s containing provisions that aimed at returning disabled employees to the labor force. Examples of these included: laws mandating that employers pay the employee for an initial period of time;[3] incentives for employers to retain and recruit disabled workers; and requiring reintegration plans for disabled individuals to be submitted to a government organization.

However, experts said in most cases, reforms resulted in only limited effects on new disability cases. Some of the laws during this period had unintended consequences. One example given by an expert is a law that intended to provide incentives to employers to limit the number of employees that claimed disability while employed with them. As a result, employers began to screen potential employees and, according to experts, would not hire those who posed a risk of becoming sick or disabled. In response, the government enacted a law that prevented employers from performing health screenings for new employees. Other disability reforms that proved controversial or problematic were repealed. Some laws did

[2] The Buurmeijer Commission also looked at unemployment benefits.

[3] This is part of the sickness insurance. Subsequent legislation increased the period of time that the employer paid.

have more lasting effects, including a 1998 PEMBA law, which indexed employers' contributions to the disability system based on their risk.[4]

Structural Reform Implemented in 2006, Prompted by the Donner Commission

In 2000, the Minister of Social Affairs and the Minister of Interior Affairs of the moderate governing coalition established a commission chaired by Piet Hein Donner, a member of the Council of State.[5] This commission (known as the "Donner Commission") was the starting point for the most recent reform, which was enacted in 2005 and implemented in 2006.

According to one expert who was involved with the Donner Commission, the commission was formed in an environment of political stalemate. Parties in the coalition government could not agree on a path for reform. Unions and employer groups were unsatisfied with progress on reform and they were considering developing a proposal. As the number of beneficiaries approached 1 million, the Minister of Social Affairs believed that forming a commission would produce meaningful reform that could break through the stalemate and the influence of unions and employers on disability policy.

The Donner Commission was a small group that included members of each of the principal parties. Five of the seven members represented the five largest political parties in the Dutch government at the time, although—with the exception of Donner—the members did not hold national political offices. The sixth was an academic expert and the seventh was a civil servant who acted as a government liaison. In addition, there was a three person secretariat that produced reports and proposals for discussion by the commission. According to an expert familiar with the commission, the members were able to negotiate the reform package for their respective parties. The meetings of the commission were closed to the public. The commission drafted a report which included a set of recommendations, the primary one being an elimination of the partial disability benefit. The recommendations received much attention from the media once they were made public.

[4]"PEMBA," when translated to English, stands for "Act on Premium differentiation and market-competition in the disability insurances."

[5]The Council of State is a constitutionally established advisory body to the government, which advises the Cabinet before laws are submitted to Parliament. Its membership includes members of the royal family and appointed members from various backgrounds including military, political, and business.

Experts and government officials noted several reasons why the Donner Commission was successful at designing a reform that was adopted and appears to be effective. One expert said that the Donner Commission was formed in part because the "normal" political channels would be unable to reach an agreement on disability reform due to the controversy surrounding it. The commission also built consensus among different political parties; the fact that the commission had members from multiple parties also made the recommendations more difficult to ignore, according to one expert.

Following the issuance of the Donner Commission's recommendations, the government asked that the Social and Economic Council (SER) provide comments on the proposals. The SER is a standing body that includes equal representation from labor, employers' groups, and government-appointed members that represent the public interests. The SER comments, either when requested by the government or by choice, on social and economic policy. In March 2002, the group issued its response to the Donner Commission's recommendations, unanimously recommending maintaining a partial disability benefit. According to an expert, vetting the recommendations through the SER brought about consensus because there was input to the reform from interests outside the government.

In July 2002, the center-right Balkenende government came to power. One expert noted that the Minister of Social Affairs was committed to disability reform. However, in October 2002, another round of elections occurred, necessitating a delay in enactment of disability reform. The reform was considered by Parliament in an environment of fiscal crisis, as the Netherlands was in a recession. Government officials said that these fiscal issues were not the drivers of reform, but that the environment of fiscal crisis made reform of the disability program more politically feasible.

Legislation was passed in 2005 and implemented in 2006 that contained elements of recommendations from both the Donner Commission and the SER. Experts said that the recent reform has had an initial impact of reducing the number of those on the disability program.

