The Third Way in Welfare State Reform?
Social Democratic Pension Politics in Germany and Sweden

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1. Introduction

Recent contributions to the literature on welfare state change emphasise the difficulty of reforming mature welfare states even when fiscal and demographic pressures are substantial. Governments intent on adapting welfare state institutions to new economic and social conditions face considerable obstacles because of the popularity of existing social programs (Pierson: 1994). As Pierson (1998) poses the question, “What happens when the irresistible forces of post-industrialism meet the immovable object of the welfare state?”

The challenge of updating welfare state institutions to meet new economic and demographic pressures raises the question of whether there is a distinctive leftist approach to welfare reform. Thus, the issue of welfare state reform provides a useful opportunity for investigating whether and to what extent there is evidence of Social Democratic renewal in the field of social policy. Pensions are one major area in that field, both in terms of social spending and political support. If there is a Social Democratic "Third Way", if partisanship still matters in welfare state development, this should be apparent in leftist pension reforms. Is this the case? Does Social Democratic participation in pension reform signal the emergence of a "Third Way" in pension politics, or are leftist pension reforms simply pragmatic, defensive, ad hoc responses to demographic and fiscal pressures?

This paper investigates the role of Social Democratic parties and trade unions in pension reform politics in Sweden and Germany. The paper argues that Swedish pension reform was more successful in this respect than the German reform. In Sweden, the Social Democratic Party (SAP) co-operated in a structural overhaul of public pensions in 1994 order to guarantee the future sustainability of the system. The state still plays a major role in the reformed pension system, but the role of market forces is much stronger. Despite these changes, the reformed system retains its core Social Democratic features. In contrast, the recent Social Democratic-led pension reform in Germany appears to be motivated less by ideological renewal and more by cost containment. The current reform can be seen as a critical juncture in that it opens up a new path towards more privatisation and greater differentiation/inequalities. However, the reform lacks a distinct Social Democratic profile. It contains only a weak, means-tested minimum pension, the reform of derived rights for spouses will lead to a deterioration of women's pensions, and citizens with weak ties to the labour market are insufficiently protected.

The paper attempts to explain this difference in outcomes by identifying the factors that facilitate and/or hinder party-union co-operation in pension reform. We argue that a crucial precondition for far-reaching Social Democratic pension reform is the emergence of party-union agreement about the need to modernise the pension system. Whether such an agreement can be reached by a viable coalition within the labour movement depends on the time horizons of Social Democratic Parties, Social Democratic experience in government, the capacity of reformers to design a reform that appeals to the interests of important segments of the labour movement, the degree of union modernisation, and the impact of institutional legacies. In Sweden, union-party co-operation functioned reasonably well in the 1990s, unions had gone through a process of modernisation, and existing pension policies did not hinder change. In contrast, in Germany there were contacts and confrontations between unions and the social-democratic party, but no real co-operation. Moreover, the outlook of the largest unions is traditionalist and existing pension policies made change very difficult.

The paper is organised as follows. The first section identifies core features of Social Democratic pension policies from the point of view of both "old" and "new" social democracy. The next two sections discuss recent pension reforms under Social Democratic governments in Germany and Sweden. For each case, we discuss the pressures that led to the reforms and the roles and behaviour of the major actors, and we assess the extent to which each reform exhibits signs of Social Democratic renewal. We also provide a brief explanation of the factors that facilitated or hindered reform. The final section compares the German and Swedish reform processes in order to identify more precisely the conditions that lead to the adoption of "modernising" but still Social Democratic pension reforms.

2. Social Democracy and Pension Policy

Is there a discernible "Third Way" in pension policies, and if so, how does it improve or add to "old" Social Democratic pension policies? This section draws on the literature on Social Democratic welfare states and recent contributions to the Third Way debates in order to identify core Social Democratic features in pension systems. This provides the basis for determining the extent to which recent reforms in Germany and Sweden bear the imprint of core Social Democratic values.

2.1 "Old" Social Democracy

Esping-Andersen (1985, 1990) provides the most elaborated statement of the relationship between social democracy and social policy. According to Esping-Andersen Social Democratic social policy must promote three goals: solidarity, decommodification, and equality. First, *solidarity* is created and maintained through universal benefits and the absence of meaningful private alternatives to state social insurance schemes. The participation of all citizens in the same system leads to the development of collective identity and loyalty to public schemes.

The second goal, *decommodification*, refers to freeing workers from the market imperative in securing basic needs, and is achieved through high income replacement rates and generous qualifying rules in social insurance programs. Decommodification was one of the earliest goals of Social Democratic social policy because dependence on the market reduced the capacity of the working class for collective action. The third goal, *equality* is strongly supported by the effects of solidarity and decommodification. Although Esping-Andersen notes the vagueness with which this term has been used by Social Democrats, its central focus appears to be the reduction of inequalities in status, income and wealth, and later came to include gender and race. In its most common formulation, equality in social policy requires that benefits not be determined by status, class, or occupational group.

What does all of this mean in terms of specific social policies, particularly pensions? Referring to the three Scandinavian countries as exemplars of the Social Democratic regime, Esping-Andersen notes the importance of two central commitments. First, the state assumes responsibility for providing and/or guaranteeing adequate levels of welfare for all members of society. Social citizenship rights, rather than the family or market, should be the main source of welfare. Second, generous entitlements to socially accepted standards of welfare should replace stigmatising means-tested benefits. (1985:159). Esping-Andersen summarises the basic contours of Social Democratic social policies thus:

> The social citizenship state, then, is compelled to pursue two goals if it is to aid Social Democratic class formation: it must both establish universal solidarity and marginalise the market as the principal agent of distribution and the chief determinant of peoples' life chances. Basically, the entire population must become wedded to the fate of the social citizenship state and must have an incentive to promote its cause actively. (1985: 245).

2.2 "New" Social Democracy

How should "old" Social Democratic ideas concerning the welfare state be updated and/or improved? Until recently, the literature on the Third Way and the renewal of social democracy provided little concrete guidance concerning the actual content of social policies.

In its broadest sense, the Third Way refers to need for Social Democratic parties to modernise their programmatic and policy commitments to respond to three fundamental changes: globalisation, the rise of the knowledge economy, and changing patterns in everyday life. We will examine the first and third type of change because these are most relevant for pension policies. The effects of globalisation influence mainly the *financing arrangements* of pension policies, whereas changes in risk biographies affect mainly the pension *benefit structure*.

Globalisation

One of the features of globalisation is the increase in capital mobility. Both productive and financial capital move much more easily across borders because of the internationalisation of financial markets, increased trade interdependence, and the capacity of firms to move production sites to locations that offer the most attractive conditions for investment. Rather than responding defensively to these shifts in the international economic environment, social democracy's task, according to Third Way theorists, is to embrace these changes and to adopt policies that minimise and/or cushion the effects of global economic forces (cf. Anderson 1998).

