Competitive Euro-liberalism and the Reform of the German Pension System

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ABSTRACT: This paper provides an integrated explanation of institutional stability and change in the German pension system. The main explanatory variable is European integration, more specifically the new European institutional framework which has emerged in the context of the single market and monetary union. The argument is, first, that the paradigm of "competitive Euro-liberalism" has been extended from economic policy to pension policy, and second, that EU-level institutions have shaped the ideas and interests of German governments. German governments have come to view the pension system as an important instrument for generating growth and employment. After the mid-1990s, they have formed a preference for fundamental institutional change which contrasts sharply with their previous commitment to preserve the existing arrangements even in the face of strong socioeconomic pressures. As a result of changing ideas and interests about the role of the pension system, the government withdrew the policy-making autonomy delegated to the German pension network, which had dominated pension policy until the mid-1990s. Due to imperfect unity the pension network was no longer able to form a strong "veto network". It lost its capability to defend its autonomy and thus was unable to guarantee the stability of the German pension system.

Paper prepared for presentation at the European Community Studies Association 7th Biennial International Conference, Madison, Wisconsin, May 31-June 2, 2001

INTRODUCTION

One of the biggest challenges for theories of the welfare state is to explain recent institutional changes in welfare states which were extremely resilient in the past quarter century despite strong socioeconomic pressures. The structural stability of welfare states from the early 1970s to the mid-1990s conformed to the propositions of institutionalist theories, in particular to their theoretical expectation that the development of welfare states is generally path-dependent.[1] The unexpected occurrence of fundamental institutional change is especially difficult to explain in the case of continental welfare states, which were the most rigid type among the different welfare regimes during the 1970s and 1980s. In Germany, a long period of institutional stability was followed by a relatively short phase of major institutional change in the core area of welfare state activities, the old-age security system.[2] Until the mid-1990s, Germany's continental welfare state exemplified the pervasive institutional stability in advanced industrialized countries. Its institutional arrangements remained unaltered even in the face of severe fiscal and demographic problems. The Pension Reform Act passed in 1989 is a textbook example of path-dependence. The reforms were extensive, yet limited to changes within the basic structure of the Bismarckian pension system. The outcome of the pension reform law was the identical reproduction of Germany's institutions of retirement provision.[3]

After the mid-1990s, the reform of the pension system advanced to the top of Germany's political agenda. The institutional stability of the German welfare state started to vanish. The culmination of the efforts to reform the structure of the contribution-financed pension system is the Old-Age Provision Act passed by the Schröder government in 2001. The pension reform law is highly innovative in two respects: first, it introduces a new private pension pillar, and second, it establishes the gradual decline of the once unrivaled public pillar by putting a ceiling on contribution rates. These two key

[1] Esping-Andersen (1996a, 1996b); Offe (1991); Pierson (1994, 1996)

[2] For analyses of major institutional change in other continental welfare states, see Bonoli (1997); Palier (2000); Visser and Hemerijk (1997).

[3] For the conceptualization of institutional stability as a process and for the interpretation of the notion of path-dependence as the identical reproduction of institutions, see Offe (1996).

measures will transform Germany's contribution-financed old-age security system. Most importantly, they will alter the distinctive public-private mix in Germany's continental pension system. In the continental type of welfare state, the market plays a marginal role in the state-dominated system of retirement provision.[4] The Old-Age Provision Act undermines the quasi-monopoly of the state in retirement provision and significantly increases the role of private-sector pensions. Unlike the Pension Reform Act of 1989, which reinforced the system's direction of development, the new pension reform law constitutes a break with path-dependence. Even though Germany is not switching to the liberal model of old-age security, the German welfare state has departed from its long-established path and is developing into a new direction with a liberal streak.[5]

What explains the sudden "path-departure" of welfare state institutions which have proved highly resilient during the 1970s, 1980s and early 1990s? Although we know a great deal about the factors accounting for the institutional stability of welfare, our knowledge about the causes and conditions for institutional change is limited. As Peter Hall has correctly observed, "[a] field long focused on the way in which institutions produce regularities of behavior must now come to grips with the problems of change rather than continuity".[6] Moreover, our accounts of institutional reform cannot disregard, or even contradict, the causes of institutional stability.[7] In the face of multiple sources of institutional stability, such as veto players, electoral constraints and institutional lock-in effects, the occurrence of major institutional change becomes a theoretical puzzle. Put differently, we need an integrated theory of institutional stability and change, not separate accounts of periods of stability and periods of change.

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[4] Esping-Andersen (1990, Ch. 4)

[5] I think that the commonly employed dichotomy of path-dependence and path-switching does not adequately capture the changes occurring in continental welfare states. Political actors do not intend to switch to another path, and the institutional changes we observe do not qualify as a path-shift, even though they clearly transform the existing institutional arrangements. Therefore, I use the term "path-departure": continental welfare states are developing into a new direction, but it is not clear yet how they will deviate from their own established path, or how close they will get to a different established path. For the dichotomy of path-dependence and path-switching, see in particular Pierson (2000).

[6] Hall (1999, 136)

[7] Pierson (1994; 1996)

In this paper, I develop an integrated explanation of institutional stability and change in the German pension system which focuses on two important actors: the pension policy network and the federal government.[8] Until the mid-1990s, the pension network was the key stabilizer of Germany's institutions of retirement provision. Enjoying a high degree of autonomy in policy-making, the pension network both reinforced the direction of institutional development and defended the system against fundamental challenges. I argue that major institutional change only became possible after the pension network had lost its autonomy. I discuss two factors which I find essential for the network's ability to defend its policy-making autonomy against challenges from the outside: first, the active support of the government, and second, the unity of the pension network. The examination of two attempts to initiate reforms during the 1990s, one successful, the other unsuccessful, provides empirical evidence for the relevance of these two explanatory factors.

