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Berner, Frank

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Frank Berner

# Beyond the Distinction Between Public and Private: Hybrid Welfare Production in German Old-Age Security

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Universität Bielefeld
Institut für Weltgesellschaft
Fakultät für Soziologie
Fakultät für Rechtswissenschaft

## Abstract

Normally, when pension schemes are described, classified and compared, the categories of 'public' and 'private' are of primary importance. However, the distinction between 'public' and 'private' in the context of old-age security has recently been questioned for two reasons. First, most pension schemes can not unambiguously be classified as either 'public' or 'private'. Consequently, the idea of an institutional welfare mix and the well-known pillar-metaphor with its clear-cut division between 'public pillars' and 'private pillars' are obviously too simplistic to convey the empirical diversity in old-age security. And second, recent pension reforms in Western-European welfare states have intensified the state regulation of what is conventionally called private pensions. The pension reform of 2001 in Germany is a good example of such public policy on 'private' pensions and its consequences: Tax-financed subsidies for and regulation of occupational pensions and personal saving blur both the distinction between occupational and personal pensions as well as the distinction between 'public' and 'private'. The emerging pension schemes are not only public-private mixes, but are genuinely hybrid. Applying the distinction between 'public' and 'private' to these schemes would be a serious misinterpretation of their essence and an underestimation of their complexity. Arguments about whether a particular scheme is predominantly 'public' or 'private' are ultimately political conflicts about the realm and extension of the state. This paper therefore pleads to leave the distinction between 'public' and 'private' to the political debate. New concepts and terminology are needed for the social scientific analysis of old-age security.

## Keywords

Pensions, public, private, welfare mix, pension reform, Germany

## Introduction

When studying the literature on the welfare mix in old-age security it is not unusual to come across a certain uneasiness with the distinction between public and private. Esping-Andersen for example, in his path-breaking study on welfare regimes, concedes "the difficulty of defining exactly what should be considered private or public" (Esping-Andersen 1990: 81). Many other authors also acknowledge that the border between public and private is not always clear-cut (O'Higgins 1986; Barr 2002; Hyde et al. 2003; Castellino and Fornero 2006). The International Social Security Association gets to the heart of the problem by asking "how free and private are private pension schemes?" (International Social Security Association 2004: 12). As these examples demonstrate, it has become quite common to observe that the boundary between public and private is either shifting, or that it is increasingly unclear and blurred. Nonetheless, where the difficulty to distinguish 'public' and 'private' comes from is rarely studied in depth.

Usually, the relation between 'public' and 'private' in old-age security is conceptualized as the relation between 'public' and 'private' *pillars*. The basic idea of this concept is that each pillar can be either 'public' or 'private'. In that sense, pension reforms that have taken place in many Western-European countries in the recent years, are described as *a shift from public to private*: Publicly administered, compulsory pay-as-you-go pension schemes are becoming less prominent , and the importance of privately administered, often voluntary, funded schemes is growing. Some commentators interpret such changes as privatization (e.g. Ellison 2003). Going beyond thinking in pillars, Whiteside (2006) argues that 'public' and 'private' in old-age security are not only attributes of distinguishable schemes, and therefore distinguishable, but are also inseparably intertwined because in the post-war development of Western-European welfare states public policy goals have been tied to private pensions.

Introducing a constructivist perspective, this paper goes one step further. The underlying idea is that pension schemes or particular elements thereof are not 'public' or 'private' by nature. The categories of 'public' and 'private' are ultimately social constructions, and assigning elements of old-age security to one of them is nothing but a normative way to give order to the social world. Starting from there, the paper has in fact three specific aims. First and foremost, it suggests that 'public' and 'private' are categories of a political discourse, and should therefore be handled with care for the purpose of scientific description. Based on an empirical examination of German old-age security, the paper will, as a second aim, support Whiteside's proposition to go beyond the distinction between 'public' and 'private'. Germany is a good case study, because recent pension reforms have even put two conventional divides into question: the distinction between occupational pensions and personal pensions, on the one hand, and the distinction between 'public' and 'private', on the other hand. And third, as a secondary effect, the paper provides the international audience with a thorough description of some of the incentives and regulatory measures introduced by recent pension reforms in Germany.

In order to develop the argument, in the next section I will start with an examination of exactly how pension schemes are classified as 'public' or 'private'. In the third section I will then present a close-up of the old-age security system in Germany, demonstrating that not all pension schemes can easily be classified as either public or private. The fourth section describes the pension reform of 2001 in detail, focusing on the subsidies for certain forms of occupational and personal pensions. The main argument is developed in the fifth and sixth sections: As a result of the reform measures, occupational and personal pensions are respectively undergoing significant institutional change. Subsidized personal pensions are becoming distinct from non-earmarked personal saving. And within occupational pensions, the reforms have lead to a differentiation between the traditional, employer-sponsored, defined-benefit company pension and subsidized, employee-sponsored, defined-contribution provision plans. The distinction between the two types of subsidized pensions is becoming blurred (section five). At the same time, these schemes are good examples for a blurring of the line between 'public' and 'private' because goals of public (social) policy are linked to the 'private' production of pensions (section six). In the conclusion (seventh section) I suggest acknowledging that pension schemes normally have both a public as well as a private side. Instead of trying to define and separate them, it might be worthwhile to go beyond the conventional categories and to search for new terminology.

