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Bismarckian pension systems and their reform

What role has path dependence played?

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Introduction

European pension systems, particularly those of Bismarckian character, have traditionally been very static and reform-resistant, even though they have been faced with serious problems threatening the long-term sustainability of these schemes. The demographic and economic changes that have taken place over the past few decades have put considerable pressure on pension funds. These problems were initially tackled through contribution increases and moderate benefit cuts in the 1970s and 1980s. More fundamental reforms did not happen. As a result, public budgets were increasingly strained as governments had to make up for pension deficits and workers and employers had to pay ever higher old-age insurance contributions, raising the costs of labor and thereby diminishing their competitiveness.

The development of Bismarckian pension systems in these days has often been analyzed through institutionalist approaches. Especially the concept of path dependence has often been used to explain the inertia of pension policies. The feedback mechanisms at the heart of path dependent processes were said to be responsible for the relatively stable reproduction of pension regimes. However, the 1990s and 2000s saw more far-reaching reforms. Many Bismarckian countries introduced supplementary private pension schemes, partially shifted from contribution to tax financing etc. These changes call into question the utility of the concept of path dependence for analyzing pension politics, since path dependence was originally conceived to explain institutional continuity rather than institutional change. However, several authors have proposed more open versions of path dependence that reject the notion of a strict dichotomy between periods of static institutional reproduction and those characterized by contingent, non-predictable innovation. These concepts have been used to explain recent pension reforms.

The main question this paper intends to answer is whether the changes that have taken place in the past two decades can be interpreted as path dependent. In order to answer this question, it is necessary to first identify the ways in which path dependence has influenced pension politics in the past. What are the mechanisms that have sustained pension arrangements? And in how far do they persist? After answering the question of whether the reforms constitute path dependent adjustment or path

departure, I will try to find out what utility the path dependence concept has for explaining these changes and institutional change more generally.

I will argue that until the late 1980s, pension politics in Bismarckian welfare states have indeed been highly path dependent. The reforms that occurred during the 1990s and 2000s, however, amount to path departure. More open concepts of path dependence can have some utility in elucidating the ways in which change actually takes place, but they cannot explain why these changes happened and why the reforms have been more radical in some countries than in others.

The paper is structured as follows: First, I will provide a more general background of the issue by presenting the most common features of Bismarckian pension systems and the challenges they face. I will then illustrate the historical evolution of the Bismarckian pension systems in Europe from their emergence in the late 19th and early 20th century to their current transformation. A case study on the evolution of Germany's old-age insurance model, which is a typical case in many respects, will provide some more detailed insights into how these pension systems actually changed. In the ensuing chapter, the concept of path dependence will be explained briefly. Thereafter, the concept will be applied to the case of Bismarckian pension systems and their reform. Finally, a conclusion will sum up the results.

What is a Bismarckian pension system?

There are various ways of classifying pension systems. The most common classification distinguishes between two types of pension regimes: Bismarckian and Beveridgean regimes. Bismarckian pension systems share the basic features of the pension scheme introduced by German Chancellor Otto von Bismarck in 1989. The main goal of this system is income/status maintenance after retirement (Natali and Rhodes 2004: 2). Benefits are therefore related to the level of a person's earnings during her professional life and her contribution record. Another defining characteristic of Bismarckian pension systems is the way in which pension expenditures are financed. In this so-called pay-as-you-go (PAYGO) system, the compulsory contributions of workers and employers are not capitalized for their own retirement, but paid into a pension fund, out of which the benefits of current pensioners are paid. The management of the pension schemes is often of corporatist nature, which means that both the state and the social partners are involved in the administration of pen-

sion schemes: “[T]here is a mix of responsibilities between the state and organized interests: the state has a supervisory role (especially regarding the system’s financial viability) while many decisions are negotiated with trade unions and employers’ organizations.” (Natali and Rhodes 2004: 2) In addition, Bismarckian pension systems are usually organized on the basis of occupational categories, with different insurance schemes for each category in terms of benefits, contributions, retirement age etc. (Rhodes and Natali 2003: 4).

Beveridgean pension systems, on the other hand, are thus called in reference to William Beveridge, a British social reformer whose ideas greatly influenced the design of the British welfare state and corresponded with those underlying other (European) social insurance systems. The focus of Beveridgean welfare states is on poverty alleviation through flat-rate, targeted benefits, which are generally funded through taxes, not contributions.