The federal government, in particular the head of government, is an important actor for two reasons. The government's active support, based on a convergence of ideas and interests between the government and the pension network, was an essential condition for institutional stability during the 1970s and 1980s. At the same time, the government has been the main initiator of fundamental institutional reforms in the German pension system after the mid-1990s. Because of its double role as stabilizer of institutions and as agent of change, the explanation of the government's change in ideas and interests about pension policy is of critical importance in explaining fundamental institutional change in Germany.[9] Why did the Kohl and Schröder governments form a preference for fundamental institutional change? What accounts for the similar and almost parallel change in ideas and interests that we can observe within the two main governmental parties, the CDU and the SPD? Why did German governments become a

[8] I choose a particular level of analysis to explain the reform of the German pension system: my account is actor-centered and does not examine the impact of structural causes of change such as demographic pressures or economic pressures. In my view, actor-centered and structuralist explanations are not mutually exclusive, but complementary. Each approach chooses a different level of analysis which emphasizes "efficient causes" and "material causes", respectively. See Heclo (1974, 284-288).

[9] I treat ideas and interests not as separate concepts, but as mutually constitutive. For a good discussion of the relationship between ideas and interests, see Blyth (2000).

powerful challenger of the network's autonomy after providing active support for its policies before the mid-1990s?

In my paper, I give an institutional explanation for the government's change in ideas and interests. My argument is, first, that the European institutional framework which emerged in the context of the single market and monetary union has become an important unit of reference for national governments. EU-level institutions increasingly define their ideas and interests. Second, I argue that a set of ideas about the role and principles of pension policy endogeneously emerged within EU-level institutions which shaped the ideas and interests of German governments. I claim that there has been a paradigm extension from economic policy to pension-policy. The reform of pension systems has become an important instrument in implementing the European strategy for growth and employment. The European Union's approach to pension reform as well as the congruent reform efforts in Germany reflect the paradigm of "competitive Euro-liberalism" which has become embedded in the European institutional framework. To account for the extension of the liberal economic paradigm, I discuss two different factors: first, the competition of the European Union with the United States, and second, the vested interests of European economic policy-makers in further integration.

In the first part of my paper, I analyze the conditions for institutional stability and explain why the institutions of the German pension system have become unstable. In the second part, I focus on the causes of institutional change, specifically the redefinition of the ideas and interests of German governments within the institutional context at the European level.

CONDITIONS FOR INSTITUTIONAL STABILITY

The analysis of fundamental institutional change in the German pension system raises an important question: what makes path-departing changes possible in normal times? As we know from institutional theory, institutions are generally extremely stable. Changes are limited to marginal alterations within the established framework. They are the result of new bargains and compromises among the actors involved. Political actors who have made extensive commitments based on existing institutions do not have an interest in, and are resistant toward, fundamental change of the institutions from which they derive substantial benefits.[10] Discontinuous institutional change is an exceptional phenomenon which usually occurs only under extraordinary circumstances such as war, revolution, conquest, natural disasters or economic crises.[11] These unusual events destabilize the existing institutional arrangements. They emasculate or abolish the set of collective political actors which have a strong interest in the preservation of the old institutions.[12]

Given the absence of such extraordinary events in Germany, how did fundamental institutional change become possible?[13] A formidable obstacle for institutional transformation was the existence of several important political actors who were strongly committed to Germany's contribution-financed public pension system, in particular the social policy experts of the two major parties, the trade unions and pension insurance providers. I argue that opportunities for institutional transformation are created when reformers are able to overcome their resistance. In Germany, fundamental institutional reforms only became possible after these political actors had lost their autonomous policy-making capacity in the area of pensions.

Institutional Stability and Network Autonomy

Until the mid-1990s, the German pension system exhibited all the main characteristics of a highly stable institutional arrangement. The development of Germany's institutions of retirement provision were path-dependent during the 1970s and 1980s even in the face of fiscal and demographic pressures. One important factor for the institutional lock-in was the symbiosis between the pension system and the political

[10] North (1990, 7); Offe (1996, 208); Pierson (1994, 1996)

[11] North (1990, 89-91)

[12] Olson (1982)

[13] Surprisingly, German unification did not destablize Germany's institutions of retirement provision despite the fact that there were massive budgetary transfers from Western to Eastern pension schemes. As studies by the Bundesbank and the PROGNOS Institute in the mid-1990s have shown, the projections about the long-term development of pension finances and contribution rates have not changed compared to projections from the mid-1980s.

actors committed to these institutions. Pension policy-making was dominated by a small number of political actors who formed an autonomous and tightly-knit network.[14] This exclusive circle was made up of fewer than 30 experts representing the three main actors in the specialized area of pension policy: trade unions, employer organizations and the state. Germany had a strongly corporatist pension policy network. The trade unions and the employers were represented by their respective umbrella organization, DGB and BDA. The representatives of the state came from the Ministry of Labor and Social Affairs and from the two major parties in the Bundestag, CDU and SPD. Other important players in pension policy were the Association of German Pension Insurance Providers (VDR) and the BfA, the single largest pension insurance provider. These two organizations, however, are themselves governed by the social partners.

During the 1970s and 1980s, this policy network was in firm control over the development of the pension system, which is best evidenced by the comprehensive 1992 pension reform. First, the Pension Reform Act passed in 1989 explicitly preserved the institutional foundations of the system. The members of the network were successful in defending the existing institutions against alternative proposals to abolish status-maintaining pension benefits and replace them with tax-financed basic pensions. Second, the most important reform decisions were not made in cabinet or in parliament. Pension policy was largely depolitized. Decisions were taken in various commissions created by the governmental coalition, the SPD, the social partners and the pension insurance providers and dominated by the members of the pension policy network.[15] Third, the major innovations of pension policy instruments did not come from outside experts or policy-makers, but all originated within the network. More specifically, these new instruments were developed by pension experts within the Ministry of Labor and within the SPD and CDU.[16]

The character of pension policy-making in Germany changed significantly during the 1990s. In the mid-1990s, the pension policy network started to lose control over the

[14] Nullmeier and Rüb (1993); Offe (1991); Winter (1997)

[15] Nullmeier and Rüb (1993, 185-223)

[16] Nullmeier and Rüb (1993, 337-338)

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development of the system. The pension network was no longer able to shield the existing institutions from major changes and guarantee their stability. The goals and guiding principles for the reform of the pension system were increasingly defined by outside political actors, which is evident in the case of the 1997 pension reform of the Kohl government and even more so in the case of the 2001 reform of the Schröder government. Pension policy became strongly politicized and contested both within political parties and between them. The stable and consensual pattern of interaction among the members of the network has been replaced by more unstructured and more competitive interactions among a much larger number of actors. So far no new pattern has emerged. Cooperation among actors is fragile and conditional upon a complex mixture of strategic and substantive motives and considerations. How did this change in pension policy-making come about? Why did the once unchallengeable pension policy network lose its autonomy in defining the content of pension reforms?

