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At the Nexus of Social Policy and Capital Markets:
Pension Reform and Enterprise Governance in Germany

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INTRODUCTION

Political efforts to reform existing pension systems are among the most significant examples of institutional change occurring in the advanced countries. Pension reform portends far-reaching shifts not only for the economic security of elderly citizens, but also for industrial relations and the structure of capital markets. In both respects, any significant change in a national pension system exerts powerful force on patterns of enterprise governance. Insofar as they are linked to an individual's employment history, pension policies can serve as powerful ties that bind employees to a particular firm. Insofar as they become reservoirs for current savings, pension systems contribute, sometimes massively, to an economy's supply of "patient" capital available for long-term investments.

This paper examines recent changes in German pension arrangements as a way of illuminating the ability of Continental Europe's largest democracy to adjust its institutions to changing demographic and competitive conditions. At first glance, the recent changes in Germany's pension system look like a clear shift away from the solidaristic elements of the country's inherited Bismarckian institutions for old-age insurance. As the policy process moved forward, however, societal pressures coalesced around less individualized arrangements and began to emphasize firm-level or industry-wide agreements between employers and employees. What initially appeared to be a surprisingly market-oriented reform quickly evolved toward arrangements that preserved

the principle of negotiated agreements at the firm- and industry levels, even as the financing arrangements hinged on pre-funded (or in American terms, defined-contribution) accounts. The effect was to give Germans new ways of investing for old-age security, but to maintain much the same balance of societal power that had shaped earlier shifts in Germany's pension system.

The underlying issue that triggered the recent case of reform was an anticipated crisis in financing the future benefit claims from Germany's statutory or "public" pension system. The statutory pensions were financed through Pay-As-You-Go (PAYGO) payroll deductions that rested on an intergenerational contract between current employees and current retirees. The solution reached in Germany (as in several other countries) was to create new options for supplemental retirement accounts that would be pre-funded or capitalized (*kapitalgedeckte*), thereby reducing the anticipated pressures from future retirees to maintain benefits from the statutory PAYGO system at unsustainable levels. As a number of alternative designs for the fully funded (defined-contribution) accounts appeared, the reform effort began to reveal how contending social groups would assess the appeal of funded pensions at different levels of aggregation and with different levels of government support.

In analyzing the different responses so far, this paper proceeds in four steps. The first section outlines the theoretical questions illuminated by this case of reform. The second section begins the empirical analysis by summarizing the German pension system as of the early 1990s. The third section explains how the idea of individualized accounts gained momentum as a solution to the dilemmas faced by Chancellor Gerhard Schroeder's

Red-Green coalition between 1998 and 2000. The fourth section traces the emergence of support for vehicles that would structure defined-contribution plans at the enterprise- or industry-level rather than through separate individualized accounts. The fifth section discusses how the initial political maneuvering around these different options continued in the implementation or “post-enactment” phase of the policy discussion. The paper concludes with reflections on the mechanisms that enabled German politicians to open a range of institutional alternatives including individually funded pensions, but that subsequently came to emphasize solutions to be negotiated in firm-specific and industry-wide arenas – levels of aggregation more in keeping with Germany’s prior arrangements for old-age insurance.

I. THEORETICAL QUESTIONS

Germany’s recent efforts in pension reform raise a number of theoretically significant questions. The first is the familiar analytic task of determining which theoretical perspective best explains the outcomes observed. This exercise examines an empirical case or broader domain and asks whether it fits within or falsifies the hypotheses suggested by a more general set of propositions or covering laws. The second question – based on an equally important but different use of theory -- asks precisely which mechanisms are exemplified by the processes through which a particular case of institutional change occurs. The third question, especially relevant for pension reform in Germany, ask about the likely,

consequences of the observed policy changes for the subsequent evolution of the broader institutional landscape.

This third question highlights the balance of change and durability in the key features of Germany's political economy. One of the stronger results of the Varieties of Capitalism highlights the role played by Germany's pension system in the complementary institutions that make Germany a coordinated market economy (CME). In particular, by insuring employees against old-age poverty on an industry basis, Germany's pension system encourages younger cohorts to invest in hard-won skills that are applicable on an industry-wide basis. The result is an occupationally segmented pattern of social benefits that supports strong institutions for developing industry-specific skills (see, for example, Estevez-Abe, Iversen, Soskice, 2001, and Thelen, 2004). At the same time, the piece of Germany's pension system that supports occupational pensions, whether organized at the industry or the firm level, contributes to the "hidden" reserves that long enabled German managers to smooth quarterly and yearly performance records, thereby insulating German firms from hostile takeovers.