The threat of capital flight means that firms have more bargaining power vis a vis national governments in terms of their political demands concerning social policies that influence the production process. This includes employment protection legislation, but more relevant for the present paper is the issue of non-wage labour costs. Simply put, Social Democratic governments ignore at their peril the need for firms to remain competitive in world markets. To the extent that the non-wage labour costs that finance social insurance programs like pensions remain high, the financial viability of the welfare state, and public pension systems, is threatened by rising non-wage labour costs. The economic logic is straightforward: unless they are offset by productivity increases, rising non-wage labour costs increase factor prices and may contribute to declining market share. This in turn leads to declining profits; declining investment; declining employment, and finally, financial pressure on the welfare state. Thus, one of the tasks for new social democracy is to reform social insurance programs in order to prevent non-wage labour costs from rising above an acceptable threshold, however this is defined. Social Democratic governments who ignore this challenge face the prospect of capital flight.

The mobility of financial capital poses a different challenge to Social Democratic governments and public pension systems. Financial capital moves even more quickly across borders than productive capital, complicating the task of ensuring adequate levels of domestic investment. Pension savings represent a potentially very large pool of investment capital that may be more reliable (i.e. less mobile/volatile) than other more mobile forms of capital. Countries such as France, Germany, and Italy rely almost exclusively on PAYG public pension systems, so the pension system contributes little to the domestic capital pool. In contrast, countries like Great Britain, the Netherlands, Switzerland, and to some extent, Sweden, have large pension reserves that can be used (depending on national regulations) as a source of domestic investment. For some Third Way theorists, reforming public pensions to reduce reliance on PAYG and to encourage pension savings (both public and private) is thus a way to try to mitigate the effects of financial capital mobility. (Latham 2001; Ferrera, Hemerijck and Rhodes 2001).

European integration, especially EMU, plays an important role as well. The Maastricht convergence criteria set concrete limits on annual budget deficits and accumulated government indebtedness. These criteria acts as severe constraints on government fiscal policies. Governments with long-term time horizons must then take into consideration the ways in which public pension commitments are expected to influence public finances as the baby boom generation begins to retire.

To sum up, the constraints posed by globalisation mean that pensions should be re-engineered so that they do not contribute to unsustainable budget deficits; provide disincentives to paid employment; or contribute excessively to non-wage labour costs.

Changes in risk biographies and the emergence of individualism

Third Way theorists emphasise the changes that have occurred in the realm of work and family patterns and the "rise of individualism." (Giddens 2001: 5) As Giddens puts it, "The welfare state developed in an era where neither the risks to be covered, nor the groups most in need, are the same as they are now." (2001: 11). In other words, the welfare state should be reformed in order to deal with new social risks.

The Third Way emphasis on individualism is also important because it recommends changes in social policies, especially pension systems, that assign more weight to individual instead of family income, and to variations in individual work patterns. Where possible, social policy should reinforce individual responsibility and respond to individuals' demand for choice and autonomy. This new emphasis does not mean, however, that the state should withdraw from, or reduce its commitment to social justice achieved via social insurance.

What does this mean for pension reform? First, a central goal of reform should be to ensure that the pension systems include persons with non-typical employment biographies (persons with periods in part-time employment, unemployment, and/or periods entirely outside paid employment). This challenge is likely to be greater in the continental/conservative pension regimes that are heavily biased toward full-time, long-term employment as the basis for entitlement, and it should be less of a challenge in the Social Democratic welfare states that provide universal, basic pensions. Second, pension reform should, where feasible, promote individual choice and responsibility by increasing transparency (so that individuals are aware of how much they can expect from the pension system) and autonomy. This appears to mean that individuals should somehow be involved in the decisions that influence the level of their future pensions, for example, by choosing among different retirement investment options and/or by electing to supplement their public pension by private pension savings, perhaps encouraged by tax incentives.

Turning Vices into Virtues

This category refers to removing incentives built into social policies for moral hazard and to correcting unintended negative effects and program irrationalities (Giddens 2001: 11). Jonah Levy (1999) calls this strategy of welfare reform "turning vices into virtues." As Levy argues, there is a left-progressive approach to welfare reform that is distinctly partisan. In contrast to neoliberal restructuring, left-progressive reformers pursue policies designed to correct inefficiencies in the welfare state without significantly compromising commitments to disadvantaged groups. Moreover, the correction of program weaknesses usually results in financial savings that can be used to expand commitments to disadvantaged groups.

The challenge of turning vices into virtues bridges both of the structural change categories discussed above by focusing, among other things, on the effects of welfare state design on the functioning of labour markets and on the impact of "breadwinner" benefit structures on women's labour market participation and gender equality. For example, one of the main causes for concern in the continental welfare states is the widespread use of labour shedding strategies, primarily through early exit, in order to promote the employment of younger workers. Modernising Social Democrats now criticise this type of strategy not only because of the considerable financial costs of such schemes, but because of their social costs as well. Pushing older workers into early retirement not only has led to little job creation, but it is also argued that such policies promote negative and unwarranted assumptions about older workers, for example the idea that they should be pushed out of paid employment to make room for younger workers. It is also argued that early exit policies waste the resources (skills and experience) that older workers possess. In other words, older workers should be valued, not discarded (Guillemard 2001).

The primary “vices” of the continental/conservative welfare states have been the widespread use of pension schemes to promote early exit from paid employment, and the dominance of “breadwinner” benefit entitlement that encourages low rates of female labour market participation and reinforces women’s dependence on their husbands (Sainsbury 1996; Meyer 1998). The Social Democratic welfare states are plagued by a different type of potential weakness, namely their extreme reliance on high levels of taxation and employment in order to maximise revenues and minimise benefit take-up rates. Social Democratic parties that claim to be modernisers must somehow address these type of problem (Esping-Andersen 2001).

How far has the theory of the Third Way moved from old Social Democratic goals? What is the meaning of solidarity, decommodification and equality today, and can these goals be maintained in modernising pension reform? The main casualty of Third Way thinking appears to *solidarity*. For example, solidarity appears to play a much smaller role in the Third Way debate because private alternatives are now supported by all Social Democrats and the heterogeneity of pension schemes is endorsed. Today, solidarity appears to mean the financing of minimum standards and protection against the new employment and family risks. This new emphasis differs from Esping-Andersen's concept, according to which the middle classes actually had an active stake in the welfare state. The goal of e*quality* appears to have changed substantially as well. Social Democrats no longer promote income equality as vigorously as in the past, but gender equality plays a much more important role than it did only a few decades ago, but in the sense mentioned above: no one should be below the poverty line because of care responsibilities, minimum standards have to be in place.

Decommodification is the only one of the three goals that still has a high priority. Universal protection against shortcomings of the market is still supported by Social Democrats. However, the meaning of the concept has changed. Nobody makes the connection between decommodification and political empowerment any more, and social rights come with responsibilities today, i.e. the means-testing element of social policy has increased.

New Social Democratic thinking about social policy still emphasises the social right to a minimum income independent of labour market status for all citizens. In addition, new social democracy is more responsive to the social risks of citizens with weak ties to the labour market than Conservative parties are. However, egalitarianism plays a much smaller role in new social democracy. With all groups of the political spectrum it shares the view that global economic changes constrain the capacity for interventionist policies. State intervention to promote Social Democratic aims is still pursued, but the *type* of intervention has changed.

