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Explaining German Selectivity Regarding European Union Pension Directives

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ABSTRACT

Why do German policymakers support some aspects of a single European pension market, but not others? This article argues that the German government's preferences towards European Union (EU) pension directives are best explained by combining historical institutionalism (HI) and domestic discourse analysis (DA). Each approach by itself is insufficient to account for the observed variation between 1991 and 2007. Arguments based on party ideologies offer less explanatory power. HI explains why all governments – Kohl, Schröder, and Merkel – protected employer-sponsored book reserve pensions, a cornerstone of Germany's coordinated market economy, from the scope of EU directives. DA allows us to grasp how interests were reframed. While the status quo stance of the Kohl government succeeded in delegitimizing supporters of alternative pension security concepts, the Schröder administration imposed an economically efficient pension reform without much public support. The grand coalition, in turn, abandoned Chancellor Merkel's initial plan to expand second-tier pensions in the light of rising pressures that the Left Party posed for the Social Democratic coalition partner.

Key words: *EU pension directives, Germany, occupational pensions, Kohl, Merkel, Schröder*

1 Introduction: The European dimension of pension policies

Much ink has been spilled on conventional obstacles to labor mobility in the European Union (EU), such as lack of language skills or problems getting college degrees recognized. However, the lack of workplace pension portability across borders has received surprisingly little attention, both in the comparative politics literature and in scholarship on the European Union (but see Pochet (2003) and Haverland (2007)).[1] This omission is puzzling, given that barriers to corporate pension portability make it unattainable for European citizens to exercise their right to live

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and work in other member states. Despite the free mobility of persons in principle, the absence of pension portability in Europe ensures the persistent fragmentation of labor markets. Yet, national governments continue to choose this outcome, thus thwarting attempts by the European Commission to create a single pension market.

Obstacles to corporate pension portability discriminate against workers with short job tenure, because a move across borders may entail the loss of previously accrued pension entitlements. Pension losses may result from incompatibility of member states' tax laws, social regulations, or investment rules. The loss of workplace pension rights is noticeably more ruinous in countries where social security pensions are low and ungenerous, because a large share of people's income is earmarked for building up pension rights (Myles & Pierson 2001). Fear of paying a heavy price for labor mobility will become even more pronounced in the context of an ageing working population, because older workers tend to be more concerned about building up adequate pensions and will therefore be even more reluctant to change jobs (Commission of the European Communities 2005*a*, p. 7). Despite representing a significant barrier to labor mobility, it was not until the early 1990s that the EU tried to remove obstacles to corporate pension portability.

To integrate the EU's fragmented pension markets, the European Commission has proposed three key initiatives: a pension fund proposal in 1991, a pension fund directive in 2003, and a proposal on pension portability in 2005. Whereas the 1991 proposal was shelved in 1994 after it became clear that the member states could not reach an agreement on investment regulations, the 2003 directive was adopted by the Council of Ministers and the EU Parliament after more than a decade of negotiations and a series of amendment requests. Seeking to build on this success, the EU Commission proposed more radical integration measures in 2005, including not only the portability of pension *assets*, but also individual pension *rights* across borders. However, this proposal was met with a howl of criticism by almost all European countries immediately after it was presented in 2005, and was changed beyond recognition when a watered down version was accepted in 2007.

The aim of this article is to explain the sources of the German government's preferences towards EU pension policies. As one the most powerful governments in the European Union, it is virtually impossible to decide on *any* EU legislation without Germany's consent.[2] Furthermore, Germany represents the ideal type of the Rhenish model of capitalism, wherein corporate pension institutions crucially shape patient capital flows and long-term career structures. Therefore, an analysis of German interests on pension market integration may shed light on the process of preference formation in EU member states with similar institutional settings.

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The EU Commission's plans to create a single pension market were met with strikingly incoherent reactions from the German government. Political incumbents torpedoed the first proposal for a pension fund directive in 1991, offered contingent support for the directive on Institutions for Occupational Retirement Provision (IORP) in 2003, and fiercely opposed the pension portability proposal of 2005. What explains this seemingly contradictory behavior? Why would successive German governments support certain aspects of a single pension market, but not others? Since German politics is often described as deadlocked (Scharpf 1988, Bräuninger & König 1999, Streeck 2006) and institutional complementarities in German capitalism are depicted as resistant to change (Streeck 1997, Hall & Soskice 2001), one might have expected a more coherent pension policy position. On the other hand, a partisan politics argument would expect differential reactions to EU pension policy based on divergent ideological proclivities of the respective government coalitions (Schmidt 1996, Marks & Wilson 2000). According to this perspective, left parties can be expected to eschew efforts to increase pension portability because such policies would primarily help the highly skilled, well-to-do voters. More importantly, support for pension market integration might signal that the Left is more concerned with a luxury problem of high-income groups than with ungenerous social security benefits of blue collar workers. Conservative parties, by contrast, should support corporate pension portability precisely because it helps their core constituency.

The central argument is that partisan theory fails to shed light on the observed variation. Instead, the German position towards EU pension policies needs to be explained by a combination of historical institutionalism (HI) and domestic discourse analysis (DA). Each approach by itself is insufficient to account for the articulation of preferences between 1991 and 2007. HI explains why the Kohl, Schröder, and Merkel governments – despite all fundamental differences in pension-related values – protected employer sponsored book reserve pensions, a corner stone of Germany's coordinated market economy, from the scope of EU directives. However, national trajectories of policy development are not destined and do not predict variation in German preferences. We therefore need to include a theoretical framework that illustrates how interests were conceptualized and reframed during this period. Discourse analysis, which consists of a coordinative dimension (who said what to whom) and a communicative sphere (how do political officials justify and legitimize change), supplies this crucial piece that is missing from HI explanations. While the status-quo oriented policy stance promoted by the Kohl government succeeded in delegitimizing pro-reform voices, the Schröder administration imposed an economically efficient pension

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reform without much public support. The grand coalition, in turn, abandoned chancellor Merkel's initial plan to expand second tier pensions in light of rising pressure the Left Party posed for the Social Democratic coalition partner. Shortcomings of DA accounts include after-the-fact justification and legitimization, or poor specification of the conditions under which ideas exert a causal influence on public policy developments. When combined, however, HI and DA remedy each others' shortcomings. Thus, to understand variation in the German position towards EU pension policies, a methodologically pluralist approach accounting for both structure and agency is necessary to get the full picture.

This article is organized as follows. The second section probes how different theoretical frameworks fare in explaining variation in German preferences towards EU pension directives. The subsequent part provides an overview of the German corporate pension system. The following sections examine the linkages between EU harmonization efforts and the social policy discourse communicated by the Kohl, Schröder, and Merkel governments between 1991 and 2007. The final section concludes with a summary of the main findings and suggestions for future research.

2 *Theoretical framework*

Since this article seeks to explain the policy positions of three governments, each consisting of a different set of coalition partners, partisan theory is a natural starting point. According to this school of thought, the left-right ideological position of governments explain government preferences better than other conflict dimensions, such as national varieties of capitalism (Hix & Lord 1997, Hooghe & Marks 2001, Hix, Noury & Roland 2007). Thus, a major determinant of national policy responses to EU pension regulations is the party composition of the government. This hypothesis is premised on the assumption that the incumbent coalition government has considerable room for maneuver in steering the economy (Hibbs 1977, Tufte 1978). Proponents of this theory argue that political parties' historically grounded ideologies constitute peculiar lenses through which political incumbents interpret and respond to issues of European integration (Marks & Wilson 2000, Marks, Wilson & Ray 2002). Regarding the issue of EU pension market integration, the observable implication of partisan theory would be that Left parties are always opposed, while Conservative parties are strongly in favor since better access to, and improved portability of, corporate pensions primarily benefit highly skilled, well-to-do voters.[3] Consequently, Left parties should resist efforts to create a single pension market because it will increase existing economic inequalities and diminish the capacity of

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national governments to regulate domestic pension markets. Conservative and liberal parties, by contrast, are expected to strongly favor pension market integration because it helps highly educated, middle class voters – their core constituency – and puts pressure on competing national governments to reduce market regulations.