Conditions for Network Autonomy in Pension Policy

My argument is that the ability of the pension policy network to defend its autonomy and to ensure the continued stability of the pension system rested on two important factors. First, the government, in particular the head of government, has to actively support and defend the policies made by the network. Second, the policy network has to remain perfectly united. In the absence of either or both of these conditions, the pension network becomes vulnerable and attempts to undermine its autonomy have increasing chances of success. I will first elaborate on these two conditions and then present two case studies which evidence their importance.

As for the first condition, I argue that the active support of the chancellor and his cabinet was a crucial determinant of the strength of the German pension policy network. The large degree of autonomy the pension network had in the 1970s and 1980s is not an accurate reflection of its strength in setting the agenda and in defining reform alternatives. In fact, the pension network was not as powerful as it might seem if judged by its relatively strong autonomy. My argument is that its autonomy was to a large extent delegated autonomy. The negotiations among network members were embedded in a hierarchical authority structure. They proceeded "in the shadow of the state", or more precisely, in the shadow of the competence of the chancellor to set the broad guidelines of governmental policy (*Richtlinienkompetenz*).[17] The second factor that contributes to the preservation of autonomy is the unity of the pension network. A large number of interest groups, or one or two very powerful political actors, are not necessarily able to guarantee the stability of institutions. In order to veto fundamental institutional changes, it is critically important that they act in concert. They need to form a cartel, a perfectly unified "veto network", to successfully defend their institutions against challenges from the outside. If one or several of the political actors with vested interests in the existing institutional arrangements stop coordinating their actions with other members or leave the network alltogether, the pension network is more likely to disintegrate when confronted with outside political challenges.

Two case studies from the 1990s provide empirical evidence for the importance of these two essential conditions for network autonomy and institutional stability. The first is a case of successful defense by a perfectly united pension network with strong backing from the government. The second case shows the beginning disintegration of the network due to lack of coordination among network members and lack of active governmental support. Both cases are taken from the era Kohl. In August 1993, the minister of economics, Günter Rexrodt, launched a fundamental attack against Germany's contribution-financed pension system. Rexrodt, who belongs to the FDP, the CDU's small Liberal coalition partner, put forward a number of proposals to reform the pension system which were perceived as radical at the time. In recent years, these positions have become part of the political mainstream, especially after the Schröder government has implemented essentially the same measures. The guiding principle of Rexrodt's reform plans was the long-term stabilization of contribution rates despite demographic changes. This ambitious goal made substantial cutbacks in the level of pension benefits unavoidable. Moreover, the economics minister demanded the introduction of tax incentives for private supplementary pensions. Günter Rexrodt wanted his pension reform plans to become part of the government's economic policy program to secure

[17] For the concept of negotiations in the "shadow of hierarchy", see Scharpf (1998, Ch. 9).

Germany's future as an attractive investment location. The Ministry of Economics was in charge of developing this comprehensive reform program (entitled *Zukunftssicherung des Wirtschaftsstandorts Deutschland*).

Rexrodt's attempted "intrusion" into the area of pension policy failed. He did not succeed in establishing new pension reform guidelines such as contribution stabilization and benefit cutbacks which could have been used as a lever to introduce fundamental institutional change. The final version of the government's economic policy program, passed by the Kohl cabinet in early September 1993, did not contain Rexrodt's proposals, but reaffirmed the core principles of the German pension system, in particular the provision of status-maintaining pension benefits. I argue that there are two reasons for the failure of Rexrodt's attack. First, it provoked a concerted effort of the members of the network to defend their autonomy in making pension policy. The social policy experts of the two major parties immediately intervened. Norbert Blüm, the federal labor minister, made it clear that as a result of the 1992 pension reform, Germany is well-prepared to deal with future demographic problems. Rudolf Dreßler, the SPD's leading social policy expert, warned against creating mass poverty among pensioners through benefit cutbacks. The VDR, representing German pension insurance providers, heavily criticized the economics minister. The trade unions were strictly opposed to Rexrodt's radical plans. Second, the chancellor as well as other important members of Kohl's cabinet completely rejected the reform ideas presented by the economics minister. Kohl actively supported the position of the pension network by making a very clear statement: "pensions remain taboo".[18] Other influential cabinet members also voiced their dissatisfaction with Rexrodt, most importantly the minister of finance, Theo Waigel, and the foreign minister, Klaus Kinkel. The fact that even Kinkel, the FDP chairman, distanced himself from his party colleague in cabinet, demonstrates how strong the cabinet's disapproval was.

In the second case study, the attack on Germany's pension system was much more successful, which is accounted for by weak governmental support and imperfect network unity. During 1996, the Christian Democratic labor minister faced increasing political pressures from the FDP as well as from his own party to make fundamental changes to the pension system. There were particularly strong demands to keep contribution rates below 20 percent in the long-term, a measure that would have required massive decreases in the level of benefits. This time, labor minister Blüm did not receive strong and active backing from the chancellor and cabinet members for his position to finance contribution reductions through increases in tax-financing, thereby preserving the existing level of benefits that ensures the replacement of income during retirement. On the contrary, in January 1997 a massive conflict erupted between Blüm and Kohl over tax-financing and benefit reduction which led to a serious cabinet crisis. Kohl emphasized his authority as chancellor over the members of cabinet, while Blüm openly threatened to resign as minister of labor. Finance minister Waigel also rejected increases in tax-financing of public pensions.