How does this reorientation in social policy thinking apply to pension policies? Obviously, the challenges discussed above do not apply uniformly to all pension systems, and the starting point for new thinking and possible reform strategies is always the existing pension system structure. Overall, however, the direction of reform aspirations is the following: a revamped pension system should promote the inclusion of new social risks, it should promote individual autonomy (at least more so than in the past); it should promote employment, it should be financially sustainable, and it should not contribute excessively to non-wage labour costs. As Esping-Andersen (2001: 146) puts it, policy choice should be guided by the goal of "re-prioritising the allocation of ..existing resources" without additional spending financed by new taxation or deficit spending. The following is a list of possible types of pension reform goals that follow from the previous discussion.

Third Way Pension Reform Goals:
1. Incorporate new social risks into pension policy. This includes atypical households (i.e. lone parents) and non-standard work careers. Especially part time workers and carers should be better protected in order to promote equality, encourage labour market flexibility, and reduce labour market segmentation. Promote the reconciliation of work and family life and reduce "breadwinner-based" regulations.
2. Reform financing rules so that pensions do not burden public finances or contribute excessively to non-wage labour costs. This may also mean increasing the actuarial features of benefit rules in order to strengthen work incentives.
3. Remove/revise the regulations in pension systems that promote labour shedding through early exit. Consider raising the retirement age and/or introducing flexible retirement age.
4. Promote private mandatory pension provision, financed by employer or employee, or both. These do not have the negative effects on employment that public systems do.
5. Promote funded pension schemes, either in the public or private sector. Funded schemes are more resistant to demographic changes, and pension contributions do not contribute to the tax wedge and thereby harm work incentives.

3. Pension Reform in Germany

3.1 Core features of the German pension system until the reform in 2001

Germany is the prototype of Esping-Andersen's conservative welfare state not least because of the structure of its pension system. This system protected employees with life-long employment histories well but maintained status differences at the same time (Esping-Andersen 1990: 21-29). The level of state pension entitlement depended on occupational status - civil servants received better pensions than white collar workers - on the level of income, and on the length of employment (Neumann/Schaper 1998: 158-173). Despite these differences until the most recent pension reform anyone with a full employment biography would have received a pension worth at least 70% of their last net wage.[1]

Citizens without lifelong employment were protected less well. A minimum pension did not exist. However, certain activities other than employment were recognised as if the person had paid contributions to the pension fund: phases of education, of military service, and of very low income, phases of childrearing. Marriage was even more effective for securing a non-contributory pension. On the death of one spouse the widow or widower was entitled to 60% of the pension of the deceased, provided the survivor did not have an income of her or his own (Neumann/Schaper 1998: 158-173). These rules modified the direct connection between labour market income and benefits but it is still fair to say that the quality of citizens' protection against loss of income after retirement was mainly determined by their former ties to the labour market.

Pensions were financed through a PAYG system, with the employer and employee each making mandatory contributions of 10.15% of gross wages (January 1999 figure). The federal government contributed an additional amount, which during the eighties remained under 20% of the pension providers' budget. After unification the federal contribution rose to 21% and towards the end of the century to 24% (VDR 2001). All pensions were administered by corporatist bodies which were major players in pension politics (see below). However, it lay within the authority of the federal parliament to make final decisions about reforms. The pensions of civil servants were tax-financed.

The German pension system lacked central features typical for a Social Democratic programme. By upholding occupational differences and by disadvantaging people with caring responsibilities, it reinforced social inequalities rather than *solidarity* and *equality*. Furthermore, it did not provide citizens with a right to an income independent of the market, in other words the degree of *decommodification* after retirement depended on employment status. However, the system also had some Social Democratic characteristics, if not in form, then in outcome. First, it guaranteed a decent income after retirement for a large proportion of the population; since the mid-eighties old age poverty ceased to be a topic of political concern because pensioners' incomes had risen. Second, the high level of protection through state pensions kept the private sector very small; in the mid nineties about 85% of all pension income was provided by the state system (OECD 1996: 68).Thus pension entitlements were determined by democratic institutions.

3.2 The political background of the reform by the Social Democrats and their scope for a turn to the left

This conservative model was shaped mainly under the aegis of Conservative governments. Since 1949 for 33 years a Conservative-Liberal coalition ruled (West-)

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[1] Since 1976 the pension level has been rather stable, i.e. someone with an employment career of 45 years of average income had a pension worth around 70% of his last net wage, and since 1997 that level had risen to 71% (VDR 2000).

Germany.[2] Nevertheless, pension policymaking was consensual. Until 1997 reforms were based on agreements between the major parties, the trade unions and employers (Schmidt 1998: 75-111). The collaboration of the two main political parties was considered esential because of the politically sensitive nature of pensions. (Nullmeier/Rüb 1992: 460; Schmidt 1998: 83). The participation of unions and employers was facilitated by their crucial role in the administration of employees' pensions. All pensions for blue and white collar workers are administered by corporations managed by equal numbers of employers' and employees' representatives. This function has given the corporations exclusive expert knowledge about citizens' employment biographies and retirement income. Their umbrella organisation, the Association of German Pension Providers (VDR) has thus been regarded as a central adviser by governments undertaking pension reforms.[3] This status has been reinforced by the fact that the VDR has traditionally and behind the scenes found a consensus between the unions' and the employers' position. The industrial peace in this area has been exceptional compared with other areas of social policy (von Winter 1997: 386).

The stability of the "conservative model" in Germany therefore cannot be attributed solely to the dominance of the Conservative party but must also be seen in the context of the support of the left. Indeed, the left favoured protecting the high pension levels of the traditional workforce rather than adopting a more modern stance, which could have been expressed, for example, by promoting the idea of a minimum pension. Against this background what was the likelihood for a left reform by the Social Democrats in 2001?

On the one hand, tradition and the established links with the VDR strongly suggested a reform maintaining the structure of the existing system, in collaboration with the corporate actors of the pension policy network. On the other hand, the tradition of cross-party agreements had been broken for the first time in 1997, when the Conservatives passed a pension reform against the votes of the opposition, paving the way for a more conflictual style of pension politics.

In the early 1990s, with expenses for unification soaring and unemployment figures increasing, the need for cost containment became a central issue for the German government. The West German pension system had just been extended to the East; the increase in expenses was paid for by social insurance contributions and by the state. As a consequence non-wage labour costs and public spending increased, dampening the prospect of more jobs and fuelling public debts. Against this background the "pension reform for a century" (Blüm, CDU Minister of Employment) passed in 1989 had already reached its limits. In 1997 the Christian Democrats had to initiate yet another reform because the financial reserves of the pension funds were below the statutory limit. It was to be a reform under austerity conditions and the CDU suggested a number of measures which would have lowered the pension level from 70% to 64% of average net income by 2030 and restricted access to invalidity and early retirement pensions (Bundestagsdrucksache 13/8011).

The Social Democrats fiercely opposed the bill. With a general election coming up in 1998 the party used the opportunity to boost their popularity by showing a leftist profile. They criticised the bill for its potential to cause poverty for a substantial share of the population, voted against it and announced that they would repeal parts of it should they win the elections in 1998 (Deutscher Bundestag 1997 a, b). This criticism showed few signs of

[2] From 1949-1965 and from 1982-1998, including 9 years after unification. The first conservative era ended with with a conservative-Social Democratic coalition (1966-69), and was followed by a Social Democratic-liberal period of 13 years between 1969 and 1982. Since 1998 the Social Democrats and the Green Party have formed the governing coalition (Bundeszentrale für politische Bildung 1996: 27-36).
[3] Nullmeier and Rüb go as far as calling it a "competing legislator" (1991: 457).

new thinking in the field of pension policy; the SPD was sticking to its long-standing policy position.