However, partisan theory is less useful in explaining public policy outcomes in proportional representation electoral systems, which allow for co-governance of the opposition party. Because the government's official position on EU regulations will always reflect a compromise resulting from prior bargaining among the coalition partners, the partisan origins of government policy tend to be blurred. Political accountability is higher in majoritarian systems, where the 'sovereignty' of the legislature and executive make it relatively easy for voters to attribute policy outcomes to incumbents (Schmidt 1996, Powell 2000). Yet, even in majoritarian systems political parties may not be the primary forces shaping public policy outcomes, as Rose showed in his analysis of Britain (Rose 1984).

In addition, any political issue may pitch ideological preferences against the interests of important national groups (Callaghan & Höpner 2005, Ringe 2005). Therefore, a government's public stance towards EU policies cannot be automatically attributed to its ideological proclivities, but must be analyzed with regard to historical trajectories of path dependence and the concerns of key constituencies. Although MEPs are accountable to two masters – the political party in the European Parliament and their domestic constituency – EU pension politics tends to be focused more on interest-based compromise than on party-based competition. Because policies are made without the kind of political competition, partisanship, and party politics typical of the national political arena, EU level decision-making has been characterized as 'policy without politics' (Schmidt 2005*b*, p. 769).

Careful examination of German preference articulation between 1991 and 2007 supports the theory that national interests, and particularly the Rhenish model of capitalism, explains the German position better than left-right ideological proclivities of the Kohl, Schröder, or Merkel governments. Even though all administrations implemented fundamentally different pension policies at the domestic level, their position towards European pension directives reflected a similar concern for Germany's unfunded book reserve pensions. Moreover, partisan theory cannot explain why a Social Democratic chancellor implemented far-reaching pension reforms and supported EU pension directives, while his Conservative counterparts did not.

We argue that the causal pathways highlighted in historical institutionalism and domestic discourse provide more explanatory leverage in

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the study of German government preferences towards EU pension policies. Historical institutionalism assumes that history unfolds through positive feedback mechanisms of reinforcement, which are difficult to change (Stinchcombe 1968, Mahoney 2000, Pierson 2000). A more refined version of HI departs from the determinism of path dependence and instead considers a variety of indeterminate adjustment processes, including path renewal, modification, or replacement (Streeck & Thelen 2005). Historical institutionalist theories have much to say about the congruence between EU directives and national institutional frameworks. The 'goodness of fit' between EU laws and domestic social policy traditions is an important predictor of a country's preference for EU mandated change (Cowles, Caporaso & Risse-Kappen 2001, Heritier, Kerwer, Knill, Lehmkuhl, Teutsch & Douillet 2001, Ferrera 2005).

As the following sections will illustrate in greater detail, this approach helps us understand Germany's intense interest in protecting employer sponsored book reserve pensions from the purview of EU pension directives. Unlike funded American 401(k) plans or British trust funds, wherein the sponsoring firm is separate from the trustee, German firms administer their employees' book reserve pensions themselves (Ahrend 1996, Estevez-Abe 2002). Ultimately, this money will have to be paid out as corporate pension. But until workers have reached retirement age, employers can do what they like with the funds they keep.[4] In the aftermath of World War II, book reserve pensions provided companies with cheap capital, thereby playing an important role in economic reconstruction efforts (Whiteside 2006). Long waiting and vesting periods tie the most cherished employees to the firm for a long time, making book reserve pensions an effective staff retention device. EU efforts to create a single pension market threatened to deprive German firms of this convenient source of corporate finance and staff retention device. Thus, the traditional role of book reserve pensions in sustaining Germany's characteristically patient capital flows and long-term labor relations is causally linked to the government's intense lobbying to exclude book reserve pensions from the scope of EU directives.

The resilience of employer sponsored book reserve pensions is counterintuitive to recent scholarship that has pronounced the erosion of *Modell Deutschland*. Strong liberalization tendencies in the areas of corporate governance (Höpner & Jackson 2002, Beyer & Höpner 2003), industrial relations (Hassel 2004, Hassel 2007, Rehder 2006), the financial system (Deeg & Lütz 2000, Jackson 2003, Deeg 2005), and economic policy (Allen 2004) have supposedly spelled the end of Rhenish capitalism. Yet, the removal of particular institutions does not automatically spell the death of complementarities – the presence of two or more institutions that enhance the functioning of each (Aoki 2001, Hall &

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Soskice 2001). Employer sponsored book reserve pensions are a case in point. Although the existence of this pension vehicle was repeatedly challenged by the EU Commission, governments of different partisan complexion have fought tooth and nail to preserve this cornerstone of Germany's coordinated market economy.

National institutional frameworks are not destined and therefore do not predict behavior. While the long-standing attractiveness of unfunded book reserve pensions explains much of the government's opposition to their elimination, historical institutionalism fails to account for *variation* in the German position towards a European single pension market. HI by itself cannot explain why Germany torpedoed the European Commission's first proposal for a pension fund directive in 1991, offered contingent support for the IORP directive in 2003, and fiercely opposed the pension portability proposal of 2005. To explain variation in policy preferences, we need to add an analysis of how interests were conceptualized and justified between 1991 and 2007. Whether EU mandated pension reforms are perceived as legitimate or not depends on how government leaders communicate the need to revamp existing practices and policies. An investigation of public discourse provides this missing link.

Discourse analysis, which includes a coordinative and a communicative dimension, highlights both the substantive content of ideas and the interactive processes by which ideas are conveyed (Blyth 2003, Schmidt & Radaelli 2004, Schmidt 2006*b*, Abdelal 2007). The coordinative sphere comprises the key policy actors who talk to each other in order to reach agreement on reforms. Particularly in the Rhenish capitalism model, it is important to trace the interaction between employers, unions, and political parties to understand how cognitive schemes of legitimacy militate in favor or against policy reform. The communicative dimension of discourse denotes the processes by which government officials, opposition party leaders, organized interests, the media, and social movements incorporate new ideas into political programs, and communicate them to the general public (Schmidt 2006*b*). 'Ideational leadership' is said to occur when policy-seeking officials manage to expose the downsides of the status quo and make consistent efforts to re-define the values underlying well-established policies and institutions (Stiller 2007). In contrast to historical institutionalism, discourse analysis avoids historical determinism by showing how political actors may or may not alter historical trajectories by acting differently within them as a result of new ideas conveyed by new legitimating discourses (Schmidt 2006*a*).

