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Sustaining the unsustainable? Maintaining collective defined benefit pensions in coordinated market economies

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Abstract

Collective (national or industry-wide) pensions are key power resources that generate corporatist governance capacity in coordinated market economies (CMEs). They simultaneously enable solidarity among large working populations, facilitate collaboration between employers and employees, and, if funded, generate funds that enable participation in corporate governance and provision of patient capital. However, they are also often perceived as unsustainable for various financial, economic, social and/or political reasons among academics as well as policymakers. This is the case especially with defined-benefit (DB) pensions. Yet, many countries with collective DB pensions occupy top positions in international pension sustainability rankings. In this paper, we argue that common to such countries is successful sustaining of collective DB pensions over time. We focus on two CMEs, Finland and the Netherlands. We show how capital, labour and state actors have engaged with institutional maintenance work to sustain collective DB pensions in face of various types of sustainability challenges in these countries. We argue that the two countries have been so far able to sustain (partly) funded defined benefit pensions thanks to effective maintenance work that has stemmed from and enhanced corporatist governance capacities that are typical to these CMEs and in part derived from the collective pension systems. The success has been enabled by the social partners' ability and willingness to keep all parameters negotiable.

Keywords: defined benefit pensions, Finland, institutional work, The Netherlands, pensions, sustainability

Introduction

Collective pensions are key for corporatist governance capacity. By collective pensions, we refer to private or public industry-wide or national pension systems that involve high degrees of risk sharing and some forms of paritarian governance, or, joint decision-making and management of pensions by representatives of organized capital and labour. Such pensions are typical to Coordinated Market Economies (CMEs) of Central, Western and Northern Europe. Collective pensions enable solidarity among large working populations, which provides legitimacy for organized labour while maintaining a level playing field for all employers involved in the collective schemes (De Deken, 2018). Paritarian governance and management of pensions facilitates long-term collaboration between employers and employees by generating "bargaining chips" for collective bargaining, increasing mutual understanding, and creating shared interests (Johanson & Sorsa, 2010). If pensions are funded, they generate funds that enable direct participation in corporate governance and provision of different forms of patient capital, which allow planned and negotiated changes in the business system (McCarthy, Sorsa & van der Zwan, 2016).

The challenge with collective pensions is that they are often deemed *unsustainable*. This has been the case more specifically with defined benefit (DB) old-age pension schemes – the topic of this paper. Due to their capacity to redistribute within and between various industries and over generations, DB pensions are key embodiments of the principles of corporatist solidarity (De Deken, 2018). DB pensions guarantee a relatively well defined and life-long pension outcome upon retirement. They are often contrasted with defined contribution (DC) pensions, which promise a fixed contribution rather than a

pension outcome. DB pensions have been described as inherently unsustainable for various reasons: financially due to population ageing and financial market conditions (if funded), socially due to incompatibility with job mobility and/or precariousness of work, and politically due to disadvantaging younger generations (see below).

Despite claims of unsustainability, key stakeholders of some pension systems have managed to hold on to collective DB pensions over time. Our focus here is on Finland and the Netherlands, two countries that are among the few mature three-pillar pension regimes that seem to have weathered the shift to DC. In both countries, collective DB pensions offer the primary source of old-age pension income for the elderly. DB pension schemes account for around 90% of private pension schemes in the Netherlands. In Finland, the mandatory earnings-related DB pension schemes cover nearly all private sector and public sector employees, and around 95 % of supplementary occupational pension schemes are DB. Instead of appearing unsustainable, the two pension regimes now appear as highly sustainable. For instance, in the influential Melbourne Mercer Global Pension Index of 2018, the Netherlands appears on position 1 and Finland 3, and both countries receive relatively high scores on the sustainability indicators of the ranking (Mercer, 2018). Both countries have also received international praise for their pension system design (see Allianz, 2016).

Te two countries represent cases in which DB pensions have not only been maintained but in fact *sustained* and actively improved whenever unsustainability concerns have arisen. The experience of these two countries poses a question: how come have some countries managed to sustain collective DB pensions in a form that has been deemed so unsustainable in academia and public debate? To answer these questions we study how

pension system stakeholders in the Netherlands and Finland have actively maintained institutions that have been perceived or framed as unsustainable in different times. Our analysis suggests that even the supposedly unsustainable features of collective DB pensions can be adjusted to changing circumstances as long as policymakers and stakeholders regard all parameters as negotiable. But maintaining the capacity to negotiate in such way requires corporatist governance capacity and high degrees of legitimacy for corporatist decision-making beyond the power resources and legitimacy provided by collective pensions.

While Finland and the Netherlands seem outliers considering the international trend away from DB pensions, the insights generated by this comparative case study have broader applicability. The results of this study raise the possibility that the sustainability of pensions, and possibly other welfare provisions, is less associated with a particular policy design and more with the nature of the underlying policy processes found in a particular political economy. Considering the term "sustainability" is often used without further substantiation, the current paper questions the extent to which sustainability has its own materiality (cf. Littig & Griessler, 2005) or if in fact it is at best an ideational construct used to legitimate policy choices (see Cox and Béland, 2013). We suggest that the claimed sustainability of a particular policy design may provide some legitimacy for policy choices and further empower their makers, but they are insufficient to legitimate or empower the policymakers in a degree that provides sufficient governance capacity to maintain those policies.