## Public and private in old-age security

The idea that welfare is generated not only by the state but results from the interplay of several sectors has a long tradition in social policy research (Marshall 1964; Pinker 1979). Applied to old-age security, the idea of a welfare mix usually takes the form of the well-known pillar-metaphor: Security in old-age is said to resemble a roof resting on several pillars, each representing a different pension scheme. In the international pension policy community the use of the pillar-metaphor spread considerably in the 1990s, after the World Bank had initiated a controversial debate about the design and reform of national pension systems (World Bank 1994; Beatty and McGillivray 1995). In the debate, the multi-pillar approach had a strong normative function, proposing that private pensions should significantly contribute to the average individual income mix in old age.

A common feature of any existing multi-pillar concept is the distinction between public and private pillars. But what exactly is it that qualifies a scheme as 'public'? When it comes to describing and classifying pension schemes, the following set of variables, each with two parameter values, is normally used:

[Table 1 about here]

Institutional reality is less clear-cut than table 1 suggests – for three obvious reasons. First, the two parameter values belonging to each variable are not always antipodes, one excluding the other. In many cases both characteristics co-exist: There are, for example, pay-as-you-go pension schemes that also have an element of funding; and some schemes are financed by contributions as well as by tax revenue. Second, the two parameter values may not always be quite distinct: In notional defined contribution schemes the pension formula is designed to mimic actuarial calculation. And third, a variable may be irrelevant for a particular scheme (the distinction between defined-benefit and defined-contribution, for example, only makes sense for funded schemes).

Nonetheless, pension schemes that are characterized by parameter values listed in value column 1 rather than by parameter values listed in value column 2 are ascribed the status 'public' schemes. But not all variables are relevant to the same degree; some variables are more important for deciding whether a scheme is 'public' or 'private' than others. The legal basis of the administration seems to be by far the most important criterion, and the only definite one. The OECD, for example, in its guidelines for the classification of pension schemes, holds that all schemes are 'private' that are not run by the state (OECD 2005). Good indicators are: the way the cash flow is organized (pay-as-you-go indicates public), the mode of participation (compulsory indicates public) and the function in the overall welfare mix (basic protection indicates public) – although these characteristics are not definite, and therefore only second best. For example there are pay-as-you-go schemes that are considered 'private' (in France and in Italy), and the German supplementary pension in the public sector is said to be public although it only provides a supplement to the basic protection of the statutory pension insurance.

**The diversity of pension schemes in Germany**

The German system of old-age security is a good case for illustrating that the distinction between 'public' and 'private' is by no means unambiguous. There are at least six schemes of considerable relevance. Schmähl (2004) has suggested categorizing the schemes by combining four mandatory basic schemes to represent the first tier (or first pillar). The second pillar is comprised of two supplementary occupational schemes, one for the private and one for the public sector. The schemes are thus categorized regardless of whether they are administered by public or by private institutions or whether they are pay-as-you-go or funded. Table 2 provides details of these six schemes in terms of their coverage and their share of the total volume of pension benefits.

[Table 2 about here]

By far the most important scheme is the *statutory pension insurance* (Gesetzliche Rentenversicherung). In the public debate, the first pillar is often reduced to the statutory pension insurance, due to its large coverage and due to the eminent importance of its benefits for the average old age income. The scheme is compulsory for all employees and – for historical rather than systematic reasons – for a few self-employed professions. Contributions are paid as a percentage of the gross wage, half of the contribution rate is paid by the employee and half of it by the employer. The contributions cover about two thirds of the expenses, the rest is financed by general tax revenue. The scheme is pay-as-you-go and has only a tiny reserve fund to compensate for fluctuations on the income side. The 19 pension insurance institutes (Rentenversicherungsträger) administrating the scheme are legally autonomous agencies that do not belong to the core state administration but operate on the basis of public law and fulfil public tasks (Becker 1996). They are self-administered (Selbstverwaltung) under the supervision of the Federal Insurance Agency (Bundesversicherungsamt).[1]

The second important scheme is the *provision for civil servants* (Beamtenversorgung), run by the Länder and by the Federal State. Civil servants do not pay contributions; their pensions are financed by general tax revenue (and therefore, in a way, pay-as-you-go). The scheme is rather generous: benefits depend not on the whole earning career but on the last income before retirement. The *pension scheme for the farmers* (Alterssicherung der Landwirte) is part of social insurance, but distinct from the statutory pension insurance. It is a pay-as-you-go scheme, with compulsory participation for farmers and their spouses. Only around 30 per cent of the expenses are covered by individual contributions, the major part is tax financed. The fourth element of the first pillar consists of the various *schemes for self-employed professionals* organized in professional chambers, like doctors, lawyers, and architects. These schemes are run by decentralized private institutions (Berufsständische Versorgungswerke). Participation is compulsory for self-employed persons who are members of the respective chamber. In most cases the financing mode is a mix of pay-as-you-go and funding, with funding being the more important component (Fachinger et al. 2004).