This reform removed the partial disability benefit from the disability program and created a separate system for those on partial disability. In addition to establishing the separate partial disability system, reforms occurring in the same period:

- increased the threshold to claim partial disability from 15 percent disabled to 35 percent disabled;
- increased the benefit for those who were totally and permanently disabled from 70 percent of predisability wage to 75 percent of predisability wage; and
- mandated medical reassessment for those under age 50 receiving disability benefits.

While it is not possible to cite the exact impact of the 2006 disability reform, there has been a decrease in the number of people in the disability program along with a reduction in the number of new beneficiaries. The Netherlands government data show that the total number on disability dropped from 963,800 in 2004 to 845,000 in 2007. The data also show that inflow into the disability program has decreased in this period, from 74,800 in 2004 to 56,000 in 2007.

Expectations: The Future of Reform

Experts said that there were pressures to soften the reform, although they disagreed as to whether there would be significant changes. According to government representatives, the Parliament is examining possible changes in the future to the benefit for those under age 18 who are covered by the program, due to recent increases in use of the program by this age group. In addition, a longitudinal study is currently underway that seeks to determine what happens to workers who claim a disability over time under the new policy. Of particular interest to the authors is whether changes in the disability policy make it more likely for individuals to apply for other social programs, such as unemployment or welfare.

Appendix VI: Pension Reform in Germany

Reform Overview: Significance of the Reforms

In Germany, as elsewhere in Europe, population aging and the accompanying increase in the number of retirees relative to workers have financially strained the pay-as-you-go (PAYGO) defined-benefit public pension program. For this reason, policymakers have reformed the pension program over the last 15 years, first by introducing measures that made it less generous while preserving the basic structure of the system in 1992 and 1999, then by changing its structure in 2001. The monolithic PAYGO pension program then became a multipillar one with the addition of supplementary pension schemes—specifically, fully funded private and occupational schemes. Further changes in 2004 and 2007 sought to put the pension system on a financially sustainable path.

The reforms occurred incrementally as in the majority of countries around the world, but were significant in the sense that, taken together, they considerably transformed the world's oldest defined-benefit public pension program, according to experts. The reforms were initiated by the Christian Democratic Party/Christian Social Union (CDU/CSU) but continued when the Social Democratic Party (SPD) came to power in the late 1990s, as well as when a "Grand Coalition" brought the two parties together in government in 2005. The reforms took place in diverse political environments that were sometimes consensual, sometimes more adversarial.

Origins and History of the Reforms

By the mid-1980s, long-term demographic projections showed that the public pension system would be financially unsustainable unless contribution rates were increased dramatically, or benefits cut substantially, according to an expert. The government of Chancellor Helmut Kohl introduced reforms in 1989— which became effective in 1992—under favorable economic conditions. Experts generally view these reforms as consensual, with the main opposition party—the SPD—and the governing CDU/CSU party agreeing on the measures. Changes included indexing benefits to net wages instead of gross wages, which effectively decreased benefits because higher contributions and taxes reduced net wages relative to gross wages; increasing the normal retirement age from 63 to 65; and actuarially adjusting pensions, reducing incentives for early retirement, so those opting to receive benefits before 65 would face permanent reductions.

However, the German reunification of 1989 made it clear that these reforms would not be sufficient to make the pension system financially sustainable for the next two decades, as expected. The unification brought a large number of new claimants from the former East Germany into the pension system, quickly putting pressure on its budget, according to government officials. Also, high contribution rates and the associated increase in nonwage labor costs became big issues in the mid-1990s following the economic recession of 1992-93. The political debate after 1995 emphasized pressures from globalization and European monetary integration. In particular, it focused attention on how high contribution rates would hinder Germany's competitiveness in the global economy and prevent job creation.

New reforms passed in 1997—becoming law in 1999—but were politically contentious. The federal elections in 1998 increased partisanship as the reelection prospects of Chancellor Kohl, who had been in power since 1982, became uncertain, according to an expert. The reform provisions included gradually bringing women's and unemployed individuals' normal retirement age in line with men's at 65. However, in the charged political climate, the Social Democrats and labor unions opposed, and subsequently reversed, the introduction of a demographic factor that would have reduced the replacement rate of pensions.