The question of how best to account for the outcome observed in this case of public policy is partly illuminated by the literature on cross-class coalitions as well as the Varieties of Capitalism. The two literatures assign somewhat different places to institutional constraint in their analytic schemas (Kathleen Thelen, 2002). The literature on cross-class coalitions (Swenson, 1991) tends to treat institutional settlements – especially in wage bargaining – as significant historical outcomes that merit explanation. By contrast, the Varieties-of-Capitalism approach accepts such institutional settlements as

given and then elaborates the nature of the firm-level rationality that derives from the institutional arrangements found in different countries.

For purposes of this paper, these perspectives offer alternative explanations for the longstanding persistence of collectively negotiated social policies that insulate individuals from the market. In addition, these two perspectives emphasize quite different levels of aggregation at which the politics of group bargaining over social policies takes place. The cross-class approach, by showing how employers have often pushed as much as workers for centralized bargaining processes, highlights the industry-wide issues that can generate common interests between capital and labor. Such common or joint interests appear not only in wage-bargaining, but also other forms of social policy (e.g., Isabela Mares, 2001) and trade policy (Hiscox, 2002). By contrast, the Varieties-of-Capitalism places more emphasis on the firm. In this approach, institutional complementarities between rules for industrial finance, social policy, vocational education, wage-bargaining, and even monetary policy tend powerfully to push firms toward distinctive production strategies, thereby leading those firms to push for the maintenance of the institutional arrangements on which their comparative advantage depends.

In the realm of social policy, both approaches have been used to show why employers have a strong interest in binding highly-skilled employees to the firm through longer-term benefits such as old-age insurance. The interesting issues highlighted by the recent reform in Germany are twofold. First, will preferences for such long-term benefits endure or will they be decisively eroded by a move to more individually defined pension accounts. Put more bluntly, will the recent pension reforms unravel the one piece of the

German model that inexorably undermines the other institutional components in Germany's form of organized capitalism. Second, if preferences for the continuation of long-term old age benefits persist, are these preferences coalescing at the firm level or the sector level? Firm-level solutions suggest that Germany's response to recent pressures on the inherited pension system takes a form that will put increasing power in the hands of management. Sector-wide solutions suggest that Germany's response is taking a form that will sustain the principles of social partnership typical of German economic policy for most of the post-1945 period.

As useful as they are, however, neither cross-class approaches nor the Varieties-of-Capitalism literature illuminate the second theoretical task – illuminating the processes or mechanisms by which the observed outcomes emerged. That is to say, while they offer plausible explanations for the persistence of solidaristic social policy in Germany, neither can easily accommodate the legislative success of the fully individualized pensions initially proposed by the Red-Green coalition. The observed pattern of bargaining is better explained by a different type of theorizing than that implied by “covering” laws. This other type of theorizing, as Jack Knight notes, puts primary emphasis on the mechanisms of institutional change that are generated by different patterns of interaction among political actors. Building on Jon Elster's early critique of functionalist explanation, Knight argues that the emphasis on mechanisms gives up predictive ambitions in favor of attention to the circumstances under which social interaction produces different processes of change.

In the case examined here, such attention to the pattern of interactions that produced legislative change is essential. The initial success of individually funded

pensions – or as they quickly became known “private” pensions – was no mere blip in the legislative process. It represented precisely the kind of market-compatible reform that is known to be extremely difficult for government to achieve against the opposition of established interests. Indeed, in this case, the traditionalists in the Social Democratic Party (SPD) were deeply dismayed by approval of the “private” pensions, which they viewed as the loose thread that could unravel the entire structure of Germany’s existing arrangements for public old-age insurance.

In addressing all three theoretical issues – explaining the outcomes, specifying the mechanisms, and assessing the consequences – this paper compares Germany’s pension arrangements in the mid-1990s with the changes effected under the Red-Green coalition between 1998 and 2002.