After winning the election, the SPD kept its promise but had to look for a solution to a dilemma of their own making: First, the financial problems of the pension funds suggested cuts or raising contributions.[4] Second, voters' expectations for a less painful reform were high and so were the hopes of the trade unions. Third, by not co-operating with the CDU in 1997 the SPD had considerably decreased their prospects for attracting the support of the opposition and thereby increasing voters' support.

Faced with these hard choices the minister in charge adopted a strategy which not only led to a reform without distinct Social Democratic imprints but that also leaves a considerable number of voters materially worse off. Moreover, the strategy created considerable tension within the pension policy network.

3.3 Content of the SPD's reforms

The pension reform departs from existing policy in two fundamental respects: the introduction of across the board benefit cuts and the strong promotion of private pension provision, encouraged by tax incentives or subsidies. The main aim of the reform is to keep current contribution levels constantly under 22% until 2030 - despite population ageing. This aim can only be achieved by the reduction of entitlements. The highest possible level of public pensions will be cut, to 67% of last gross earnings and an additional cut of the widow's pension was made. Derived rights are thus no longer sufficient for the surviving spouse. To counterbalance the cuts care-related pension rights have been extended; however, this extension will not compensate for the losses mothers encounter through the levelling down of pensions in general and derived rights in particular (Langelüddeke/Rabe 2001 a/b).

To make up for these reductions citizens are strongly encouraged to invest in private or occupational pension schemes. They receive state subsidies or tax exemptions if they do, and parents are entitled to extra money for each child.[5] This is an individualisation of risks that disadvantages women in particular. Because their life expectancy is higher than men's they will be required by private companies to pay higher contributions. Given their lower average incomes many will find this difficult; increased inequality is therefore likely (Langelüddeke/Rabe 2000 a).

Citizens who under these circumstances acquire pension entitlements below the level of the means-tested income support will find it easier to make claims to this benefit. From now on the pension administrations are obliged to inform people about such entitlements and pass on their claims to the social welfare offices. In addition the means-test is less harsh. However, means-testing remains the condition for receiving income support and people owning property or savings will not be able to claim it. Also, children or parents will still be asked to pay if the claimants are under 66 years old or if they have caused their dependency "deliberately or by culpable negligence" (AVmG 2000: 72). Thus the minimum pension discourages early exit from employment and it is combined with social control.

For employers the reform reduces mandatory contributions while they are under no obligation to pay for the private pension schemes; however, employees have the right to demand that employers deduct contributions from their payroll to go directly into an occupational or private pension fund.

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[4] The acute problems of the low financial reserves of the pension funds had been solved by a considerable increase in the state's subsidy in 1998 and 1999. However, this left the root of the problem untouched (VDR 2001).

[5] The flat-rate subsidies will start 2002 and will increase gradually until 2008 when they will comprise 154 Euro yearly, fully payable only to citizens who invest 4% of their gross wages in private pension funds. In 2008 parents will receive 185 Euro yearly for each child.

With the exception of the employers the reform does not produce many winners. Benefits for current pensioners will rise more slowly than before. Employees will continue to pay the same contributions to the public system, but their pension level will decrease. The private pensions will have to be financed with additional individual savings. So in order to receive the same pension all citizens and particularly women will have to pay more. For the generations born after 1970 the Bundesbank calculates that their higher investment will lead to returns above 70% of last earnings (Bundesbank 2001: 57). So this group stands to gain the most. However, this does not affect large parts of the current population and it is doubtful whether it applies to all young citizens, given that a considerable number of them will not be pursuing the full-time, life-long career on which the calculations of the Bundesbank are based.

The new pension law is not a Social Democratic piece of legislation, at least in terms of benefit provision. The SPD's overriding strategy for meeting the new social and economic challenges is to cut public spending and reduce non-wage labour costs. In this sense, the reform reflects the Third Way emphasis on reforms that improve the financing side of public pensions. The introduction of financial incentives for private and/or occupation pension savings to supplement public benefits might also be considered to respond to Third Way theorists' call for more individual responsibility and choice in social policies. However, this aspect of the reform weakens the existing degree of employers' obligation towards employees and it reduces the legally guaranteed *solidarity* between men and women, expressed by equal contributions despite women's greater life expectancy. It is likely to lead to greater gender *inequality* and generally to higher pension differentials, given the fact that the private sector is less redistributive. Its strongest Social Democratic hallmark concerns *decommodification*. By making it easier for citizens with very low pension entitlements to claim income benefit the reform does provide a minimum protection against market failure and family breakdown. However, because this provision is low and means-tested it is still a far cry from the original Social Democratic concept of decommodification.

3.4 Analysis of Reform Process[6]

From the outset the reform process was characterised by acute conflicts and latent tension among the central actors in the pension policy network. Not long after the elections in winter 1998 the Social Democratic Minister for Labour and Social Affairs, a former leader of the Metalworkers Union (IG-Metall), started the preparations for a pension reform. In summer 1999 the cabinet released a paper containing the main characteristics of the proposed reform. Among the proposals was the plan to reduce the highest pension level faster and more drastically than the Christian Democrats had intended; in contrast to the Conservative reform the Social Democratic measures would also have negatively affected the income of current pensioners by indexing pensions to inflation instead of wages for two years.

The draft was immediately rejected by the leaders of the German Trades Union Association (DGB) and by all other big unions (einblick 13/00), who threatened the minister with industrial action. Within the SPD the traditional wing and the head of the Social Democratic employees expressed their criticism. The Christian Democrats - whose consent the government was seeking - also rejected the plan out of hand. Moreover, the chairman of the corporate Association of German Pension Providers publicly expressed his fear that the reform would lead to a system change by replacing the earnings-related principle by a programme merely ensuring a minimum pension (VDR, 2.6.2000). The head of the almost equally powerful Insurance Institution for Employees (BfA) saw the danger of the reform

[6] Unless indicated otherwise this analysis is based on the press coverage of the reform process in the most important German papers: the Süddeutsche Zeitung, the Frankfurter Allgemeine Zeitung, der Spiegel, die Zeit.

leading to increased poverty (BfA 28.6.2000). Shortly after this public relations disaster the minister came out with a revision of his plan that left current pensioners untouched, but would reduce public pensions gradually from the year 2003 to allegedly the level of 64% in 2030. This met with only little more approval.