*Occupational pensions in the private sector* are organized in five ways, three of which are fully funded. An unfunded way of providing occupational pensions is through direct employer pension commitments (Direktzusage), covered by book reserves. Support funds (Unterstützungskasse) are partly funded. The fully funded forms of occupational pension provision are: direct insurance (Direktversicherung), pension insurance funds (Pensionskasse)[2] and pension funds. Occupational pension provision in the private sector is voluntary for employees. Since 2002 the employers are obliged to provide access to an occupational pension scheme at the employees' request (see below). During the 1980s and 1990s, the coverage of occupational pensions in the private sector was stagnating and in some economic sectors even on the decline (Kortmann 2004), but the pension reform of 2001 has brought about what has been called a renaissance of occupational pensions. Contrary to the private sector, the *supplementary provision of the public sector* (Zusatzversorgung des öffentlichen Dienstes) is quasi-compulsory. The employees are automatically included in the scheme and can opt out within the first six months of their employment. Contributions are partly made by the employer and partly by the employee. There is one scheme for the employees of the Federal State and the Länder, and there are various smaller schemes for the employees of the municipalities and of the churches. The schemes are pay-as-you-go with a small amount of additional funding to compensate for income fluctuations. The scheme functions on the basis, not of federal pension law, but of collective bargaining agreements. Of all six schemes, the supplementary provision of the public sector is the one whose status as 'public' or 'private' is the most disputable.

*Personal saving and personal pension provision* is generally considered the third pillar. Because of the multitude and diversity of savings products it is difficult to say what proportion of the total income in old age stems from personal savings. Life insurance is by far the most popular savings product (Gesamtverband der Deutschen Versicherungswirtschaft 2004). Around half of all private capital is accumulated in life insurance, one quarter is invested in securities, shares and bonds, and another quarter is used for building savings contracts, savings accounts and other forms of savings (Bruno-Latocha 2000). Many people (54 per cent of all persons 65 and more years of age) have invested in real estate, either to live in it, or to rent for an additional income (Bundesregierung 2001).

## Pension reforms since 2001: stirring up the welfare mix

In 2001, the German government implemented a major pension reform. In the public debate, the reform is called „Riester-Reform", referring to the Federal Minister of Labour and Social Affairs in office at that time, Walter Riester. Another reform was passed in 2004.

### *Cost-containment in the statutory pension insurance*

The principal aim of the reform was to control and to contain the rise of the contribution rate to the statutory pension insurance, which at that time amounted to 19.1 per cent of the gross wage.[3] The government set up target contribution rates for the future: The contribution rate should not exceed 20 per cent in 2020 and 22 per cent in 2030. To reach that aim, the formula for benefit adjustment was changed, with the effect that the net standard pension level was projected to decrease from 69.5 per cent in 2000 to 64 per cent in 2030.

However, in 2003 it became clear that the assumptions about the development of life expectancies and of the work force that had been made to calculate the projected target contribution rates for 2020 and 2030 had been too optimistic. New projections with updated assumptions predicted a contribution rate of 21.5 per cent in 2020 (instead of 20 per cent) and of 24.2 per cent in 2030 (instead of 22 per cent). In order not to miss the target contribution rates for 2020 and 2030, another pension act, the so-called Pension Insurance Sustainability Act, was passed in 2004 with additional measures to reduce the future standard pension level. Again, the adjustment formula was changed by introducing the so-called sustainability factor. The sustainability factor is a parameter based on the ratio of the number of pensioners to the number of contributors. If the pensioner ratio rises (e.g. because of a rise in the average life expectancy or because of a shrinking work force), the benefit adjustment is smaller, and, as a consequence, the standard pension level is lowered. According to the projections, the introduction of the sustainability factor and other minor measures will bring about a decrease in the net standard pension level to 58.5 per cent in 2030 (see table 3).

[Table 3 about here]

The projected reduction of the net standard pension level due to measures of cost-containment introduced in 2001 and in 2004 reveals a path breaking element in the German policy of public pension provision (Hinrichs 2002). In the past, the policy of the statutory pension insurance scheme was aimed at guaranteeing a net standard pension level of around 70 per cent, and increasing the contribution rate or widening the income basis of the scheme has always been one of its means. Since the reform of 2001 the priorities have been explicitly turned around: A stable contribution rate has become the focus of pension policy, and the adjustment of the standard pension level is now considered an appropriate means to reach this goal. Subordinating the standard pension level to the contribution rate can certainly be described as a "shift from an 'expenditure-oriented revenue policy' towards a 'revenue-oriented expenditure policy'" (Schmähl 2004: 183).

*New subsidies for occupational and personal pensions*

In order to compensate for the reduction of the benefit level of the statutory pension insurance, a programme to promote voluntary occupational and personal pensions was launched. Basically, two types of subsidy were introduced, one for personal as well as occupational pensions, and one for occupational pensions only.

The 'Riester-subsidy'

The first type of subsidy can be claimed for contributions from *net wage* to

- either a fully funded occupational pension provision scheme (in the private as well as in the public sector), this form of contribution is called *net salary sacrifice,*
- or a personal pension plan, if the plan is declared eligible for subsidies by the Federal Financial Supervisory Authority.