II. GERMAN PENSION ARRANGEMENTS IN THE MID 1990s

By the middle of the 1990s, the German pension system had come to rest on three main pillars: “public” or statutory (*gesetzlich*) pensions; occupational pensions; and private insurance schemes. In practice, the public or statutory tier was (and is) by far the largest. With outlays of EUR 214 billion, it accounted for 10.5% of GDP in the year 2000 and amounted to roughly half of all social insurance payments. This amount represented approximately 80% of all pension payments and the statutory plan included over 90 percent of employees in the western *Länder*, and almost 100 percent of employees in the East. The system is financed largely by payroll contributions, split equally between employers and

employees, with some subsidies from the federal government. For the early postwar years, statutory pensions were partially capitalized, but legislation in 1957 switched the entirely to pay-as-you-go financing, which allowed for only a small liquidity reserve (amounting roughly to the equivalent of one month's payments to current beneficiaries). In the early 1990s, benefits were calculated on a formula that led to a net standard pension level (for individuals with 45 years of work credit) equal to 70 percent of the average wage for all employees working when the pensioner retired.

Supplemental pension insurance could be extended by individual firms, usually to their better-paid employees, or obtained by individuals through private insurance plans. These two pillars of the pension system played a much smaller role in aggregate old-age income security than the statutory system outlined above. The company-level pension mechanisms did play an important role, however, in making substantial amounts of investment capital available to firms in the form of tax-privileged reserves that could be invested prior to paying benefits (Manow, 2001).

III. REFORM INITIATIVES UNDER THE RED-GREEN COALITION

The system outlined above faced an impending financial crisis in the late 1990s. The growing number of pensioners combined with the declining workforce and slowing rates of economic growth all meant that the federal government needed to take growing payroll deductions from current workers in order to pay retirees. As part of the strict pay-as-you-go nature of the statutory system, the pension administrators calculated a new contribution

rate annually. In contrast to the United States, Germany's public accounting conventions allowed for no fictional surplus and left the pension administrators with a small "buffer" amount that could cover benefits for less than two months. This rate, hovering just below 20% was, without reform, expected to reach over 30% (split between employer and employee) by 2030.

Accordingly, the Red-Green government of Chancellor Schröder faced an unappetizing set of options when it took power in September 1998. It could cut benefits, raise payroll taxes, tinker with benefit formulae, or find a way of switching the population's aggregate dependence for old-age benefits from the statutory PAYGO system to some kind of pre-funded or capitalized accounts. As much as any other government before it the Red-Green coalition wanted to avoid prevent the contribution rate from rising above 20% – at which point Germany's PAYGO would push deductions from employee paychecks above the (the glaringly) transparent threshold of 10.0 percent.

Not surprisingly, given the vehemence of opposition to any cuts in old-age benefits, the new government was drawn toward the third and fourth options – tinkering with the basis for benefits and switching gradually to plan based on funded pension accounts. In elaborating the government's proposals, Labor Minister Walther Riester found the idea of individual, defined-contribution accounts particularly attractive. Such accounts bolstered the "modernizing" image of the Schröder government and simultaneously provided one of the least painful escapes from the financial crunch that seemed otherwise unavoidable.

The idea of defined-contribution accounts for individuals had great political appeal – especially in a decade of steadily rising equity prices – because it pegged future benefits

to stock-market performance rather than to government-guaranteed levels of fixed income. The inherent uncertainty of future benefits made it difficult for societal actors to bargain over specific benefit levels. Partly for this reason, the division of payments into the defined-contribution accounts became the main substantive issue for debate. The contest over who should bear the burden of contributions to the new accounts was particularly bitter within the SPD parliamentary delegation, where staunch advocates of organized labor confronted the modernizing proponents of the new pension options. The labor-aligned members of the SPD argued that the principle of parity financing required that equal shares of the new pension schemes be born by employers and employees alike. The modernizing wing argued -- with backing from Chancellor Schroeder and some members of the Greens as the junior coalition partner -- that any increases in non-wage labor costs would threaten the already fragile competitiveness of German industry.