The board of the SPD - grudgingly - accepted the new proposal, against the votes of their social policy experts. A number of MPs continued to be opposed and intended to vote against the reform in parliament. The CDU continued their criticism and threatened to lead a "pension election-campaign" in 2002. The IG-Metall remained opposed and started a campaign against the reform. Only the public sector union (ÖTV) and a few other, smaller unions became more sympathetic on the grounds that the long-term problems of the pension fund needed to be solved together. The leader of the DGB was critical and initially showed willingness to find a consensual solution (einblick 14/00). By the time the bill was given a first reading in parliament in November 2000 that willingness had evaporated. The main criticism of all these actors remained the planned reduction of the pension level. The unions considered it generally too low and were opposed to giving employers no responsibility for private pension schemes. The Conservatives complained that the decline of pensions did not warrant the continuously high contributions and they strongly opposed the erosion of the widow's pension. The Association of German Pension Providers maintained that the pension level would in fact go down to 61% in 2030 - lower than envisaged by the Conservatives in 1997. The reform would therefore be unfair to younger generations. The association suggested a way of alleviating this problem (VDR, 1.12. 2000). By spreading the financial burden to more people, including current pensioners - albeit more moderately than originally planned by the SPD, contributions could be contained while the pension level would not sink below 67% of the last net wage. During a public hearing of a parliamentary committee in December 2000 the proposal was endorsed by all invited representatives from the pension policy network and by academic experts, all of whom criticised the government's reform. Faced with such strong disapproval the government yielded. Four days after the hearing the cabinet decided to integrate it into their bill - in the absence of Walter Riester, the minister in charge.

It is ironic that the SPD-Green government adopted a reform solution influenced at the last minute by the VDR, the most important organisation in the established pension policy network. Throughout the reform process, the government deliberately side-stepped the pension policy network, but in the end they could only fashion a feasible reform with the pension network's help.

3.5 Explaining outcomes

The main puzzle that emerges from the previous discussion is, why did the Social Democrats up until the last moment attempt to pass a reform that was bound to be materially unfavourable for large parts of the population and that all players in the pension policy network opposed. Four factors seem to be particularly relevant.

First, when the Social Democrats came to power they were under enormous *time pressure* to adopt a pension reform. A solution to the financial problems of the pension funds had to be found quickly. In addition, the party had promised to repeal parts of the Conservative reform, so they had to replace these with new regulations fast. The electorate also expected a quick reform. This time pressure contributed to the quick publication of a reform draft without much consultation with the pension policy network.

Second, this time pressure was imposed on an inexperienced government. The SPD had not participated in central government for 15 years, and for the Green party it was their first time. In fact, all cabinet members had to perform new roles and could not rely on the previous experience of colleagues. This inexperience might explain in particular why the minister did not co-operate with the Association of German Pension Providers before releasing the first draft of the pension bill.[7]

Third, SPD-Green government was determined to contain spending, lower non-wage labour costs and find a viable long term solution to the problems of the pension system. They were therefore prepared to take the risk of being unpopular.

Fourth, the traditionalist position of the trade unions and the political goals of government were hard to reconcile. German unions have a reputation for being conservative (see for example Koch-Baumgarten 1997). This is due in part to the fact that the age structure of unions is biased towards older male workers. As a result the policy preferences of the German Trades Union Association largely reflects the interests of older workers at the expense of younger workers. So the DGB would be expected to oppose any type of reform that would mean cuts for core segments of its membership. The Minister of Employment and Social Affairs, with his insider knowledge of the IG-Metall, arguably the most traditional union, knew the unions' position very well. There is evidence that he nevertheless consulted them about his reform plans before his first draft was published but that the talks did not come to anything because the unions did not want to give up their traditionalist position. Given these constraints, keeping a distance from the unions was a plausible strategy for a minister who wanted a structural reform.

The German reform process shows that it was impossible for the government to act against the opposition of all relevant actors and a population that did not stand to gain much. It is therefore no surprise that the SPD and the Greens changed the bill shortly before the reform went to parliament for a final vote, thus showing the limits of their confrontational political style and highlighting the fact that the established power resources of the Association of German Pension Providers and the unions were still substantial.

4. Pension Reform in Sweden

4.1 Core features of the Swedish pension system before the 1994 reform

Esping-Andersen (1985, 1990) identifies the Swedish public pension system as the prototype of Social Democratic pension policy because of its high degree of decommodification and the overwhelming dominance of the state in pension provision. In addition, the public pension funds play an important role in generating national savings.

In 1990, the public pension system consisted of two tiers: the flat-rate basic pension (folkpension) and the national supplementary pension (ATP). Both tiers operated as pay-as-you-go (PAYG) systems financed by earmarked employer contributions. In 1990, the basic pension contribution (7.45% of payroll) financed 85% of benefits (the state paid the rest), while the ATP contribution (13.5% of payroll) financed both current benefits and the accumulation of savings in the AP funds. For retirees with few or no ATP pension credits, the basic pension system provided a flat-rate benefit while the ATP system provided income-related pensions calculated according to “defined benefit” principles. A full ATP pension pays 60 % of average income for the best 15 years of at least 30 years of labour market participation, up to the benefit ceiling. Both the basic pension and the ATP pensions are indexed to inflation every year.

The pension system is the largest government program in terms of spending, and in 1992 accounted for 12.2 % of GDP. In 1992, the publicly controlled pension funds (AP Funds) stood at 512 billion Swedish Kronor (SEK), or 35 % of GDP (Proposition 1993/94: 250, p. 16).

[7] In their first year of office the government was increasingly portrait as a bunch of amateurs by the press. Members of the Sozialbeirat also had the impression that the minister of social affairs lacked experience (Expert interview, March 2001).

Private pensions in Sweden play a relatively minor role in pension provision except for the collective agreements which pay about 10% of the terminal salary for 90% of the labour force. In addition, the tax code provides for a number of private pension savings schemes, but these are largely insignificant for most pensioners.[8] In any case, the collective agreements are designed to provide a small supplement to public pensions rather than compete with them.

How is this system Social Democratic? First, *solidarity* is promoted by the existence of one public pension system for all citizens, regardless of occupational status. The role of private and occupational pensions is relatively small, employers finance benefits, and substantial pension capital is accumulated in publicly controlled pension funds. Second, *decommodification* is promoted by the provision of a flat-rate pension that ensures an adequate minimum standard of living in old age. Entitlement is based on citizenship, thus avoiding the stigma of means-testing. Most pensioners also have earnings-related ATP benefits. Finally, income *equality* is promoted by the redistribution of income from high earners (who pay via their employer contributions on income above the pension-carrying threshold) to low earners through the basic pension (and pension supplements). Gender equality is also promoted by the absence of qualification rules related to gender, marital status, and hours worked.

Besides promoting Social Democratic values, the development of the pension system also contributed to the political success of the SAP. The adoption of the ATP system in 1959 marked a turning point in SAP electoral mobilisation strategy as the pension issue was used to construct a white collar-blue collar wage earner alliance. The 15/30 benefit formula was intended to benefit women and white collar workers who tend to work fewer years and experience more rapid wage growth in their later years of employment and was the primary concession made to white collar groups in order to gain the support of white collar workers for the ATP reform in 1959 (Heclo 1974; Esping-Andersen 1985).

4.2 The political and economic background of Social Democratic participation in the pension reform

As noted, the electoral hegemony of the SAP has heavily influenced the design of the pension system.[9] Despite their opposition to the 1959 ATP reform, political necessity led the non-socialist parties to grudgingly accept the basic features of the pension system. The few pension retrenchment measures carried out by non-socialist governments in the early 1980s provoked widespread public outcry and helped to return the Social Democrats to power in 1982. In the elections of 1985 and 1988, the future of the welfare state featured prominently, and the bourgeois parties were repudiated at the polls for suggesting modest reductions in pensions (among other things).

