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Abstract

The public pension scheme has been an important element of the successful model of 'Rhenish Capitalism' (social market economy) in post-war Germany. On the one hand, the promise to guarantee status maintenance during retirement sustained the incentives of the labor market in that it promoted individual effort and mobility. On the other hand, the public pension scheme definitely contributed to the legitimization of democratic politics because it corresponded to approved notions of social justice. Not the least for these reasons, in the end, this branch of the social insurance system developed with general approval from the governing parties, the party in opposition, and the social partners. After the legislation of the public pensions reform in 1989 (which became effective in 1992) it was assumed that in Germany no further "structural" reform should enter the political agenda during this century. Nevertheless, in 1997 another far-reaching reform proposal was enacted in 1997 (*Rentenreform 1999*). In the paper the background of the revived reform debate, the (disputed) elements of the reform proposal(s), and the process of compromise-building are analyzed. Special emphasis will be given to the question of whether the conflictuous reform process and the still ongoing debate indicate an end to the long-standing consensus between the large political parties and between the social partners which has prevailed in German pension politics so far and that would be, at the same time, an expression and result of notable changes of the politico-economical conditions in Germany.

Contents

1. Introduction

In 1989 a major public pension reform intended to keep the scheme viable in view of an aging population passed the legislative bodies in Germany. Already five years after this reform act (*Rentenreform 1992*) had gone into effect another and again substantial reform package was enacted (*Rentenreform 1999*). Whereas all major public pension reforms from 1957 up to 1989 were consented among the two large *Volksparteien* (CDU/CSU and SPD), at least when it came to the final vote in parliament, this time the Social Democrats opposed the reform plan, and the government parties had to overrule the objection of the *Bundesrat* by an absolute majority vote in the *Bundestag* in December 1997.

Within the Western world, the 1983 Amendments to Social Security in the U.S. were the first *major* reform predominantly meant to meet the challenge of an aging population. The passing of the *Rentenreform 1992* (Pension Reform Act 1992; hereafter: *PRA 1992*) in Germany six years later preceded policy changes in e.g. Sweden, Austria, Italy, and Finland which were brought about in the early and mid 1990s and are likewise aiming at the schemes' financial viability in the short and long run. Whereas the debate on Social Security in the U.S. flared up again in the 1990s but has not resulted in legislative changes yet, in Germany, the assessment prevailing among political actors after the enactment of the *PRA 1992* that a further *structural* reform had not to be considered much before the year 2010 was revised very soon. What has driven on the German government to pursue further changes although latest demographic projections and estimates of the long-term financial prospects of the pension scheme hardly differed from those of the late 1980s? What were the elements of the Pension Reform Act 1999 (hereafter: *PRA 1999*) and of reforms included in an omnibus bill enacted in 1996 that, furthermore, prevented a continuation of the "Grand Coalition" of the Christian parties (CDU/CSU) and the Social Democrats in pension policy and even led the SPD to announce a reversal of central parts if the party would be back in government after the federal election in autumn 1998? Why is, despite the legislation of 1996 and 1997, the political debate on the future of the public pension scheme[1] still not fading? Have these developments altered popular

1) The "public pension scheme" (*Gesetzliche Rentenversicherung*) is made up of the regionally organized schemes for *blue-collar* workers and the (one) scheme for *white-collar* employees. They are identical in regard to contributions and benefits. Furthermore included is the (much smaller) scheme for *miners* where contributions and benefits are higher due to its "bifunctional" objective. This scheme combines the first and second (occupational) tier of old-age security. The public pension scheme covers about 80 percent of the total labor force. Its expenditures (above 10 percent of GDP during the 1990s) amount to roughly 70 percent of total spending on old-age security. The remaining 30 percent comprise the civil servants' pension scheme, occupational pensions and life insurance companies' paying off (Schmähl 1997: 111-5). The civil servants' pensions (which will not be dealt with here), financed out of current tax revenues, are affected by the aging process in like manner as the

support for and confidence in the sustainability of the public pension scheme? Do the latest reforms in Germany and the ongoing debate on demands for more fundamental changes fit into a common pattern that can be observed in several OECD countries differentiated by the type of the existing pension system (Myles/Quadagno 1997)?

The underlying hypothesis of this paper is that both the pension reforms of 1996/1997 and the obviously no longer attainable consensus in pension policy are linked to an ongoing reconceptualization of Germany's economic and societal order of *social market economy*. Universal changes (like population aging and economic globalization) combined with specifically national developments have triggered attempts to reinterpret the attribute 'social' of Germany's market economy. In order to substantiate this hypothesis and to partially answer the questions raised above I will first turn to the interrelation of the most central public pension reform of 1957 and the concept of social market economy and to recent developments of the political economy putting strain on the established consensus. Next, I will give a few information on the demographic development in Germany and on the limited set of policy changes by which a public pension scheme can be adjusted to population aging (section 3.). In the fourth section the recent reforms, how they came about and their impact are analyzed. The subsequent section (5.) discusses whether the (continual) conflicts imply an end of the traditional consensus in pension policymaking, and in the concluding section I deal with the question whether the time is ripe for radical changes. Due to the interwoven structure of the German *social insurance state* it is not unproblematic to study the development of public pension policy in isolation. Thus, where necessary I will take into consideration the broader context of social policy-making in Germany and interaction effects.

2. Rhenish Capitalism and Public Pensions

Trajectories Leading to Consensus

'German capitalism' is one distinct variant (or even the prototype) of what Michel Albert (1992) has labelled 'Rhenish Capitalism' (Streeck 1997). The concept of *social market economy* functioned as an 'irenic formula' (Müller-Armack 1950) that reconciled the basic positions of economic and political liberalism, democratic socialism and christian conservatism, and its adoption facilitated a stable welfare state consensus. This model of economic and societal order encompassed two complementary goals: Firstly, it aims at *protection of the market*, i.e. to establish and maintain functioning competition on all markets for the sake of economic efficiency. At the

unfunded public pension scheme (Färber 1997).

same time, it secondly aspires *protection from the market* when labor and social policies modify the results of the market process and thus people's life chances according to approved standards of social justice. The shared belief of parties, associations and other political actors that by pursuing the twofold objective of corresponding institutional arrangements it would be possible to increase economic efficiency *and* ensure social stability and integration facilitated a willingness to compromise. The conflict between economic policy and social policy which agonized development during the Weimar Republic was transformed into reconcilable positions. Further enhanced by the results of the beginning "economic miracle" it promoted an understanding to be (socially responsible) "stakeholders" in a positive-sum game rather than to act as "veto players" with short time horizon. Of course, the general orientation toward compromise and consensus does not mean that there were no disputes over the various steps of labor and social policy development or that party politics was absent.

The public pension reform 1957 is a case in point: It was controversial until the final vote in the *Bundestag* (Hockerts 1980). Nevertheless, this reform act *(1)* became the "cornerstone" of post-war social policy reform and stands out as its most popular element, and *(2)* it paved the way for a broad consensus on pension policy that lasted until the early 1990s.[2] Brought about during the "hot phase of the Cold War" this reform contributed to the support for the new *economic order* of "social market economy" and further consolidated the legitimacy of the restored *democratic system* in general. It could develop these stabilization effects (apart from helping the CDU/CSU to win the absolute majority of votes at the subsequent federal election) because *(a)* benefits went up immediately (by more than 60 percent in spring of 1957) so that "being old" was considerably less synonymous with "being poor", *(b)* rather than providing a floor of retirement income, earnings-related pensions were actually made a wage replacement that was expected to rise to a higher ratio, *(c)* pensioners were given continuous participation in annual wage growth,[3] *(d)* the

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2) It became the "cornerstone" because an encompassing welfare state reform failed after the incomprehensive structure of the German *Sozialstaat* had been reinstated and new programs were added and others reformed one by one. The Social Democracts were the protagonists of an encompassing reform but gradually departed from it when it turned out that corresponding demands were not very appealing and could not win a majority even within the party itself (von Berlepsch 1991). The pension reform bill they introduced in 1956 was largely in line with the one the government finally presented, and since there was no longer a fundamental dissent the Social Democracts pushed the government to consider further liberalizing provisions (Hockerts 1980: 342-63) as they had repeatedly done already before World War I (Benöhr 1981).

3) Despite a series of *ad hoc* decisions on benefit indexation notably after 1976, in the long run, *both* net benefits and net wages increased by roughly 125 percent in *real* terms between 1957 and 1995 (see *Table 1*, below). One

reform met the desire for "security" (Kaufmann 1973; Braun 1978) and, finally, *(e)* embedded principles corresponded to prevailing intuitions of distributive justice (Kohli 1987). It is thus not unfounded to argue, as Nullmeier/Rüb (1994) do, that the public pension scheme as it was institutionalized in 1957 created a 'welfare state republicanism' (*sozialstaatlicher Republikanismus* - Nullmeier/Rüb 1994: 68-71) since it accomplished political integration via an institutionally constituted lifetime participation in economic growth on the basis of individual effort. Titmuss' (1974: 30-1) disparaging characterization of the 'industrial achievement-performance model' as a 'handmaiden' model and the accompanying welfare institutions as 'adjuncts of the economy' ignores the contribution to the lasting legitimacy of democracy in the Federal Republic and to the political stability of the public pension scheme itself as it enjoyed almost unanimous support from the social partners, political elites and the public.