The failure to reduce nonwage labor costs provided momentum for further reforms once the SPD came into office under the leadership of Chancellor Gerhard Schroeder. Paradoxically, the new government's package of legislation in 2001 contained more drastic measures than those they opposed a few years earlier, as the following examples illustrate.

- The Riester[1] reforms transformed the public pension system into its current multipillar structure, with the traditional earnings-related statutory PAYGO pensions constituting the first pillar; occupational pensions making up the second; and the funded private pensions representing the third pillar.[2] These private pensions were made voluntary, but the government sought to encourage people to take them up by offering direct subsidies or tax advantages.[3] The relatively good performance of the stock market in the 1990s and the idea that everyone could benefit from it played

[1]The reforms were passed through parliament by the labor minister Walter Riester.

[2]Older workers with low incomes and those with reduced earning capacity are also entitled to a means-tested benefit.

[3]The individual pensions are specially regulated contracts with financial institutions. People investing in these are guaranteed, at a minimum, to get back the amount they put in. The government subsidies are especially high for low-income people and those with children.

a role in the promotion of these private pensions, according to an expert. The successful introduction of individual accounts in other countries, especially Sweden, which was viewed as a model by the Social Democrats, also played a role.

- The Riester reforms stipulated a gradual reduction of the PAYGO first pillar pensions by modifying the adjustment formula. They also set to stabilize contributions rates at no more than 20 percent before 2020 and 22 percent before 2030 for the first pillar[4] to avoid negative effects on employment and growth. In addition, the reform package fixed a target for the replacement rate, promising that pensions would not fall below 67 percent of average net earnings, from the current 70 percent. The replacement rate was actually redefined insofar as it assumed the average worker would invest 4 percent of his or her gross earnings in the new voluntary supplementary pensions. Some experts view this replacement rate target more as a symbolic concession that “modernizers” within the SPD made to the “traditionalists” and to labor unions.[5] The modernizers also managed to reach a consensus with the opposition led by the CDU.
- The reforms included a built-in reexamination clause that called for government action if contribution and replacement rate targets were not expected to be met. This mechanism was triggered soon after as the pension system experienced a financial crisis in 2002-2003, which eventually led to further reforms.

A deep economic downturn in 2002-03 caused, to a large extent, this financial crisis in the pension system. Unexpectedly high unemployment rates and dismal economic growth created a sense of urgency for reforms, according to an expert. In November 2002 immediately after winning a second term in the federal elections, Chancellor Schroeder’s government set up a commission. The Rurup Commission[6] was charged to make recommendations on ways to achieve sustainability in the pension system, as well as in health and long-term care insurance schemes. The commission was a way for the government to build consensus for further changes in these programs. It gave more legitimacy to reforms as the government lacked the strong mandate it enjoyed during its first term, with the CDU-led opposition clearly dominating the upper house—or

[4]The contribution rate on this earnings-related pillar is shared equally between employers and employees.

[5]Some experts view fixing targets for both contribution and replacement rates as contradictory.

[6]Bert Rurup chaired the commission, more formally called the Commission for Sustainability in Financing the German Social Insurance Systems.

second chamber—of Parliament, the Bundesrat, according to government officials. By deferring responsibility—and blame—to a commission of experts, the "modernizers" within the Social Democratic Party also sought to overcome intraparty opposition.

The Rurup Commission was composed of 26 members with representatives of various interests in society, including labor unions and employers' organizations, and officials from lower levels of government. The subcommission on public pensions had about a third of the total number of members. It was successful in pushing for broad reforms, unlike the other two subcommissions on health and long-term care insurance, partly because the group agreed early on to avoid extreme ideological positions and find a rational, rule-bound middle ground acceptable to everyone, according to a member of this group. The subcommission on health insurance, on the other hand, was deeply divided and could not achieve a majority behind a policy model.[7] Moreover, the media focused its attention on the bitter debates over health insurance financing as those became public, even though commission members were supposed to avoid public commentary and position taking, according to government officials. This allowed the pension group to work without close public scrutiny.[8]

All but one of the recommendations of the Rurup Commission regarding pensions—the 2004 reforms[9]—became legislation fairly rapidly. Building on the Riester reforms, the new provisions included supplementing the pension benefit adjustment formula with a new "sustainability factor" to reflect changes in the number of workers supporting the system relative to

[7]The Rurup Commission was more limited in its options for health insurance reform, according to an expert, because of strong organized interests—doctors, hospitals, pharmaceutical companies, health insurers, etc.—and the conflicting political values behind the different financing models. Some observers also believe that the Federal Minister for Health and Social Policy Ulla Schmidt's choice of appointments on the commission may have led to this division.