The modernizers won this debate, establishing that payments to the supplemental accounts would be made entirely by employees without parity or matching contributions from employers. By late 2000, the new individually funded accounts -- which quickly came to be known as "private" pensions or "Riester-Rente" -- were announced as the centerpiece of the proposed legislation. The accounts were to be introduced gradually, with individuals allowed to contribute steadily increasing increments of their gross wages, beginning with 0.5% in 2001 and rising to a maximum of 4% by 2008. There were direct subsidies available for low-income families and families with children. A major advantage of the new accounts was the freedom of contributions from income tax and, until 2008, from

social-insurance contributions (approximately 20% of gross wages).

Having won the struggle over financing of the individually funded accounts, the modernizers in the Red-Green government were able to enact the initial provisions for pension reform through approval in Germany lower legislative house, the Bundestag, where they held the majority. Full execution of the reform would still require a vote in the upper chamber or Federal Council (the Bundesrat), whose approval was necessary for the fiscal authorization to finance the government subsidies and administrative investments entailed by the reform. Even without full fiscal authorization, however, the enactment of a legal framework for individual or private pensions signified a dramatic step toward the market and away from state-guaranteed benefit levels.

IV. EMERGENCE OF A COALITION FOR FUNDED COMPANY PENSIONS

Significant though it was, the government's establishment of individually funded pensions left some important questions unresolved – particularly whether to adapt the existing company-organized pensions (known as Betriebsrente) to the general scheme for defined-contribution pensions. Company-level pensions became increasingly important in the debate between the initial legislative steps in late 2000 and full fiscal authorization in May of 2001. Through early 2001, the opposition Christian Democrats (CDU) had considered it

tactically advisable to play the role of a responsible partner in a bipartisan effort for necessary reforms. In March of 2001, however, the CDU opted for tactical reasons to withdraw from the consensus talks for reform. Accordingly, the Red-Green government turned back to organized labor for the renewed support it would need to push its reform through both the Bundesrat and the Bundestag without the CDU's support. The coalition's renewed dependence on organized labor gave the unions enhanced leverage to push for company-level variants of the defined-contribution plans that might bring this important new category of social policy under the rubric of collective-bargaining.

Already by the early months of 2001, individual trade unions had begun to reconsider their opposition to defined-contribution pension alternatives. The construction union (IG Bau) and white-collar employees (DAG) were among the first to recognize their need to offer members a union-sponsored alternative to the purely individual Riester-Rente (Handelsblatt, 22 February 2001; Associate Press Worldstream, 13 February 2001). The metal workers (IG Metall) and unified service workers (Verdi) soon followed suit (Die Zeit, 12 March 2001; Handelsblatt, 12 April 2001). The plan for defined-contribution pensions at the company level reopened the possibility that unions might extract pension contributions for their members as part of their wage negotiations. Such arrangements in turn promised a very real chance of re-establishing the principle – held nearly sacrosanct by German unions – of parity financing and perhaps even of obtaining 100% employer-financed accounts in the medium and longer-term.

The primary modality by which company pensions were to be adapted to the defined-contribution framework was a new organizational form, the so-called

“Pensionsfonds.” Already existing vehicles for company pensions included four schemes that ranged from outsourced insurance arrangements to company-benefit plans, all based on the defined-benefit approach. In contrast to these vehicles, the new “Pensionsfonds” were to be entirely capitalized (kapitalgedeckt) through agreed-upon, or “defined,” contributions. Like the individual Riester-Rente, the Pensionsfonds would be invested in a range of assets whose value might fluctuate and produce variable benefits set by the market rather than the state. The Pensionsfonds would have tax advantages similar to the new individual Riester-Rente.

Because they were fully funded through tax-shielded contributions, the new Pensionsfonds differed quite clearly from the earlier insurance schemes available for company and occupational pensions. These earlier implementation schemes (Durchführungswege) included:

Direktzusage.	Employer-financed benefits paid directly to retirees after the requisite number of years.
Unterstützungskasse	Pension-servicing firm, which collected payments and distributed benefits on behalf of the employer, who remained legally responsible;
Pensionskasse	Independent insurance company, which invests insurance premiums as it sees fit in exchange for direct contractual obligations to insured employees;
Directversicherung	A pension product financed by joint contracts between the employer firm and the insurance firm, with insured employees as beneficiaries.