Before 1990 major pension reform was never seriously discussed or attempted even though pension expenditures increased significantly during the previous decade. The SAP government appointed an Official Commission of Inquiry in 1984 to investigate pension reform. The ATP system was nearly mature, so the commission was instructed to evaluate the system and pinpoint areas in need of reform. The Pension Commission followed the customary procedure for major reform by incorporating representatives from the political parties, union confederations, employers, and the National Social Insurance Board, as well as independent experts. The commission structure is typically, but not always, the forum within which reform compromises are worked out, and commission proposals usually provide the

[8]Private pension savings are relatively insignificant in Sweden because the SAP has repeatedly resisted the sort of legislation required to make such schemes attractive, such as tax deductibility.

[9] The SAP has governed Sweden from 1933-1976 (sometimes in coalition with the Farmers' Party); 1982-1991; and 1994-present. For a more detailed analysis of the pension reform, see Anderson (2002; 1998).

basis for reform legislation. After six years of deliberations and study, the commission produced a vast amount of expert information and even consensus about the problems confronting the pension system, but there was no agreement on the direction of reform (SOU 1990: 76). The main obstacle to reform was the refusal of TCO (Tjänstemännens Centralorganisation, Confederation of White Collar Workers) to accept any change in the best 15 of 30 years benefit formula.

The rapid deterioration of the Swedish economy in the late 1980s dramatically changed this outlook. In the wake of stagnant economic growth and rapidly rising levels of unemployment, the pension system faced the twin shocks of shrinking tax revenues and increasing expenditures because of the growing number of retired persons. Between 1990 and 1993, Sweden went from budget surplus to recording a deficit of 12.3 % of gross domestic product (GDP). During the same period, open unemployment climbed from 1.7 % to 8.2 %. The depth of this crisis can hardly be exaggerated. The recession undermined two crucial preconditions of the Swedish welfare model--full employment and stable growth--and prompted massive reductions in public spending. (Pontusson 1992; Huber & Stephens 1998). The willingness of both non-socialist and SAP governments to attempt retrenchment is explained by the crisis in state finances caused by the recession.

The economic crisis exposed the instability of the pension system and shoved the issue of pension reform to the top of the political agenda. Moreover, the shift to the right in electoral politics in 1991[10] gave the non-socialist government the legislative initiative even if the SAP was still the largest party in parliament and occupied a veto player position. Additionally, central features of the system were singled out as serious weaknesses after a series of expert studies published in the early 1990s triggered an intense policy debate. These studies identified four weaknesses: the sensitivity of the ATP system to economic swings and low growth; projected reduction of the AP Funds; the weak link between contributions and benefits; and the rising cost of basic pensions (Olsson & Schubert 1991; Bröms 1990; Söderström 1991; Lindbeck 1992). Moreover, the Swedish Employers Federation (Svenska Arbetsgivareföreningen or SAF) called for radical reform, arguing that the pension system adversely affected national savings, contributed excessively to non-wage labour costs, and reduced work incentives (Svenska Arbetsgivareföreningen 1990).

The design of the ATP system assumes a stable annual economic growth rate of 3-4 % and full employment. When inflation began to exceed real wage growth in the 1980s, the indexing mechanism resulted in rising pension costs relative to payroll tax revenues, raising the spectre of trust fund reduction. In 1982, AP fund strength was 7.4 and had declined to 5.1 in 1992 (fund strength is the number of years the AP funds can finance benefits; Riksförsäkringsverket 1994). Since 1982, ATP contributions have not covered expenditures, and the gap has increased because of the economic crisis. Figure 1 shows the growing gap between contributions and expenditures in the ATP system since 1981. Revenue shortfalls in the basic pension system also exacerbated central budget deficits as the state absorbed higher proportions of program financing. Figure 2 shows the rapid increase of state grants to the basic pension system between 1981 and 1998.

------------Figs. 1 & 2 about here--------------

Both political blocs struggled to control the pension reform debate. For the non-socialist parties (and their allies in organised business), their tenure in office during an economic downturn provided the strategic opportunity to advocate changes only recently considered politically impossible. The maturity of the system made radical privatisation impossible, but reform offered the promise of trimming the Social Democratic excesses from

[10] The SAP served as a minority government from 1982-1991 when a multiparty non-socialist coalition led by the conservative party took power.

the system, especially the perceived disincentive to work and the accumulation of large public pension funds. However, reform was impossible without the participation and substantial influence of the SAP. For the SAP, retrenchment has been both a painful necessity brought on by the severe economic crisis and an opportunity to preserve the basic structure and scope of the pension system by correcting its perceived weaknesses.

4.3 The Content of the Reform: is the new system still Social Democratic?

The SAP co-operated with the four main non-socialist parties on a far-reaching pension reform that resulted in the passage of framework legislation in the Spring of 1994. Between 1994 and 1998, the same parties in Parliament passed follow-up legislation to fill in the details of the reform.

The new system departs from the existing system in several fundamental respects. First, ATP benefits will be based on lifetime earnings rather than the best 15 years of 30. Thus the link between pension contributions and benefits is made explicit, and the new system will lose much of its redistributive character. Second, pension contributions will be evenly divided between employers and employees. The switch to employee payroll taxes is intended to increase public awareness of the costs of retirement. Previously, employers paid the pension payroll tax, and it was not reported on wage earner's paycheques. Third, a new index will link benefits to wage developments and real economic growth. Pensions will also be adjusted if average life expectancy changes. These changes mean that the pension system will be more resistant to economic swings and it will be self-financing regardless of the state of the economy. Fourth, pension rights may be shared by spouses and pension points will be earned for military service, child rearing, and education. Finally, the new system contains a premium reserve; of the total 18.5% in pension contributions, 2.5% will be placed in an individual investment fund. Thus the pension system is designed to be transparent in that individuals receive an annual statement about the size of their projected pension. In addition, the old basic pension and pension supplement will be replaced by a higher guaranteed pension for those not eligible for income-related benefits. The transition to the new system will take 20 years (Proposition 1993/94: 250). Table 1 summarises the main changes in the structure of the pension system.

The pension reform reflects the nature of compromise among five parties. The Christian Democrats and Centre Party wanted shared pension rights for spouses, the SAP wanted to retain the obligatory system with high replacement rates, while the Liberals and Conservatives wanted a more explicit link between contributions and benefits, the premium reserve, and the elimination of contributions above the ceiling. All of the political parties advocated the introduction of real wage indexing. Although the influence of the SAP in the reform process has been substantial, they have acquiesced in three main areas: contributions above the ATP ceiling, shared pension rights, and the premium reserve system. The switch to visible individual contributions was also a concession by the SAP.

Is the revamped pension system a major departure from Social Democratic policy, or has the system retained its core Social Democratic features? The pension reform is a complex set of new rules, and sorting out the effects on future retirees is difficult. There is no doubt, however, that the new system is a major departure from existing pension policy. In particular, the switch from defined benefits to defined contributions in the ATP system is a radical change. In order to receive the same pension benefits under the new system, at least 40 years are required. A study conducted by the National Insurance Board estimated that 2/3 of those studied would be worse off in the new system, mainly TCO members and women who work fewer than 40 years (Statens Offentliga Utredningar 1994: 21, bilaga A). The biggest winners are those who work less than 20 years and receive the new higher guaranteed pension.