However, ideas-based approaches also have drawbacks. They have sometimes underestimated the mobilization to which cognitive templates are subject, or failed to specify why politicians favor a certain outcome

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and how they manage to get their preferences implemented. The usefulness of ideas-based approaches then, depends on a clear specification of the conditions under which discourse exerts a causal influence on the dependent variable. Existing streams of research have fruitfully shown that the causal influence of ideas on policy outcomes is best demonstrated when combined with rational choice or historical institutional accounts of policy development, e.g. Stiller's research on ideational leadership in German social policy reforms (Stiller 2007), Zohlnhöfer's examination of German economic policy in the Kohl era (Zohlnhöfer 2003), or Cox' analysis of why welfare reforms happened in Denmark and the Netherlands, but not in Germany (Cox 2001). We adopt the same approach to the study of workplace pension policy, a so far neglected area of comparative public policy. To understand the sources of German preferences on EU pension policies, the next section provides a brief outline of the German workplace pension system.

3 The German corporate pension system

It is well-known that employer sponsored old age insurance has a longer tradition in Germany than the social security pensions Bismarck introduced in the late 19th century. Early firm-sponsored insurance programs reflect employers' sense of responsibility for their workforce at the time, commensurate with the paternalist ethos commonly ascribed to conservative welfare states (Esping-Andersen 1990). The perceived role of corporate pensions and its diffusion changed in the 20th century, when employers realized that offering corporate pensions was in their own self interest, and not just a charitable or humanitarian responsibility. Occupational pensions can take on a variety of institutional forms. Some pension claims are externally managed by insurance companies or trust funds, others only exist on the books and are not funded. Some corporate pensions are exclusively controlled by the employer; others are jointly managed by employer and labor unions. The criterion that distinguishes occupational pensions from state sponsored or private pension schemes is that they are provided by individual employers or a whole industry. Sixty-five percent of all German employees subject to social insurance contributions have occupational pension rights. In 2001, only fifty-two percent of employees had access to an occupational pension (Kortmann 2007). The most popular form of occupational pension provision in Germany is the book reserve pension, which is hidden within the company's own corporate assets.[5] Book reserves account for 60 per cent of German pension liabilities out of a total of Euros 331bn. Funded pension vehicles play only a minor role in corporate pension provision: only 8 per cent of corporate pension rights are held as support funds; 12

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per cent as direct insurance; and 20 per cent in the form of *Pensionskasse*. While the number of people with access to workplace pensions has increased, the share of beneficiaries holding book reserve pension rights versus other forms of workplace pensions has remained constant between 1996 and 2006 (aba-online.de).

German employers favor book reserve pensions over alternative schemes for two reasons. First, book reserve pensions provide firms with access to capital independent of current profitability. This allows companies to finance their core businesses activities cheaply. Instead of having pension funds invested in a broad range of assets – stocks, bonds and real estate – they are all embedded within one company. The pension entitlements are retained and used to finance business activities. Book reserve pensions were particularly prominent after 1945, when workers' contributions to these schemes met urgent postwar requirements for internal investment (Whiteside 2006, p. 46). To protect employees' pension entitlements in the event of corporate bankruptcies, German firms have to be a member of the *Pensionssicherungsverein* (PSVag), a mutually-owned association that reinsures employers' pension obligations against the risk of insolvency. Another favorable feature of book reserve pensions is their role as effective staff retention device. Research has shown that protective employment security regulations increase the long-term horizon of firms and strengthen the incentives of employers to invest in the skills of their staff members (Hall & Soskice 2001, Iversen & Soskice 2001, Mares 2003, Thelen 2004). To protect their investments, employers need institutions that reduce the risk of competitors poaching their skilled workers. A corporate pension that belongs to employees only after long waiting and vesting periods constitutes an effective commitment device that encourages employees to stay with their firm for a long time.

Occupational pension plans are quite unevenly distributed among the population. The majority of employees with access to employer-sponsored plans work in large corporations concentrated in the unionized sector, whereas occupational pension coverage is rare in smaller firms or the lower end of the service sector. In contrast to social security pensions, occupational plans do not extend the kind of inviolable social rights that statutory legislation provides and may be abused as weapon of managerial power (Esping-Andersen 1996, p. 328–329). Furthermore, occupational pensions magnify existing inequalities because employees who have access to a corporate pension already receive a higher PAYG pension (Schoden 2003). For this reason, occupational pensions are often a target of labor movements who see their extension as undesirable. In contrast to book reserves, externally funded pensions (Pensionskasse, Unterstützungskasse, and pension funds) play only a minor role in

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Germany, because only a tiny part of the population is covered by such plans.

4 The failure of the 1991 proposal for an EU pension fund directive

Given this institutional setting, how might we expect German political and economic actors to react to EU pension policies? To create a European-wide framework for pension portability, the member states need to find answers to a complex set of problems: whether the social laws of the sending or the receiving country should apply; what kind of pension institutions should be subject to European supervisory control; and whether the sending or receiving employer should bear the administrative costs of calculating the amount of transferred assets. Naturally, member states will try to keep adjustment costs as low as possible. This is because corporate pension institutions evolved along member states' distinct social policy trajectories and locked in particular types of labor relations, capital flows, and benefit design. EU mandated regulatory changes may have favorable distributional consequences in some nations, but not in others. Thus, a one-size-fits-all framework governing the movement of pensions across borders requires adjustments in sensitive policy areas – social and financial regulations – that the majority of member states fiercely guard against intrusion from Brussels.

The first attempt to create a single pension market occurred in 1985, when it became clear that pension funds had been forgotten in Jacques Delors' White Paper on the single market (Delors 1985). Yet it was not until 1991 that the EU Commission began to take action in this field. To create pan-European pension funds, Commissioner Brittan proposed reforms in three critical areas: first, investment managers should be able to operate in all EU countries without having to adhere to twelve different investment regulations. The way to circumvent national investment rules was to adopt the so-called 'prudent man rule.'[6] Secondly, EU citizens should be free to join any cross-border pension scheme of their choice. Thirdly, a single administrative body was going to be in charge of supervising the operation of the affected pension schemes. The German government soon joined the vocal drumbeat of member states opposed to Brittan's directive proposal. Suspecting that a single European pension market would only serve the interests of countries with a mature pension fund culture (i.e. Britain, the Netherlands, and Ireland), the Bismarckian insurance states (all other member states) feared that they were going to bear the brunt of adjustment costs.

The German government rejected the Commission proposal for three reasons. The first is linked to its rejection of the prudent man rule, the equivalent of liberalization of investment regulations. The existence of

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stringent investment limits has been traditionally justified with the need to protect investors against market risk. Given the divergent investment regulations in the member states, no common definition of 'prudent man' could be reached at the EU-level. Thus, along with like-minded Bismarckian states, Germany tried to turn the 1991 directive proposal into its antithesis: instead of agreeing to liberalize investment rules across Europe, Germany demanded that quantitative investment limitations be cast in stone (personal interviews with six EU Commission officials, Brussels, 2006). While the struggle over investment regulations was settled in 2003 – all member states finally agreed on a definition of the prudent man rule – contestation over cross-border membership and the scope of EU pension directives continues unabated. The second reason for Germany's opposition has to do with the EU Commission's concept of cross-border membership. The proposal would have allowed EU citizens to join occupational pension schemes that operated on the basis of PAYG. Since PAYG systems are inherently ill-suited for accommodating late entrants, permitting people to enjoy the benefits of the system without having contributed to it would have dealt a blow to common perceptions of generational justice.