Without active support from the chancellor and the cabinet, the pension network was no longer able to maintain its autonomy in setting policy priorities. Blüm was unable to resist the intra-coalitional pressures to present plans for reducing the level of benefits. In January 1997, he proposed to lower benefits from 70 percent to 64 percent until 2030. However, the labor minister was able to prevent even more radical cutbacks by getting the government coalition to agree to an increase in tax-financing and to accept higher projected contribution rates than originally envisioned. Blüm's reluctant acceptance of benefit cutbacks substantially weakened the unity of the pension network. A concerted defense of its autonomy became impossible because one important member of the relatively small network, the minister of labor, unilaterally made substantial compromises. From the perspective of the SPD and the trade unions, Blüm broke the long-established pension consensus and changed sides. What followed was the rapid disintegration of the pension network after a long period of unity and stability. The unity of the pension network was precarious because it included two important members, the social policy experts of the two major parties, who are each others' main competitors in the electoral arena. As a consequence of strong party competition between the two major parties, the formerly depoliticized area of pension policy was quickly politicized by the SPD after Blüm had endorsed benefit reductions. Therefore, whereas the cause for the

[18] Süddeutsche Zeitung, August 23, 1993.

initial division of the pension network were political pressures on the labor minister and CDU social policy experts exerted by the governmental coalition, the complete disintegration of the pension network is largely a result of self-destruction.

The dissolution of the pension consensus

The pension network's autonomy loss and disintegration destabilized the existing institutional arrangements for retirement provision. These developments disrupted the "mechanism for identical reproduction of institutions" (Offe) and created opportunities for fundamental institutional reforms. However, an explanation of major institutional change has to deal with two questions. First, how have the existing institutions become unstable considering their generally remarkable historical robustness? Second, what explains the initiation of institutional change and how has the form of the new institutions become defined? In the case of pension reform in Germany, both questions are closely interrelated, since the actors who destabilized the existing arrangements and those who designed the new institutions are identical. It was the chancellor and his cabinet who reasserted their authority over the definition of pension policy, thus withdrawing the autonomy delegated to the pension network in general and to the social policy experts in his own party in particular. Similarly, both under Kohl and under Schröder, it was the government which defined the broad outlines of the new institutions.[19]

The crucial question thus is: why did Kohl decide to centralize pension policy-making in the mid-1990s after having delegated it to the pension network for over 12 years? Why did Schröder decide to define the guiding principles of pension reform himself instead of leaving this job to the social policy experts in the SPD? I argue that the delegation of decision-making authority to the pension network until the mid-1990s is evidence for a strong and broad consensus about the guiding principles of pension policy which extended well beyond the small circle of pension policy experts. During the 1980s, the chancellor and his cabinet had highly similar ideas and interests. In the absence of the

[19] For an analysis of the redefinition of pension policy within the German Social Democratic Party, see Hering (2001). My account focuses on Schröder's consolidation of power in the SPD and the chancellor's polarization strategy to establish new guiding principles in pension policy.

convergence of ideas and interests, the important policy choices about the 1992 pension reform would not have been delegated to expert commissions. During the 1990s, the ideas and interests of the pension policy network remained stable, but those of the chancellor and his cabinet, in particular of the finance and economics ministers, changed in fundamental ways.

Until the mid-1990s, pension policy was primarily social policy. The most important principle was to ensure status-maintenance during retirement by providing income-replacing pensions (*Lebensstandardsicherung*). In recent years, the priorities have changed. Long-term contribution stabilization (*Beitragsstabilität*) has become the overriding concern in pension policy. The motivations of the advocates of contribution stabilization are primarily economic. Stabilizing contributions has numerous beneficial economic effects. Most directly, long-term contribution stabilization leads to social wage moderation by reducing non-wage labor costs. More indirectly, since contribution stabilization requires governments to substantially decrease public pension benefits, it increases personal savings and the demand for private supplementary pensions, especially when combined with the introduction of a new private pension pillar. Private pensions, in turn, lead to an expansion of capital markets, thus facilitating investments. Finally, contribution stabilization has a positive effect on the budget of the German government considering that federal subsidies to the pension system automatically increase when contribution rates are raised. In short, during the 1990s the German pension system has become an instrument of an economic policy strategy to enhance growth and employment.

In the mid-1990s, the ideas and interests of the members of the pension network and the government started to diverge. The different principles that social policy-makers and economic policy-makers advocate, *Lebensstandardsicherung* and *Beitragsstabilität*, are in direct conflict with each other because the German pension system is confronted with enormous demographic changes in the next three or four decades. Status-maintenance requires stable levels of pension benefits which would lead to increasing contribution rates in the face of population ageing. Vice versa, contribution stabilization requires substantial benefit cutbacks to avoid the fiscal imbalance of the pension system as demographic change progresses. My argument is that the decision of Kohl and Schröder to intervene in this formerly autonomous policy area followed from conflicting ideas and interests regarding the primary political goals of pension policy. As a consequence of this conflict, the government could no longer achieve its goals through delegating decision-making authority to the pension network. Delegated autonomy was an adequate solution for the government as long as pensions were a relatively independent policy area. By contrast, as soon as contribution stabilization is used as an instrument for creating growth and employment, the interdependency between the areas of pension policy and economic policy becomes very strong.

To conclude, the political actors who have made commitments to existing institutions are not the only source of institutional continuity. The second source of institutional stability is a political consensus within the government about the guiding principles in a particular policy area. Although the German pension network had the ability to defend its autonomy and policy principles against most political challenges from the outside, its capabilities as a "veto network" were limited when confronted with an extremely powerful challenger, the chancellor and his cabinet. In order to explain fundamental institutional change in Germany's pension system, we therefore need to analyze why German governments changed their ideas and interests about pension policy. Why did German governments decide to challenge the traditional principles in pension policy? Why did they choose to press for fundamental institutional change? In the next part, I want to provide an institutional explanation for the change of ideas and interests by focusing on the impact of the institutional framework at the European level on political actors in Germany.