The new Pensionsfonds enjoyed some advantages that went beyond the tax-shielded status of the new individually funded accounts. In particular, employee contributions under the company schemes could be set at 4% immediately (i.e., as of 2002) rather than phased in

gradually as for the individual Riemer-Rente. Such employee contributions would be tax-shielded and through 2008 exempt also from social-insurance deductions (but after 2008 shielded only from income tax). In the latter rounds of pre-enactment negotiation, the unions also obtained slightly but decisively different tax treatment for employer contributions. Deferred pension benefits were particularly attractive to employers when they could be offered in lieu of wage increases. Under the final legislation of 2001, employers could contribute to pension accounts in lieu of wage increases (an arrangement known as Entgeldumwandlung). This form of compensation depended upon negotiated employer contributions that would remain tax-shielded and also shielded from social-insurance contributions through 2008 and beyond (Sueddeutsche Zeitung, 1 September 2001; Versicherungswirtschaft, 1 October 2001). Given the fiscal crisis looming over social benefits, in which pension entitlements were a large part, these marginal tax advantages of employer-financed contributions made the new Pensionsfonds look distinctly advantageous in comparison to other pension options. Subsequent legislation in 2004 introduced a sustainability factor (Nachhaltigkeitsfaktor), which enabled the governing coalition to impose fractional reductions in benefits as the ratio of contributors to pensioners declined. This change amounted to a major recalibration (Pierson, 2001) and sparked sharp dissents from within the SPD, leading the cabinet to limit overall losses from the sustainability calculation to no more than 46% of the baseline average wage. If the Nachhaltigkeitsgesetz signaled potentially serious reductions across the board, additional legislation in 2004 (Alterseinkunftssetzung) extended the important tax advantages given to employer-based plans in the original reform to some of the traditional company-based

insurance plans in the older category of Pensionskasse (Schulze and Jochem, 2007). Once again, refinements to the initial reform gave marginal but decisive advantages to the employer-based plans.

The business community's assessments of the new Pensionsfonds revolved around the distinction between company-specific plans and industry-wide plans organized through the new arrangements for defined-contribution Pensionsfonds. The initial position of the employers' association (BDA, Bundesvereinigung der Deutschen Arbeitgeberverbände) was voiced by its president, Dieter Hundt, a well-known proponent of limiting labor's role in the implementation of social policy. According to Hundt, the new pension laws opened "a high degree of pluralism and investment freedom in the implementation of ... old-age provisions, whether through private, company, or industry-wide solutions" (Hundt, 2001). This pluralism, Hundt argued, was a bulwark against union pressures to privilege the treatment of pensions benefits set in labor-management negotiations, which, in Germany typically occurred through industry-wide umbrella agreements.

The result of the legislation as enacted was to create a broadened range of new options (Durchführungswege) for capital-funded pensions, with contributions split between individuals and employers according to a range of formulas depending on whether the rules of implementation were worked out through individual choice (as regulated by the legislation), company-level decisions, or sector-wide collective bargaining. The consequence was that the weight of the different options would depend at least as much on disaggregated choices made at the firm and sector levels as on the weight of contending societal actors in the process of policy formulation.

V. POST-ENACTMENT POLITICS

The differing assessments of the new pension arrangements became clearer after the range of options was settled through the Bundesrat's approval in May 2001. The peak association stuck to its commitment to pluralism in contracting possibilities that could be tried and compared. Under Dieter Hundt's leadership, the employers' association steadfastly opposed any efforts to generalize the practice of making employer contributions to pension funds a mandatory part of industry-wide wage agreements. At the level of more specific sectoral groupings, employer groups displayed more variegated preferences.

The finance and insurance industries strongly favored the development of the Pensionsfonds, whether implemented at the company or industry-wide level. For the larger banks and insurance companies, the defined-contribution plans represented a potentially huge new market for asset-management services. According to industry experts, the management of individually funded Riester-Rente was too costly to provide profitable business for the insurance providers (*Boersen Zeitung*, 6 September 2001). The company Pensionsfonds were expected to generate a much more attractive flow of business, but the proportion of their assets that could be invested in equity portfolios remained a matter of controversy between the Finance Ministry and the Labor Ministry. The insurance companies sided strongly with the Finance Ministry in favor of flexible equity quotas and against the Labor Ministry's preference for strict limits on the proportion of assets that

could go into stock-market investments (for example, see Allianz Insurance's position in the *Boersen Zeitung*, 25 October 2001). When the two ministries agreed in November 2001 that there should be no maximum limit on equities in the investment portfolios, insurance companies quickly touted investment flexibility along with scale economies in advertising the advantages available to German citizens through the company pensions instead of the individual accounts (*Boersen Zeitung*, 6 November 2001; *Sueddeutsche Zeitung*, 24 November 2001).