Anticipating lengthy delay, the European pension fund lobby EFRP had worked hard, via the EC Committee, to separate two freedoms – cross-border investment and cross-border pension management – from cross-border membership. However, the attempt to make cross-border membership a separate issue was rejected by the EU Commission (EFRP 2001, p. 45). The third reason why the EU plans were unacceptable for the federal government concerns the costs of providing corporate pension coverage, in particular book reserve pensions. Employers feared that permission to transfer pension fund assets across borders would require the capitalization of pensions that have hitherto only existed on the books. If book reserve pensions are no longer available to finance current business activities, employers lose an important source of capital as well as a staff retention device (BDA 2006, aba 2006). In addition, improved pension transferability rights may increase job turnover, which may impose greater liquidity constraints on the firm sponsoring occupational pension coverage. Greater liquidity requirements, in turn, will increase both the costs of sponsoring occupational pensions and decrease the return on invested pension assets. 'Such losses would be borne by everyone, including loyal workers, which is not fair. Why should workers with long job tenure be required to pay a loyalty tax?' (Interview with aba chairman Klaus Stiefermann, Heidelberg, 2006).

The German government questioned both the desirability of a single pension market and the appropriateness of promoting labor mobility at the expense of occupational pension coverage: 'European-wide

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regulations to encourage labor mobility must not lead to a deterioration of national structures governing occupational pension provision. (...) The costs associated with pension portability may discourage employers to offer occupational pensions. However, the build-up and expansion of occupational pension coverage is no less important than the goal of increasing worker mobility' (German Bundestag, Ausschussdrucksache 16(11)1999, Entschliessungsantrag der Fraktionen CDU/CSU and SPD, p. 1–2). This means that the German government considered the risks associated with implementing EU pension policies to be greater than the potential repercussions of failing to create a single pension market. Negotiators at both domestic and EU levels now agree that the 1991 directive proposal was too ambitious in its attempt to tackle all obstacles to cross-border pension movements at once. 'The member states simply had too much on their plate.' (Interview with EU Commission official, Brussels, 2006).

Consistent with earlier works analyzing the nature of German labor relations (Thelen 2000), this episode demonstrates that the major players in the corporate pension game – employers, the government, and the occupational pension association – preferred the known stability of the status quo to unknown measures that might have made labor markets more dynamic. In other words, the 1991 directive proposal was a poor fit with Germany's patient capital flows and long-term labor relations. However, institutional misfit explains only partly why Germany rejected the proposal. How the pension-related values of the government were communicated and legitimized is every bit as important in understanding the government's preference articulation at the EU level. The following section will analyze how the 1991 EU pension fund proposal was perceived by political actors in Germany.

4.1 Domestic discourse – the Kohl era

Where the majority of the population depends on social security pensions as the sole income during the retirement phase, few topics are as emotionally loaded as the long-term sustainability of pensions. As former CDU deputy chairman Kurt Biedenkopf put it: 'If a hard to comprehend system, which is critical for retirees' financial security, suddenly causes tongues to wag, fear and emotions run high. Both provide poor guidance.' (Biedenkopf 1981). Commenting on this statement, Meusch (2002) concludes that successful pension policies are either reflected in a pension system capable of keeping citizens' *Angst* to a minimum, or in the extent to which political incumbents are able to exploit fears of competing pension systems (Meusch 2002, p. 57). The Kohl government managed to keep pension reform off the table because it successfully played on public fears of alternative pension security concepts.

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In 1991, when the EU Commission first presented a proposal to create cross-border pension funds, the ideas communicated by the Kohl government strongly militated against expanding second pillar pensions. Public discourse was famously dominated by the notorious slogan of former social affairs minister Norbert Blüm: 'One thing is certain: the [social security] pensions are safe.' This was Blüm's response to social democratic accusations of fiscal recklessness regarding his pension policies. In 1984, during the first hearing on budgetary procedures in the Bundestag, he insisted that social security pensions are guaranteed by the state and urged citizens not to worry about social democratic Cassandra prophecies. Headlines in the Westdeutsche Allgemeine Zeitung read: 'Blüm: pensions are safe – opposition: state coffers are empty.' (Westdeutsche Allgemeine Zeitung, September 14, 1984). The Labor minister regurgitated his motto during the second reading in the Bundestag, reacting to allegations that the state had to borrow in order to finance social security pensions (Frankfurter Allgemeine Zeitung, November 29, 1984).

In the same vein, the coordinative dimension of discourse was not favorable to the expansion of workplace pensions, either. Although the Social Democrats accused the Conservative-liberal government of jeopardizing first tier pensions by what they deemed an irresponsible fiscal policy, the SPD had no plans to strengthen second or third tier pensions. Despite these quarrels, pension policy was largely dominated by a 'grand coalition of social policy experts' and was based on a highly valued bipartisan pension consensus (Hering 2007, p. 4). The labor unions were even more unlikely supporters of alternative pension policy concepts, particularly regarding plans to strengthen second pillar pensions. They are traditionally opposed to the inegalitarian properties occupational pensions entail and worry that any expansion of second tier pensions will be accompanied by cuts in social security pensions (Esping-Andersen 1996).

Significant social security pension reforms in the Kohl era did not happen until 1996, when contribution rates surpassed the psychological barrier of 20 per cent (Hering 2007, p. 4). The government reacted by passing a law that would have gradually reduced benefits from 70 per cent to 64 per cent through the inclusion of a 'demographic factor' in the pension adjustment formula. Zohlnhöfer argues that this unpopular move, along with further economic reforms, shortly before a major election was the government's desperate reaction to an economic predicament that put the incumbent's re-election at risk and at the same time could not be solved by moderate reforms (Zohlnhöfer 2003).

In 1991, however, pension reform was not high on the political agenda. The status quo-oriented pension policy discourse of the Kohl administration and concomitant delegitimization of opposing viewpoints

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are a consequence of agenda setter effects resulting from the high degree of autonomy German ministers enjoy. In Germany's big peoples parties (*Volksparteien*), certain factions are responsible for particular policy fields. Blüm's reluctance to change the existing pension policy discourse crowded out reformist voices because the labor wing of his Christian Democratic Party not only dominated the ministry of Labor and corresponding Bundestag committee, but also the chairmanship of the Social Committees, which Blüm had held until 1987 (Zohlnhöfer 2003, p. 129). In addition, the divisions within the Christian democratic party, particularly discord between the business and labor wings, reinforced the status quo bias in the area of pension policy.

Today, Blüm's assertion of the safety of social security pensions is rarely cited without cynicism or mockery. His assurances notwithstanding, pensioners eventually had to contribute their part to fiscal consolidation by succumbing to the introduction of health insurance contributions, relinquishment of dynamic increases, and cutbacks on disability pensions. In fact, the biggest cost reductions between 1982 and 1990 resulted from cutbacks in social security and survivor pensions, decreasing their share of GDP by one per cent (Schmidt 2005*a*, p. 101). However, curtailments of social security pensions were not flanked by efforts to expand occupational pension coverage. On the contrary, the neglect of workplace pensions is mirrored in the tax policies of the conservative-liberal coalition. The government decided to raise the tax on employee contributions to direct insurance, an occupational pension vehicle that is particularly popular among small and medium sized enterprises, from 10 per cent to 20 per cent (Schoden 2003, p. 25).

Such measures destroy trust in the funding principle and discourage employees from saving for their own retirement. Trust in externally funded pension institutions was further undermined by Blüm's public reminders of past experiences with pension funding. Seeking to deflect skepticism about the soundness of social security pensions, the Labor minister argued that the German experience with economic crises in the first half of the 20th century strongly militated against the funding of pensions. In the aftermath of 1945 and the monetary reforms of 1948, German pension funds had lost value as they converted from Reichsmark into Deutschmark on a ratio of 10:1. By contrast, contributors to book reserve pension schemes were less penalized, as their future pension relied not on monetary reserves, but on current contributions and future company profits (Whiteside 2006, p. 46).