This type of subsidy is called the 'Riester-subsidy', again after the former Minister of Labour and Social Security, Walter Riester. The Riester-subsidy consists of tax financed allowances and a tax rebate. If a saver pays contributions from their net wage to an eligible personal pension plan or to a fully funded occupational pension scheme, he/she will at least get the so-called basic allowance. For each child, the saver gets an extra child allowance. To get the full allowances, savers have to contribute an amount as high as 4 per cent of their gross wages per year (this is confusing because the savers are expected to contribute the amount of 4 per cent of their gross wage, but in order to draw the Riester-subsidies they have to pay it from their taxed net wage).[4] The basic allowance as well as the child allowance are fixed lump-sum amounts per year.[5] The allowances are already included in the percentage of the gross wage that people are supposed to contribute. This means that if a saver has several children, and if his/her gross wage is low, the allowances will make up for a great part of the total contribution. Especially parents with low income have therefore to contribute only a small amount from own resources (see Viebrok et al. 2004: 131ff.).

Later, the savers can claim in their annual tax assessment that the contributions made to an eligible personal or occupational pension plan be deducted from their taxable income. They thus get a tax rebate for their contributions. Because of the progressive income tax, the tax rebate for persons with high income may be higher than the allowance they have received in the first place. If this is the case, the tax authority does not refund the whole tax rebate, but only the difference between the tax rebate and the allowance. This means in fact that the tax authorities take back the allowance from people with high earnings. At the end of the day, the allowances make no difference for high-earners whose tax rebate amounts to more than the allowances. Only those people whose tax rebate is smaller than the allowances profit from the redistributive effect of the allowances. For high earners, whose tax rebate amounts to more than the allowance, the system is nothing more than an application of the principle of deferred taxation, since the benefits that result from Riester-subsidized private pension provision are fully subject to taxation.

Some commentators do not consider deferred taxation a subsidy, but just a principle of taxation. Savers profit from it only to the extend to which their general income is lower during the benefit phase than during the contribution phase, due to the progressive taxation rate. According to this interpretation, the Riester-subsidy consists only of the allowances, not of the tax rebate. The combination of an element of tax financed redistribution (the allowances) and of the deferred taxation principle in the system of Riester-subsidy is a tricky means to direct the allowances to low-earners and to parents, without having to employ means-testing.

The 'Eichel-subsidy'

A second type of subsidy is called the 'Eichel-subsidy' after the former Minister of Finance, Hans Eichel. It can be claimed for contributions that are paid into a fully funded occupational pension scheme. In Germany, contributions to occupational pensions are always paid by the employer, but the expenses can be covered in two ways. Either the employer offers to contribute to occupational pensions in addition to the individual salary – this is the classical form of occupational pensions. Such expenses are a kind of remuneration in addition to the cash wage. Or the employee agrees to give up the right to receive a part of his/her wage, and the employer in return agrees to use this part of the wage to provide for a pension payment. This way of financing occupational pensions is called salary sacrifice (*Entgeltumwandlung*). In many pension plans, both ways of financing contributions are combined. Whatever the source of financing, contributions to a fully funded occupational pension scheme up to a certain ceiling are exempt from taxation.[6] In the case of salary sacrifice the contributed amount is deducted from the taxable gross wage. It is therefore called '*gross salary sacrifice*'.

In addition to the exemption from taxation, contributions to occupational pensions financed by salary sacrifice are exempt from social insurance contributions.[7] The benefit payments that eventually result from such Eichel-subsidized pension provision are fully liable to taxation. Insofar, in analogy to the Riester-subsidy, it is disputable if the tax exemption part of the Eichel-subsidy is a full fledged subsidy. The government calls it a subsidy, but some people say it is just deferred taxation. From the latter point of view, the Eichel-subsidy consists only of the exemption of contributions from social insurance contributions.

## Blurring, part one: Emergence of a new twin-pillar

### *The institutionalization of personal pensions*

Before the 'Riester-subsidy' was introduced in 2001, there was no institutionalized distinction between non-earmarked personal saving and personal pensions. Of course, many people have already saved and transferred income from working life to the retirement phase, mainly by means of life insurance, investment in real estate, and investment in stocks and funds. For some of these forms of personal saving (e.g. life insurance) tax deductions or allowances could be claimed. Yet, most of these saving products were non-earmarked: They are not necessarily used to provide a source of income until the end of life. The German annuity market has therefore been quite small.

Then in 2001, the government's decision to subsidize contributions to personal pensions entailed the necessity to introduce such a distinction, since the government did not want any kind of personal savings to be eligible for the subsidy. In order to draw the distinction, the government defined a set of requirements, outlined in a specific act that was introduced as a part of the pension reform of 2001 and modified and amended in 2004. Personal pension plans are only eligible for the Riester-subsidy if they fulfil these requirements. The financial service companies have to present their provision plans to the Federal Financial Supervisory Authority, which checks if a contract meets the requirements and, if it does, awards a certificate. The new regulation provides that the Riester-subsidy can only be applied to contributions to personal pension plans that

- do not allow benefit payment before benefits of the statutory pension insurance scheme are paid or before the age of 60,
- provide that the benefits are calculated regardless of the sex of the saver (unisex contracts),
- guarantee that at least the sum of the paid contributions (its nominal value) is available at the end of the contribution phase to be converted into an annuity,
- allow no more than 30 per cent of the accumulated capital to be paid in a lump-sum,
- result in a continuous, monthly, constant or increasing benefit payment until death (benefit payment can take the form of either a lifelong annuity or a capital drawdown plan up to the age of 85 and a subsequent annuity for the remaining life time),
- are protected against ceding and seizure,
- provide for the possibility to interrupt contribution payment, to cancel the contract or to transfer it to another supplier.