The outline of this paper is as follows. First, we will discuss the institutional characteristics of collective DB pensions, previous explanations for their maintenance, and the sources of their claimed unsustainability. We will then introduce our conceptual

framework for analyzing the maintenance of collective DB pensions, and the methodology used in our comparative case analysis. In the following section, we will demonstrate the development and maintenance of DB schemes in our two case countries from the post-war years until today. In the last section of the paper, we discuss the importance of these findings and provide some avenues for further research on the sustainability of social policy.

Unsustainability and Maintenance of Collective Defined Benefit Pensions

DB pensions have been regarded as unsustainable due to their inability to adapt to changing economic and political circumstances. Especially the Anglo-American single- and smaller multi-employer DB pensions have been deemed incompatible with the changing institutions of financialized capitalism (Langley, 2004) and corporate governance (Clark & Monk, 2006). Collective DB schemes are better equipped for dealing with such challenges, as they have a broader base for sharing risks and are often legally and liability-wise separated from individual companies (Anderson, 2019). Their sustainability has been questioned for other but similar reasons. Collective DB pensions have been regarded as too inflexible to deal with international and/or inter-sectoral job mobility, and too focused on providing pensions for labour market 'insiders' while neglecting the needs of emerging and 'outsider' groups such as precarious workers (Engelen, 2006). If PAYGO-financed, collective DB pensions have been seen as simply too expensive in the face of increasing pension expenditures brought on by ageing populations (Blake & Mayhew, 2006). But some have argued that funding cannot provide a sustainable solution for this problem

either, since financial crises are argued to turn DB schemes into deficit (Ebbinghaus et al., 2012). A vicious circle emerges here: the financial crises weaken the ability of states to compensate for failing DB pensions schemes while the problems of DB schemes make the fight financial crises more difficult.

Negative appraisals of DB pensions are not surprising considering the uncertain nature of these schemes. Traditionally, pension plans of a defined benefit nature mean they offer a particular benefit at retirement to be enjoyed for the remainder of life: for instance, a defined benefit of 70% of the average or final salary. Following the nature of this promise, DB pensions are clouded in uncertainty. As today's pension promises need to be materialized in an unknown future that can be up to fifty years from now, it is simply impossible to know in advance whose pensions the collective schemes come to cover and what a DB pension promise will truly cost.

Four types of risks add this more fundamental uncertainty. First, pensions need to be provided for the duration of one's lifetime in retirement, yet it is simply not known in advance how long an individual will live past the retirement age. The actual duration of the pension is therefore not known in advance (*longevity risk*). Second, pensions need to guarantee at least a minimum standard-of-living, yet it is unknown which sum will be sufficient in the future to realize that goal. The depreciation of money values over the long term means that pension entitlement will have to be periodically adjusted to wage and/or price increases (*inflation risk*) to remain adequate. Third, to facilitate these, pension contributions are likely to vary over time, which causes uncertainties concerning future generations' willingness to pay for the pensions (*political risk*). Finally, contributions are often invested in financial markets to generate more return than the sum of contributions

could normally provide. This leads to uncertainty associated with financial market performance (*investment risk*).

Despite their claimed unsustainability and the uncertainties involved in their provision, collective DB pensions have been maintained in various systems across the world. The OECD's *Pensions at a Glance* report (2017, p. 123), for instance, reveals that – besides the two cases studied here (Finland and the Netherlands) – collective DB plans constitute more than 50% of pension assets in Canada, Israel, and Portugal (OECD, 2017, p. 153). Additionally, DB occupational pension assets exceed assets accumulated in DC occupational plans in Mexico, Turkey, Spain, South Korea, and the United States (OECD, 2017, p. 153). The population profiles of these countries and the performance of their schemes seems to vary greatly. Some political economies that have sustained DB pensions have below-average old-age dependency ratios (Canada, Israel), while others face above-average DB dependency ratios (Finland, the Netherlands, Portugal). Canada, Mexico and the United States were facing continued underfunding in their DB plans, while funding ratios in the Netherlands, Finland and Portugal were high enough to cover DB pension liabilities (OECD, 2017, p. 163).