Indeed, that productivist design, a seemingly strict link between benefit level and work merit, was perfectly compatible with maintaining labor market incentives and thus met employers' interests (von Winter 1997: 185-90). The removal of basic security elements from benefit calculation (Döring 1990)[4)] and the prospect of receiving a comfortable "retirement wage" reflecting lifetime work effort undoubtedly induced employees to strive for upward occupational mobility and a long, uninterrupted employment career as well as it sustained their willingness to pay compulsory contributions. Moreover, conveying the insight that a socially appreciated and an individually beneficial life course coincide made other modes to gain the means of subsistence comparatively inferior and contributed to the growth of labor supply.

Furthermore, a relatively high replacement ratio (coming at an initially low and always uniform "surcharge" on the firms' wage bill; the

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advantage of linking pension benefits to wage development is that during retirement pensioners' income does not fall behind if there is real wage growth, i.e. the year of entering retirement is of no importance. At the same time, this mode of indexation largely avoids budget problems in case of *stagflation*, a problem U.S. Social Security ran into almost immediately after introducing the cost-of-living adaptation in 1975.

4) The payment of a (however insufficient) "minimum pension" (topped up by earnings-
related elements) was the main reason for federal grants to the (blue-collar) pension scheme since 1891. After 1957 those federal grants out of general tax revenues (about 30 percent of the scheme's total expenditure in the late 1950s) were meant to cover non-contributory elements of pension benefits (foremost, credits for time spent in military service, education, unemployment etc.) but not specified as concrete reimbursements, rather, were (loosely) linked to the development of gross wages until 1992. The lump sum subsidy was (and still is) regarded as the state's contribution to *ex ante* risk redistributions and further interpersonal redistributions occuring in a *social* insurance scheme.

contribution rate remained unchanged at 14 percent until 1968) relieved the employers from selective demands for occupational pensions to supplement public pensions but did not rule out firms' own initiatives to attract and motivate workers when they "decommodified" labor themselves.[5)] This meant an advantage for the unions as well: They were not forced to burden collective bargaining with the supplementary pension issue. Unions' strength was further enhanced because the pensioners were made implicit allies. Due to index-linking of pension benefits they subsequently gained from unions' successful wage policy. Exactly this connection was made a strong argument in the debate before the enactment because one feared that unions would be encouraged to pursue an "expansive" wage policy causing wage-price spirals. However, those objections proved unsubstantiated. Unions were willing and able to pursue a coordinated wage policy *largely* in line with productivity growth and without triggering strong inflationary pressure. In macroeconomic perspective, not impeding workers' inter-firm mobility by the "millstone" of hard-to-portable occupational pensions, predominantly public earnings-related retirement benefits could help to optimize the allocation of labor.

Finally, the (*individual*) employers' consent in the restructured public pension scheme was promoted by the fact that easy access to disability pensions and early retirement, provisions which both were further liberalized in the 1970s, provided an opportunity to "rejuvenate" the firm's workforce when older and less productive workers could be smoothly referred to those options because, compared to continuing work until the age of 65, the benefit reduction was small. The generosity of these provisions became salient after 1974 when they were strategically used to shed surplus workers. Regularly, unions and works councils (as well as the younger workforce) supported this "externalization" strategy which resulted in a substantially declined labor force participation rate of workers in the age bracket 55 to 64.

There are two further and somewhat interrelated factors to be taken into account for the explanation of the stable consensus that prevailed in public pension policy.

(1) The reform of 1957 meant *the* decisive step toward a pay-as-you-go financing of public pensions albeit the final step, the transition to a small

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5) In West Germany, hardly ever more than half of *private* sector employees, predominantly those in larger firms, have been covered by occupational pension plans (and a considerably smaller percentage of elderly actually receives those benefits) and, since the mid-1970s, the trend in coverage was clearly downward. For most recipients the actual level of this supplementary retirement income is low whereas a small percentage of former (white-collar) employees, i.e. those with earnings at or above the ceiling on contributions, receive comparatively high amounts (Bundesregierung 1997: 122-4; Ruppert 1997; Schmähl 1997).

contingency reserve, took place in 1969. The debate on this central element of reform went along with the rise in the 'generational compact' metaphor. It denotes the relations of solidaristic exchange as a self-reproducing cooperative solution based on serial reciprocity. But, above all, the *fictitious* generational compact is a conceptual arrangement to overcome the temporal cleavage of contributing to and receiving benefits from the pension system (Zacher 1987: 726-9; 1991: 36-41). The time horizon of the insured might cover about sixty years – from entering employment until termination of benefit payment. For the legitimacy of the system *institutional trust* is thus crucial, i.e. the insured have every reason to expect 'security' because the scheme is stable and reliable in the long-run. Since an unfunded pension scheme has to be guaranteed by the state the redemption of claims to benefits earned during employment is ultimately dependent on the state's 'power of compelling successive generations of citizens to become insured' (Beveridge 1942: 13). The insured need to be permanently assured that the state's ability to claim parts of future workers' income is maintained and used in a way that no 'rule instability' (Lindbeck 1994) comes from democratic politics which would damage their security expectations. Constitutional protection (granting claims a property rights status) and institutional design (separated funds, self-administration, automatic adjustment formulas and further pre-commitments) are means to insulate the system from *political* risks (Diamond 1997).

However, the long-term horizon of the insured diverges from that of democratic politics: Institutional stability has to be organized as a permanent process, and a matured, unfunded pension scheme is particularly sensitive to economic and demographic fluctuations which occasionally require short-term adaptations. The strong inclination of all actors involved in this policy arena to consent stems from the problem to reconcile the different time horizons. Ensuring the scheme's viability in a dynamic environment and, at the same time, sustaining institutional trust should be accomplished most easily if *(a)* the political elites are consensually committed to the present institution, *(b)* rule changes aspire to incorporate a long-term, consistent perspective and thus occur at infrequent intervals and, if they are deemed necessary, *(c)* are unanimously concluded so that legislated modifications will be sustained regardless of a change in government.

The distinction between 'credit claiming' and 'blame avoidance' strategies (Weaver 1986; see also Pierson 1997) is useful to explain why the inclination to consent prevails in different choice situations: It is, of course, somewhat unproblematic to reach a consensus between government and opposition when an *expansion* of the scheme is at stake. The expectation of the opposition to be rewarded at the next election when actively supporting a liberalization of entitlements might even temptate the party to outbid government proposals. Only an unfunded pension scheme permits such an opportunistic behavior because the costs of promising better benefits accrue in a more or less distant future. In Germany, an 'unrestained outbidding' between the CDU/CSU and SPD reached its climax in 1972 (Hockerts 1992) and subsequently, in the wake of the oil-price shock crisis, triggered "rule instability" as a politically induced risk.

If *retrenchments* are considered the government's endeavor should be to take the opposition "on board" in order to share the blame because the elderly and those close to retirement age make up a large part of the electorate (in 1993, 33.7 percent of citizens entitled to vote were 55 years and older in Germany). It might be wise not to refuse cooperation because the opposition cannot be interested to work on a delayed legislation after it had returned to government. Trying to influence the direction and magnitude of retrenchments which are generally conceived as inevitable can be beneficial (and possibly opens up the chance to claim credit for having warded off the "worst"), all the more, since attempts to save on expenditure have to be accompanied by phasing-in or phasing-out provisions in order to give those cohorts affected a chance to individually accomodate to enacted changes. These provisions reduce the immediate savings effect but can be more generous the earlier a reform is passed. It means a further incentive not to delay retrenchments because the public's perception of policy stability is best preserved if actual impairments will occur far in the future and predominantly affect insured of age-groups presently less concerned with retirement.

(2) Pension policy is a complicated and very technical matter and thus preponderantly an experts' and special commissions' affair. Moreover, a comprehensive evaluation of the impact of reform proposals requires to involve independent professional expertise and the knowledge of the pension scheme's administration. In Germany, this situation meant that a small dense policy network had been established which was capable of largely insulating the policy development from outside interferences. All actors involved in actual decision-making, including representatives from *both* "social partners" and the scheme(s)' administration, were normatively committed to the existing institution and its objectives and principles. This "grand coalition" of defenders, aware of the "lock-in effects" as well as of the political success, jointly warded off proposals which were non-incremental and would represent a break in continuity. Instead, they preferred *technical* solutions within the given framework which, fostered by mutual learning processes due to close interactions and commonly shared knowledge, increased the likelihood to be acceptable to all of them. Such a cooperative strategy implies *(a)* that compromised and largely "conservative" reform packages promote the perception of time consistency on part of the public and *(b)* that the politics of pension policy was highly *de-politicized* and, what is especially true of the *PRA 1992*,

de-parlamentarized (Hinrichs 1993: 15-6).[6)]

Therefore, it remains to be answered what has changed after 1989 that hampered the continuance of the traditional consensus stretching well beyond public pension policy and of which, for the time being, the introduction of the long-term care insurance in 1994 was its last manifestation (Götting *et al.* 1994).