CAUSES OF INSTITUTIONAL CHANGE

The change in ideas and interests of governments in Germany seems to be accounted for neither by different party ideologies nor by idiosyncratic factors, specifically the subjective perceptions and preferences of heads of government. First, both major parties held highly similar pension policy objectives until the mid-1990s. Fundamental political differences only surfaced in 1997 and lasted for less than three years. In the present decade, Social Democrats and Christian Democrats again advocate similar guiding principles in pension policy, although these principles are opposite from those they shared until the mid-1990s. Therefore, a change in party control cannot explain the change in ideas and interests of German governments. This change took place within each of the two major parties. The CDU changed its pension policy in 1997, the SPD followed with a short time-lag in 1999, not long after the Social Democrats were elected into office after having been in opposition for 16 years. Second, the chancellor's subjective perceptions and preferences are an unlikely candidate to account for changing ideas and interests. It is striking that after the mid-1990s, Helmut Kohl and Gerhard Schröder have held relatively similar views on pension policy. What explains the parallel change in the two major parties in the German political system? Why do both chancellors have shared ideas and interests about pension policy? I think that we need to explain this commonality through common factors. My argument is that the institutions at the European level are an important explanatory variable capable to account for the similar changes within the CDU and the SPD.[20]

Institutional Definition of Ideas and Interests

My argument about the effect of European integration draws on historical institutionalist theory.[21] The historical institutionalist approach is interested in the definition of actors' ideas and interests through institutions. The interests of actors are not treated as given, but as something to be explained. As Hugh Heclo has noted, "self-interest is not self-defining".[22] Institutions are a major source for defining actors' ideas and interests and therefore provide us with valuable information about their preferences. Although a complete explanation of a given actor's behavior would require us to also

[20] The conceptualization of the effect of European integration depends on the way we conceptualize the European Union. I think that the two most widely used concepts of supranationalism and intergovernmentalism do not capture the characteristics of the EU. I find the new concept of multi-level governance, although it is still insufficiently defined, far more adequate. I see EU policy-making predominantly as an exercise in "puzzling" (Heclo 1974) and "problem-solving" (Kohler-Koch 1999). For the concept of multi-level governance, see: Kohler-Koch and Eising (1999); Marks, et al. (1996); Scharpf (2000); Wessels (1997, 2000).

[21] See, among others: Hall (1986); Scharpf (1998); Thelen and Steinmo (1992); Weaver and Rockman (1993).

examine more idiosyncratic factors, information based on institutions generally allows us to formulate satisfactory explanations in a parsimonious fashion.[23] Institutions have two essential characteristics, which Claus Offe refers to as "positive" and "negative" features of institutions.[24] On the one hand, they have a "negative" impact on actors in the sense that they constrain their choices. Institutions restrict actors' choice options or alter the attractiveness of certain options relative to others. On the other hand, institutions have a "positive" effect through shaping the ideas and interests of actors. Institutions embody principles, rules and values. Through interactions and deliberation within institutions, actors become socialized into these shared orientations. My argument on the impact of European-level institutions focuses on the "positive spirit" (Offe) of institutions. In this paper, I will not deal with the numerous institutional constraints which European integration creates for political actors.[25]

The European institutional context has become increasingly important for German political actors during the past two decades. The two core projects of European integration, the single market and monetary union, have greatly expanded and intensified the interactions among national executives and bureaucracies of the member states and their counterparts at the EU level, especially in the area of economic policy.[26] The new dynamism in integration had a significant impact on the German state. Most German politicians and bureaucrats do not make a clear distinction between German and European politics anymore. Instead, they see themselves operating in a system of multi-level or network governance with strong interdependencies among the different levels. According to Wolfgang Wessels, the progressive intensification of interactions and joint policy-making has led to a "fusion" of the different levels of government.[27]

Over the course of the 1990s, the orientations of German political actors have become more and more Europeanized. As Peter Katzenstein points out, EU-level

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[22] Heclo (1994, 378)
[23] Scharpf (1998, 38-43)
[24] Offe (2000). See also: Heclo (1994); Katzenstein (1997); Scharpf (1998)
[25] See in particular Scharpf (1999).
[26] See in particular Wolfgang Wessels extensive empirical study on the "opening of the state" (Wessels 2000).

institutions have transformed "a.relationship between Germany *and* Europe to one of Germany *in* Europe".[28] The orientation of German institutions toward the promotion of European integration is so deeply engrained that they are "programmed for integration".[29] As a consequence of the Europeanization of the German state, German governments increasingly define their ideas and interests within the institutional context at the European level. My argument is, first, that new ideas about the role of pension systems have emerged at the EU-level in recent years.[30] These ideas have become firmly embedded in the European institutional framework. The area of pension policy, formerly a strictly national affair, has become Europeanized to a significant extent. Second, I argue that the new thinking about pension policy has strongly influenced the ideas and interests of German governments and bureaucracies, leading them to initiate fundamental institutional change in Germany's pension system. In the next section, I first want to outline the content of these ideas, as well as the policy objectives derived from them, and then discuss how they have emerged at the EU-level.

The Use of Pension Systems as an Economic Policy Instrument

After the mid-1990s, the reform of pension systems has gradually become a top priority in EU policy-making. Pension systems have become an essential tool for implementing the European Union's comprehensive and integrated economic policy strategy, which has recently been termed the *Lisbon Strategy*.[31] For EU member states, the institutions of retirement provision are instrumental in generating growth and employment and in making the European Union more competitive vis-à-vis the United States. The EU's economic motivations for reforming pensions manifest themselves in three different sets of goals : the reduction of non-wage labor costs, the expansion of capital markets, and the stabilization of governmental budgets. The first and most

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[27] Wessels (1997; 2000)

[28] Katzenstein (1997, 19) [emphasis in original]

[29] Goetz (1996)

[30] I do not claim that any particular idea is entirely new and was newly invented within European institutions. What is new is the particular combination of ideas. I agree with John Kingdon's view that in studying ideational change the origins of ideas are less important than their recombinations, the "new packaging of already familiar elements" (Kingdon 1984, 130-131).

important objective is the reduction of non-wage labor costs. Already in 1993, the Commission's *White Paper on Growth, Competitiveness and Employment* identified the lowering of social security contributions as a win-win solution to address the problem of structural unemployment: job creation could be achieved through influencing the supply-side, but without having to reduce wage levels.[32] Reducing non-wage labor costs thus became a substitute measure for, or functional equivalent of, labor market deregulation. EU member states regarded labor market deregulation and wage differentiation as "socially unacceptable and politically untenable", as the Commission put it in its White Paper.