These losses must be considered in the context of the "improvements" introduced by the reform. First, the new pension system is much more resistant to economic and demographic shocks so its long-term stability is vastly enhanced. Second, the new indexing rules will stop the erosion in the value of ATP pensions. The old index rules meant that more and more workers earned income above the pension-qualification ceiling, for which they accumulated no pension rights. This trend threatened to transform the ATP system into a bigger basic pension. Third, the new system corrects the unintended redistribution from lower income groups to higher income groups because of the best 15 years of 30 benefit rule.[11]

Although the overall impact of the reform is to reduce the degree of decommodification in the pension system, it still retains its core Social Democratic features. The state remains responsible for providing a minimum level of provision for all citizens, and this commitment is strengthened. The earnings-related pension is now less generous, but this type of pension remains firmly within the public sector. Moreover, the reduction in generosity for white collar workers cannot be considered to be a major departure from traditional Social Democratic policy, especially since this is accompanied by improvements for most blue collar workers who tend to have longer employment histories and those with atypical risk profiles. The introduction of the premium reserve amounts to partial privatisation, but this will carried out under public regulation.

The pension reform also demonstrates some renewal in Social Democratic thinking. Changes in the financing structure and indexing mechanism will reduce the pension system's pressure on central government finances, contribute to reductions in non-wage labour costs, and reduce the tax wedge. The new guarantee pension results in greater protection for vulnerable groups and increases the pension systems' responsiveness to new social risks, but this was not a particularly glaring weakness in the existing pension system from the outset, so it cannot be considered a remarkable achievement. Finally, the new system significantly increases work incentives with the introduction of a more actuarial benefit formula, and the premium reserves enhances individual choice in pension planning.

4.4 Analysis of the reform process

In 1991, the Swedish non-socialist government appointed a working group composed of representatives from the five main parliamentary parties[12], including the opposition SAP, to formulate reform legislation. Unlike earlier pension investigations, the working group excluded members of the interest groups, including the union confederations TCO, SACO (Sveriges Akademikers Centralorganisation or Confederation of Professional Associations), and LO (Landsorganisationen, Confederation of Blue Collar Unions). TCO, SACO, and LO were still consulted and their views were well known, especially to the SAP, but they could not directly influence the content of the reform. The working group issued a comprehensive report in early 1994, and parliament passed the initial reform legislation in June 1994. Between mid-1994 and 1998, an implementation group worked to finalise the details of the reform. By early 1999, nearly all aspects of the reform had been implemented.

Unions' responses to the 1994 proposals ranged from cautious acceptance to strong criticism. The LO’s main concern was the retention of a publicly financed, income-related system, so it accepted the main features of the reform in return for improved stability in the system. However, the LO had to compromise on two central issues: the premium reserve and,

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[11] This appears to contradict our previous statement that the payment of pension contributions above the income ceiling redistributes from high income groups to lower income groups. However, at the same time, the 15/30 year benefit rule had the opposite effect. Both types of redistribution were present in the system and the extent of the latter type of redistribution was not intended (Ståhlberg 1993: 90-91).

[12] The non-socialist government (1991-1994) was composed of the Conservatives, Liberals, Christian Democrats, and Center Party. The Conservatives dominated the government,but the Minister of Social Affairs came from the Liberal Party. Despite the change in government, the SAP was the largest party in parliament, with 38% of the seats (check statistic).

especially, shared employer-employee financing (Landsorganisationen, 1994). In contrast, TCO and SACO accepted the necessity of reform but argued strenuously that pension points for education were entirely too low. Both union confederations demanded the postponement of the reform until this issue was resolved (Tjänstemännens Centralorganisation, 1994; Sveriges Akademikers Centralorganisation, 1994). TCO and SACO also opposed the switch to shared financing. Significantly, LO declined to join with TCO and SACO in their opposition to the proposed method of pension credits for education. The Employers Organisation cautiously supported the legislation. Despite their non-participation in government, pension reform has occurred more or less on SAP terms. The SAP dominated the process, with the LO and to a lesser extent the TCO and SACO acting as junior partners.

4.5 Explanation of Outcomes

What accounts for the capacity of the SAP to dominate the pension reform process? How did the SAP and its reform partners manage to construct a workable reform compromise?

First, the structure of the Swedish party system meant that the SAP occupied a veto position in parliament, despite its non-participation in government. The non-socialist government had minority status in parliament, and it was composed of four different parties. For pension reform to survive the next election, SAP support was essential. The SAP's long experience in government and its virtual capture of the pension issue in electoral politics strengthened its bargaining position. Finally, the SAP's institutionalised contacts with LO would ensure that LO interests were accommodated as much as possible.

Second, the reform process has been characterised by the conscious attempts of the five parties backing the agreement to depoliticise the issue and minimise potential veto points (cf. Bonoli 2000). All parties agreed to compromise at an early stage, and they used the structure of the working group to strengthen their bargaining power vis à vis the unions. The LO, TCO, and SACO were consulted and, given the close contact between the SAP and the LO, the LO's position was well known to the SAP. Of the three confederations, the LO had the most influence on the reform because of two factors: the president of the LO sits on the SAP's seven-member executive committee and thereby participates in high-level SAP policy discussions, and the chairperson of the pensions working group was Anna Hedborg, a social democrat and former LO economist. Despite these channels of influence, consultation was carefully controlled, thereby limiting the LO's and especially TCO's and SACO's influence. The LO tacitly accepted this strategy.

Finally, the structure of existing pension policy facilitated reform by creating opportunities to construct a reform that created both winners and losers. Moreover, the accumulation of substantial pension reserves in the AP funds lessened the time pressure on political actors to find a solution to the pension system's financing problems (reserves were sufficient to finance ATP benefits for at least five years) and the AP funds could be used to finance the transition to the new system, thereby obviating any "double payment" problems.

5. Comparing Sweden and Germany

It is clear from the case studies that the Swedish pension reform exhibits more signs of Social Democratic renewal than does the German reform. What explains this difference in outcomes? Five factors seem to be particularly relevant.

First, the Social Democratic Parties were subject to very different ***time horizons.*** The Swedish system gave the reformers more leeway, because existing pension reserves were sufficient to last at least five years. In Germany urgent action was required because of the financial problems of the pension fund and because of the SPD's 1998 election campaign promise to reverse the CDU pension cuts and to replace them with a fairer reform. As a consequence Swedish political actors had the opportunity to construct a broad consensus over time, more or less incorporating all relevant organised interests. The German Social Democrats did not have that time.

Second, ***experience in government*** differed in the two cases. In Germany, the SPD's legislative strategy was to circumvent the established pension policymaking network, especially the VDR and BfA. Whereas the Swedish SAP could draw on its very long record of government experience, the German SPD was relatively inexperienced. Moreover, the SPD's coalition partner, the Green Party, was completely new to government power. The relative lack of experience in the German government probably contributed to the strategic mistake of excluding the corporatist pension associations and choosing a confrontational strategy concerning the unions.