Developments Bringing Pensions Back on the Political Agenda

Unification of West and East Germany was the most important factor posing current problems of financing the public pension scheme. The *Renten-Überleitungsgesetz* which unanimously passed in 1991 extended the West German system (including the *PRA 1992*) to the five new states. It contained several temporary provisions intended to smoothen the transformation process. As long as those pension supplements have not melted away they imply considerable West-East transfers out of contribution revenues and are causing a higher contribution rate (in overall Germany) than otherwise necessary.[7)] The dramatic decline of gainful employment from an extremely high level in East Germany and a notable reduction of covered employment in West Germany after the end of the "unification boom" led to a concomitant rise in registered unemployment. The labor market development thus implied a loss of revenues for all social insurance schemes and required further increases of the contribution rate(s).[8)] Additional expenditure arose because higher

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6) For an excellent analysis of the pension policy-making process in Germany, see Nullmeier/Rüb (1993); on the pension "policy community" see also von Winter (1997: 384-400). The consensus-governed style of policymaking prevailing in U.S. Social Security until the 1970s and the strong role of the program administration in that process (Derthick 1979) resembles the German case.

7) Regarding public pensions, a somewhat paradoxical result of the complete "institution transfer" to East Germany, carried out under time pressure and meant to avoid repercussions on the West German institutions, is the *ex post* confirmation of the former GDR's employment and gender policy when the average benefit of male and notably of female pensioners in East Germany is already lifted above (and, for some time, will remain above) the West German level (Bundesregierung 1998: 92) and because of that considerable inter-regional transfers of contribution revenues are taking place.

8) The unemployment insurance actually transfers contributions on behalf of unemployed beneficiaries to the public pension scheme, the statutory health and the long-term care insurance on the basis of 80 percent of notional gross earnings which are used to calculate unemployment benefits. The statutory sickness funds pay contributions to the public pension scheme, the long-term care and unemployment insurance for recipients of sickness benefits based on the same formula. The public pension scheme transfers contributions to the

open unemployment was prevented as a growing number of older long-term unemployed (in both parts of the country, but relatively more in East Germany) entered retirement at age 60. While in the late 1980s annually about 50,000 older unemployed made use of this pathway into retirement the figure rose to nearly 300,000 in 1995. In that year 37 percent of all pension benefits granted to *males* in unified Germany were due to previous unemployment (VDR 1997: 52). Beside reducing the number of contributors, early retirement causes additional expenditure at the year of entry and also during subsequent years if the standard retirement age is taken as a yardstick. Finally, the share of employment liable to contribution payments is shrinking due to an accelerated erosion of the "standard employment relationship". Although empirical estimates differ widely it is uncontested that the number of marginal part-time workers (Bogai/Classen 1998) and of "false self-employed" (one-man business having only one customer which, very often, is the former employer) has grown during the 1990s. At present, these legal types of "contribution evasion" intensify the revenue problems of social insurance schemes whereas, in future, they might push up the number of elderly with insufficient entitlements.

Table 1: *Social Expenditure and Public Pension Financing in Germany*

Year	Social Expenditure in Percent of GDP **(1)**	Combined Contribution Rate to Social Insurance Schemes **(2)**	Public Pension Expenditure in Percent of GDP **(3)**	Net Standard Pension in 1991 DEM/*in % of Real Net Average Earnings* **(4)**	Contribution Rate to the Public Pension Scheme (*Upper Earnings Ceiling; DEM/month*) **(5)**

long-term care insurance and the statutory sickness funds on the basis of individual pensions, i.e. half of the contribution is deducted from a "gross pension" while the "employers' share" constitutes an additional expenditure of the public pension scheme. It is quite obvious that more persons paying contributions out of *actual earnings* is advantageous for the financial situation of *all* social insurance schemes and, in tendency, imply lower contribution rates.

1957		21.6		8,868/*70.2*	14.0 (*750*)
1960	21.7	22.4	6.4	9,497/*66.4*	14.0 (*850*)
1970	26.0	26.5	7.7	14,447/*64.6*	17.0 (*1,800*)
1975	33.4	30.5	9.8	17,228/*66.4*	18.0 (*2,100*)
1980	32.2	32.4	9.6	19,852/*70.6*	18.0 (*4,200*)
1985	31.4	35.1	9.5	19,233/*71.9*	19.0 (*5,400*)
1990	29.0	35.5	9.0	20,412/*67.5*	18,7 (*6,300*)
1992	32.4	36.8	9.3	20,458/*68.2*	17.7 (*6,800*)
1995	34.0	39.3	10.4	20,354/*71.5*	18.6 (*7,800*)
1996	34.9	40.8	10.6	20,213/*69.7*	19.2 (*8.000*)
1997	34.4	42.0	10.5		20.3 (*8,200*)
1998		42.1			20.3 (*8,400*)

Sources: **(1)** = BMAS 1998: 20-4 [figures not comparable to OECD calculations; 1997 figure estimated]; **(2)** = BMAS 1994: 270; BMAS 1998: 519; **(3)** = BMAS 1998: 40-4; **(4)** = VDR 1997: 206 ["standard pension" is based on 45 years of employment at always average earnings; all figures relate to West Germany]; **(5)** = VDR 1997: 209 and 211 [1992 and after: contribution assessment ceiling valid in West Germany].

All in all, unification and the labor market development have considerably contributed to the increase in the combined contribution rate to all social insurance schemes from 35.1 percent in 1990 to 42.1 percent in 1997 (*Table 1*). About three percentage points of this rise are due to West-East transfers within the public pension scheme and unemployment insurance. In 1996, when the new long-term care insurance was fully implemented and a contribution rate to this scheme of 1.7 percent was levied the symbolic benchmark of 40 percent was breached for the first time. This development and the publication of a report by the *Prognos* institute, commissioned to evaluate the financial prospects of the public pension scheme, predicting a combined contribution rate within the range of 48.6 and 52.7 percent in 2030 (Prognos 1995: K-6) pushed the issue of non-wage labor costs into the focus of attention, especially since it was put into the interpretative framework of "globalization".[9] Due to the assumed negative effects on Germany's international competitiveness and

9) Virtually, for employers the split between direct wages and non-wage labor costs is purely artificial. They are interested in *total* labor costs (whereas for the competitiveness of a national economy or a certain industry the *unit* labor costs, which take into account labor productivity, are important). But rising contribution rates to social insurance schemes represent a problem for employers as they imply a *mandated increase in total labor costs* determined outside collective bargaining. Employers thus face the challenge to either have this increment being taken into consideration during subsequent bargaining rounds or to accomplish higher product prices at the market. A third alternative to offset the cost push is to enhance labor-saving rationalization measures.

on the level of employment the actual contribution rate to the public pension scheme (as well as to the other social insurance branches) was generally deemed as too high already.

Within this context the issue of benefits regarded as "alien" to a social *insurance* scheme (*versicherungsfremde Leistungen*) gained unprecedented prominence in the debate on how to curb the seemingly incessant rise in contribution rates. It was discussed either to eliminate those benefits altogether or, if considered as genuine tasks of the general public, to shift the financing to (preferably indirect) taxation. Although the definition of "non-contributory benefits" (to what extent they represent the essence of a *social* insurance scheme) and thus the volume of "mis-financed" expenditure are still disputed, in principle, CDU/CSU, SPD and the social partners agreed to lower non-wage labor costs through increased fiscalization of social insurance expenditure. Independent of whether "globalization" means an actual and exogenous threat or not, interpreting obvious problems of unemployment and social security financing within this context helped to get going all actors' preparedness for reform although they differed over the direction and magnitude.

Moreover, the quarrels preceding the introduction of an unfunded long-term care insurance enhanced the debate on the consequences of population aging. Strongly pushed by the mass media "generational equity" which, since the early 1980s, has dominated the dispute on the future of Social Security in the U.S., finally arrived as an issue in Germany.[10] Calculations of the "internal rate of return" of contributions to the public pension scheme had been almost absent until the end of the 1980s but after that were carried out more frequently and received much more attention than before. Quite unsurprisingly, they show that, if compelled to further contribute to an unfunded scheme, each birth cohort will make a "worse deal" than the preceding one.[11] Independent of whether

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[10] The implications of demographic change are a most suitable theme to put the public into a state of uncertainty because the mass media could and *did* portray them in most vivid manner as dramatic discontinuities (grave intergenerational *in*equities) and universal threats ("war between generations"). It was thus possible to create a high degree of attention and to influence the political agenda setting (Bräuninger *et al.* 1998). On the "career" of this issue in the U.S. and Canada, see Cook *et al.* 1994.

[11] The latest one was carried out by the *Institut für Altersvorsorge* which is a subsidiary of, among others, the *Deutsche Bank* (*Frankfurter Allgemeine Zeitung*, No. 153/July 6, 1998). "A *social* insurance scheme, however, is not a state-run life insurance solely aiming at individual equity and a maximum return on one's contributions. Rather, it pursues, in every respect, *politically* shaped goals of old-age income security and political risk balancing when the concepts of *commutative* and *distributive* justice are combined (Hinrichs 1997: 13). Due to the complex benefit package a public pension scheme provides and to which no real private alternative exists those calculations and comparisons are rather meaningless – apart from methodological problems (Green Book 1993:

(alternative or additional) payments into private, fully funded schemes would actually prove more profitable, highlighting the consequences of the aging process in regard to generational equity and possible macro-social tensions between generations had, at least, three effects: *(a)* While support for the state's responsibility to guarantee income security at old age remained high, like in the U.S., it increasingly became at odds with the public's declining confidence in the continuation of an appropriate benefit level (Reno/Friedland 1997). Influenced by the ongoing public debate, trust in the reliability of the existing scheme dropped to an all-time low.[12] *(b)* More often, political elites, notably the younger ones, emphasized that in order to preserve the generational compact the younger cohorts must not be encumbered with the consequences of population aging in an unbalanced manner. Different from the *PRA 1992*, an intergenerationally equitable distribution of this burden was explictily mentioned as a goal of the *PRA 1999* (BMAS 1997a: 6; 1997b: 3; Blüm 1998). *(c)* Within the two *Volksparteien* (CDU/CSU and SPD) the pension issue surpassed a level of attention that made it impossible for the respective policy experts to keep down the discourse from flourishing (see also Nullmeier/Rüb 1993: 348). With ranks no longer closed in unanimous defence of the existing scheme, dissenting voices favoring radical changes became more frequent and influential than before.