[8]The opposition led by the CDU set up its own Herzog Commission to look into the same issues. The two commissions worked closely together behind the scenes on pension reform, according to a member of the Rurup Commission.

[9]The reforms were passed under the Old-Age Pensions Insurance Sustainability Act.

pensioners;[10] and loosening the rules and regulations governing the Riester pensions to encourage greater participation.[11] The sustainability factor would lead to smaller pension adjustment, hence smaller increase in benefits, whenever the ratio of contributors to pensioners declines.[12] The pension adjustment would be allowed to go down to zero but not lower to prevent pensions from declining, in nominal terms. The commission's projections showed that individuals choosing to invest in supplementary pensions, either in the second or third pillar, would be able to maintain a constant replacement rate.[13] The sustainability factor was introduced to ensure that the pension system would be self-sustaining, balancing itself automatically in line with demographic development and employment levels.[14] The expectation was that such a mechanism reduces the need for future reexamination and helps "depoliticize" the system.

The 2004 reforms also stipulated that the government should report to the legislative bodies—the Bundestag and Bundesrat—every 4 years on whether targeted replacement rates for 2020 and 2030 are at risk, given the contributions rates, and if so, propose remedies.

Only one recommendation of the Rurup Commission—the gradual increase in the retirement age from 65 to 67—was adopted later in 2007 by the current coalition government, which includes both the SPD and the CDU. The fact that this highly unpopular measure was postponed for several years can be interpreted as a sign that the reformers in the Schroeder government recognized the need to reach a compromise with its opponents, both inside and outside of the party, according to a German

[10]Benefits are computed as follows: for each year of contributions, an individual receives pension points. At retirement, the sum of pension points are multiplied by a pension point value currently set at about 23 euros. This pension point value is adjusted annually by an index that is based on net wage growth and the sustainability factor. All German pensions—both for new and current retirees — are affected by these adjustments.

[11]For example, individuals eligible for government subsidies for the supplementary pensions now include all taxpayers. Also, the procedures for granting government subsidies have been simplified.

[12]Conversely, pension adjustment would increase if the number of working people contributing to the pension system rises relative to the number of individuals receiving pensions.

[13]With the Rurup Commission's economic and demographic projections, pension replacement rates will initially decline then reach their 2004 level by 2030.

[14]Hence, the sustainability factor takes into account not only changes in life expectancy but also fertility rates, immigration, as well as other factors.

expert. But it was more a symbolic concession in the sense that the provision had not been scheduled to come into effect before 2011.

The Reforms and the Public

According to an OECD official, the pension reforms were technical but efforts were made over several years to ensure that the public understood them. Experts also told us that the need for change in the public pension system in Germany has been discussed widely since the early 1990s. Successive governments in the last 15 years have made citizens aware of the necessity of reforms by using the recurring themes of population aging and high labor costs hampering economic growth. Reforms took place incrementally over this period of time. Overall, there was a mix of behind-the-scene work on the specifics and public information.

Since 2004, every year individuals receive a report detailing their pension information.[15] Financial institutions offering private pensions must also provide information on possible investments, portfolio structure, and risk potential to their clients before contracts are signed.

Expectations: The Future of Reform

Government officials and some experts expect these reforms to be, on the whole, sufficient to ensure the sustainability of the pension system for the near future, and therefore do not foresee significant changes to the system. Officials seem cautiously optimistic that with time and the tax incentives and subsidies provided for supplementary pensions, people will enroll at sufficiently high rates. Experts estimate that the demand for Riester pensions doubled in 2004 after a slow start, then again in 2005 to reach more than 20 percent of all workers covered by the statutory first pillar, with another steep increase in 2006.[16] Taken together, the three pillars of the pension system should ensure adequate pensions, according to officials.