There are more fine-grained classifications of European pension systems, but in my opinion, these two ideal types capture the essential difference between European pension systems in terms of their objectives and institutional design. While the countries in continental Europe are mostly characterized by Bismarckian pension regimes, the Nordic countries, the UK and Ireland adhere to the Beveridgean model (Bonoli 2000: 11).

There are a number of different classifications of pension systems and welfare regimes more generally. Most importantly, Gøsta Esping-Andersen, in his seminal work “The Three Worlds of Welfare Capitalism” distinguishes between a conservative-corporatist, a social democratic and a liberal welfare state model (Esping-Andersen 1996a). The conservative-corporatist model predominates in Continental Europe and largely corresponds with the Bismarckian model described above. It is based on the idea of status maintenance and therefore involves little redistribution. Social democratic social protection systems are mostly found in the Scandinavian countries and are characterized by comprehensive and universal coverage, mostly financed through taxes. They are based on the principles of universalism and decommodification and are supposed to guarantee a high degree of equality in living standards and social rights. Liberal welfare states, on the other hand, exist mainly in Great Britain and Ireland and they provide limited benefits only to the most needy

parts of the population, while the more affluent classes recur to individual, private insurance and provision for old age.

Most conservative-corporatist welfare states can be found in Continental Europe. According to Palier (2007b: 4), Germany, Austria, France, Netherlands, Luxembourg, Italy, Spain, Belgium, Hungary and the Czech Republic have developed this type of social security arrangement.

The problems facing these countries (as well as other countries, although to a lesser extent) are similar and so have been the solutions adapted. These challenges have generated considerable pressures for reform. I will present the most important ones in what follows. First of all, a demographic transition is taking place (not only) in Europe, which leads to a rapidly ageing population. European women get less and less children. In a number of West European countries, fertility has reached levels around 1.3, significantly below the replacement rate of 2.1. At the same time, mortality decreases, which means that Europeans are getting older and older. While this is not a bad thing per se, it means that the number of old people is steadily increasing, while the number of young people is declining due to lower fertility. Thus, the ratio of old to young people is shifting in favor of the former.

Increases in overall employment, generated mostly through the incorporation of formerly inactive persons – in many cases women - into the workforce have alleviated the pressures generated by the growing numbers of pensioners in the past. However, this effect has its limits, as employment cannot be assumed to rise indefinitely and certainly not at the rate that would be necessary to offset the increase in elderly people. In addition, the incorporation of formerly inactive people into the workforce can only be a short-term solution, since in the long run it has the negative consequence of creating pension entitlements for these newly activated persons, which will further increase the pressures on the pension system (Disney 2003: 1428).

Pension systems based on the Pay-as-you-go (PAYGO) principle are particularly vulnerable to population ageing. The PAYGO principle in old age insurance means that the benefits paid to current pensioners are paid through the contributions of current workers. In contrast, in a funded system workers accumulate savings for themselves which are paid out when they are retired. As old age insurance contributions

are basically determined by the ratio of retirees to contributors, contributions need to rise when the number of workers per retiree is falling. PAYGO (or Bismarckian) pension systems are therefore very vulnerable to demographic changes. In the current situation, the number of retirees is increasing rapidly, while the number of workers is stagnating or even decreasing in many European countries, which means that either the pension contributions need to rise or the benefits have to be cut. While there are currently four working-age people per retiree, this ratio is projected to drop to only two to one by the year 2050 (European Commission 2007: 61). As a consequence, the burden on the productive population becomes heavier. Workers (and employers) have to pay higher taxes and social security contributions, making them less productive and competitive on the world market.

As work gets more and more expensive through ever higher old age, health and other social security contributions, West European workers are increasingly replaced by machines or their jobs are transferred to other countries, where wages are lower. High and growing pension contributions therefore partly explain the high unemployment rates in European, particularly Bismarckian, countries. However, the relation is bidirectional, because the high unemployment rates themselves further aggravate the problems of pension systems in a similar way as the demographic changes do. On the one hand, unemployment lowers the number of people paying into the pension funds. On the other hand, the number of retirees rises, as a common response to high unemployment rates has been the extension of early retirement programs.

