

# Does pension privatization increase old age poverty?

## A comparison of Germany and Great Britain

Katja Möhring

Research Training Group SOCLIFE at University of Cologne, Germany

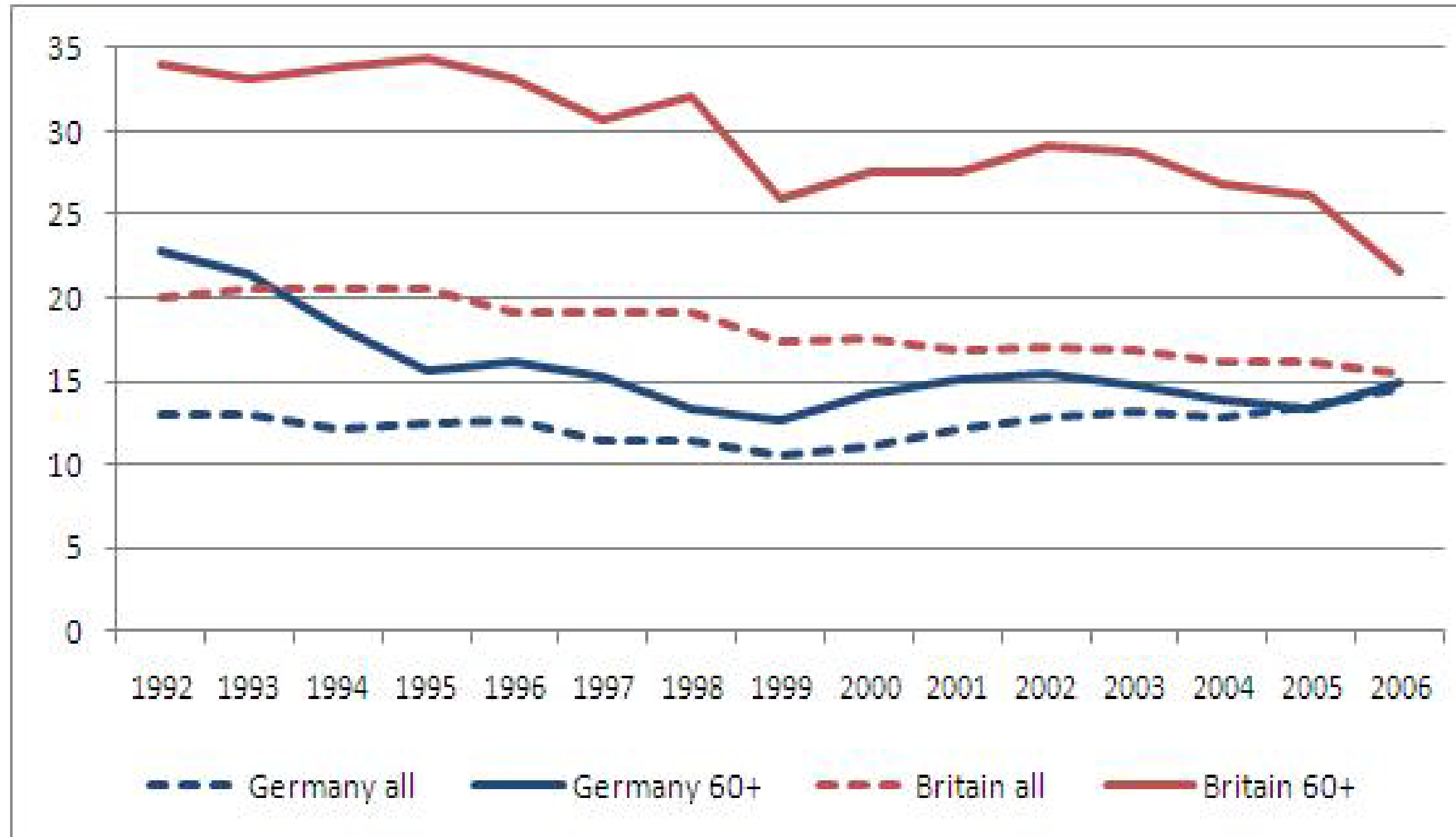
### Starting point: Pension privatization and poverty in old age

#### Country sample: Germany and Great Britain

Both countries differ with regard to the role of private and occupational pension provision:

- **Multi pillar pension system of Great Britain:** reforms towards an expansion of **private provision** for old age at the end 1980s. Flexibility and **free choice** of pension provision
- **State-centred social insurance pension system of Germany:** Private and occupational pension provision play a minor role. **Strongly regulated** and **obligatory public pension system.**

#### Relative income poverty of total population and elderly



Source: Own calculations from BHPS and GSOEP  
Poverty line: 60% of national median; basis: Equivalized net household income

#### Research Questions

- What role plays the income composition during retirement in explaining income poverty in a multi pillar compared to a state-centred pension system?
- What differences exist over time, as an effect of privatization reforms?