Given such divergence, population and performance characteristics seem to offer little explanation for the maintenance of these schemes. Unsurprisingly, the maintenance of DB pensions has been primarily attributed to political factors instead of structural explanations or rational choice. First is policy inertia, or, the unwillingness to reform due to legitimacy and popularity issues. Similar to blame-avoiding politicians in the context of public pension reform (Myles & Pierson, 2001; Weaver, 1986), business and labour actors might refrain from changing a popular DB scheme, as their continued involvement in

pension plan administration might be jeopardized by the loss of legitimacy resulting from painful reforms. The opposite may also be true: it may be beneficial for governments to leave all major decisions to business and labour actors to avoid blame (Johanson & Sorsa, 2010). Second is institutional path dependence. Similar to the 'double payment' problem involving the shift from PAYGO to funded pensions (Myles & Pierson, 2001, pp. 313-315), the shift from DB to other pension plans might involve considerable costs. When DB plans are terminated, unfunded liabilities will need to be paid, and additional contributions might be needed to compensate beneficiaries for the transition to a riskier pension contract (van der Zwan, 2018). Such transition costs might prevent the actors involved, employers in particular, from initiating a broad-scale reform of the pension system, since gaining approval for new costs from specific groups or actors might be next to impossible.

Previous research suggests that, when policy inertia or path dependence exists, policymakers have two types of institutional maintenance strategies at their disposal (Streeck & Thelen, 2005). First, policy drift, or the maintenance of an institution without adjustment to changing external conditions, may occur (Béland, 2007). For example, the DB-based Swedish ATP pension scheme was regarded as too legitimate to be reformed, which eventually led to its demise under changing economic and demographic conditions (Kangas et al., 2010). Second, a scheme might be maintained through layering, or the maintenance of a "drifting" institution (e.g., an increasingly inadequate public DB pension scheme) by adding new institutions (e.g., supplementary third-pillar personal savings accounts) to cover for the emerging deficiencies of the old institutions (e.g., Béland, 2007; Gildiner, 2007). If such measures are not made, paradigmatic changes to existing policies and institutions will become necessary over time (Bonoli & Shinkawa, 2006).

The problem with these explanations based on inertia and path dependence is the assumption that one maintains a pension policy paradigm that is inherently unsustainable and must be eventually abandoned or supplemented. However, they offer little help with cases in which the objective and result of pension reform has been to *sustain* the scheme – that is, to maintain the policy paradigm and avoid path departure by overcoming perceived or actual obstacles for institutional continuity. In order to address sustaining in these terms, one must follow Barr and Diamond (2009) who argue that no type of pension scheme is inherently sustainable or unsustainable: the sustainability of the scheme depends on both the particular parameters of the scheme and the successful adjustment of these parameters over time. Our two case studies, the Dutch and Finnish DB pensions, are a case in point. As we will show in our case study, the DB schemes in the two countries have been maintained through continuous parametric adjustment.

So far, scholars of pension sustainability have discussed sustainability in relation to only some pension scheme parameters. Scholars of fiscal sustainability have considered pensions an implicit form of public debt and focused on the ability or willingness to repay it at given contribution levels (Meier & Werding, 2010). This type of sustainability is focused on the given benefits, while leaving policy considerations like adequacy as secondary (Blake & Mayhew, 2006). Social sustainability scholars have focused on broader functions, such as adequacy, maintenance of acceptable living standards and effective poverty alleviation, and broader parameters, such as intergenerational balance in terms of benefits, contributions and transfers across generations (Grech, 2013, p. 149; see also Zaidi, 2012). These studies have assumed contribution or/and benefit levels to be the

determinants of sustainability. In contrast, our analysis seeks to identify the pension scheme parameters that have been in fact adjusted in order to sustain the scheme.

The sustainability of adjustment process itself has also escaped attention among pension policy scholars. In other fields of public policy, such issues have been addressed under the label of political sustainability. This scholarship is focused on "the capacity of any public policy to maintain its stability, coherence, and integrity as time passes, achieving its basic promised goals amid the inevitable vicissitudes of politics" (Patashnik 2003, p. 208). When applied to pension scheme parameters, political sustainability can be understood as the continued ability of political actors to maintain a consensus around a coherent set of pension scheme parameters and avert away pressures for their reform.

In order to address politics of parametric adjustment in empirical research, we draw on theory of institutional work, which has gained some interest among pension policy scholars in recent years (McCarthy et al., 2016). Institutional work refers to the intentional attempts to institute, maintain and/or disrupt institutional structures (Lawrence, Suddaby & Leca, 2011). Sustaining of pensions can be interpreted in this context as maintenance work, or, intentional acts to maintain institutional structures and practices, in circumstances in which the continuity of the institution is ostensibly or actually questioned. Maintenance work involves a range of different activities, including enabling work that creates certainty for institutional survival, and use of sanctions and rewards to enhance compliance or economic and authoritative measures to increase obedience with the institution (see Lawrence & Suddaby, 2006). Previous research on pensions has shed some light on the nature of maintenance work. Our analysis will expand the focus on the power resources

that enable and facilitate maintenance work in order to identify relevant sources of political sustainability.

Towards the Comparative Case Study

Next, our attention turns to methodological issues regarding our comparative case study. Our comparative case study is focused on reforms of collective DB pensions in Finland and the Netherlands. Both countries represent typical characteristics of CMEs in the sense that they provide large degree of negotiation-based self-governance capacity for the social partners (i.e., industry-wide and central unions and employer associations/confederations). In both countries, social partners bargain collectively over pension schemes, jointly govern pension fund boards, and play an important role in pension policy formation. If state actors wish to change pension schemes, they usually mandate the social partners to design, prepare and implement the reforms.