Additional disincentives for expanding occupational pension coverage included vast increases in non-wage labor costs, especially after reunification. German reunification posed unprecedented challenges for social and economic policy. The decision to pay for reconstruction programs in

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Eastern Germany (*Aufbau Ost*) with employees' social security contributions – as opposed to tax increases – significantly increased the cost of labor for employers.[7] To make matters worse, the German government tried to hide the ensuing unemployment upsurge with early retirement measures, exacerbating the extant strain on state social security pensions. The resulting increase in non-wage labor costs reduced the room of maneuver for unions to negotiate wage restraint and maintain the virtuous impact autonomous wage bargaining previously had on the economy (Mares 2006). This new environment eroded labor unions' wage discipline, discouraged employees from using part of their wage to build up retirement savings, and induced them to renew their previous demands for compulsory occupational pension coverage.

This section has shown that not only national institutional frameworks, but also cognitive schemes of legitimate pension security designs, militated against the adoption of EU pension policies. The popularity of Germany's generous first pillar pensions, along with the status quo-oriented pension discourse communicated by the Kohl government, delegitimized any debate about alternative (more risky) pension concepts. That this fight was not just a matter of harmonizing different institutional structures, but different value systems, is also reflected at the EU level. Whereas countries with a Beveridgean pension tradition framed the debate in terms of unequal conditions of competition that the EU needed to rectify, member states with a Bismarckian pension culture categorized it as a 'social' issue that strictly belonged into the purview of the member states.

5 *The adoption of the 2003 directive*

These divergent philosophies continued to shape national discourse when European Monetary Union (EMU) heralded another phase of EU pension policy development. Given that banks and insurance companies had long been able to operate EU-wide on the basis of a single license, pension market integration was gradually viewed as the last missing link in completing financial market integration. Although representatives in the EU Council and Parliament still had competing ideas about the role of the private sector and about the role of capital markets in taking care of old age provision, they were able to agree on several welfare-finance reforms in 2002, paving the way for the 2003 European pension fund directive.[8] Although the level of integration varied across issue areas, and many legal uncertainties make it still difficult for employers to take full advantage of the directive, this first step towards a single pension market represents a success.

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EU Commission officials interviewed for this project spoke of a 'mentality change' they had noticed when discussing pension policies with members of the EU Council and Parliament (Interviews with six EU Commission officials, Brussels, 2006). While representatives from Bismarckian insurance nations had categorically rejected pension funding during the 1991 negotiations, they now acknowledged that it was no longer feasible to depend on the first pillar alone. Although the more favorable attitude towards pension reform in Germany is partly due to demographic change, a more important reason is the changing significance of unfunded PAYG pension liabilities due to European Monetary Union (EMU). The Stability and Growth Pact (SGP) provided governments with an incentive to reform social security pensions, because unfunded pension liabilities constitute the largest part of government debt (Eijffinger & De Haan 2000, Truglia 2002, p. 4). Given the constraints of the SGP criteria, political incumbents can no longer postpone pension reform into the future without being compelled at some point to cut entitlements of *current*, rather than *future*, retirees. Therefore, failure to strengthen second pillar pensions became more costly for national governments.

Yet the existence of additional incentives for cooperation must not belie the friction the member states had to overcome in order to achieve the adoption of the IORP directive in 2003. Protracted struggles over the application of the prudent man rule, biometric risk coverage, and the location of the supervisory authority delayed negotiations. Commensurate with its risk-averse insurance culture, the German government demanded that cross-border pension funds should offer a high level of biometric risk coverage and operate according to restrictive investment regulations. Germany also insisted on installing the European supervisory authority in Frankfurt. However, due to the weakly developed second pillar pension sector, unfavorable demographic developments, and the constraints posed by EMU, German negotiators found themselves in a weak bargaining position vis-a-vis member states representing a pension fund culture. In the end, the government made concessions in a number of policy areas that were previously regarded as non-negotiable (investment rules, biometric risk coverage) in exchange for excluding Germany's most sacred cow – unfunded book reserve pensions – from the scope of the directive. Although the liberalization of investment rules was perceived as too far-reaching and the application of the home country control principle to biometric risk coverage as too lax, the government was able to retain its ideal point in the policy area that mattered most to employer associations, the occupational pension association aba, and workers with skills that do not travel well (Hennessy 2008).

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The German negotiators fought hard for the exemption of book reserves and support funds by making the case that they are on-balance sheet pensions. EU Commission officials point out that long educational sessions held in the Council eventually helped Germany get what it wanted (Interviews with six EU Commission officials, Brussels, 2006). In contrast to the hurriedly adopted directive text the EU Commission had proposed in 1991, the 2003 directive was the result of a meticulously prepared consultation process with the member states. 'Once we understood Germany's biggest concern and supported the request to exclude book reserve pensions from the scope of the directive, the Germans were in favor. This was two months before we reached an agreement in the Council [in 2002; under the Spanish presidency]. The support of the Germans made things a lot easier for us, because they helped us get other hesitant members on board.' (Interview with EU Commission official, Brussels, 2006).

This explains in part why the government agreed to support the 2003 pension fund directive, but not the 1991 directive. First, the Stability and Growth Pact imposed constraints on government debt – of which unfunded pension liabilities are the largest part – that had previously played no role in the formulation of Germany's pension policy preferences. While the SGP exacerbated existing pressures to improve access to second tier pensions, Germany's willingness to make concessions and support the 2003 IORP directive is the result of excluding book reserve pensions from the scope of the directive. In addition to these structural constraints, public discourse during the Schröder era was also more favorable towards the expansion of workplace pensions, as the following part will show.

5.1 Domestic discourse – the Schröder era

Contrary to the unwillingness of the Kohl government to expand second pillar pensions, the sociopolitical catchwords of the Schröder administration – 'personal responsibility', 'generational responsibility', and 'sustainability of the welfare state' – suggested a radical break with Germany's traditional social policy path ('Bundesregierung legt Sozialbericht vor.' Ministry of Labor, March 6, 2002). While pension policies had played no role in previous election campaigns, they became one of the most hotly contested issues in 1998 after the Kohl government had passed a series of cutbacks shortly before the election (Hering 2007).

The introduction of a new capital funded occupational and private pension tier (*Riesterrente*), named after Labor minister Walter Riester, signified the most visible break with Germany's past focus on social security pensions. The government expected that a pre-funded pension

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sector would affect the mind of workers, making them more 'shareholder-value-oriented.' Although the *Riesterrente* is unlikely to radically change the institutional architecture of the German market economy (Estevez-Abe 2002), it marks an important change compared to the pension policies of the Kohl era. A major innovation of the *Riesterrente* is that employees are now *entitled* to an occupational pension by their employer whereas in the past firms have provided occupational pension coverage *voluntarily*. Employees may now request their employers to set up externally funded pension plans and convert a certain per centage of their wage into a future pension claim (Schoden 2003, p. 26). To support uptake of so-called 'Riester-pensions' the government generously subsidized the conversion of up to four per cent of net wages into future supplementary pension coverage.