### Income composition in old age and pension reform steps

#### Income composition of 60+ and pension policy in Great Britain



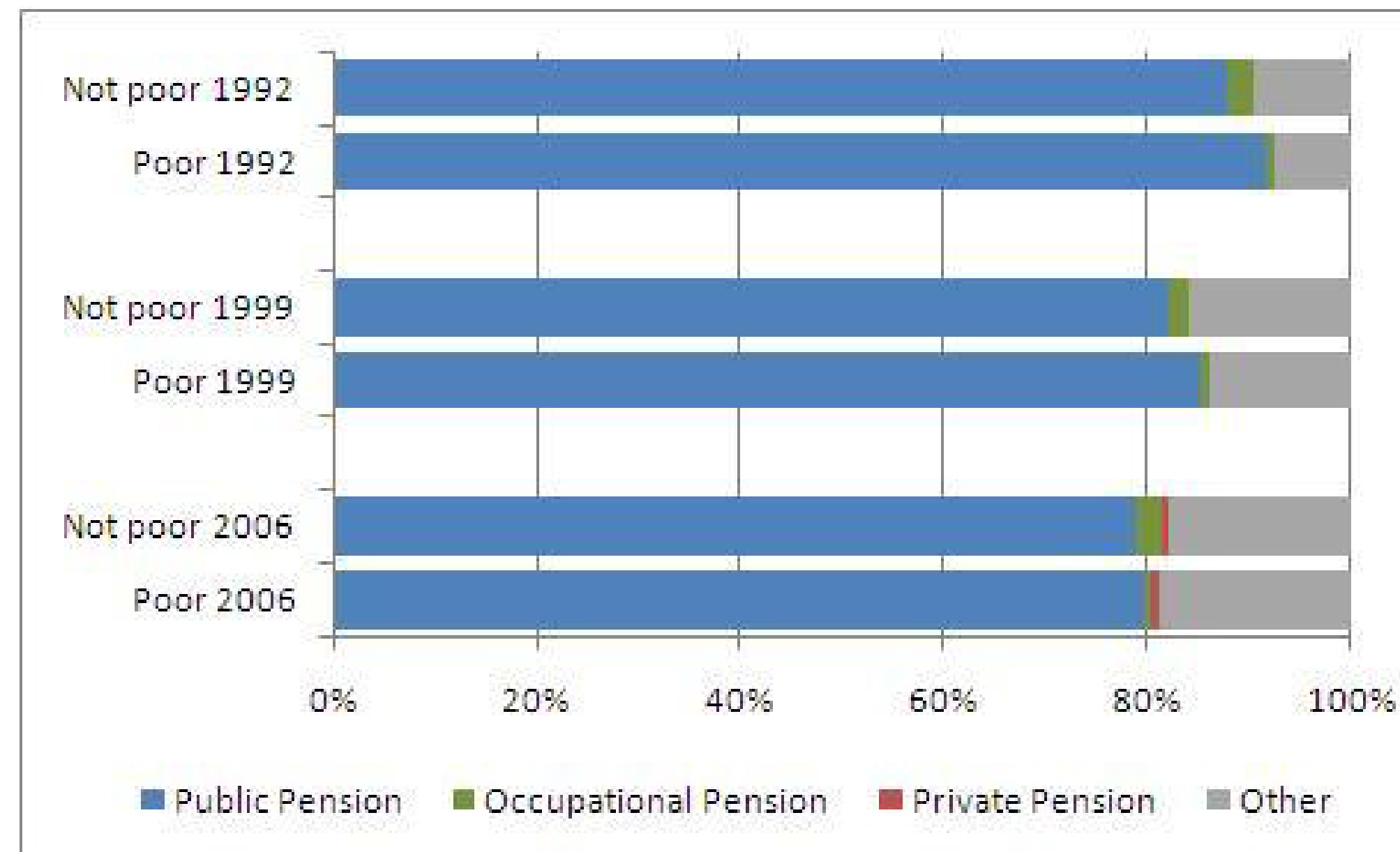
1986 reform: Easy access to **private provision**, possible **contracting-out** from public social insurance pension

1990s: **Downsizing of public pension level, contracting-out wave**

Recent years: Stricter regulation of private pensions, additional public means-tested benefits for low-income elderly ("pension credit")

Source: Own calculations from BHPS. Notes: "Other" includes labour earnings, other state benefits, income from savings; "Public Pension" includes benefits for widows/widowers.