In addition, the acquisition and marketing costs have to be paid off over a period of at least ten years in equal annual amounts.[8]

The introduction of the requirements for certification institutionalized the distinction between non-earmarked personal saving and earmarked personal pensions. Subsidies can now only be drawn on certified provision plans, the existing tax privileges for non-earmarked saving and insurance plans have been cut and presumably will be completely abolished in the future. As a consequence, a market for certified personal pension products has emerged that is distinct from the market segments for uncertified products for personal pension provision and personal savings.

Obviously, the financial service industry would have preferred subsidies for already existing products for pension provision and savings, without any certification. The list of requirements for certification was therefore one of the most disputed parts of the pension reform 2001, especially the requirement that, in order to be certified, provision plans must provide for a benefit payment in form of either a lifelong annuity or a capital drawdown plan to the age of 85 and a subsequent annuity for the remainder of the beneficiary's lifetime. The government considers this requirement an important instrument for securing a steady pension income until the end of life, and ultimately to prevent poverty in old age. It has a strong effect towards the emergence of a distinct market segment for certified provision products, because of all the savings products that existed before the pension reform of 2001 only private pension plans offered a lifelong annuity in the benefit phase – and the market for private pension plans was rather small.

*Individualized occupational pensions*

Historically, contributions to occupational pensions were paid for exclusively by the employer, as a fringe benefit in addition to the individual's wages. The employers were free to offer occupational pensions, and if an employer chose to do so, he/she normally covered the expenses for the contributions. Such pension arrangements usually were defined-benefit plans, based on the last wage or on average lifetime earnings. This is the classical form of occupational pension.

In the 1980s salary sacrifice appeared as a way of financing contributions to occupational pensions. For some years it was controversially discussed whether pension provision by means of salary sacrifice was to be regarded as personal pension provision or as occupational pension provision. In 1990, the Federal Labour Court ruled that entitlements to pension payments that result from salary sacrifice have indeed the legal status of occupational pensions (Steinmeyer 1992). From the 1990s on, salary sacrifice has become widespread. In 2001, the provision plans in 53 per cent of all companies with occupational pensions were financed exclusively or partly by the employees (see table 4).

[Table 4 about here]

The boom of occupational pensions in the wake of the reform of 2001 was mainly due to the expansion of provision plans that were financed jointly by the employer and the employee. In contrast, the classical company pension (exclusively funded by the employer in addition to the individual wage) is on the retreat. The proportion of companies with this way of funding the contributions has declined from 54 per cent to 38 per cent. Most of the occupational pensions that have been taken up since 2001 are partly or exclusively financed by Eichel-subsidized salary sacrifice.

The rise of occupational pensions on the basis of salary sacrifice is mainly due to two features of the pension reform of 2001. First, the employees are now entitled to demand that their employer give them the possibility to sacrifice salary.[9] Second, the reform act includes a clause that allows the sacrifice of collectively bargained wages only if this is agreed upon by the social partners. The government has included this clause in the reform act with the intention of stimulating the employer associations and the trade unions of the various economic sectors to negotiate favourable pension arrangements. And indeed, as soon as the reform was passed, the social partners of many economic sectors negotiated about and agreed on new forms of occupational pensions.

As a part of the Eichel-subsidy, sacrificed salary is exempt from social security contributions. Since in Germany social security contributions amount to around 40 per cent of the gross wage and are paid in equal parts by employers and employees, both save approximately 20 per cent of the sacrificed salary. For the employers, the prospect of saving social security contributions is therefore an incentive to offer access to occupational pensions and to motivate the employees to sacrifice salary. Some of the new collective bargaining agreements on occupational pensions provide that the employer passes on a part of his/her savings to the employee in the form of employer contributions to a provision plan. The employer can thus contribute up to around 20 per cent of the total contribution without having additional costs. As these employer contributions are only made if the employees sacrifice salary, they have the character of an incentive, in contrast to the full-fledged employer contributions in classical occupational pensions.

Moreover, the increase of salary sacrifice represents a *development away from defined-benefit plans*, a tendency that can be observed in many countries with occupational pensions (Döring 2002). In Germany, weaker variants of the defined-benefit principle were introduced in two steps. In 1999, the government allowed occupational pensions to take the form of so-called *contribution-oriented defined-benefit plans*. In these plans, the guaranteed benefits depend on the contributions that the employer agrees to pay, similar to the principle of life insurance policies. Then in 2001, the government introduced the so-called *defined-contribution plan with a minimum benefit*. This means that the employer agrees to pay contributions, and guarantees that at the end of the contribution phase at least the sum of the contributions is available. From a legal perspective, the defined-contribution plan with a minimum benefit is therefore still nearer to a defined-benefit plan than to a defined-contribution plan (Langohr-Plato and Teslau 2003).[10]

In short, since the 1990s, the public policy of occupational pensions has led to a functional differentiation within occupational pensions (figure 1). On the one hand, there is the classical company pension with employer-sponsored defined-benefit plans, which are obviously on the decline. This type of plan will certainly continue to exist as an instrument of companies' human resource management regarding the recruitment of highly desirable employees, and as an instrument of operative cash flow management and internal financing of the company. On the other hand, occupational pensions that are financed either exclusively or partly by salary sacrifice are booming. Most of these new plans are defined-contribution plans with a minimum benefit, which means that the employees carry not all but a good deal of the risk of low returns. If the employers contribute as well, their contributions have a different character than the employer contributions to classical company plans, serving as an employee salary sacrifice incentive, in addition to the incentives provided by the state (Eichel-subsidy).