The two countries represent one extreme among countries with collective pensions due to extensive reliance on DB pensions. The mandatory country-wide or industry-wide participation guarantees high coverage in both countries. In the Netherlands, collectively bargained pension plans can be extended to entire industries. This mandatory extension has resulted in a de facto participation rate of 96%. In Finland, all work done in the country must be insured through a mandatory earnings-related pension insurance scheme. Both pension regimes also represent early cases of funded (the Netherlands) or partly funded (Finland) pensions on a large scale: in the Netherlands, capital funding of occupational

pension plans was legally mandated in 1952, and Finland adopted partial funding in its mandatory earnings-related pensions only ten years later.

Drawing on scholarship on institutional work, we argue that the process of shaping institutional parameters, the motivations for doing this and the enabling factors and facilitators of such activity can be best empirically studied by addressing the attempts of key stakeholders to maintain institutional parameters of pension schemes. As noted above, we will focus on maintenance work (as presented by Lawrence & Suddaby, 2006) over pension scheme parameters in particular situations, that is, when key stakeholders perceive challenges or experience obstacles for institutional continuity. We have first identified such situations on basis of historical accounts of our two case studies and then identified the activities that both qualify as maintenance work and reform of pension scheme parameters.

We limit our analysis to three sets of institutional actors: business actors (employers, business associations and central employer associations), labour actors (employees, unions and central trade union organizations), and government actors (governments, ministries, political parties and government agencies). Business and labour actors have long been recognized as the key institutional actors when it comes to occupational pensions (e.g., Ebbinghaus, 2011), while government actors can be expected to be essential in mandatory and highly regulated schemes, as can be found in our cases (Meyer and Bridgen, 2012). Given the similarities in pension scheme design in the two countries, we expect to find similar perceptions of unsustainability. These can be expected to revolve around problems like funding ratios (both countries rely on funding), pension adequacy (both countries provide primary retirement income via mandatory DB schemes), and coverage (schemes in both countries are mandatory). We also expect to find similar

actors (central or at least industry-level labour market organizations) involved in maintenance work efforts and similar instances of consensus (agreement in bi- or tripartite negotiations) on the policy goals that need to be realized. As both countries already have mature pension schemes, we expect maintenance work to include relatively long-term considerations that take forms with relatively clear follow-up processes.

We find that, in our two cases, these actors have targeted eight types of pension scheme parameters. On the benefits side, the *pension salary* (1) and the *accrual rate* (2) have been adjusted to influence the accumulation of pension rights. The period over which these rights are accumulated have also been adjusted, typically by increasing the *years of employment* (3), most often by raising the retirement age directly. *Additional conditions for retirement* (4) have also been introduced, including more flexible choices between early or late retirement with financial incentives. On the financing side, *contributions* (5) paid by employers and/or employees have been adjusted in terms of contribution rates and distribution between different payers. *Investment policies* (6) and *regulations* (7) have been adjusted to affect the realization of financial returns and investment portfolio allocation. Finally, *indexation* (8) of accrued pension rights have been adjusted in numerous ways in both countries.

Our analysis is mostly based on secondary research and publicly available documentation on pension reforms, which are cited in the text. Thanks to lack of previous research on the topic, we also conducted five interviews in the summer of 2015 in order to get information on the most recent pension reform negotiations in Finland. The interviewees include negotiators from one central employer association and two central

trade union organizations, and representatives of two bodies providing expert assistance to the negotiations, the Ministry of Finance and Finnish Centre for Pensions.

Finland

The sustainability of Finnish pension schemes has been a key concern throughout their existence. All the main schemes in all three pillars have been reformed parametrically dozens of times to adapt to changing social and economic circumstances (Hinrichs & Kangas, 2003). Our main focus here is on the largest and most influential collective pension scheme, the mandatory earnings-related pension scheme for private sector employees (originally TEL, since 2007 TyEL, according to the abbreviations of the laws defining the scheme). TEL, the old-age pension scheme for private sector employees that came in effect in 1962, was the first large-scale DB scheme in Finland. The parameters of public and private schemes have homogenized during the last two decades, and all mandatory earnings-related schemes are now based on the same parameters developed in connection with TEL/TyEL. The TEL/TyEL scheme is partly funded, administered by partly competing pension providers (pension insurance companies, industry-wide funds and company funds), and includes a number of different pension entitlements (e.g., survivor pensions and rehabilitation assistance).

The idea of social insurance based on a DB formula originated in the design of the TEL scheme in the late 1950s (Niemelä & Salminen, 1999). The alternatives presented in the original preparation and related negotiations were heterogeneous private pension insurances, advocated by insurance companies, some conservatives and some influential

employers, and public flat-rate pensions, supported by the agrarian party and the far left. Although most actors disagreed on the accrual rates and size of benefit caps, they all came to regard DB as the appropriate way to define pension benefits, since that way, pensions were something earned by employees. This idea of 'extended salary' has dominated Finnish pension policy discourse ever since (Johanson & Sorsa, 2010).