3. Population Aging and Pension Financing

It should be sufficient to limit the description of the ongoing process of population aging which implies a serious challenge to the future viability of existing old-age security systems to a few facts. As the combined result of fallen fertility rates and greater longevity the working-age population (15 to 65 years of age) will decline while the elderly share (65 years and older) will grow: The elderly share in Germany stood at 15.2 percent in 1993. According to the latest projections, it will rise to 19.3 percent in 2010, slightly decline to 18.4 percent in 2020, amount to 25.3 percent in 2030 and 27.5 percent in 2040 (Sommer 1994). When it comes to the financing of old-age pensions as well as health and long-term care of which the elderly are the main consumers the 'elderly dependency ratio' is

1293-1306) or that the existence of a large volume of *private* intergenerational transfers (cash and in-kind) invalidates the concept of 'intergenerational equity' as such (Börsch-Supan 1997: 13-4). Notwithstanding those objections, they entail a serious threat to the continuance of public pension schemes: 'Once generational inequity is acknowledged as a problem, then the system loses legitimacy and the inevitable solution must be privatization' (Moody 1988: 53).

12) *Inter alia*, this statement is substantiated by the results of the following studies: Föste/Janßen 1997; Jung 1995; Köcher 1996; Rinne/Wagner 1995; Roller 1996; see also Mau 1998.

more important because, under almost all circumstances, the population of employable age has to carry the elderly “burden”. Comparing OECD projections, Germany will top the “geriatric league table” in 2030: The estimated ratio for Germany is 49.2 (USA: 36.8; Japan: 44.5; OECD Europe: 39.2 – OECD 1996: 102). However, it has been demonstrated that pure demographically induced expenditure growth of social security schemes will considerably fall behind the rise in the elderly share or the elderly dependency ratio (Fachinger/Rothgang 1997).

Figure 1: *Measures to Cope with the Effects of Population Aging on the Financing of Public Pension Schemes*

I.Measures concerning current/future contributors 1.increasing the contribution rate 2.utilizing parts of an increased contribution rate to build up a (private or public) fund reserve 3.broadening the contribution base a)making hitherto non-covered employed liable for mandatory insurance b)increasing the ceiling of earnings subject to contributions 4.differentiating the contribution rate according to the number of children 5.calculating employers' contribution share on value adding items (profits, interest revenue, depriciation)
II.Measures concerning current/future beneficiaries 1.suspending automatic benefit indexation and/or changing the indexing formula 2.raising the standard retirement age 3.increasing benefit reductions in case of early retirement up to actuarial level 4.changing the benefit formula 5.tightening the rules of eligibility for disability pensions 6.reducing/eliminating derivative/auxiliary benefits
III.Measures concerning the state's engagement *directly:* 1.increasing/introducing subsidies out of general taxation to public pension schemes *indirectly:* 2.intensifying population policy (fertility, migration) 3.increasing the employment ratio (reducing the unemployment level, facilitating higher female labor force participation) 4.promoting investments in physical and human capital to facilitate higher productivity growth rates

Since population aging in industrialized countries has been acknowledged as a common although unequally serious challenge to the future viability of existing old-age security systems various international organizations (IMF, OECD, World Bank) and national experts have proposed reform measures, ranging from incremental adaptations to radical changes. Almost ever a call for *early action* is added. Making use of the narrow window of opportunity would to allow people time to plan and adjust, in particular to changes in pensions, and to attain to an intergenerationally fairer distribution of the financial burden of aging less painfully (see e.g. OECD 1996: 24; 1998: 18; Chand/Jaeger 1996: 32). If one examines incremental changes *within* an unfunded, mandatory, contributory, earnings-related social insurance scheme as it is in place in Germany, Austria or the United States (or in public second-tier schemes like the earnings-related ATP in Sweden) there is only a limited repertoire of levers which can be applied to meet the challenge of a declining worker-pensioner ratio (*Figure 1*; see also Weaver 1998; OECD 1998).[13] However, due to policy feedbacks of existing programs not all measures are immediately accessible, some are limited in their financial impact, and others will develop their effects only over a longer time span.

Among the policy responses affecting the present and future working-age generation, a gradual but ultimately substantial rise in the contribution rate (I.1.) in order to pay unchanged benefits to more and increasingly long-lived retirees is exactly what one intends to avoid. The reasons are obvious: Additionally burdening the employers' wage bill might induce detrimental employment effects and set in motion a spiral of a declining number of covered employees followed by the need for again raised contribution rates. If overall taxation is perceived as having an upper limit a rising contribution rate might crowd out or preclude additional public spending on newly arising social needs or is increasing budget competition among existing welfare state programs. A rising contribution rate when real wage growth is slow also depletes employees' ability to make individual provisions for old age. Related to this, one can furthermore assume that being obliged to ever larger contribution payments while not becoming entitled to correspondingly higher benefits would not be accepted by the mandatorily insured and lead to evasive behavior – apart from equity reasons if only the current and future working-age generations are negatively affected by the aging process. Contingent upon whether the present contribution rate is regarded as an

13) The classification of policy changes either affecting workers liable to contributions, pensioners or the state is, of course, not clear-cut: In longitudinal perspective, contributors become pensioners and might well be affected twice, and, regularly, those who contribute to a social insurance scheme are taxpayers as well. Nevertheless, only if the revenue side, i.e. the relief of mandatorily covered workers, is disregarded and solely the retirement phase is focused on, all measures concerning present and future retirees (*Figure 1*, II.1 to II.6) appear as "retrenchments".

independent variable to be kept constant (like in the U.S.) or as a dependent variable permitted to rise to a higher level the scope (and direction) of additional coping strategies varies.

The potential policy changes listed in *Figure 1* cannot be dealt with in detail here, not the least, because they might come in a number of variants, given the institutional peculiarities of social insurance schemes in place in industrialized countries. For example, changes of the benefit formula (II.4.) open up a wide array of possibilities to save on expenditure either across-the-board or targeted at certain categories of insured when the replacement ratio of newly retired beneficiaries is lowered. The concrete options for change are largely contingent upon the construction of the applied benefit formulas which differ widely across countries (as do "standard" replacement ratios; OECD 1988: 67-74).

Measures listed under the heading of the state's engagement may go beyond a *direct* involvement through an expanded utilization of general taxation to finance public pensions. Intensifying population policy (III.2) could be one of the *indirect* state strategies to improve the financial prospects of public pension schemes. Whereas nowhere in the Western world pronatalist measures have been overly successful and produced a permanent rise in fertility rates, higher net immigration could partially compensate for birth rates below unity and, under certain circumstances, actually prove beneficial to public pension financing (however, it is an hopeless strategy if one would aspire to halt population aging as such, i.e. an increase in the population's median age). Those countries which will face very substantial demographic shifts over the next decades can be expected to easily attract migrants from regions with lower per-capita income. The one-off benefit is that working-age immigrants have no parents to be provided for by the receiving country's social security system. It is not the old-age ratio pure and simple which is crucial for a pay-as-you-go funded pension scheme. What matters most is the worker-pensioner ratio. Hence, enlarging the numerator through lower registered unemployment or fewer "discouraged workers" imply additional contribution revenues out of actual earnings (III.3) but, subsequently, higher entitlements.

Very often it is overlooked that even if there is only a moderate annual productivity growth, gradually rising contribution rates do not result in declining net real wages (Prognos 1995). This is not to say that a growing "tax wedge" will effect no economically negative impact, but if productivity growth can be enhanced due to more investments in physical and human capital the resulting income growth will make the "burden" of aging felt less grave (III.4.). Provided that the present working-age generation intensifies efforts at future-orientated investments which will facilitate income growth for subsequent generations potential intergenerational tensions on the macro-level might be moderated. Foremost economists who complain about a too low national savings rate and thus demand a transition to partial or full advance-funding of pensions might retreat to those arguments.

I will now turn to the mix of policy changes that has been chosen in Germany over the last decade and that aimed at to enhance the financial viability of the public pension scheme.

4. Public Pension Reform: From 1989 to 1997

In 1989 when the contribution rate stood at 18.7 percent it was expected that, compared to the current law, the *PRA 1992* would reduce its future rise by roughly one half: Instead of a projected rise to 24.9 percent in 2010 the effects of the reform package should lower the figure to 21.6 percent, and for 2030 the contribution rate should amount to 26.9 percent instead of 36.3 percent (Schmähl 1993: 47). It meant that a further gradual increase in the contribution rate was accepted. The difference to the current law projections mainly stemmed from three changes (for details see Hinrichs 1993; Schmähl 1992, 1993): *(a)* According to the new adjustment formula current benefits are no longer indexed to the growth of gross wages of all employees but are automatically (without approval by the *Bundestag*) adapted to the preceding year's *net* wage development (average gross earnings minus income tax and employees' share of social insurance contributions). This new formula became part of a *self-regulating mechanism* ensuring a stable net *standard* pension level (70 percent) as well as, via the benefit adjustment rate, pensioners' participation in a demographically (or otherwise) induced changes of the contribution rate(s) and income tax codes.[14] *(b)* Federal grants were increased to 20 percent of the scheme's expenditure in 1992. The main reason given was higher spending resulting from the extension of child care credits. Due to the working of the self-regulating mechanism the subsidy makes up a constant share in future. *(c)* Except for seriously handicapped persons, in 2012 all provisions to retire before age 65 without benefit reduction were scheduled to phase out. Beginning in 2001, retiring earlier will imply a permanent deduction of 3.6 percent for each year below the standard retirement age which amounts to *about* two thirds of an *actuarially* fair adjustment. The timing when this provision should start to phase in was the most disputed issue between the government parties and the Social Democrats when they strived for an inter-party compromise on the reform bill.