Small and medium sized employers had a different set of concerns. Many of these firms had long invested in the older vehicles for company pensions, most commonly the direct-insurance schemes (*Direktversicherung*) offered by third-party insurers. Once the regulations governing the *Pensionsfonds* grew clearer, small-business spokesmen said they entailed substantial costs caused by new book-keeping and investment services that would have to be built up internally or outsourced (*Versicherungswirtschaft*, 1 October 2001). Partly for this reason, the large insurance firms such as Allianz sought to offer services for all five company-level pension vehicles, the four older schemes as well as the new *Pensionsfonds* (*Boersen Zeitung*, 9 November 2001).

It was hardly surprising that organized labor favored the new *Pensionsfonds* that provided for funded accounts to be financed through firm- and industry-level negotiations. This option tended to pre-empt the possible attractions of the fully individualized accounts known as individual *Riester-Rente*. The *Pensionsfonds* also gave particular trade unions a new role in negotiating – and sometimes in servicing – this new form of insurance. The chemical workers had taken the lead by establishing the so-called “*Pensionsfonds*

Chemie,” while the metal workers followed with a pension agency known as “MetallRente.” By the end of 2001, at least fifty-two collective bargaining units had negotiated frameworks for partial replacement of wages with employer-financed pension contributions under the advantageous conditions available for this particular pension option (Bispinck, 2002).

The degree of involvement by organized labor in such plans generated a good deal of debate. Some members of the SPD’s more left-leaning groups argued that the unions should offer a full range of financial services (interview with Andrea Nahles). Some of these views harkened back to much earlier calls for “investment steering.” The development of MetallRente, the pension service agency established by the metal-workers union, showed that the new arrangements fell short of such pension-fund socialism by a considerable margin. MetallRente quickly became a hybrid entity. It acted as the occupational pension agency for new capital-funded plans that were adopted by many of the firms in the metal-working industry. In this sense, MetallRente built directly upon its links to IG Metall and the patterns of collective wage bargaining that IG Metall followed with the employers association, Gesamtmetall. But MetallRente had to compete with other pension servicing firms, which were free to offer their services to firms in Gesamtmetall, and MetallRente similarly offered its services to firms in many sectors that were trying to utilize the new options for funded pensions created by the 2001 legislation. With regard to asset management – the heart of most concepts of pension fund socialism – Metallrente played no role (interview with Heribert Karch, Metallrente). Indeed, in its evolution, Metallrente was sufficiently concerned to avoid criticism for making “political”

investments that it outsourced the asset management function to the pillar of Germany's private financial services sector, Allianz Insurance.

Beyond organized labor and the the financial services industry, there were many other societal interests whose preferences among the mix of pension alternatives did not quickly become clear. These interests tended to be less well organized within Germany's highly structured landscape of interest associations – such as individual free-lancers and self-employed professionals. In principle, these groups could exert an important effect on the refinement of different options and their relative weight in structuring future pension politics. Perhaps most important in practical terms, however, was the growing view that the individual Riestler-Rente had too many restrictions and disadvantages in comparison to company- and industry-level pensions under the second pillar. By the end of 2003, the sectors that had negotiated industry-wide pension possibilities covered over 19 million employees (check: Bispinck, 2004). Meanwhile, parliamentary observers estimated as late as 2004 that the number of people opening new contracts under the plan for individual Riestler-Rente was somewhere in the tens of thousands per year. Already by 2003, it was clear that group-negotiated pension options were gaining the upper hand. There was strong momentum among unions to negotiate industry-wide arrangements for all of their members. On the management side, there were advantages to company-level arrangements that could be matched to the needs of particular occupational groups on terms that might vary considerably from firm to firm. Since both of these approaches were facilitated under the legislation creating the Pensionsfonds, the eventual dominance of one or co-existence of both will not depend on any centralized decision, but rather on a complex mix of

separate decisions made at multiple levels of aggregation.