Unsustainability concerns have emerged in the TEL/TyEL scheme in three different waves. The maintenance work in each wave has enabled some forms of future maintenance work. For example, the increase of paritarian management of pension funds in the first wave legitimated the later use of funds to pursue higher profits to cut pension costs in the second wave. Similarly, the splitting of pension contributions between employers and employees in the second wave legitimated the capping of contribution rates in the third wave.

The first wave of sustainability concerns emerged in the early stages of TEL. The main concern was that the emerging pension system was regarded as too complex to gain popular appraisal. Pension professionals had raised this concern by the early 1970s, but it was also common among employers and unions (Hannikainen & Vauhkonen, 2012, p. 141). These actors regarded a uniform accrual scheme for old-age pensions with clear pre-defined conditions for related special pensions, complemented with uniform legislation defining these elements, as a key way to simplify the system.

At the same time, the central labour market organizations at both sides, but especially employers, argued that they should have the right to govern the simplified system to achieve the aspired stability. These arguments were articulated perhaps the clearest by Teivo Pentikäinen, the self-proclaimed father of the TEL scheme. He claimed

that if governance of the scheme was too fragmented, the parliament could nationalize the system gradually. The way in which public basic pensions were coupled with the earnings-related pensions could enable the expenditures of the earnings-related pensions to exceed its incomes (Hannikainen & Vauhkonen, 2012, p. 143). In order to avoid such problems, the decision-making over earnings-related pensions should be in the hands of "pensions men", or, the central labour market organizations and their representative pension professionals that speak for those who pay for the system (Hannikainen & Vauhkonen, 2012, p. 144).

Government actors regarded these suggestions as legitimate, since they enabled coordination between pension policy and other economic policy tools, and thus expanded the state's economic governance capacity into crucial domains. As part of the so-called UKK-deal of 1970, president Kekkonen and the government mandated central labour market organizations as part of broader incomes policy agreement to take a more overt role in governing pension policy. Employers granted labour unions access to the management of pensions (through board representation) later in the 1970s in order to avoid critiques of the new governance scheme on basis of investment (Sorsa, 2011).

The second wave of unsustainability perceptions range from early 1970s to late 1990s, and revolve around the appropriate distribution of contributions and benefits over time. Early concerns over sustainability were voiced in early 1970s, when the central labour market organizations had advocated and the social democratic majority government agreed to raise pension benefit levels through various means. The government had stated that, despite raising benefit levels, it sought to avoid the generation of "excessive" pensions, or, pension benefits that exceeded the replacement rate of 100 % at the individual level, since

they would not seem legitimate in the eyes of future generations who would foot the bill (Hannikainen & Vauhkonen, 2012, pp. 167). First concerns over the costs of ageing population were also voiced at the same time, since the decline in fertility was found to deepen this problem. The issue of ageing population and rising pension costs dominated the pension debates in 1980s and 1990s.

These concerns motivated changes in the indexation mechanism, raising the retirement age, and adoption of employees' pension contributions in the early 1990s (Hannikainen & Vauhkonen, 2012). Similar unsustainability concerns played an important role in the reforms of late 1990s. The key reforms adopted then – incentives to work longer, new indexation rules, increased funding ratios and regulations related to the new modern portfolio-theory based investment paradigm (e.g., Hinrichs & Kangas, 2003; Sorsa, 2011) – all sought to tackle challenges of population ageing. It must be noted here that many of the sustaining measures drew on the previous wave of sustaining work. Increasing investment returns was seen as the best way to maintain control over the pension scheme, while increased equity investment could be also used to provide stable and paritarian 'anchor ownership' over Finnish companies and hence further enhance corporatist governance capacity (see McCarthy et al., 2016).

The third wave of sustainability perceptions that rose in the 2000s and related reforms differed from previous waves in two respects. First, it was not only the unsustainability of pensions *per se* but also the related fiscal sustainability that have driven reforms. Employers' willingness to pay for pensions remained a key controversy. Employers had called for stabilization or cutting of their contribution rates since the early days of the scheme (Sorsa, 2011). However, the employees now shared the interest of

decreasing contribution rates, since the social partners agreed already in the 1990s that all contribution rises would be divided 50/50 between employer and employee contribution rates. Moreover, the pension contributions are tax deductible for employees and employers, which means that contribution rates have direct impact on state tax revenue. The idea of 'sustainability gap' (*kestävyysvaje*) became the hegemonic policy idea in Finnish public policy in 2007 (Eskelinen & Sorsa, 2013). It was often presented as the indicator for the sustainability of the entire welfare state, not just public finances (ibid.). The idea also framed pension negotiations of 2014-15 (Lindén, 2016). Our interviews suggest that neither employers nor labour unions dared to question the need to control pension contribution rates, since they believed they would have been burdened with public perception of broadening the sustainability gap.