The *PRA 1992* was not only meant as a timely attempt to adapt to a shifting age struc-

14) Participation also implies that pensioners subsequently benefit from lower taxation of employees' income, thus causing higher spending on public pensions.

ture. Moreover, it was intended to call a halt to non-systematic changes (arbitrarily fixing the contribution rate, selective retrenchments, fiddling about with the indexation formula) which, since the second half of the 1970s, had been made in view of the social insurances' financial problems resulting from risen unemployment and which had weakened institutional trust on part of the public. The condition of pension politics two years after the implementation of the *PRA 1992* can be read off from a publication of the peak organization of German employers' associations (BDA 1994). Only the public pension scheme was almost spared from demands to substantially scale back and reorganize the German welfare state, and it was expressed what was largely common understanding of all actors involved in public pension policy: The *PRA 1992* was praised as a(nother) proof of the scheme's adaptability while its basic structures were retained. Despite the favorable effects on the contribution rate further action was regarded as indispensible to keep in check an unbearable rise after 2010. Hence, around the turn of the century the search for an appropriate reform package would have to start and, as before, a broad political consensus should be aspired. All proposals which would do away with central features of the existing scheme (advance-funding, basic pensions) were firmly rejected. The next pension reform going into effect at around 2010 should be another reform *within* the system (BDA 1994: 29-40).

In view of rising unemployment figures the unions launched the "Alliance for work" (*Bündnis für Arbeit*) in January 1996. Among others, the government, the unions and the employers agreed upon to force down the combined contribution rate to the social insurance schemes below the 40 percent benchmark. As a kind of "emergency measure" it was decided to discontinue the pathway into retirement at the age of 60 after a minimum of one year of unemployment and to replace it with a model of "elderly part-time work" (*Altersteilzeit*). Due to the almost "exploding" intake during the early 1990s the current provision had become very costly for the pension scheme and the unemployment insurance (see above). The new model shifts the costs to a larger extent to employers and older workers viz. subsequent retirees[15] but the aspired savings do not accrue

15) It is not required that older workers really work "part-time". Collective agreements may provide that, at the age of 55 at the earliest, they continue to work full-time for half of the years until retirement is possible and work zero hours for the second half of these years (the age when, after working part-time for a minimum of 24 months or after one year of unemployment, retirement without permanent benefit reduction is possible increases to 65 *until* end of 2001, i.e. that year when, according to the *PRA 1992*, it should *start* to phase in). However, earnings are continuously based on the reduced working hours, but the employer has to pay contributions to the public pension scheme on the basis of 90 percent of full-time earnings and, additionally, must to top up the "part-time" worker's earnings by a tax-free supplement of 20 percent. The unemployment insurance refunds these expenses if a previously unemployed worker or a former apprentice is hired. Taking into account that supplement

immediately, rather, will materialize gradually.

The "alliance for work" collapsed when the government (supported by the employers) started to dismantle dismissal protection and to attack the 100 percent level of sick pay which the unions regarded as a central working-class achievement. Without consent from the unions and the Social Democrats further changes concerning the public pension scheme were included in the *Wachstums- und Beschäftigungsförderungsgesetz* (*WFG*) that was enacted in 1996. The most important ones included in this omnibus bill are the following: Periods of education after the age of 17 are credited at a lower value and for not more than three years. The *PRA 1992* had already stipulated a reduction to a maximum of seven years so that the new provision meant a further loss of four years which implies a considerable reduction of the entitlements of university graduates.[16)] Furthermore, three instead of the first four years of covered employment when earnings are regularly low are revalued to a level of 75 percent of average earnings (formerly: 90 percent). The phasing-out periods of options to retire before age 65 without permanent benefit reduction are cut down. In particular, the accelerated increase in the standard retirement age for women (from 60 to 65 until the end of 2004) was vehemently opposed by the unions and the Social Democrats. When the government, moreover, announced to set up a "pension reform commission" to investigate further savings measures in order to attain its target of a total contribution rate below 40 percent the Social Democrats refused the invitation to participate. Its social policy spokesman declared the consensus in pension policy (*Rentenkonsens*) as being over. On most issues the proposals of the government's "pension reform commission" (BMAS 1997a) differed from those of the SPD which had set up an own commission (SPD 1997). The subsequent legislative process went a "normal course": Counterproposals by the opposition parties were turned down, and the government's proposal (which was slightly modified after the expert hearing) finally passed parliament in December 1997 because the no consent by the SPD led *Bundesrat* was required and its objection was overruled in the *Bundestag*.

Of the proposals brought forward by the government's commission which finally became enacted there were only few on which, in principle, *no* dissent between government and opposition existed (for a synoptic view of the proposals, see SVR 1997: 103-5). One was to increase federal

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the "part-time" worker regularly ends up with 70 percent of his/her former net earnings which is not much less attractive than the hitherto utilized pathway into retirement.

16) Understandably, the Association of Executives (*Union Leitender Angestellter*) opposed that impairment because it largely (and *retroactively*) took away an element of the benefit formula that made mandatory coverage attractive for even the wage-dependent upper middle classes (*Handelsblatt*, No. 91/May 10/11, 1996; von Winter 1997: 182).

subsidies to the pension scheme so that the contribution rate could be lowered by one percentage point. When it became obvious in late summer 1997 that in 1998 the contribution rate would have to be raised from 20.3 to 21.0 percent the SPD shied away from blocking the government's proposal in the *Bundesrat* to put into effect this *part* of the *PRA 1999* one year earlier than planned. It was agreed upon to increase the standard rate of value-added tax from 15 to 16 percent beginning in April 1998. The additional revenues are transferred to the public pension scheme and facilitated an unchanged contribution rate in 1998.[17)]

Another non-controversial element was the only one that (as in the 1989 legislation) represents an expansion of the scheme: Two decisions by the Constitutional Court demanded to change and to improve the provision on child-care credits. The *PRA 1999* stipulates that the value of child-care credits will be raised from 75 percent of average covered earnings to 100 percent, and paid contributions out of covered earnings during the three-year period (one year for children born prior to 1992) will no longer replace the value of child-care credits. Rather, they are added to factual earnings up to the ceiling on contributions (which stands at about 185 percent of average earnings). This *improvement* implies considerable and long-term financial commitments (0.2 percentage points of the contribution rate, rising to 0.3 in 2030). The co-existence of (improved) child-care credits, women's increasing own entitlements and survivors' pensions (60 percent of the deceased spouse's benefit with, so far, generous disregards of own income) is *commonly* seen as a problem - in terms of expenditures and in regard to inequities among women after a plurality of female life-course patterns has emerged. Since an improved data basis to evaluate old-age income security of presently working-age women will not be available before 1999 the government abstained from changing current provisions regarding survivors' pensions (the Social Democrats already committed themselves to an earnings sharing model [SPD 1997: 11-3], somewhat similar to one proposal discussed in the U.S. - see Holden 1997).[18)] Whatever concrete shape this

17) Uncontested was furthermore a technical change of the self-regulating mechanism effective since 1992: If the contingency reserve will fall short of a level of one-month expenditure or will exceed this target a change in the contribution rate is triggered which, in consequence, induces a changed amount of federal grants, net wages and the subsequent adjustment rate. The reason for an annually fluctuating contribution rate was hard to understand by the public and, hence, casted doubts on the solidity of the scheme. In future, these changes will be less frequent because the contingency reserve is permitted to vary within a defined corridor.

18) Another issue not settled was the taxation of retirement benefits (viz. the exemption of contributions to the public pension scheme and of private provisions for old age from income tax). The Constitutional Court has required of the government to remove inconsistencies in the taxation of civil servants' and other employees' retirement income. Due to the failure of the income tax

reform will eventually take it can be assumed that the scheme will continue to depart from the male breadwinner model to which it was traditionally geared to (Meyer 1998).

The three most controversial elements of the *PRA 1999* are the following: *(1)* The legislation of 1996 already meant a decisive departure from the previous conception that sending older workers into (desired) early retirement is preferable to the (presumed) alternative of higher unemployment of young and prime-age workers. In order to raise the *actual* age of entry into retirement it was deemed indispensable to close two remaining loopholes to which older worker might retreat when trying to avoid permanent benefit reductions in case of early retirement. So far, the option of severely handicapped persons with at least 35 years of insurance have the option to retire at the age of 60 (and, like other early retirees, merely renounce benefit increments which would be attainable due to a longer contribution period) had remained unchanged. For not to give an incentive to strive for a certification as "severely handicapped" the retirement age for this sub-category of insured will be raised to 63 years (they remain eligible to retire at the age of 60 however, but have to take a benefit reduction which, altogether, amounts to about 17.5 percent compared to employment until age 63).