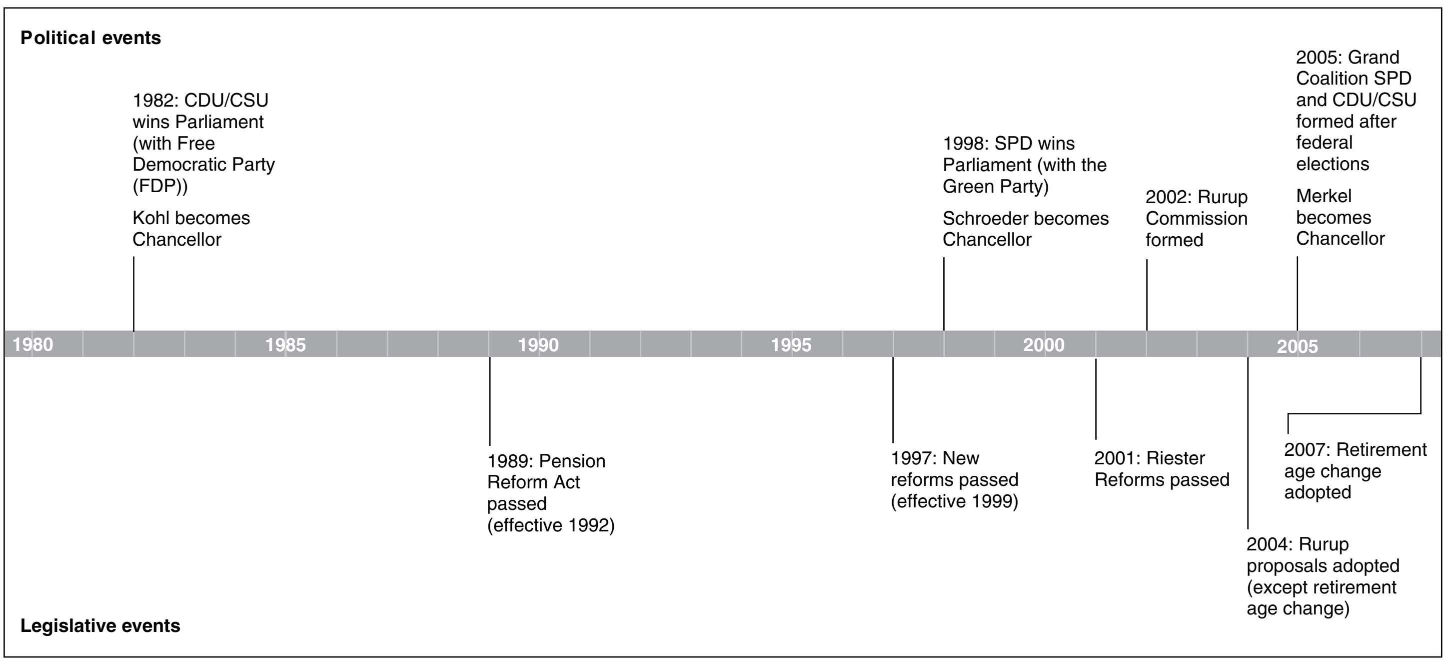
However, some characteristics of the system may lead to certain groups of people retiring with insufficient pensions. For example, supplementary

[15]Specifically, individuals from age 27 receive an annual pension statement; from age 54, they receive a more detailed statement every 3 years. The report includes information on their entitlements and their expected pension. People can also check their report online.

[16]Axel Boersch-Supan, Anette Reil-Held, and Christina B. Wilke, “How a Unfunded Pension System Looks like Defined Benefits but Works like Defined Contributions: The German Pension Reform,” Paper written for the Fundacion Carolina (May 31, 2007).

private pensions are voluntary rather than mandated, and even though the take-up rate has been increasing, individuals may fail to contribute to them on a regular basis throughout their working life. Moreover, the market returns on these private pensions may be too modest. Also, low-income individuals may have less incentive to contribute to private pensions despite the high subsidies provided to them because these pensions would affect their eligibility for other means-tested payments, such as the minimum social security guarantee for old age.

Figure 7: Key Events in German Pension Reform Process



Source: GAO analysis.

Appendix VII: GAO Contact and Staff Acknowledgments

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