[Figure 1 about here]

*A new twin pillar of subsidized individualized 'private' pensions*

The pension reform of 2001 entailed a double process of differentiation. Within the institutional structure of occupational pensions, the classical company pension is becoming distinct from a new individualized occupational pension (process of differentiation 1 in figure 2). At the same time, certified and Riester-subsidized personal pensions are now distinct from non-earmarked personal saving and uncertified personal pensions (process of differentiation 2 in figure 2).

[Figure 2 about here]

The differences in legal and organisational terms between occupational pensions by means of salary sacrifice, on the one hand, and subsidized personal pensions, on the other hand, are still considerable. Regarding their legal and organisational framework, the new forms of occupational pensions are still closer to the classical company pension than to certified personal pensions. Nonetheless, the two subsidized forms of pensions approach each other in several respects. First, in the case of subsidized personal pensions, the degree of protection of the saver against the providing company, and the individual rights of the saver have been increased in comparison to uncertified personal savings by the certification requirements. On the other hand, the move away from defined-benefit plans means that there are more individual risks linked to occupational pensions. Second, the costs of subsidized occupational pensions are to a great extent covered by the individual savers (and, in form of the subsidies, by the state), similar to subsidized personal pensions. Third, due to the spread of contribution-oriented occupational pensions, employees bear more of the risk of low investment returns – just as is the case in personal pensions. Fourth, employees who sacrifice salary have more choices to make and have become a new target group for financial advisors and the selling agents. As a consequence, consumer protection has become a new issue in the field of occupational pensions (Verbraucherzentrale Bundesverband 2005). All in all, the two subsidized forms of pension provision have become similar (although they do not merge) and constitute *a new twin pillar* in the institutional landscape of old-age security.

## Blurring, part two: A hybrid mode of pension provision

The last section has shown that, in the case of occupational pensions, the German government has created a complex arrangement of incentives, in which salary sacrifice can be favourable for employees as well as for employers. At the same time, it has introduced a legal requirement that makes the sacrifice of wages negotiated by collective bargaining dependent on collective bargaining agreements. It has thus stimulated (some would say: forced) the social partners of the various economic sectors to negotiate conditions of occupational pensions. In most economic sectors the social partners have actually done so. On the basis of such agreements employers often supplement the employees' salary sacrifice, and still save money or at least have no additional expenses. This example demonstrates that the new twins - subsidized and individualized pensions - consist of mixes on several dimensions:

- A *mix of governance modes*: The governance structure of the schemes is characterized by an interplay of state intervention (law-making), hierarchical command and control (within administrative bodies), corporatist negotiation (collective bargaining), and market mechanisms. Accordingly, there is political, corporatist, as well as individual decision-making involved.
- An *administrative mix*: On the whole the new twin pillars are based on a combination of public administration (concerning e.g. the distribution of subsidies, or the certification of eligible pension plans), private administration of provision plans, and private management of funds.
- A *mix of financial resources*: The subsidies are tax-financed, private contributions can either come from the employer (in the case of employer contributions to occupational pensions), or from the individual saver.
- A *mix of goals*: Through the various reforms since 2001, the government, has tried to set up an institutional arrangement that reconciles public policy goals (social policy as well as financial market policy) with the internal business strategy of the companies (e.g. human resource management and internal finance strategy) as well as with the profit-seeking goals of the providers of private pensions.

In order to characterize such pension schemes, one obviously has to go beyond the conventional categories. Rather than being either public or private, state or market, corporate or individual, they represent a *hybrid sphere of pension provision*.

## Conclusion: Going beyond 'public' and 'private'

In the preceding sections I have described the blurring of two distinctions in German old-age security, both as a consequence of recent pension reforms. First, individualized occupational pension schemes, which are based on salary sacrifice, subsidized by the state, and supplemented by the employer, have in many respects become similar to certified and subsidized personal pensions. Second, public policy and its typical instruments of intervention, on the one hand, and what is conventionally called 'private' pensions, on the other hand, have become deeply interwoven. Such public policy regarding what is conventionally called private pensions constitutes *hybrid pension schemes*.

In general, purely public affairs and purely private affairs have become rare in modern welfare states, and hybrid forms of welfare production are playing an increasingly important role. Most issues of social life are neither 'public' nor 'private', but have 'private' *as well as* 'public' aspects (Kaufmann 1991). Forcing them into one of these two categories for the sake of classification inevitably disregards and undervalues their complexity. In addition, from a sociological point of view, 'public' and 'private' are socially constructed categories, emanating from liberal political thinking. Liberalism tends to divide the world into these two categories, even if many aspects of social life are difficult to assign to one of the two poles (Benn and Gaus 1983). Whether a particular pension scheme is predominantly public or private is *a political debate*. Categorizing a pension scheme as 'public' or 'private' relates the scheme to particular norms and expectations, e.g. about how much control and influence the government is presumed to have. Since this is an issue of political conflict, it should not be made a concern of scientific definition and classification. It has, however, become common to refer to occupational and/or personal pensions as 'private' pensions, in political as well as in scientific language. Social scientists tend to take the conventional classification of some pension schemes as 'private' and other schemes as 'public' for granted. But there is no point in social scientists arguing that employer or employee funding or voluntary participation is to be regarded as 'private', and pay-as-you-go or compulsory plans as 'public', and, consequently, that a particular pension scheme is to be categorized as 'public' or 'private'.