(2) Likewise, a momentous reform of disability pensions aims at foiling evasive strategies: After 1999, a different formula to calculate the benefit level will be in place (concerning the parameters how the years between the age when invalidity is ascertained and the standard retirement age are assessed). This change makes disability benefits financially less attractive for applicants younger than 63 years of age. On *average* it will imply a reduction of 7.7 percent (at most: 10.8 percent) compared to current law (Kruse 1998). Regularly, disability pensions are no longer granted as permanent benefits. And if the remaining work capacity allows an employment between three and six hours per day only *half* of the benefit is paid. Whereas so far the non-availability of a part-job was a reason to grant a full disability pension, in future the concrete labor market conditions are disregarded (*abstrakte Betrachtungsweise*). Thus, a disabled "half-beneficiary" (or "non-beneficiary" due to a work capacity of at least six hours per day) becoming or remaining unemployed is referred to (additional) benefits from the unemployment insurance, and this scheme's expenditure will rise accordingly. It was uncontested in principle to establish a proper delimitation of responsibilities between unemployment insurance and public pension scheme so that the latter is no longer burdened with increased benefit payments due to an existing (part-time) job shortage. The unions and Social Democrats objected these concrete

reform in 1997 nothing happened in this regard yet. It is obvious that an appropriate solution to this problem (as well as promoting the coverage of occupational pensions or additional private provision) will imply an extension of "fiscal welfare", i.e. an increase in foregone taxes (for a detailed analysis see Schmähl 1998a).

changes when pointing to the public pension scheme's original and basic mission to protect against the income risk of disability withering away: Combined with 1996 legislation on assessing non-contribution periods and the "demographic factor" (see below) these impairments might imply that recipients of disability pensions (and, possibly, later on their survivors) will fall into poverty much more often than before.

(3) Increased longevity implies a "rectangularization" of the survival curve so that almost all insured who ever paid contributions are actually claiming benefits and then receiving their old-age pensions for a longer period. In *West* Germany the average period was 9.9 years for pensioners who deceased in 1960. In 1996 it had risen to 15.9 years (VDR 1997: 112). It thus seems plausible if newly and already retired persons enjoying more work-free years take part in the financial consequences when the total amount of pension benefits is stretched over that longer time period. The *PRA 1999* provides that with a time-lag of nine years *half* of the risen life expectancy at age 65 will be taken into account in the formula by which the *initial benefit level* as well as the *annual indexation* is calculated. Thus mortality changes as one element of demographic shifts are additionally included in the self-regulating mechanism established in 1992 (see above). In contrast to an increased retirement age this provision does not spare the already retired from partaking in retrenchments and facilitates larger amounts of expenditures saved much faster (and regardless of the current labor market situation). Further rising longevity assumed, it means that the *net* standard pension level (or: "ratio") of presently 70 percent is gradually lowered to 64 percent (but not below) when benefit adjustments will be lower than net wage development (but there will be no nominal cuts if net wages stagnate). Unions, Social Democrats, and the associations of the elderly described this stipulation as "pension cut" (*Rentenkürzung*) which is not completely unfounded although benefits will, according to assumptions on wage development, continue to grow. However, the "demographic factor" is an effective and, at the first glance, non-arbitrary device to lower the replacement ratio which can be publicly legitimized by pointing to the longer period of benefit receipt. Moreover, the net standard pension level is a statistical artefact (relating to a fictitious employee who, for 45 years, constantly attained the average earnings of all covered employees) and says nothing about the *actual* distribution of benefit levels or household income (Bundesregierung 1998: 30 and 93; 1997: 140-61). When the effects of the "demographic factor" proceed those insured with lower than average earnings and/or a shorter contribution record might see their benefits approaching (or even falling below) the social assistance level.[19] Contrary

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[19] Assuming that the general reduction of the benefit level down to the target figure of 64 percent would have been valid already in 1997 a *single* "average earner" needs about 28 years in covered employment to attain an old-age pension that matches his/her claim on social assistance (Schmähl 1998b). In case, individual earnings continuously amount

to a basic principle of social *insurance*, they will 'get nothing for their contributions' (Beveridge 1942: 141) what could possibly (further) delegitimize the mandatory public pension scheme. In that case, attempting reforms *within* the system would turn out as a reform *of* the system.

It is expected that the combined effect of the 1996 legislation and the *PRA 1999* will again substantially lower the increase in the contribution rate which was projected after the legislation of the *PRA 1992* (see above). According to the government's bill the figures are: 2000 = 19.7 percent; 2010 = 19.1 percent; 2020 = 20.0 percent; 2030 = 22.4 percent (BMAS 1997b: 16). The most recent *Prognos* report (Barth 1998) and the calculation by the association of the pension schemes (*VDR* - Hain/Müller 1998) arrive at slightly higher figures. Nevertheless, compared to the calculations carried out in the context of the *PRA 1992* legislation the projected figures express an intensified focus on the pensioners, i.e. in a longitudinal perspective, while in employment the *additional* burden is reduced but after becoming a pensioner benefits will be lower than before.

The stipulation of retroactive retrenchments and rather short phasing-in and phasing-out periods supports neoliberal economists' argument that members of public, unfunded pension scheme are permanently exposed to politically generated risks (Disney 1996; James 1997; Glismann/Horn 1997). If additionally the *PRA 1992* is taken into account what do the stabilization efforts mean to the "identity" of the German public pension scheme? Its success regarding social and political integration was due to the inherent combination of three "types" of justice: effort, need, and participation (*Leistungs-, Bedarfs- und Teilhabegerechtigkeit* - Nullmeier/Rüb 1994: 69-71, quoting Zacher [1991: 42-51]). This flexible "triangle" becomes endangered if one end is stressed too much at the expense of the others. Contrary to demands for a minimum pension (SPD 1997: 9-10) it was exactly intended to strengthen the relationship between actual contributions and benefit level (*individual equity*). "Effort"

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to 80 percent of the average, 35 contribution years are required to attain the social assistance level. The reduction of the number of years credited for education makes it more difficult to obtain the required number of contribution years, apart from the fact that ongoing changes on the labor market will hamper a long and uninterrupted employment career. The expected growth of insufficient benefit entitlements has led to very different conclusions: Schmähl (1998b) pleads for an unchanged benefit formula and linking the reference retirement age to the development of life expectancy instead. In his minority vote in the Government's pension reform commission (BMAS 1997a: 44-6), Meinhard Miegel demands the introduction of a tax-financed minimum pension which would firmly forestall old-age poverty (see also Biedenkopf 1997). Thiede (1998), who refers to the feedback effects triggered by the self-regulating mechanism, arrives at a more optimistic evaluation of the impact of the "demographic factor" saying that the lowered standard pension level will relate to a higher level of net earnings than without this reform element, a not much higher level of old-age poverty will be induced, and even the internal rate of return on contributions will improve for younger cohorts.

being documented in a long and continuous employment record and meaning a prolongation of earnings inequality into retirement has thus gained in importance. In contrast and although a "standard employment biography" will be harder to attain in future, "need" (or: *social adequacy*) was given a lower status since provisions of interpersonal redistribution ensuring income maintenance (wage-replacing benefits, regularly exceeding the poverty line) after retirement have been reduced or removed. The gradual reduction of the (standard) pension level is a further factor impairing the adequacy of benefits. So far, the balanced growth of net wages and net pensions has realized "participation". Due to the "demographic factor" (and, possibly, the additional inclusion of a "labor market factor" as demanded by the employers - BDA 1998: 19) the pensioners will partially excluded from the growth of market income. The perception of a changing "identity" of the public pension scheme combined with declining confidence in its stability and reliability to guarantee "security" might well be desastruous to the legitimacy of the "cornerstone" of the German *Sozialstaat*.

However, the public pension reforms of 1996/1997 have stirred little public grievance and protest. This is surprising insofar as *(a)* at the same time, the curtailment of employers' wage continuation payment for sick workers (from 100 to 80 percent) led the unions to organize large rallies and caused spontaneous strikes in firms which subsequently tried to apply this new rule and *(b)* the various retrenchments, especially if combined, are substantial and effective for the whole period of benefit receipt (and even beyond in case of survivors' pensions). One reason might be that in Germany there are no large and influential organizations representing the interests of the elderly (comparable to the *American Association of Retired Persons*) able to organize vociferous protest. In fact, the altogether largest elderly organization are the unions, and although they claim to represent the interests not only of the working population, but also of former employees and their relatives, it would be a difficult undertaking to engage in a protest movement cutting across all age groups when benefit reductions at the same time turn out as an immediate net wage advantage for employed workers.

A possibly more important reason for the absence of open protest should be related to the extraordinary complex and unintelligible nature of the public pension scheme. It can be safely assumed that most insured cannot estimate what the legislated changes actually mean to them personally. Those who are already closer to retirement age and thus more interested in eligibility criteria and entitlements might be able to roughly ascertain that they will be more or less exempted from deteriorations due to "guarantee rules" and phasing-in/-out provisions. An again intensified intransparency of the scheme can be presumed to have two implications: *(1)* As long as policy-*makers* can reasonably expect policy-*takers'* behavior is largely passive and unresponsive (being 'pawns' - Le Grand 1997) their scope to enact retrenchments with undistinct individual effects is considerable. Nevertheless, after a dispute among the government parties on whether to put into effect the *PRA 1999* already in 1998 and thus reap some of the aspired savings one year earlier it was decided to stick to the original time schedule: Not even granting a small increment if the new indexation formula was applied in July was expected to set the pensioners especially against the CDU/CSU at the forthcoming federal elections in September 1998. *(2)* Intransparency should be disadvantageous for the development of institutional trust, and the (correct) supposition that the recent reforms will intangibly impair one's eligibility and benefit level while not preventing a higher contribution rate is not conducive either. It cannot be answered yet whether the latest reforms have altered the support for the public pension scheme, but one can rule out that they have very much helped to regain lost confidence in this welfare state institution because the future stability is still questioned in the ongoing debate and advice on individually wise behavior is contradictory.