The biggest resistance to Schröder's pension reform did not come from the opposition, but from the left-wing of his own party and the labor unions. They viewed the introduction of new capital funded occupational and private pension plans, along with tax and benefit cuts as evidence of an unacceptable neoliberal turn in social democratic policymaking (Schmidt 2005*a*, p. 113). One aspect the labor unions found particularly provocative was the departure from the principle of parity financing. Employees were obliged to pay 2,5 per cent of their gross wages into private pension plans, whereas employers were not required to make any contributions. Klaus Zwickel, the chairman of the German metal workers union IG Metall, called Riester's pension reform plans 'a disgrace for a social democratic government.' (Hering 2007, p. 12). A Social Democratic chancellor whose pension policies provoke the very constituency who has just helped elect him is highly counterintuitive to partisan theory. Schröder's pension policies show that the coordinative discourse among policy actors may not be as elaborate in compound polities as the DA literature assumes. Schröder simply imposed social policy reforms from above without much support from either labor unions or the left wing of his own party. When a leader imposes reforms without much support from his core constituency, the communicative discourse becomes increasingly important. Walter Riester managed to credibly reject the status quo, frame the reform as desirable in terms of intergenerational solidarity, and rebuff critics as irresponsible supporters of a system that was doomed to collapse under the growing fiscal and demographic strains. Stiller argues that Riester's capability to recast this hotly contested reform in a favorable light embodies 'ideational leadership' (Stiller 2007).

The changes heralded by the red-green coalition, along with previous cuts in PAYG pensions and selective deregulations of private pension investments, have gradually increased the awareness of future beneficiaries that social security pensions alone will not provide financial security in old

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age. A 2005 survey by the Allensbach institute shows that 73 per cent[9] of Germans believe that their state pension will not suffice to maintain their current standard of living, compared to 45 per cent of West Germans and 57 per cent of East Germans in 1996 (Associated Press Worldstream, October 23, 1996). However, greater awareness for the need to supplement social security pensions is not accompanied by a rush to set up new occupational pension schemes. The main reason is that Germans are ill-informed about state assistance in creating pre-funded pension schemes: 80 per cent of Germans know very little or nothing at all about state subsidies they may be entitled to. Even highly trained executives fare no better: only 36 per cent feel that they are sufficiently informed about state subsidies for building up a funded occupational pension (Institut für Demoskopie Allensbach, press release, December 5, 2005).

The move of the social democratic-green coalition towards pension funding made it easier for the German government to compromise on certain provisions (investment liberalization, biometric risk coverage) specified in the EU pension fund directive of 2003. Yet, despite the gradual acceptance of future beneficiaries that pension reform is necessary, employers, pension associations, and the government continued to defend book reserve pensions from interference by Brussels. The reasons for doing so were the same as in 1991 – subjecting book reserve pensions to EU regulations would have stripped employers of their cherished source of capital and staff retention device. As soon as the reform requirements of the 2003 pension directive were limited to off-balance sheet pensions, Germany was in favor of the directive.

6 The pension portability proposal of 2005

While the 2003 pension fund directive accomplished the EU Commission's goal of liberalizing investment regulations, barriers to individual pension portability – and therefore labor mobility – remained firmly in place. Therefore, in 2005 the Commission embarked on the next step towards pension market integration: the improvement of individual pension portability across and within any country. Contending that opportunities for cross-border mobility are of little use when within-country mobility barriers continue to persist, the Commission's 2005 directive proposal targets three regulatory areas that play a critical role in obstructing labor mobility: 1) the transferability of acquired pension assets, 2) the acquisition of pension rights, and 3) the preservation of dormant pension rights.[10] Unlike previous EU pension proposals, this endeavor encountered noticeably more resistance from governments and labor unions in Europe. The reason is that the 2005 portability proposal drills much deeper into national institutional frameworks than was the

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case for the rather technical provisions recorded in the 2003 pension fund directive. Instead of focusing on the removal of barriers to the transfer of pension assets (negative integration), the EU Commission has gone much further and proposed to regulate dynamic adjustments, vesting and waiting periods (positive integration).[11] However, delegating control over the latter to Brussels would profoundly alter the nature of labor relations and capital flows in coordinated market economies. Consequently, the occupational pension association has dubbed the EU Commission's proposal a 'Trojan horse' that could alter Germany's institutional architecture in ways nobody desires – not even the EU Commission (aba 2006). The following section explains how the EU portability directive – in its original version – would have increased employers' costs of offering occupational pensions and transformed German labor relations and capital flows.

Ostensibly, the adoption of recent pension reforms in Germany and the objective of the EU to promote pension portability do not seem irreconcilable. In anticipation of developments at the EU-level, the German government had already adopted the retirement income act in 2005 *(Alterseinkünftegesetz)*, granting citizens the right to transfer pension assets. However, the EU proposal differed from Germany's law in important ways. While the German *Alterseinkünftegesetz* limited the transferability of pensions to *assets* and therefore to off-balance schemes, the EU directive proposal envisioned the transferability of pension *claims*, which includes unfunded book reserve pensions.

Predictably, the reaction of the key domestic actors was essentially the same as in 1991, when pension market integration was initially proposed. BDA, aba, and the governing parties (CDU/CSU and SPD) again thundered that capitalization requirements of book reserve pensions would endanger the long-term investment horizon of German companies and concurrent changes in corporate liquidity planning (aba 2006, BDA 2006, Deutscher Bundestag 2006), depriving workers of valuable corporate social protection and firms of their cheap source of capital. If adopted, the portability directive would force employers to look for external capital sources, such as international financial markets. Borrowing on financial markets, however, is both more expensive (and therefore less attractive) as well as onerous, since this step requires the adoption of international accounting standards (IAS). Although many large firms listed on foreign stock exchanges have already assumed IAS, many smaller firms with a domestic focus may consider this option as too costly. An additional burden employers would face is an increase in administrative costs, resulting from the need to calculate the amount of employees' pension assets that are being transferred from and to the firm (aba 2006).

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In the same vein, German politicians fear that EU portability demands will make it unattractive for employers to offer occupational pension coverage, which in turn could lead to an underprovision of corporate pensions. This prospect is particularly troublesome in light of recent attempts to persuade people to build up supplementary pension coverage. As a German MEP pointed out, 'If pension portability translates into higher costs for employers, this directive will constitute a death blow for occupational pension coverage. After all, we are talking about *supplementary* pension rights, not *compulsory* pension laws.' (German Christian Democratic Party member, during a hearing of the Employment and Social Protection Committee, Brussels, 2006). German actors have made it clear that they would support an EU agreement regulating the transfer of pension assets – but not pension claims – if the mobile employee will bear the administrative costs of transferability. 'Why should companies bear the costs of mobile employees? Loyal workers must not be penalized. The costs associated with portability should be borne by those who cause them, that is to say, by mobile employees.' (aba 2006, p. 8). This statement assumes that immobile employees will have to pay a 'loyalty tax' due to a diminished actuarial rate of return, which will result when frequent pension transfers force the company to hold more liquid assets.