As the above analysis has shown, the categories of 'public' and 'private' are not adequate to describe and categorize a major part of the institutional scenery of old-age security. For a thorough understanding of pension provision, we should therefore break with the simplistic idea that each pension scheme belongs to either the public or private sphere (International Social Security Association 2004).[11] The older concept of 'welfare mix' indicates that, on the institutional level, a multitude of schemes with different characteristics co-exist and provide benefit payments which, on the individual level, form an income mix in old age. However 'welfare mix' is a concept that can not grasp the essence of new hybrid forms of pension provision. The idea of a *public policy of hybrid pensions* is an attempt to go beyond the distinction between public and private.

## Notes

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1. The Federal Insurance Agency must not to be confused with the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*). The former supervises the administrative bodies of the social security system, the latter supervises the banking, investment, and insurance sectors.
2. Contrary to the newly introduced pension funds, pension insurance funds have the same legal status as insurance companies and are thus submitted to the same regulation and supervision as insurance companies.
3. It has since risen to 19.5 per cent.
4. In fact, 4 per cent of the gross wage is the target contribution for 2008. The recommended contribution rate rises in four steps. When the reform came into effect in 2002, it was recommended that from 2002 on, people spend 1 per cent of their gross wage of the preceding year. In 2004, this recommended rate rose to 2 per cent, in 2006 to 3 per cent and in 2008 it will reach the final level of 4 per cent. Individuals investing these proportions of their wages in eligible private pensions are entitled to the full subsidies. If a saver invests less than the recommended rates, he/she will, on a pro-rata-basis, get lower subsidies. If he/she invests more, only the officially recommended amount will be subsidized.
5. The maximum amount of the allowances rises in four steps from 2002 to 2008, parallel to the rise of recommended contributions (see note four). The basic allowance amounts to Euro 38

per year (in 2002), rising up to Euro 154 (in 2008), and the additional allowance for each child amounts to Euro 46 per year (in 2002), rising up to Euro 185 (in 2008).

6. The ceiling is defined as 4 per cent of the income limit for assessment of contribution to the statutory pension insurance (this amounts to 2,520 Euro in 2006).
7. Since the exemption from social security contributions deprives the social security system of badly needed resources, the regulation will be restricted until 2008: from 2009 on, sacrificed salary will be liable to social security contributions, just as any salary is.
8. In the German insurance sector, it is common to use front-end loads to cover the acquisition and marketing costs. The contributions paid during the first years are used to pay off these fees and costs, only then does the accumulation of capital begin. From the perspective of consumer protection, this practice is dubious: If a saver cancels his/her contract within the first few years, he/she will get nothing or very little payback because no capital stock has been accumulated yet. Extending the paying off of the costs diminishes the financial loss in case of early cancellation.
9. This regulation is not compulsory: If in a company no employee wants to sacrifice salary for pension provision, the employer doesn't have to introduce pension provision schemes.
10. The next step in this development would be to introduce full-fledged defined contribution plans. This step is currently being discussed, but the debate is controversial (Steinmeyer 2005).
11. However, the distinction between 'public' and 'private' is quite predominant in the human rationalization of the world: "We apprehend a great deal of our social world by distinguishing things that are public and things that are private" (Benn and Gaus 1983: 6). It may therefore prove difficult to overcome the concepts behind the terminology. Even attributions like 'hybrid' or 'welfare mix' cling to the distinction between 'public' and 'private'.

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Table 1

Variables and their values commonly used to describe pension schemes

| variables | values | |
|---|---|---|
| | value column 1 ('public') | value column 2 ('private') |
| legal basis of the administration | *public law* | private law |
| way of organising the cash flow | *pay-as-you-go** | funding |
| function in the mix of schemes | *basic protection* | supplementary topping-up |
| mode of participation | *compulsory* | voluntary |
| principle of benefit calculation | *formula designed by political decision* | actuarial standards |
| institutional social goal | prevention of poverty | *maintenance of the living standard* |
| relation of benefits to former income | none (flat-rate) | *income-related* |
| financing mode | *general tax* | *contributions (payroll tax)* |
| coverage | universal | *particular group* |
| social scope | *collective* | individual |
| significance of rate of return | defined-benefit | defined-contribution |

* features of the statutory pension insurance (the most important 'public' scheme in Germany) are put in italics

Table 2

Importance of different pension schemes

| Pension Scheme | Percentage of the old (65+) with income from the scheme | Benefits as percentage of the sum of benefits from all six schemes* |
|---|---|---|
| Statutory pension insurance | 95 | 76 |
| Provision for civil servants | 7 | 12 |
| Pension scheme for farmers | 4 | 2 |
| Pension schemes for self-employed professionals | 1 | 1 |
| Occupational provision in the private sector | 15 | 6 |
| Supplementary provision in the public sector | 9 | 3 |
|  | **Σ 131 | 100 |

Source: Bundesregierung 2001

* Old Länder only. In the new Länder, the benefits of the statutory pension insurance amounts to 99 per cent of the benefits from all six schemes. I.e. in the five new Länder the statutory pension insurance exclusively provides income for almost the entire retired population.