Subsequently, the goal to reduce non-wage labor costs became firmly institutionalized at the EU-level. Following the Amsterdam Council's *Resolution on Growth and Employment* in 1997, both the annual Broad Economic Policy Guidelines (BEPG), the annual Employment Guidelines (EG) as well as numerous Presidency Conclusions have repeatedly reaffirmed the member states' commitment to lower the charges on labor. By the end of the 1990s, the economic objectives pursued with the lowering of non-wage labor costs have gotten much broader and more ambitious. Whereas the 1993 White Paper mostly focused on reducing high levels of unemployment, the European Union is now first of all concerned with increasing low levels of employment. At the 2000 Lisbon European Council, member states defined a new strategic goal for the EU. The European Union aspires to become the "most competitive and dynamic economy in the world" within the next 10 years.[33] Increasing the level of employment is seen as an important source for economic growth. EU member states have thus agreed to raise the Union's employment rate from the current 61 percent to 70 percent by 2010.[34]

As for the second objective, by means of reforming pension systems, specifically by introducting and developing private pension schemes, EU member states want to integrate and expand European capital markets. In numerous Communications, the

[31] European Council (2000b)

[32] European Commission (1993)

[33] European Council (2000b, 2)

European Commission has emphasized the prominent role of pension funds in contributing to the generation of growth and employment. By providing companies with more and better financing opportunities, larger capital markets promote investments.[35] In recent years, the need to develop an integrated capital market in Europe has become a recurrent concern in the annual BEPG. The partial privatization of pension provision has particular significance for the creation of an efficient risk capital market in the EU. Pension funds are an important source for the provision of venture capital for small and medium-sized businesses. In turn, these companies contribute in major ways to job creation.[36]

The third objective is directly related to the commitment of member states to maintain balanced budgets in the context of EMU and the Stability and Growth Pact (SGP). The long-term budgetary implications of ageing populations has become a common concern in the European Union.[37] Stable finances are regarded as a requirement to achieving stronger growth and higher employment. Additional expenditures due to demographic changes endanger the ability of governments to keep their finances "close to balance or in surplus" as required by the SGP. At the 2001 European Council meeting in Stockholm, the EU member states therefore decided to address the problem of long-term sustainability of public finances annually by incorporating respective provisions in future BEGP and Stability and Convergence Programs.[38] Considering that EU member states have agreed to reduce contribution rates as well as the overall level of taxation, the long-term stabilization of governmental budgets will have to be achieved mostly through expenditure decreases, not through revenue increases. As a consequence, the maintenance of balanced budgets in the face of population ageing has significant implications for the level of public pension benefits.

[34] European Council (2000b, 10)

[35] European Commission (1997; 1998a; 1998c; 1999a; 1999b; 2000a; 2000c)

[36] European Commission (1998c; 2000b; 2001)

[37] Economic Policy Committee (2000); European Central Bank (2000)

[38] European Council (2001)

Extending the European Economic Paradigm to Pension Policy

In order to conceptualize the effect of European integration on fundamental institutional change in the German pension system I first demonstrated that the European institutional framework is an important unit of reference for German political actors because of their frequent participation within these institutions and because of Germany's Europeanized state identity. Put differently, European-level institutions increasingly shape their ideas and interests. Second, I showed that there exists a set of ideas at the European level with direct relevance for the reform of pension systems. In addition, there is a strong congruence between these ideas and the policy objectives derived from them on the one hand, and the substance of pension reforms in Germany on the other.

However, one essential question remains to be addressed: if institutions define the ideas and interests of political actors, how did these institutionally embedded ideas emerge? Analyzing the way these ideas emerged is of fundamental importance to determine whether European integration had a genuine effect on pension reform in Germany. The effect of European integration is genuine if these ideas emerged endogeneously, that is within European institutions and a as a result of their distinctive characteristics. Conversely, if these ideas were exogeneously defined, the impact of European integration is questionable. More specifically, considering Germany's influential role as institution-builder in Europe, we might suspect that German governments generalized their ideas and interests at the European level. In other words, Germany's ideas and interests about pension reform were predefined. In this case, the congruence between EU-level ideas and the substance of institutional reform at the national level would not constitute evidence for the effect of Europe on Germany, but of the effect of Germany on Europe. Another possibility is that other influential member states, particularly France and Britain, succeeded in generalizing their predefined ideas and interests. In this case, European level institutions merely served as a channel for the transfer of existing ideas, but not as an arena for the development of new ideas.

I argue that the development of new ideas about pension policy was endogeneous. The generation of growth and employment through stabilizing contributions and expanding private pensions is a case of paradigm extension at the EU level.[39] By including the area of pension policy in an overarching strategy for growth and employment, the EU's economic policy paradigm has been extended beyond the original areas of economics and finance. With the completion of the single market and the creation of monetary union, the European economic paradigm has become embedded in the institutions of the European Union. It is frequently characterized as a "neoliberal policy consensus".[40] I argue that the European Union's activities in encouraging and coordinating the reform of pension systems in member states clearly reflect the liberal "spirit" of the institutionalized economic paradigm at the European level.[41]

Probably the best evidence for the use of pension policy as an instrument for liberal economic policy is the defensive reaction of key social policy-makers at the European level. In a number of reports on the coordinated reform of pension systems, the Social Protection Committee (SPC) and its predecessor, the High-Level Working Party on Social Protection (HWPSP), have repeatedly criticized the liberal direction of the reform activities initiated by heads of governments, economics and finance ministers, and the European Commission.[42] There is disagreement about the definition of the problem, about its solution and about the guiding principles of pension policy. In the SPC's perspective, the problem of pension systems is on the revenue side, not on the expenditure side.[43] The two policy communities deal with different problems. Social policy-makers focus on the revenue problem of pension systems created by demographic change. By contrast, economic policy-makers are primarily concerned with the cost problem of the economy created by pension expenditures, which is exacerbated by population ageing. These contrasting perspectives are reflected in different conceptions of sustainability of pension systems. Economic policy-makers emphasize their financial

[39] For the notion of policy paradigms, see Hall (1992; 1993). For the institutionalization of the liberal economic paradigm at the European level, see McNamara (1998).