The policy changes effected by the 1996 and 1997 legislation show that several of the levers available for directly stabilizing the financial viability of unfunded pension schemes in view of population aging have been pulled (see above, *Figure 1*). The starting point of recent public pension reforms in Austria, Italy, Sweden and further countries has been broadly similar. Does this mean that, given a limited set of policy options, cross-nationally there will be more convergence in public pension policy? In Sweden, the second-tier scheme will play a pivotal role, and since the contributory and insurance elements are strenghtened (and child-care credits similar to the German variant as well as a special variant of a "demographic factor" are introduced - Ministry 1998; Palmer 1998) it will look more "German" in the end. This might also be true for Austria where the recent reform aimed at tightening the link between contributions and benefits and, as in Sweden and Germany, a higher factual retirement age (Geppert 1998; Wöss 1998) what confirms the general trends ascertained by Myles/Quadagno (1997). However, if the concept of "path dependence" is taken seriously comparable adjustments to a common challenge adopted in different institutional contexts hardly lead to convergence (North 1990: 101; Bonoli et al. 1996). Rather, mediated by national institutions which produce different debates and different coalitions, the expected outcome should be *revised diversity*. Insofar, only a detailed comparison of whether the reform strategies chosen express a change of the explicit and implicit goals of the public pension system and an altered conception of the retirement income mix could show to what extent *revised* diversity actually implies *reduced* diversity.

5. The End of the "Grand Coalition"?

It could be argued that the break-up of the traditional consensus in pension policy becoming visible in 1996 is only temporary and largely caused by party politics because several reform elements were not disputed in principle. The Social Democratic opposition to the latest legislation and the announcement to undo at least the "demographic factor" and the impairments regarding disability pensions after a victory in the 1998 election could be meant to strategically position the party in the beginning election campaign well in time. This possibility cannot be ruled out completely because the SPD has had a growing electoral "deficit" among older voters (notably women above 60 years of age). Promising to spare the pensioners and those close to retirement age from momentous retrenchments possibly helped to reduce this electoral gap.

There are, however, good reasons to assume these controversies as being more permanent: In fact, one has to distinguish between two "grand coalitions" – one between the two *Volksparteien*, the other between the social partners, and both coalitions converged at public pension policy (Nullmeier 1996). As long as the laborist wing within the CDU/CSU clearly dominated the discourse on social policy development and kept in check alternative conceptions of the business-oriented wing a formal or informal coalition between the small circle of experts from CDU/CSU and SPD was recurrently possible and led to consensually legislated social policy reforms. The Federal Ministry of Labor and Social Affairs, itself a manifestation of the "grand coalition" contributed to a smooth development. For long, their concurrent orientation toward solidaristic notions fostered by the cognitive legacy of social insurance has prevented the intrusion of market solutions – not only in health care policy (Giaimo/Manow 1997). The declining influence of the laborist wing became most obvious when, after the relative "victory" of the Liberal party (FDP) in three state elections in spring 1996, the business-oriented wing within the CDU/CSU and the FDP pushed the legislation of the *Wachstums- und Beschäftigungsförderungsgesetz* that offended the unions and meant the end of the "alliance for work" (see above). The Liberal party which, due to the health care providers as a large group of its constituency, had always been most interested in health care policy put itself at the head of demands to contain contributions to *all* social insurance schemes. When the *PRA 1999* was first read in parliament (June 27, 1997), Gisela Babel, FDP social policy spokeswoman, referred to the debate on the previous pension reform in 1989 when the prospect of attaining a contribution rate of 26 or 28 percent in 2030 stirred no critique: 'That was flatly taken to be acceptable then. Today, we do not consider this as acceptable anymore.' (*Das Parlament*, No. 29/July 11, 1997, p. 9). This quote shows that a "frame switch" had taken place when almost unaltered and well-known projections of the long-term financial status were reinterpreted in the light of current economic developments and a changing ideology. Within the Liberal party that re-evaluation had gone farthest, and it was able to carry through its more rigorous demands for savings measures in cabinet circles (*Kanzlerrunden*) and working groups of the coalition parties (*Koalitionsarbeitsgruppen*) which evolved as informal, extraparliamentary centers of decision-making (Manow 1996).[20)]

The divergent positions of the SPD and the Green party (*Bündnis 90/Die Grünen*) on the one and the coalition government on the other side thus became more pronounced. In regard to public pension reform they differ to what extent efforts to attain a higher level of employment (and by which measures) and further improvements of the *revenue* situation should be given priority to attempts aiming at the curtailment of benefits. Concretely, there is disagreement on which additional burden can employers be expected to carry, which sacrifices can be expected from present/future pensioners, or to what extent the role of the public pension scheme may be allowed to decline so that the opportunities for interpersonal redistribution according to the social adequacy principle are not unreasonably limited. The last question is increasingly relevant since income inequality is growing and more private protection reinforces inequality in old age and the vulnerability associated with a changed composition of retirement income (see also Börsch-Supan 1997). A growing gulf between party positions is not limited to pension policy. The conceptions on the future of health care policy as well differ more than ever since the 1950s on questions like to what extent patients' co-payments should extended, or to how far the system's efficiency should be increased at the expense of health care providers' interests (Hinrichs 1998).

The recent reforms in health care and pension policy clearly show that, after the orientation towards consented changes has come to an end, development is determined by *prevailing majority* in parliament, thereby disregarding alternative conceptions as long as the bicameral structure does not necessitate this. And they were, as well as other legislative changes aiming at retrenchment, designed as to effectively circumvent expected objections by the *Bundesrat* and the SPD as a "co-governing" party. Obviously, this new pattern social policy-making by majority decision will continue after the new Red-Green coalition government has come into power in autumn of 1998: According to the agreement between the SPD and *Bündnis 90/Die Grünen* (*Das Parlament*, No. 45/October 30, 1998, p. 6-10) the then most controversial elements of health care and public pension reforms enacted in 1996 and 1997 will be cancelled.

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20) It was foremost the FDP which has also blocked a provision that would have made marginal part-time workers and the "false self-employed" (see above, section 2.) liable to contribution payments. Both the Ministry of Labor an Social Affairs (BMAS 1997a: 7 and 16-20) as well as the SPD (1997: 9-10) had strongly approved such an expanded coverage. Furthermore, a proposed change that would have improved employees' vesting rights regarding occupational pensions was omitted in the final law (BMAS 1997b: 61 and 88).

Notably, the "demographic factor" and the changed rules concerning disability pensions will not take effect. It was concluded to legislate a *structural* reform of the public pension scheme in 1999 of which (in November 1998) the contours are not fully discernible because the intentions are phrased rather vaguely.

In the past, the Federal Republic has been repeatedly praised for its peaceful industrial relations. Corporate governance of the social insurance schemes by the social partners has contributed to preserving a consensus among the labor market associations — or, at least, a general willingness to compromise as an attitude of mind. This was particularly true of the public pension scheme which unions and employers alike always regarded as "their" institution (Nullmeier/Rüb 1993: 329). The social partners were actively involved in pension policymaking, and still in the preliminary stages of the *PRA 1992* they agreed upon a set of reform proposals that, ultimately, was largely taken into account. The institutional architecture of this scheme was completely accepted by the employers as was still documented in the BDA publication of 1994 (see section 4.). During the 1996 and 1997 legislation both social partners were not directly included, and a common blueprint for further reforms was no longer possible or striven for. Persistently high unemployment and the final cessation of "system competition" after 1989 strenghtened employers' power position *vis-à-vis* labor as have heightened "exit" options resulting from economic globalization. It has also intensified interest diversification among employers — between small and large firms, between export-oriented and domestically oriented enterprises, between "modern" and "traditional" sectors. The conflict on how to reform the system of industry-wide collective agreements expresses employers' problem to maintain unity and cohesion. Under these circumstances it is most obvious to take a tough position, to present distinct demands which meet a common interest of all employers, i.e. above all (non-wage) labor costs, and to signal willingness not to shy away from *confrontation* instead of showing a precommitment to consensus.

Their reinterpretation of the substance of the *social* market economy furthermore implies that the employers have departed from the conception of a balanced growth of *all* incomes — profits, wages, public pensions and other social transfers. The latest manifesto (BDA 1998) illustrates this changed position very clearly: It is demanded to say farewell to the public pension scheme's principle of status maintenance (*Lebensstandardsicherung*) and to replace it with the principle of basic security.[21] Therefore, they present elements for a further reform which would lead to a contribution rate of 19 percent on a permanent basis. Although it is emphasized that central principles of the public pension

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21) In this regard, the Federation of German Industry (BDI 1998: 76-7) is more rigorous when it demands a contribution-financed basic pension topped up by mandatory private provision.

scheme (earnings-related contributions and benefits, pay-as-you-go funding - BDA 1998: 17-8) should be retained it is obvious that if these proposals would be realized the principles of "need" (social adequacy) and "participation" (see above, section 4.) are further suppressed. As part of a structural redirection of social policy aiming at a combined rate to *all* social insurance schemes below 38 percent, once and for all, it would relieve employers from the problem to see risen rates adequately taken into account during annual wage bargaining (see above, *n. 9*).