**The sum of 131 indicates that on average each person 65 or more years of age receives income from 1.31 of these schemes.

Table 3

Recent German pension reforms and their effect on the replacement rate

| | Impact: projected replacement rate in 2030 |
|---|---|
| Before 2001 | 70.0% |
| Pension reform of 2001 | 64.0% |
| Pension reform 2004 (pension insurance sustainability act) | 58.5% |

Data for projected replacement rate: Hain et al. 2004

Table 4

Financing occupational pensions in Germany

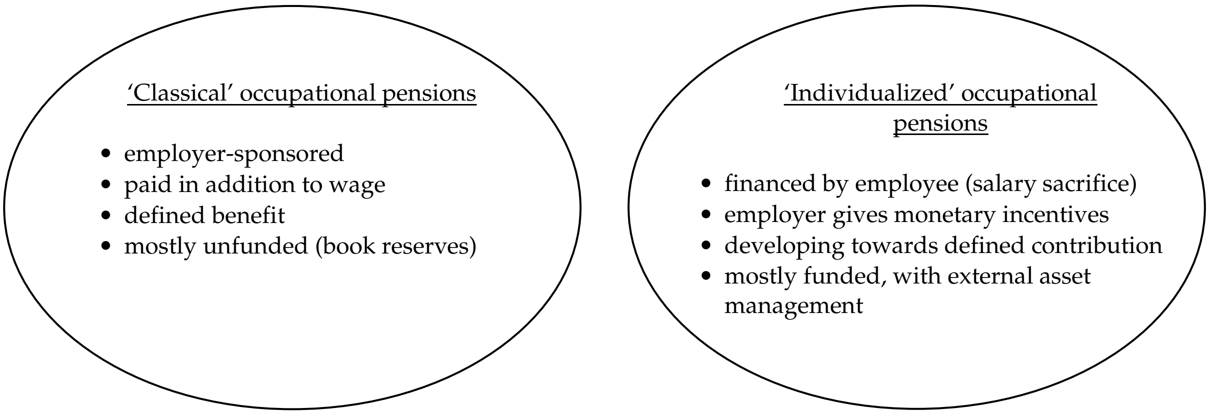
| | Companies using source of finance (in %) | |
|---|---|---|
| Source of finance | Dec 2001 | June 2004 |
| Employee only (salary sacrifice) | 26 | 29 |
| Employer only (classical occupational pensions) | 54 | 38 |
| Employee and employer combined | 27 | 41 |
| Total | 107 | 110 |

Source: Kortmann and Haghiri 2005: 72

Random sample of 20,000 companies with at least one employee. Total exceeds 100 because some companies use more than one financing mode (e.g. for different groups of employees).

Figure 1

Occupational pensions in Germany – classical and new variety



'Classical' occupational pensions

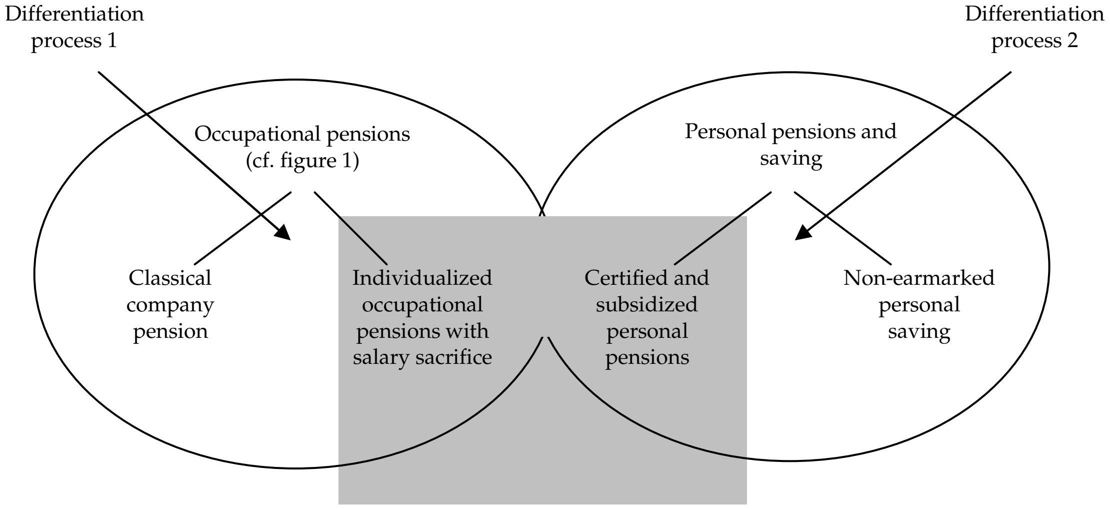
- employer-sponsored
- paid in addition to wage
- defined benefit
- mostly unfunded (book reserves)

'Individualized' occupational pensions

- financed by employee (salary sacrifice)
- employer gives monetary incentives
- developing towards defined contribution
- mostly funded, with external asset management

Figure 2

The new (twin) pillar in German old age security (since 2002)



Differentiation process 1
Differentiation process 2
Occupational pensions (cf. figure 1)
Personal pensions and saving
Classical company pension
Individualized occupational pensions with salary sacrifice
Certified and subsidized personal pensions
Non-earmarked personal saving

The new twin pillar of hybrid pensions