[40] McNamara (1998)

[41] See in particular European Commission (2000b; 2000d)

[42] Council of the European Union (2000a; 2000b; 2001)

[43] As the HWPSP stated in its report to the 2000 European Council in Nice, "[t]he pension issue cannot be simply reduced to an argument over redistribution between generations, focusing on the generosity of pensions and the weight of costs borne by the actively employed or taxpayers. It must first address the level of work and employment rates." (Council of the European Union 2000b, 12).

sustainability, whereas the SPC stresses their social sustainability.[44] EU social policy-makers also try to resist the redefinition of the guiding principles of pension pòlicy which has resulted from paradigmatic "intrusion". The SPC has repeatedly defended the primacy of the traditional principle of status-maintenance: "The fundamental objective of pension schemes remains as always: to provide people with a securely financed income after retirement, an income to replace earnings or derived income during working life".[45]

The Driving Forces of Paradigm Extension

What are the driving forces behind the endogeneous extension of the EU's economic paradigm? My argument is as follows: the single market and EMU have created a new economic entity in Europe which changes the perspective of European policy-makers. Influenced by their liberal economic paradigm, European policy-makers define their interests from the perspective of a single European economic unit which competes with other economic entities in the world, particularly with the United States. EU economic policy is thus no longer predominantly the result of converging interests among EU member states, but increasingly flows from the interests of the European Union as a single economic unit in a competitive economic environment.[46]

The competition with the United States is important for two reasons. First, the US has become a new benchmark for the member states of the European Union. As long as European countries compared their own economic performance mostly with that of other European countries, the reform impulses from comparisons were limited as performance differentials are small. By contrast, the US is a much more demanding point of reference for making comparisons due to its outstanding economic performance during the 1990s.

[44] Council of the European Union (2000b, 6)

[45] Council of the European Union (2000a, 24)

[46] In my view, the interests of the European Union as a single economic entity are not directly determined by its structural economic position vis-à-vis the United States. As Hugh Heclo has pointed out, changes in the external environment "do not come with an instruction sheet" (Heclo 1994, 378). Although EU interests are defined in response to these structural conditions, their content is critically shaped by the liberal economic ideas that European policy-makers hold, and they are collectively defined within the European institutional framework. For the argument that ideas and interests are not an accurate reflection of underlying structural conditions, but are creatively generated in response to these conditions, see Blyth (2000).

Second, the United States provides a successful example for the kind of supply-side policies the European Union wants to implement. Thus, in conjunction with the dominant problem-solving orientation in the European Union, the comparison with the US has a decisive impact on both the identification of problems and the development of solutions in the EU.[47] In the next section, I will first elaborate on these two points and then provide an additional, complementary explanation for endogeneous paradigm extension, namely the vested interests of European economic policy-makers in further integration.

What has emerged at the European level as a consequence of the EU's comparison with the United States is an approach to economic policy which could be termed "competitive Euro-liberalism". First, this form of liberalism in policy-making did not primarily originate from an ideological commitment to liberal principles, but from the European Union's competitive position vis-à-vis the United States.[48] Second, the EU's liberal economic policy paradigm is distinctly European. Although European policy-makers want to emulate American growth and employment policies, they are at the same time strongly committed to preserving the European social model. The attempt to balance these two conflicting objectives is evidenced by the EU's approach to employment creation.[49] The European Union does not directly emulate American employment policies, but tries to emulate the mechanism that underlies them. The EU's approach is to achieve the same goals through different means, yet by employing a similar mechanism. The goal is to increase profitability, and thus employment, through the reduction in real unit labor costs. However, a substantial downward widening of the wage distribution, and a parallel lowering of social benefits, are not an option for European policy-makers. The EU wants to reduce labor costs without reducing wages. Negative side-effects of

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[47] Beate Kohler-Koch argues that the core idea of European multi-level governance is the view of politics as problem-solving, see Kohler-Koch (1999). For the concept of problem-solving more generally, see Scharpf (1998, 130-132, 252-254). The distinctive feature of problem-solving is the pursuit of common interests, or as Scharpf puts it, "... the common search for new solutions that will extend the possibility frontier – without regard to their distributional consequences".

[48] I agree with Kathleen McNamara that European leaders follow a pragmatic, not an ideologically purist type of liberal economic policy which has emerged as a result of economic competition (McNamara 1998, 56-71). In a very similar way, McNamara terms the EU's approach to economic policy "competitive liberalism", and Wolfgang Streeck characterizes the new approach to social policy in the EU as "competitive solidarity" (Streeck 2000).

[49] See in particular European Commission (1998b, 18-22).

American-style employment policies, specifically widespread social exclusion, is regarded as unacceptable.[50] Therefore, the EU's policy approach to growth and employment focuses on the reduction of non-wage labor costs as an alternative means. Social wage moderation and differentiation is thus a functional equivalent for labor market deregulation and wide-scale cutbacks in unemployment and welfare benefits. The mechanism by which it produces its beneficial employment effects is similar.

The comparison with the United States is ubiquitous in EU policy papers. The magnitude of the American challenge, and the seriousness of Europe's problems, is constantly emphasized, particularly the growing gap in per capita income. The living standard in the EU is 35 percent lower than in the US. There has been a considerable relative decline of European living standards over the course of the 1990s. The reason is a combination of strong growth of GDP and employment in the United States and low economic growth and stagnating employment in Europe.[51] The European Commission has provided a devastating diagnosis of European labor markets, one that is also reflected in the annual BEPG: "... the most dominant feature of the EU is *the mediocrity of its employment growth and level*".[52] The economic performance of the European Union during the 1990s has been disappointing compared to the US. The single market and EMU were not sufficient to catch up with the US during the 1990s.[53] Consequently, European policy-makers have committed themselves at the 2000 European Council meeting in Lisbon to mobilize all available resources in order to reverse Europe's decline as an economic entity vis-à-vis the United States in the short-term and in order to become the most dynamic and competitive economy in the world in the medium-term.

The United States does not only serve as a benchmark for European economic policies. By drawing comparisons with the US, European policy-makers have also identified the causes of Europe's lagging performance and possible solutions for generating growth and employment. They believe that low employment rates and low

[50] For similar strategies to make labor markets more flexible while avoiding social exclusion, see Hemerijk and Schludi (2000).