VI. CONCLUSION

Germany's recent pension reforms represent a major shift in the underlying terms by which the country makes ongoing arrangements for old-age insurance provisions. The real-world magnitude of the shift will, however, depend heavily on post-enactment implementation at the level of industry-level bargaining and in some cases individual firm-level negotiations. The reform allows employees to dilute their dependence on the public system by investing in purely individual pension accounts. It also enables managers to offer, and social partners to negotiate, supplemental pension arrangements at the company and the industry level. These new options may gradually temper political support for the statutory pension system. They may over time also alter the relative power of management and labor in shaping social protections. What is most notable about the reform to date, however, is how closely the bargaining process reproduced the pre-existing power relations. If the pension reform is going to cause a change in the relative power of unions or employers, that change will hinge much more on post-enactment politics than on the way the legislation was written.

This finding makes it clear that the mechanisms of institutional changes hinge on more than formal legislative enactments. As Kathleen Thelen has shown (2003), the identification of specific mechanisms of change is never simple. Thelen draws a distinction between layering and conversion as two different kinds of gradual institutional

change. The introduction of the individual pension accounts in Germany clearly exemplified the layering of an option for individualized pensions on top of the public or statutory arrangements. At the same time, however, the formal options do not alone tell us much about the course of future institutional evolution. The layering of formal rules observed in Germany's 2001 pension reform has in its implementation clearly taken on the traits of institutional hybridization (Zeitlin and Trubek). There is no doubt that the strong form of social partnership implicit in prior arrangements has been diluted. Periodically negotiated contractual agreements to share pension costs between employer and employee are not as secure as legislatively required parity financing. Yet, the shift of pension arrangements away from intergenerational PAYGO liabilities toward fully funded accounts need not necessarily lead to the end of jointly financed benefits. If anything, the rapid growth of company- and industry-level agreements shows that the social partners are moving toward a hybrid but distinctive solution of their own rather than rushing toward solutions adopted from foreign models.

Accordingly, while the open-ended nature of the reform is one of its notable characteristics, there are three more specific conclusions that can be drawn. First, contrary to initial commentators, the Red-Green pension legislation did not trigger a wholesale conversion toward American-style defined-contribution plans. The individually-funded or "private" pensions unquestionably represented a major step in the direction of voluntaristic, market-based benefits. But these accounts also remained far more circumscribed than their American counterparts in magnitude and investment flexibility. More important, toward the end of the legislative process, the "private" pensions were balanced by company- and

industry-level options that became even more important in the post-enactment efforts to mobilize support for one or another of the newly available alternatives.

Second, the reappearance of company-level and industry-wide solutions shows that both the cross-class approach and the Varieties-of-Capitalism literature offer plausible explanations for Germany's resistance to simple neoliberal recipes for change. Indeed, the coexistence of the company-level solutions offered by management and industry-wide solutions negotiated by unions suggests that these two theoretical perspectives are quite compatible and that they each offer important insights into Germany's adjustment capabilities.

Third, although they each offer explanations that fit central features of the outcomes observed, neither the cross-class approach nor the Varieties-of-Capitalism approach can easily show why the initial legislation created individual pension arrangements that were so tightly tied to market dynamics. To account for the surprising introduction of market-compatible recipes for pension reform and the subsequent reversion to arrangements more in keeping with the norms of social partnership, theoretical perspectives on alternative mechanisms are more useful. As a case of social policy with substantial redistributive effects, Germany's pension reform was decisively shaped by the initial differences in power that are quite consistent with Jack Knight's emphasis on bargaining mechanisms. The power of organized labor in Germany – combined with its tactical leverage under a Red-Green government – enabled the unions to inject company-level and industry-wide variants of the defined contribution approach into the discussion shortly before final legislative authorization.

As much as the initial power asymmetries shaped the outcome, the process of interaction showed that relative power was also one of the key stakes in the negotiations. The re-establishment of joint or parity financing was unquestionably a key goal for the unions between late 2000 and enactment in May 2001. In light of the uncertainty regarding eventual benefits, it was clear that labor's desire to retain a central position in the implementation of social benefits was as important as the substantive resources at stake. In this sense, there is little doubt that Knight's emphasis on mechanisms illuminates how relative power relations shaped the goals as well as the process by which the contending societal actors bargained.

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