Second, the reforms introduced simultaneously a broad variety of parametric changes. For example, still in the 1990s, no actor had explicitly questioned the idea of accruing life-long pension rights after retirement or considered cuts or limits to accrued pension rights justified (Eläkekomitea, 1991, pp. 53-55; HE 118/1995). In contrast, the main reforms of the TEL/TyEL scheme in 2005 and 2017 adopted various automatic adjustment mechanisms to benefits in order to stabilize the contribution rates. The 2005 reform tied pension benefit levels to life expectancy, while the 2017 reform (that overrode the 2005 reform) tied benefits to life expectancy, introduced an actuarially neutral (i.e., benefits cannot exceed contributions) flexible retirement age, tied retirement age to contribution levels, as well as changed the principles of using certain investment reserves (Eläketurvakeskus, 2017). In effect, these changes made the current scheme more a hybrid DB/DC scheme instead of a pure DB scheme.

The third wave of sustaining work has mixed implications towards social partners' governance capacity. The social partners have been able to determine the contents of earnings-related pension policy and legislation due to long-term coalitions with key political parties (see Johanson & Sorsa, 2010). Still in the early 2000s, the social partners had threatened to halt the Finnish economy when the then Prime Minister Matti Vanhanen had only informally suggested that the retirement age could be raised even without central labour market organizations' consent (ibid.). Yet, in the tripartite pension negotiations in 2014-15, the right-wing government could dictate one of the objectives for the negotiations: the permanent reduction of the fiscal sustainability gap by one percentage point, which in this context means a permanent cap for contribution rates.

Moreover, the social partners perceived that if they could not come up with a favourable outcome, the government would have imposed a number of measures even without the social partners' consent (which is exactly what they did in connection with a later reform, see Kaitila, 2018). The social partners did not reject the government mandate, because the government also offered them – for the first time ever – an official legal status as pension scheme stakeholders, albeit only with a supervisory status. In this sense, the central labour market organizations of both sides accepted the previously unacceptable government intervention and made one parameter nonnegotiable in order to retain some kind of status as the governing parties of the scheme.

The Netherlands

The Netherlands has a mature, three-pillar pension system that consists of a basic state pension (dubbed *AOW*, after the *Algemene Ouderdomswet*) in the first pillar, occupational pensions tied to a particular company or industry in the second pillar, and a third pillar consisting of personal pension insurances. The first and second pillars provide the largest shares of total pension savings: 54% and 40% of pension entitlements, respectively (Bruil et al., 2015). The AOW is a pay-as-you-go social insurance scheme, administered by the Social Insurance Bank (*Sociale Verzekeringsbank*). The occupational pensions, meanwhile, are fully funded collective pension schemes, administered by a total of 290 industry-wide, company-level and professional pension funds (ultimo 2016). Due to the large size of the second pillar, the third pillar is relatively small in the Netherlands compared to other advanced political economies. The focus here will be on the second pillar of the pension system.

The DB formula has been a long-term source of legitimacy for Dutch occupational pensions. It embodies the principles of collectivity, solidarity, and mandatory participation, which policymakers often invoke as the normative basis of the Dutch pension system (cf. Tweede Kamer der Staten-Generaal, 2008-2009). From their introduction in the early twentieth century, Dutch occupational pensions have been collective DB plans with a uniform contribution rate. Collectivity enables risk-sharing between participants, while the uniform contribution rate is an important source of solidarity in the system: uniformity ensures that participants with actuarially higher pension costs (i.e., older workers, women and the highly educated) can accumulate the same pension rights as younger workers, men or the low educated. Solidarity is furthermore accomplished by making most occupational pensions mandatory for both employers and employees at the industry level, a legal rule

introduced in 1947. Mandatory participation allows for the organization and administration of occupational pensions at the industry level, which reduces competition between employers over labour costs. Finally, the high participation rate allows for economies of scale within pension funds, which results in lower administrative fees.

Following a long period of relative stability, the first concerns over unsustainability emerged in the Netherlands in the 1980s and 1990s. While costs of the original final salary plans were initially limited thanks to post-war wage controls, the elimination of such controls had led to a massive growth in pension entitlements in the 1960s. While positive for workers and retirees, this imposed massive costs on the sponsoring employers, whose willingness to pay became a key issue for sustainability. During the 1980s and 1990s, several large employers such as Rabobank (1987) and Philips (1997) made the switch to average-salary DB plans. Joost van Genabeek (1998) argues that the revitalization of Dutch consociationalism through the 1982 Wassenaar Accord facilitated these transitions politically. The Accord had traded wage moderation for job creation, and the positive effects of final salary plans to employees were substantially restricted. The adoption of average salary plans was also palatable to labour unions thanks to limited financial repercussions.