Whereas it is conceivable that the "grand coalition" of parties can be revived if the new Red-Green government seeks a compromise with the CDU/CSU on the forthcoming legislation (or, in future, election results suggest a differently composed government coalition), no easy fix of the associational consensus on pension policy can be expected. If "globalization" shows effects beyond the growth of transnational trade and integration of financial markets it is that employers, particularly a "new generation" of executives and functionaries, do no longer cling to the consensus-oriented style of social policy-making embedded in the concept of social market economy and do no longer see themselves as stakeholders in "German capitalism" as a distinct variant. The presentation of their interests in social policy is coming increasingly closer to the trend prevailing in the international debate, thereby having been successful to establish the notion of a reduced *protection from the market* as inevitable in the political process.

6. Conclusion: Time for a Radical Change?

Among neoliberal economists (e.g., Habermann 1988; Koerfer 1997) the notion prevails that the public pension reform of 1957 has been a serious *mistake*. It meant a defeat for Ludwig Erhard, at that time Minister for Economic Affairs and regarded as the "father" of the economic miracle, and his vision of a *social market economy* placing more emphasis on self-reliance and subsidiarity, thus opposing comprehensive, paternalistic social protection by the state (*Versorgungsstaat*). Moreover, the decision in favor of the pay-as-you-go principle made the scheme extremely vulnerable to demographic shifts and, at the same time, most resistant to attempts for replacing it with a more equitable and economically superior system (SVR 1996: 232).

Regarding the first accusation, it is indeed true that the mandatory and almost universal German public pension scheme provides generous benefits: The *public* pension share of total retirement income (and even within the top quintile) is highest among eight OECD countries included in Börsch-Supan's (1997) comparison. Moreover, Germany shows the smallest difference between disposable pre- and post-retirement income[22], and the savings rate out of disposable income actually *increases* after age 60 (more than half of the elderly do not completely consume their annuity income although homeownership is, except for Switzerland, lowest among OECD countries). Comparatively high retirement incomes also facilitate an extremely low percentage of elderly coresiding with their children (Börsch-Supan 1994: 317-23) – what does not inhibit bidirectional cash and in-kind transfers among family members living in different housholds. However, although the percentage of elderly receiving (additional) social assistance benefits has steadily declined to less than two percent in the 1990s there is a considerably larger number of elderly whose retirement income is only slightly exceeding the poverty level. But income distribution among the elderly is far less unequal (and the income level drops less after retirement) than in the U.S. (Burkhauser *et al.* 1997; Schwarze 1998).

The second accusation is also true: The scheme has accumulated an enormous "implicit debt" due to the property-like entitlements of those who already draw a pension and those of working age who have based their retirement income expectations on mandatory contributions to the scheme (Chand/Jaeger 1996: 15-8). Even if it would turn out that a capital funded system is (more) immune from population aging and, due to the higher rate of return, advance-funded individual-account schemes are "cheaper" than the existing unfunded pension system, the imperative to serve these commitments prevents an immediate return to a "pre-1957" situation and the realization of the liberal version of the social market economy. Because of the "double payment" problem for the transitional generation economists have not been able to present an *unchallenged* pareto-efficient ("all win") and thus politically viable strategy to *completely* change from an old-age security system based on the functioning of the labor market to one dependent on capital markets' performance (and to dispel objections related to the inherently different risks and distributional consequences of a fully funded system applying the "defined contribution" principle).

Due to these hard "lock-in effects" the protagonists of a social policy design within which solidarity is pushed back in favor of self-reliance and subsidiarity, for the time being, concentrate on a funded non-public *supplement* to a more or less radically altered public pension scheme. Although enjoying much public attention the proposal to turn to a

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[22] This finding seems to be at odds with most comparisons of "standard replacement rates" which show Germany's public pension scheme as not being overly generous (Weaver 1998, Table 2). However, as long as both spouses are alive pension benefits out of own entitlements are paid unconditionally so that a retired couple regularly receives *two* public pensions, and the wife's pension share is increasing among the younger cohorts of newly retired. Moreover, quite often, pension benefits from other public schemes (civil servants, farmers) add to the total retirement income (Bundesregierung 1997). Finally, benefits from the public pension scheme are rarely subject to income tax so far.

tax-financed system of basic security (comparable to the Danish one), topped up by non-mandatory private and occupational pensions, clearly represents a minority position (Miegel/Wahl 1985; Biedenkopf 1997). Replacing contributions with substantially increased direct and/or indirect taxes does not fit into market liberal notions, while the defenders of the existing scheme especially point to the lack of reciprocity which contradicts entrenched notions of distributive justice. Supported by the tail wind of the international debate on pension reform and the trend away from pay-as-you-go financing, the increasingly influential alternative conception is to further scale down the existing contributory scheme. By providing nothing more than a still differentiated floor of retirement income a lower contribution rate would facilitate enlarged voluntary or mandatory savings for retirement. In the eyes of the advocates of this approach[23] the hitherto enacted reforms have not gone far enough to tackle growing intergenerational *in*equities and to adjust the system of social protection to changing conditions of production in a globalizing economy. In the light of the intertwined party consensus and associational consensus being in a process of dissolution (see above, section 5.) it explains why the debate on the future of the public pension has not faded after the reform legislation of 1996 and 1997.

So far, the institutionally solidified configuration of the pension policy arena has limited the possibilities of alternative conceptions to become virulent. Albeit the status of a once 'coherent policy paradigm' (Hall 1993: 290-2) is weakened, the political strength of the guardians of the existing public pension scheme and vested interests involved as well as still prevalent tenets, ideas and basic beliefs have as yet prevented a massive redesign, rather, promoted incremental stabilization adjustments. The political opportunity structure for those demanding a fundamental goal shift of the public pension scheme (basic security but, at the same time, giving less concern to effective poverty prevention; see SVR 1996: 234-5) and supplementary advance-funded pensions would be improved if their proposals were more concretely developed. Beyond demands to accelerate the reduc-

23) Beside numerous individuals (foremost market liberal economists and politicians), see especially SVR 1996: 227-42; Institut der deutschen Wirtschaft Köln 1997; BDA 1998; Wissenschaftlicher Beirat 1998. - Interestingly enough, the economic advisers (SVR 1996: 233; Wissenschaftlicher Beirat 1998: 28) do not flatly oppose a family-oriented reconstruction of an altogether downsized public pension scheme: Parents providing the indispensable human capital to the scheme should be favored at the expense of those who benefit from other people's children when the latter are either asked to pay a higher contribution rate or will face a lower benefit level (see also *Figure 1*, measure I.4). Proposals of that kind (adding to already institutionalized child-care credits) have been brought forward time and again by conservative (but not only christian) politicians and family advocacy groups. They are meant to correct a fundamental flaw in the generational compact, and it is also hoped for higher fertility and thus a more balanced size of successive cohorts (Meyer 1998; Werding 1998).

tion of the standard pension level (and to further limit non-contributory benefits) not much has been said about a new model of "mixed" old-age security. Neither the financial and distributional consequences are comprehensibly calculated, nor has been evaluated how the aspired downsizing of the public pension scheme could be achieved without violating the interests of the pensioners and older workers or contradicting the Constitutional Court's verdicts to respect the property-like entitlements. Moreover, it is not clear yet how to finance the tax expenditure obviously essential to expand the coverage of occupational pensions (or a consistent and budgetary viable model for exempting private and mandatory provision for old age and taxing benefits when received; see above, *n. 17*). And finally, those proposals lack concrete guidelines for a regulatory framework for private pension funds. Apart from life insurances there has been no market for retirement income products, and an emerging business would encounter very inexperienced customers. Because the generous public pension scheme has suppressed the development of a parallel system of old-age provision of considerable relevance for a large part of the population and an elaborated regulation, the situation in the U.S. is clearly different, and demands to somehow "privatize" Social Security can develop much more pressure (Teles 1998) albeit legislators' fear of imposing necessary and easily traceable transition costs on large groups of the present electorate should be a principal impediment to translate those plans into action there as well (Arnold 1998).

Thus, no consensual agreement on a substantially redesigned system of old-age security, emerging out of a clear concept on the mix of retirement income components, the role of redistributive elements etc., appears to be in sight. The accusations of the public pension scheme as being unfair, unreliable and unsustainable, however, can be expected to continue, and disputes about the proper reform policy and the distribution of concomitant costs will be dealt with more publicly. Since the *security of old-age security* is an extraordinary sensitive issue it is well conceivable that subjective security perception and institutional trust in the public scheme are lost completely (Mau 1998), thus, leading to the worst scenario when the transition to a different mix of retirement income is "silently" executed: Employees capable of taking additional provision for old age and, in view of an uncertain level of public benefits, actually turning to private alternatives will more and more reluctantly pay mandatory contributions to the public scheme on which they are less dependent then and when they discover that their private efforts (seemingly) yield a higher return. This lesson on individual utility maximization learned it might cause them to disregard the socially integrative significance of the existing scheme and to tolerate further benefit cuts so that, ultimately, the *culture of solidarity* (Hinrichs 1997) upon which this welfare state institution as well as all other *social* insurance programs rest is depleted.

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