[51] European Commission (2000b); European Council (2000a)

[52] European Commission (1998b, 5) [emphasis in original]

[53] European Council (2000a)

levels of investment are the causes of relative decline. They identify the high tax burden on labor and underdeveloped capital markets, especially risk capital markets, as the main factors accounting for low employment growth and stagnating investment during the 1990s. As the Commission and ECOFIN have stated in their joint report to the 2001 European Council in Stockholm, the tax burden on labor amounts to over 40 percent in the EU compared to less than 25 percent in the US.[54] Europe's capital markets are strongly underdeveloped, which applies in particular to risk capital markets. Europe has nothing comparable in size or scope to NASDAQ.[55] Through its contribution to the reduction of non-wage labor costs and the provision of capital, the reform of pension systems becomes essential for the success of the European strategy for growth and employment.[56]

The view that Europe should mobilize its "full potential" to catch up with and surpass the United States is widely shared among European policy-makers, including the social policy community. In particular, there is a broad consensus that non-wage labor costs need to be reduced in order to create employment. Even the SPC supports the lowering of social security contributions and generally acknowledges the new linkage between pension policy and economic policy.[57] However, the integration of pension policy into the European strategy for growth and employment is not only driven by a broadly perceived political "necessity" given the shared goal to reverse the economic decline vis-à-vis the United States. Another driving force behind endogeneous paradigm extension, one that interacts with the first, is the interest of economic policy-makers at the EU level in further economic integration.

In the European Union, we can observe the same dynamic that is characteristic for institutional development in general. As Lindberg and Scheingold have aptly observed, as European integration progresses it creates its own vested interests.[58] Functionalist theory and institutionalist theory both emphasize the reinforcement of development paths once

[54] European Commission (2000b, 23-26)
[55] European Commission (1998c; 2000b)
[56] European Commission (2000b, 58-61)
[57] Council of the European Union (2000a)

institutions are created. The phenomena of functional spill-over and path-dependence are produced by a similar inherent institutional logic, specifically increasing costs of exit and increasing returns from institutional commitments.[59] My argument is that the completion of the single market and the creation of monetary union were a historical juncture. In the years after this formative moment, economic policy-makers, including heads of government, became increasingly committed to these new institutions and began to prefer an extension of economic integration over stand-still. Thus, paradigm extension is also a result of "paradigmatic spill-over": guided by their liberal economic paradigm, EU economic policy-makers began to search for and identify more and more functional linkages between the areas of fiscal and economic policy on the one hand and pension policy on the other. According to their perspective, remedying Europe's economic problems requires reforms in other policy areas. The repeated emphasis on linkages and interdependencies between social, economic and employment policies in Presidency Conclusions, BEPG and Commission Communications give us some indication of the activities of EU economic policy-makers to extend their policy paradigm to other policy areas.

CONCLUSION

What lessons can we draw from the German case study about the conditions for institutional stability and the causes of institutional change? What does it tell us about the way European integration impacts on national politics? As for the conditions for institutional stability, the analysis of the German case suggests that governments have been more important for the preservation of welfare state institutions during the 1970s and 1980s than is often assumed. Unlike their counterparts in Great Britain and the United States, German governments did not have an interest in dismantling the welfare

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[58] Lindberg and Scheingold (1970, 126-128)

[59] Functionalists and historical institutionalists use essentially the same terms to conceptualize institutional dynamics. According to Lindberg and Scheingold's functionalist theory of integration, "[e]ach step forward has tended to increase both the costs of going back and the incentives for going on" (Lindberg and Scheingold 1970, 157). According to Paul Pierson, the essence of path-dependence is that "... preceding steps in a particular direction induce further movement in the same direction" (Pierson 2000, 252). In addition, "[a]s social actors make commitments based on existing institutions and policies, their cost of exit from established arrangements generally rise dramatically" (Pierson 2000, 259).

state and in reforming its pension system in fundamental ways.[60] Put differently, the institutions of the German welfare state did not remain stable because of the existence of powerful interest groups which successfully resisted governmental reform attempts. They remained stable because none of the actors involved, especially the CDU-led government and the Social Democratic opposition, wanted to introduce fundamental institutional changes of the pension system. Until the mid-1990s, the politics of pensions was highly depoliticized and followed a pattern of "smooth consolidation" (Offe). The German case study further suggests that the power of interest groups to resist political challenges might be more conditional than we might expect. As I tried to show, the ability of German interest groups to preserve their autonomy and guarantee institutional stability depended on two conditions. First, they needed to act as a united "veto network". Second, since its autonomous policy-making proceeded in the "shadow of the state", the ability of the pension network to defend the existing institutions depended on active backing from the government. A more general conclusion from this study is that a broad consensus among the major political actors about the guiding principles embodied in the pension system is an important foundation of institutional stability. Put differently, institutional stability has an ideational basis.

As for the causes of fundamental institutional change during normal times, i.e in the absence of crises, conquests or wars, my study of the German case shows that a change in the pension policy paradigm is a necessary condition for the initiation of major reforms. In Germany, the paradigm change in pension policy has resulted from the "intrusion" of economic policy-makers, including the heads of government, who have successfully extended their liberal economic paradigm to the area of pension policy. The case of Germany thus confirms the findings of institutionalist theorists that discontinuous institutional change is generally not endogeneously initiated by political actors who act within, and are strongly committed to, the existing institutional arrangements.[61]

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[60] For an analysis of the reform initiatives of conservative governments with an ideological commitment to dismantle the welfare state, see Pierson (1994).

[61] North (1990); Offe (1996)

As for the impact of European integration, I tried to demonstrate in this paper, first, that the extension of "competitive Euro-liberalism" to the area of pension policy developed endogeneously within the new European institutional framework created by the single market and monetary union. Second, I argued that EU-level institutions exert a growing influence over the definition of ideas and interests of German political actors, specifically the German government. Thus, the effect of European integration is not primarily the "strengthening of the state", but the redefinition of the ideas and interests of the state. According to Andrew Moravcsik's argument, European integration empowers governments and enables them to loosen domestic constraints imposed by interest groups at the national level.[62] By contrast, the German case study suggests that governments have been powerful political actors before the single market and monetary union. Through European integration, however, German governments have become challengers of the existing institutional arrangements.

[62] Moravcsik (1994)

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