A new sustainability narrative entered the Dutch pension policy debate in the 1990s. In its 1996 report "Working on Security", the Kok government announced new objectives for the Dutch second pillar pensions. Citing demographic ageing and the subsequent pressures on the PAYGo-financed state pensions, the cabinet expressed a deep worry that occupational pensions would become unaffordable in the long run. Academic experts had estimated that by 2030 occupational pension contributions would have increased to around

18-25% of the wage sum (Tweede Kamer der Staten-Generaal, 1996-1997). The cabinet deemed the contribution increases as a less feasible way to deal with the growing costs of occupational pensions, a position that the major Dutch business federations concurred with (Tweede Kamer der Staten-Generaal, 1996-1997). To encourage the social partners to introduce cost control measures, the state made changes to the fiscal treatment of occupational pensions, capping tax-free pension savings at 2% of average salary. The state thus introduced a strong incentive for the social partners to reduce one of the parameters – the accrual rate – in the formula.

Further changes to the DB parameters were made following the 1997 Convenant on occupational pensions between the social partners and the state. Most important was the elimination of automatic adjustments of pension rights to wage or price increases (Stichting van de Arbeid, 1997). When the Convenant was evaluated in 2001, it was found that the number of active participants in a final salary plan had decreased: around a third of all fund members now participated in an average salary plan, against 25% in 1999. While the number of participants with DC pensions had increased slightly, the overall number was still negligible at 1,2% of active participants (Werkgroep Evaluatieonderzoek Convenant Arbeidspensioenen, 2001). Additionally, a growing number of funds had made indexation of pension rights conditional on investment performance, covering around 90,4% of active participants (Werkgroep Evaluatieonderzoek Convenant Arbeidspensioenen, 2001).

At the turn of the century, the pressing issues that had dominated the policy debate in the 1990s had seemed solved: pension coverage had increased to almost the entire workforce, employers had received new ways to avoid the mandatory extensions of collectively bargained pension plans, and the costs of DB plans had been reduced by

shifting to average salary plans and making indexation conditional on investment performance. Yet, the optimism proved to be temporary. During the dot.com crisis of 2001, the average funding ratios of Dutch pension funds dropped from 199% in 1999 to 124% at the end of 2002. The declining financial performance of the funds was a direct consequence of a fundamental change in investment practices during the 1990s, when Dutch pension funds began to increase investments in corporate equities (McCarthy et al., 2016). While the switch to equity investments led to a massive growth in available pension assets, it also introduced new vulnerabilities to financial market fluctuations.

The dot.com crisis of 2001 brought renewed attention to the sustainability of the DB pension system. Over the course of several years, expert reports advocated new ways to "shockproof" the system (CPB/DNB/PVK, 2003; Van Ewijk and Van de Ven, 2004; Van Ewijk et al., 2006). Increasing contribution rates was decidedly not included among the policy alternatives. While experts concurred that contribution rates had reached a maximum, a growing number of employers bargained for formal contribution caps in pension contracts. With this parameter now deemed non-negotiable, attention switched to other elements in the DB formula: most notably, increasing the career span by eliminating early retirement options and stimulating higher returns by adopting riskier investment policies. Both solutions proved to be highly problematic. The elimination of early retirement caused substantial political opposition from left-leaning political parties and the labour movement. Meanwhile, pension funds' financial performance took a big hit after the 2008 financial crisis. With contribution increases off the table, several pension funds had to take the unprecedented action of reducing the pension entitlements of active and

retired workers for millions of beneficiaries, thus making the DB schemes *de facto* hybrid DB/DC overnight.

Political leaders responded to the post-crisis problems by setting in motion a new round of broad policy reforms ("*brede aanpak*") to futureproof ("*toekomstbestendig maken*") the Dutch pension system in 2009. This reform agenda centered on three themes: the creation of new financial rules for pension funds; developing new, more flexible pension contracts, and; tying pension benefits to increases in life expectancy (Tweede Kamer der Staten-Generaal, 2008-2009). In true corporatist fashion, the Minister of Social Affairs called on policy experts to assess the problems at hand and instructed the social partners to translate the experts' findings into concrete proposals (Tweede Kamer der Staten-Generaal, 2008-2009). The resulting policy proposals in 2014 and 2015 involved a gradual increase in the legal retirement age for the state pensions, new fiscal rules limiting tax-free accumulation of occupational pension savings, and regulations that explicitly enables indexation and entitlement cuts if the financial performance of the fund is insufficient. The consequence of these reforms is that Dutch occupational plans have become more like DB/DC hybrids also *de jure*.

A more fundamental overhaul of the Dutch pension system is looming, as the meagre financial performance of Dutch pension funds have spilled over into concerns over the perceived political sustainability of the system. During the post-crisis years, several surveys showed that public confidence in the system is on the decline (De Nederlandsche Bank, 2016; Sociaal Cultureel Planbureau, 2014). According to the expert committee tasked with investigating the post-crisis future of the Dutch pension system, declining public confidence was a result of a "gap between perception and reality": the citizen

consistently expected too high pension benefits, and did not consider that benefits could be reduced (Commissie Toekomstbestendigheid Aanvullende Pensioenen 2010, p. 45). The "expectations gap" has been proposed to be solved by eliminating the uniform contribution rate and to switch to personal pension accounts with collective risk-sharing (Tweede Kamer der Staten-Generaal, 2014-2015a; Tweede Kamer der Staten-Generaal, 2014-2015b). Whether these plans will pass in their current form is still uncertain, as the transition costs involved are estimated to be considerable and unevenly distributed among generations. For this reason, the labour federation FNV withdrew its support from the government's reform plan.