Third, the ***ratio between winners and losers*** as a result of reform was different in Sweden and Germany. Important groups represented by powerful organisations in Sweden stood to gain from the reform whereas central actors in Germany did not. The Swedish blue collar unions were motivated to participate in the reform because they hoped that reforming the existing system would result in improved pensions for their members. Many LO members stood to gain from the switch to the lifetime earnings benefit formula. Moreover, all wage-earners would gain from the reformed indexing rules that halted the long-term decline in the real value in earnings-related benefits. In other words, the slow, unintended transformation of the ATP system into a quasi-basic pension was halted. These opportunities to correct intended and unintended features of the pension system meant that the unions, especially the LO, were ready to negotiate and also ready to compromise. Moreover, the pension reform would *not* result in benefit cuts for current pensioners because of the long transition period.

In the German case there was no group that stood to gain from the reforms, except employers. The only improvements for younger people were that the reform would not exacerbate existing problems in the pension system and that they would receive higher returns for their higher contributions in the future. The lesson is that far-reaching pension reform must appeal to the interests of core segments of the labour movement.

Fourth, the ***degree of union modernisation*** facilitated reform in Sweden and hindered it in Germany. In Sweden, union-party co-operation functioned reasonably well in the 1990s because the unions had gone through a process of modernisation. In the late 1980s, internal conflict within the LO, the SAP, and between the LO and SAP (the "war of the roses") resulted in the victory of the modernising wing of the party and union federation. Arguably the rapid and extreme deterioration of the economy in the early 1990s helped to consolidate the influence of the modernising wings of the party and unions. Moreover, the SAP's election failure in 1991 that brought a non-socialist coalition government to power (until 1994) contributed to the strength of the modernisers.

In contrast, the outlook of the largest German unions is traditionalist. As a consequence there were contacts and confrontations between unions and the social-democratic party, but little real co-operation. The age structure of union membership in Germany added to the conservatism of the unions regarding pension reform.

Fifth, ***institutional legacies*** prevented the German SPD from adopting changes that would have improved the pension system's responsiveness to new social risks. This constraint was not present in Sweden. The Swedish system, with its basic income attached to citizenship, was already better equipped to deal with the challenge of new social risks. Thus, the Social Democrats could support tightening the link between contributions and benefits in the earning-related part of the system, because the basic protection would remain. In Germany one of the main features of the existing system was its earning-related structure *without* a minimum pension. The SPD's original plan to integrate a minimum pension into the insurance system was rejected by the VDR (including the union representatives) and by the opposition. The centrality of earnings-related benefits is so deeply entrenched in the German system that it is rarely questioned. All of the major actors in the corporatist pension policy network regard the introduction of a basic pension to be incompatible with the principle of earnings-related benefits. Moreover, these actors represent the interests of labour market insiders and do not respond well to the concerns of labour market outsiders.

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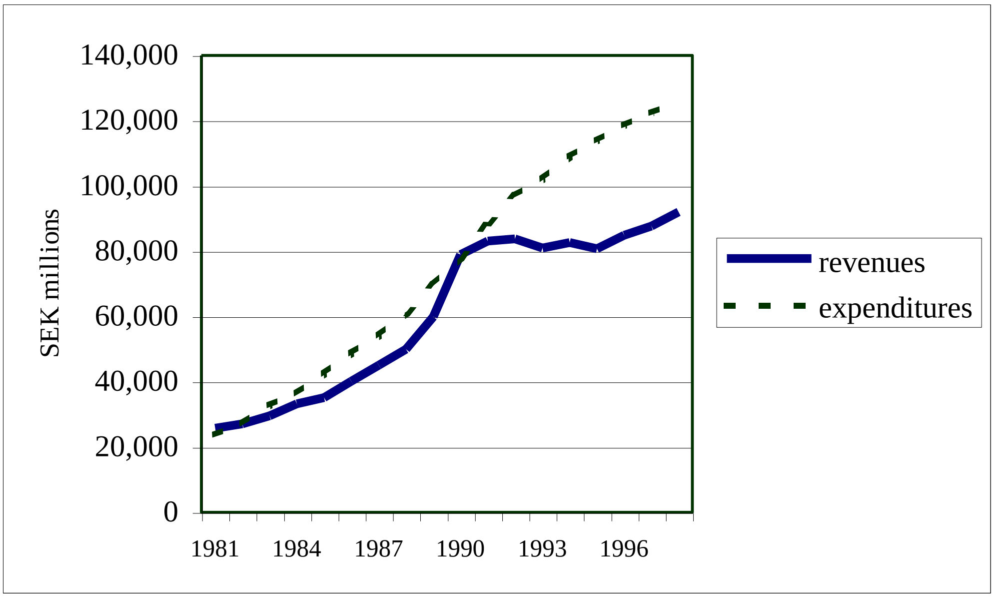
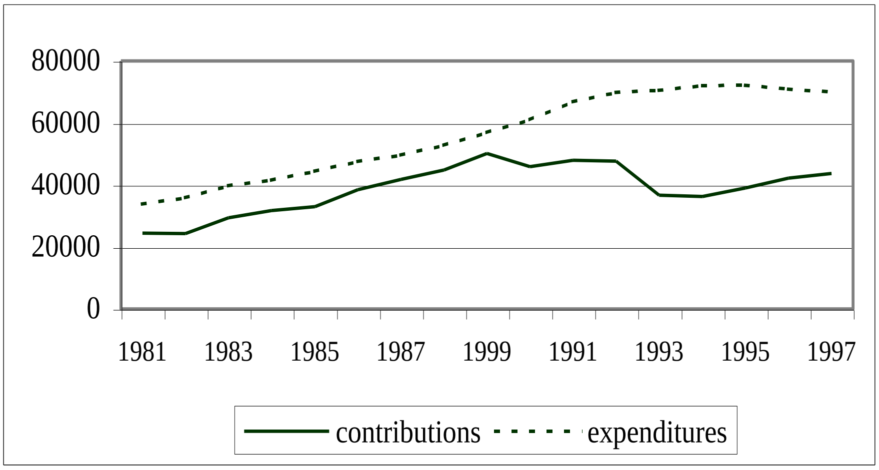


Source: Riksförsäkringsverket, *Social Insurance Statistics. Facts* (Stockholm: Riksförsäkringsverket, various years).



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	1990	1999
BENEFITS		
ATP benefit formula	Best 15 years of 30	Lifetime earnings
Basic/Guarantee Pension Benefit formula	Flat rate minimum	Flat rate minimum
Coverage (both tiers)	Universal	Universal*
Indexing	Annual adjustment to CPI	Annual adjustment according to inflation and real wage growth
FINANCING		
ATP	Employer: 13% Employee: 0	Employer: 6.4% Employee: 6.95%
Basic/Guarantee Pension	Employer: 7.45% Employee: 0	Employer: 6.83% Employee: 0
ADMINISTRATION		
Funding structure	Public trust fund	Public trust fund and publicly regulated premium reserve
Role of funds	Substantial source of national savings	Premium reserve replaces AP Funds as major source of national savings

*The guarantee pension is pension-tested in that only pensioners who do not qualify for an income-related pension will receive it. If both tiers are considered, the pension system is still universal.