Whereas the issue of transferring pension *assets* left room for a middle ground between the German and the EU position, Germany categorically rejected the Commission's proposal on the acquisition of pension *rights*, in particular qualifying ages, waiting and vesting periods. The reason is that the proposed measures would critically alter Germany's characteristically long-term labor relations and patient capital flows.[12] As is well known, long waiting and vesting periods penalize frequent job changers, in particular women who interrupt their career for domestic care responsibilities. The right to a pension materializes only after a long period of uninterrupted job tenure. In 2001, the vesting period in Germany was lowered from ten years to five years, but the EU Commission still regards this reduction as insufficient. To improve corporate social protection for people with intermittent career paths, the directive proposal suggests a European-wide vesting period of two years, and a waiting period of one year.[13]

This implies that the EU Commission attempts to shift the function of occupational pension provision away from 'golden handcuffs' towards ownership of supplementary pension rights. The purpose is that employees should not have to pay a 'pension penalty' in the event of career interruptions. The implementation of the original portability proposal would have eliminated the staff retention function of book reserve pensions. Easier pension portability might have reduced fears of occupational mobility and increased labor turnover in German

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companies. This development, however, would have changed employers' incentives to train their workers. As Hall and Soskice have pointed out, the willingness of firms to invest in their employees' education depends on their belief that employers who do not invest in workers' training will not poach extensively from those who do (Hall & Soskice 2001, p. 10). Unfunded book reserve pensions that belong to employees only after long waiting and vesting periods effectively prevented poaching. Therefore, the disappearance of this staff retention device would have rendered employers reluctant to invest in the education of their workers or offer occupational pensions in the first place (Interview at the German Ministry of Labor, 4 July 2006). Thus, providing citizens with better pension portability rights at the EU level might have caused the perverse result of leaving more citizens without any workplace pension coverage at all.

Similar to long waiting and vesting periods, high minimum age requirements attached to workplace pensions also discourage labor mobility. A departure before reaching a certain age would result in the loss of pension rights (Commission of the European Communities 2005*b*, p. 7). In 2001, the qualifying age to draw an employer sponsored pension in Germany was reduced from 35 to 30 years. The EU Commission proposal, however, proposed to lower the minimum age further, to 21 years. A reduction of the qualifying age is another reason employers and political actors opposed the EU portability proposal. Given that labor turnover in the group of employees aged 21–30 is much higher than is the case for older cohorts, employers feared that a soaring turnover rate would result in more pension claims being transferred, which in turn would increase firms' administrative costs (BDA 2006, aba 2006, Deutscher Bundestag 2006). Because the EU Commission proposals on acquisition rights would have considerably increased firms' costs of providing occupational pension coverage, they were rejected by the German government.

Another controversial point in German–EU deliberations concerned the regulation of dormant pension rights. Article 5 of the 2005 proposal states that 'member states shall adopt measures they deem necessary in order to ensure a fair adjustment of dormant pension rights so as to avoid that outgoing workers are penalized.' The EU Commission justified legislative activity in this area by the need to protect outgoing employees from a depreciation of their dormant pension rights due to inflation or other factors.[14] The Commission suggested adjusting dormant pension rights to a variety of different parameters, including inflation, wage levels, social security benefit levels, and employer's capital gains.

Although it remains somewhat unclear to what extent dynamic increases of dormant pension rights constitute a 'fair' adjustment, aba

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estimates that this provision would have increased employers' costs by over 30 per cent (aba 2006, p. 7). Echoing aba, the BDA complained that the compulsory dynamic increases would essentially penalize the sponsoring firm as well as the loyal workforce, 'who can expect lower and qualitatively inferior pension claims due to the costs imposed by their mobile colleagues.' (BDA 2006, p. 2). Since the additional costs of dynamic increases can only be kept under control with sufficiently long transition periods, employers requested that the right to dynamic increases should be limited to new hires to preserve trust between employers and the workforce. Employers also feared that compulsory dynamic increases would lead to a complete overhaul of the German occupational pension system, affecting in particular tax breaks they have traditionally benefited from (aba 2006, p. 7).

The general misfit between the EU pension portability proposal and the institutional framework sustaining the German capitalism model explains why it will be a long way until obstacles to labor mobility will be removed in Germany. The following section illustrates why the pension policy ideas communicated by the Merkel government are similarly unlikely to spark enthusiasm for future EU integration efforts in the pension sector.

6.1 Domestic discourse – the Merkel era

How does the trajectory of Angela Merkel's policies toward EU pension policies contrast with the policies of her predecessors? During the first one and a half years of her tenure, several pointers suggested that Merkel would carry on her predecessor's policy of increasing incentives to build up workplace pension rights. The tenor of the CDU/CSU/SPD coalition agreement resembled the catchwords of the Schröder administration – more personal responsibility, more generational justice, and making the social security system 'fit for the future.' In the same vein, the grand coalition raised the retirement age from 65 to 67 years and undertook steps to encourage young families to save for supplementary pensions. These developments suggested that Merkel would continue with Schröder's novel social policy course of strengthening supplementary pensions at the expense of the first pillar.

However, the rise of the Left party has robbed the Social Democrats of their eagerness to implement any pension reforms that prioritize economic efficiency over redistribution. Between 2004 and 2006, the *Linkspartei* (or its precursor, the party of Democratic Socialism, PDS) was represented in six state legislatures. In May 2007, it accomplished the unprecedented feat of moving into a West German state parliament after attaining more than 8 per cent of the vote in Bremen. In 2008, the

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Linkspartei followed up on these victories by moving into the state parliaments of Hesse and Lower Saxony. In 2007, the Left party consistently scored between 10 and 14 per cent in national opinion polls, a significant rise compared to previous years. The SPD reached an all-time low of 28 per cent. Initially, the numbers for the Christian Democrats were put at an equally bleak 30 per cent, but in the second half of 2006 and in 2007, they consistently enjoyed a 10–15 point lead over their social democratic coalition partner (http://www.wahlrecht.de/umfragen/forsa.htm, last checked in June 2008).

The SPD now finds itself in the uncomfortable position of fighting on two fronts: on the one hand, it needs to prevent disaffected social democratic voters from defecting to the Left party. Hoping to woo voters who regard Schröder's social policy reforms as a sellout of social democratic principles, the Left party has vowed to fight for the removal of many agenda 2010 reforms. The Christian Democrats, on the other hand, work hard to portray themselves as the *Volkspartei* committed to maintaining Germany's lavish welfare state. This is reflected in a number of initiatives by state prime ministers, such as North Rhine-Westphalia's Jürgen Rüttgers, to advocate more generous social policies. In 2006, Rüttgers proposed to extend unemployment benefits for elderly citizens from 18 to 24 months and cut this period for younger unemployment recipients. Challenging the insurance principle, he suggested that unemployment benefits should be based on the number of contribution years.[15] Although this initiative initially positioned the Christian Democratic premier Rüttgers to the left of the Social Democrats, SPD chairman Kurt Beck quickly made this proposition his own. Under electoral pressure from both the Left and the Conservatives, the Social Democrats have decided to abandon the 'new middle' and return to their left-wing, blue collar roots. This move entails the retraction of many hard won accomplishments of Schröder's reform program. Key reforms the grand coalition has enacted – aside from raising the pension age – include more unemployment benefits for older workers, an increase in social security pensions (pensions are to rise by 1.1 per cent in 2008 and by 2 per cent in 2009), and, more generally, privileging social security pensions at the expense of workplace and private pensions. Although the Christian Democrats initially sought to rescue some reform measures the Schröder government had implemented, the CDU feels increasing pressure to follow the Social Democratic coalition partner in its move to the left. As chancellor Merkel put it: 'Because the SPD is moving to the left, we have to follow (...). We will have to move to the left frontier of the middle.' (quoted in Der Spiegel, 3 December 2007, p. 36).