Discussion and Conclusions

In this paper, we have explored the reasons why Finland and the Netherlands – two mature, multi-pillar pension systems – have retained defined benefit (DB) collective pensions in face of perceived unsustainability of the schemes of this type. We argue that the standard explanations rooted in policy inertia and institutional path dependence offer few answers to this question. Our answer to the question is based on the particular governance arrangements characterizing both systems: with pension policy being the outcome of state and social partner deliberations, we have argued that the ongoing willingness of these actors to negotiate adjustments to all parameters of the pension scheme has resulted in the sustaining of that particular pension model through increasing hybridization, pursuit of higher investment performance and various retrenchment measures during the 2000s. The two countries thus represent cases of policy renewal instead of inertia and institutional

sustenance instead of institutional path dependence. The key success factor in sustaining work has been social partners' progressive increase of governance capacity and improved ability to maintain all parameters open to negotiation. In short, solutions to previous problems have helped to solve future problems, too, as they have raised the status of social partners and helped to explore broader parameters for legitimate adjustment.

Sustainability offers a useful concept for understanding the long-term prevalence of social policy institutions like pension systems. However, without explaining why different actors in fact sustain some social policies instead of others, research on sustainability will have very little to say about the actual longevity of welfare institutions. We have argued in this paper that collective DB pensions are an excellent case in point. Even though they have been framed and often perceived as unsustainable, they have been nevertheless sustained in several political economies. Rather than conceiving sustainability in light of designs and financial or social outcomes that supposedly determine the fate of policy paradigms, we have focused on the process of *sustaining*, that is, the attempts of state and stakeholders to keep the pension system viable

Our case study suggests that sustainability in terms of designs and outcomes is relevant for sustaining in the sense that they may empower the actors who have the know-how, motivation and capabilities to maintain and renew the scheme. Our findings can be summarized as a following maxim on sustainability: the institutional capacity to sustain a welfare scheme is primary to any particular conception of sustainability based on the design of that scheme. The maxim can be also interpreted so that a welfare scheme can be made unsustainable in many ways. The simplest of means are to refuse to negotiate over some parameters or introduce parameters that cannot be adjusted.

Our analysis suggests that questions over the sustainability of collective defined benefit pensions boil down to the conditions in and processes through which they are governed. If the prevalent form of pension governance is institutionally legitimate and individual parameters are considered negotiable, the actors involved are certainly capable of sustaining the pension policy paradigm through parametric adjustment. In these conditions, the DB formula can serve as a frame for assessing the sustainability of the scheme or even a direct way to improve the legitimacy of the scheme. But once any of the actors involved deem individual parameters within the DB formula as non-negotiable, the DB formula itself or the form of governance over the scheme may become perceived as unsustainable.

The great irony here is that explicit efforts to make the scheme more sustainable in such conditions may in fact lead to decreased legitimacy (the Netherlands) or governance capacity (Finland) of the key governing parties, which, in turn, may make it more difficult to sustain the schemes in the future, unless a more legitimate form of pension governance is found for the task. Indeed, recent developments leave the longer-term viability of DB pensions uncertain in both Finland and the Netherlands. In case of the Netherlands, reliance on funding and investment returns has questioned the sustainability as well as the credibility of pension governance arrangements to sustain the scheme. As contribution rates have been capped, the strong normative consensus that solidarity and collectivity constitute the essence of the Dutch occupational pension system is waning (De Deken, 2018). It remains unlikely that initiatives retaining DB schemes will gain sufficient legitimacy. In the Finnish case, no single parameter can question the sustainability of the scheme thanks to the new automatic adjustment mechanisms. But due to the very principle

of automation, the entire scheme and its governance have become built on a static conception of sustainability, based on principles of fiscal sustainability and technocratic governance. It remains to be seen whether this type of arrangement can be sustained if the legitimacy of pension policy becomes seriously questioned.

We acknowledge that our two case countries may be outliers in the world of DB pensions with their country- and industry-wide schemes. They nonetheless suggest that DB plans are not necessarily unsustainable unless someone so decides. Further research should explore the causes for the unwillingness and inability to sustain a particular social policy paradigm over time. In the case of pensions, this involves exploration of whether or not the choice to sustain DB pensions is supported by favourable old age dependency ratios, financial market volatility and other socio-economic trends associated with the "old-age crisis", or some other factors. Another key topic is the changing political sustainability and legitimacy of pension governance and presence of a politics of flexible adjustment: not only the Netherlands and Finland, but also in in political economies such as Canada, Israel and Portugal on the one hand and those of Denmark, Sweden, and the United Kingdom on the other.

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