#### Income composition of 60+ and pension policy in Germany



Until 1990: **Generous public pension benefits** and early retirement regulations, specific regulations for East Germany's transition period

1990s: **Pension benefit reduction** for early retirees and specific groups

Recent years: Introduction of means-tested minimum income benefit especially targeted at elderly ("Grundsicherung im Alter")

Source: Own calculations from GSOEP. Notes: "Other" includes labour earnings, other state benefits, income from savings; "Public Pension" includes benefits for widows/widowers; "Private Pension" not included in 1992/99.

### Pension income sources and poverty risk in cohort comparison

#### Cohort Comparison

- Cohort:** Individuals who **retire until the mid 1990s** (born 1910-29)
- Cohort:** Individuals who **retire from the mid 1990s** (born 1930-43)

#### Assumptions

- In general, private and occupational pension income components play a larger role in Britain
- Due to the shrinking level of the public pension in Great Britain, its role for poverty reduction is decreased in the second cohort
- The newly introduced means-tested benefits should show a positive effect in both countries

#### Regressions on income poverty during retirement in Britain and Germany (coefficients of fixed effects models)

Great Britain	First Cohort		Second Cohort			
	M1	M2a	M2a	M2b	M2b	M2b
Age	0.0102	(1.46)	-0.00895	(-0.72)	-0.00181	(-0.14)
Became widower	0.0816	(0.35)	-0.412	(-0.62)	-0.386	(-0.58)
Became widow	0.682**	(2.43)	1.649**	(2.30)	1.615**	(2.25)
Became married	0.325	(1.99)	0.343	(1.09)	0.34	(1.07)
Income share public pension	-0.0115***	(-4.39)	-0.00182	(-0.41)	-0.00193	(-0.44)
Income share occupational pension	-0.0280***	(-13.13)	-0.0116***	(-4.93)	-0.0116***	(-4.92)
Income share private pension	-0.0289***	(-5.01)	-0.0117***	(-2.76)	-0.0128***	(-2.98)
Income share Pension Credit	-	-	-	-	-0.0308***	(-4.09)
Observations	11066		5387		5387	
Groups	1307		777		777	
log-likelihood	-4306.3		-2043.9		-2033.6	

#### Great Britain:

- In the first cohort, a higher share of any pension income source does alleviate poverty, this is no longer the case for public pension in the second cohort
- The newly introduced minimum income benefit Pension credit does have a positive effect in the second cohort
- Demographic factors have no strong effects

#### Germany:

- Due to the homogenous income composition, the source of pension income does not play a role in explaining poverty during retirement. Also the newly introduced targeted minimum income benefit shows no effect
- Demographic factors generally play a larger role in Germany than in Great Britain, although the effects are reduced in the second cohort.

Germany	First Cohort		Second Cohort			
	M3	M4a	M4a	M4b	M4b	M4b
Age	-0.0667***	(-5.91)	-0.0565***	(-4.91)	-0.0560***	(-4.86)
Became widower	-0.249	(-0.50)	-0.0259	(-0.04)	-0.0229	(-0.04)
Became widow	2.270***	(4.29)	2.216***	(3.24)	2.212***	(3.24)
Became married	0.654***	(3.09)	0.36	(1.55)	0.359	(1.55)
Income share public pension	0.000642	(0.20)	-0.0000985	(-0.04)	-0.0000955	(-0.04)
Income share occup./priv. pension	0.00289	(0.59)	-0.00375	(-0.82)	-0.00375	(-0.82)
Income share new basic benefit	-	-	-	-	-0.00524	(-0.55)
Observations	5425		6312		6312	
Groups	619		855		855	
log-likelihood	-1799.9		-2233.5		-2233.3	

t statistics in parentheses; \* p<.10, \*\* p<.05, \*\*\* p<.01

Source: Own calculations from BHPS and GSOEP. Notes: Analysis group: Retired individuals older than 60 years; dependent variable: Relative income poverty (income below 60% of national median)

#### ... and, does pension privatization increase poverty in old age?

The example of Great Britain shows that pension privatization alone cannot be blamed for high old age poverty. Rather the level of the public pension, which is the main income source for low income groups, plays a crucial role in poverty alleviation. Public minimum benefits have a positive effect in Great Britain, but might reduce saving incentives for low income groups, and thus lower the participation in private pension plans in the long run..