Continuous efforts by the grand coalition to water down the agenda 2010 program have been harshly criticized by the independent Council of

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Economic Advisors (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2007). In the area of pensions, an extension of unemployment benefits for older workers could open the door to the pernicious early retirement policies of the 1990s. Employers have exploited the early retirement option excessively for staff reductions, leading to a dramatic increase of beneficiaries entitled to unemployment assistance at a time when the pool of contributors to unemployment insurance continued to shrink (Rosenow & Naschold 1994). The ensuing strain on the welfare state demonstrates that the most important rationale of early retirement policies – sugarcoating unemployment figures – had backfired badly. In a recent evaluation of the state of the economy, the Council does not see any need for further reforms in the area of pension policy, because the agenda 2010 reforms seem to have fulfilled their purpose (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2007, p. 16). In the past two years, more than 250,000 unemployed people over 50 years of age have found jobs. In light of these positive employment effects, the Council prefers no further activity in this area to pension reforms that aim at turning back the wheel (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2007, p. 17).

Public debates of 'turning back the wheel' are commensurate with Meusch's prediction that successful pension policies are reflected in the extent to which politicians are able to exploit voters' fears of alternative pension insurance concepts. A recent survey, which found that 82 per cent of Germans support an extension of the period older workers can receive unemployment benefits, corroborates this hypothesis (Süddeutsche Zeitung, 11 November 2006). This implies that mistrust in the soundness of statutory pensions is growing, while lack of information about building up supplementary pensions is still common, as recent surveys of the Allensbach institute found (Frankfurter Rundschau, 10 March 2006). How do these incidents matter for negotiations at the EU level? The rise of the Left party and gradual reposition of the grand coalition to the left edge of the middle suggests that the German government will be unlikely to support further steps towards market competition and economic freedoms in the area of EU pension harmonization. Current attempts to deepen pension market integration by harmonizing corporate pension taxation are unlikely to be resolved soon, let alone find their way on the agenda in Brussels.

7 *Alternative explanations*

A possible objection to the argument advanced here is that the three time points examined in this analysis are not comparable since many variables

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have changed in between. Circumstantial incidents, such as German unification or the fate of the German economy, could have been more important in explaining the government's behavior than concerns over book reserve pensions. However, these factors do not constitute convincing alternative explanations.

Reunification represented a momentous turning point for German society that could have sparked major changes in the organization of economic and political life. Yet, political incumbents showed little enthusiasm for experiments, and therefore West German institutions were simply transferred to the East. This risk-averse attitude was mirrored in the negotiations over the first pension fund directive proposal between 1991 and 1994. Despite unfavorable demographic and economic developments – the decision to allow East Germans to convert their ostmarks into deutschmarks at par crippled the economy and saddled the West with years of subsidies to the East – the German government refused to introduce funded elements to its pension system or open the corporate pension market to European-wide competition.

What about the fate of the German economy? A decade of sluggish growth in the 1990s and between 2001–2003, which strained public finances, could have influenced the German government. As the German economy contracted, benefits for future pensioners were repeatedly cut. However, economic developments hardly explain the government's behavior towards EU pension policies. Germany was in a recession when the first pension fund directive was shelved in 1994, but also when the IORP directive was adopted in 2003. Since we observe two different outcomes under similar economic conditions, the overall health of the economy does not constitute a credible alternative explanation.

Conclusion

This article asked why the German government supported some EU pension policies, but not others. The question was motivated by the observation that Germany torpedoed the first attempt to create a single pension market in 1991, offered contingent support for a pension fund directive in 2003, and fiercely opposed the pension portability proposal in 2005. We argued that partisan theory cannot explain why a Social Democratic-Green government implemented a major domestic pension reform and supported liberal EU pension policies while Conservative governments did not. German selectivity regarding EU pension directives is better explained by a combination of historical institutionalism and discourse analysis.

Historical institutionalism accounts for the resilience of employer-sponsored book reserve pensions, which only exist on firms' balance

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sheets and are not funded. Because of their role in sustaining long-term labor relations and capital flows, book reserve pensions are diametrically opposed to the EU Commission's goal of improving pension portability. Thus, Germany's support for EU pension policies has been consistently contingent upon the exclusion of book reserves from the scope of EU directives. However, historical trajectories of pension policy development explain only part of the story. For this reason, we also included an ideas-based account to show how interests were framed and reconceptualized between 1991 and 2007.

This knowledge helps us understand why a crucial element of German coordinated capitalism persists despite strong liberalization tendencies in other policy areas. Obstacles to a truly integrated pension market in the European Union are unlikely to be eliminated any time soon. Future works on EU pension market integration may productively examine how the balance between EU-wide market competition and domestic distributive policies is influenced by national institutions and pension policy ideas. Historical-institutionalist accounts demonstrate how past policy trajectories have shaped the rules of the game, but institutions alone do not determine actor behavior. Ideas-based approaches tell us how templates of generational and distributional justice shape member states' preference articulation at the EU level, but sometimes poorly specify the conditions under which ideas exert a causal influence on public policy developments. When combined, however, these approaches remedy each others' limitations.

NOTES

1. We use the terms 'corporate pension', 'second tier pension', 'workplace pension', and 'occupational pension' interchangeably. All refer to pensions sponsored by an employer, which differentiates them from social security (first tier) pensions and private (third tier) pensions.
2. Of course, the preferences of other EU member states over pension market integration are just as important. Yet this paper concentrates on Germany because the focus of the analysis is the German model of capitalism in an increasingly Europeanized environment, not the interaction of the German government with peers at the EU level.
3. I thank an anonymous reviewer for pointing out that one might conversely expect Left parties to support more pension workplace portability since they favor employees' over employers' rights. However, Left parties generally disapprove of the inegalitarian properties of workplace pensions because the beneficiaries already receive a higher social security pension (Esping-Andersen 1996). To the extent that Left parties are concerned with employees' pension rights, they devote their efforts to improving the generosity and portability of social security, but not corporate, pensions (personal interviews with officials at the German Ministry of Labor, Bonn, 2006; and a Socialist member of the European Parliament, Brussels, 2006.)
4. Because this practice could give rise to liquidity risks as future pension obligations might be inadequately reflected in company balance sheets, the EU Commission has repeatedly sought to make external funding compulsory under a European directive. However, there is no consensus in the literature whether book reserve pensions or externally funded pensions are superior in terms of pension security.
5. Book reserve pensions are also found in France, Greece, Ireland, Latvia, Luxembourg, the Netherlands, Norway, Poland, Portugal, and Britain. However, the share of book reserves in total corporate pensions is highest in Germany.

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6. This rule denotes an early standard for responsible money management. Trustees or fund managers are obliged to conduct themselves faithfully and exercise sound discretion in the investment of funds. According to the common law standard, a trustee is to 'observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested.' (*http://www.russell.com/us/glossary/pensions*.)
7. Some tax increases did occur, such as the solidarity surcharge and an increase of the value added tax, but they played a minor role compared to the hike in social security contributions.
8. Directive of the EU Council and EU Parliament on the Institutions for Occupational Retirement Provision (IORP), 2003/41/EC.
9. Institut für Demoskopie Allensbach, press release, September 19, 2005.
10. Articles 6, 2, and 5 of the pension portability proposal.
11. Scharpf (1996) has coined the terms 'positive' and 'negative integration'.
12. The waiting period *(Vorschaltzeit)* is the elapsed time before an employee earns the right to acquire corporate pension contributions. The vesting period *(Unverfallbarkeitsfrist)* is the time from acquiring corporate pension contributions until the benefits belong to the employee.
13. Waiting periods in Germany are often two years or longer.
14. EU pension portability proposal, article 5, section 7.
15. Under the current law, beneficiaries receive unemployment assistance regardless of the number of years they have contributed to it.

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