Rhodes and Natali put it this way: "the increase of unemployment figures since the 1970s, as well as lower economic growth, the rise in inflation, and a slower increase in wages have all contributed to financial strains on pensions. But the same variables are often argued to be the effect rather than the cause of the burden of social protection systems in Europe. Thus, these factors are both pressures on the sustainability of current pension programmes and possible consequences of their impact on the economic competitiveness of the countries under analysis." (Rhodes and Natali 2003: 5) The problems of high pension contributions and high unemployment therefore seem to be mutually reinforcing, resulting in a kind of vicious circle. But high unemployment is not the only characteristic of European labor markets that has a negative impact on pension systems. Lower levels of productivity and wage growth

are another factor affecting pensions. As the level of contributions depends on the wage level, in a situation in which governments try to contain or even reverse increases in contribution rates, the overall revenue raised by pension funds could only be increased through growing wages. However, productivity and wage growth rates are much lower now than they were in the 1950s and 1960s in most western European countries (Rhodes and Natali 2003: 8).

Another effect of the troubles that pension systems have gone through has been problems for public finance. Many governments have had to make up for deficits in public pension systems, often at the expense of incurring large budget deficits themselves. For example, the German government has had to subsidize pensions with about 40 percent of its budget over the past few years.

It seems that Bismarckian welfare states have far greater problems in coping with these challenges and at the same time are more difficult to reform than other types of welfare regimes. As Martin Hering states, there is a "collision between socioeconomic pressures and political obstacles" (Hering 2003: 4). This collision is stronger in Bismarckian welfare states because, on the one hand, they face more severe pressures due to the way their welfare schemes are financed (see above) and, on the other hand, they are confronted with stronger opposition, since the contribution model leads to a "highly legitimate nature of the claim structure" (Palier 2007b: 12), i.e. people feel entitled to a complete pension, because they pay or have paid directly into a fund that is supposed to guarantee them a standard of living comparable to that of current retirees once they are retired themselves.

Emergence and evolution of Bismarckian pension systems

Since their establishment in the late 19th and early 20th century, Bismarckian pension have undergone many changes, so they look very different today from what they looked like at the time of their establishment. In this chapter, the most important developments of Bismarckian pension systems shall be described.

Origins and early developments

As mentioned above, the labeling of pension systems or welfare regimes more generally as "Bismarckian" goes back to Otto von Bismarck, who as Chancellor of the German Empire introduced a number of social insurance mechanisms in the 1880s. The welfare institutions he created were the first of their kind, although their magni-

tude was low measured by today's standards. The level of assistance was low and the insurance schemes initially covered only parts of the population, mainly industrial workers.

The three institutions that were created by Bismarck and that laid the foundations of the German welfare state were health insurance (1883), accident insurance (1884) and old-age and invalidity insurance (1889). The latter, according to Tampke (1981: 80), was the least popular among the three, because the conditions were very distinct from those of today's pension schemes. In order to qualify for a full pension, a worker had to have worked 48 years (of 300 working days each) from his 18 years on. As life expectancy was considerably lower in these days, few actually got to enjoy their pension. Old-age insurance as well as health and accident insurance was compulsory for workers under a certain wage threshold and it was paid in form of contributions from workers and employers that was topped up by a grant from the state. As today, contributions and benefits were earnings-related (Cutler and Johnson 2003: 97).

The idea of social insurance soon spread all over Europe and beyond. Many countries installed their own welfare systems, many of them closely corresponding to the German system, others oriented at different models. Denmark was the first country to follow suit when it installed a universal means-tested pension system in 1891. Other Scandinavian countries and Britain introduced similar institutions as Denmark over the following decades. These countries followed what we would now call a Beveridgean approach to welfare in that the main goal of old-age provision was not income maintenance, but poverty alleviation and benefits were distributed in the form of a universal flat-rate or means-tested assistance for the most needy. Most countries on the European continent adopted the Bismarckian old-age insurance model between the two World Wars (Italy and Spain in 1919, Belgium in 1924, Austria in 1928, France in 1930 and Portugal in 1935; Cutler and Johnson 2003). As in the case of Germany, old-age insurance schemes in these countries were based on contributions and were mostly compulsory for certain groups of the population (particularly workers under a certain income threshold) while excluding others, such as white-collar workers or farmers.

The pension schemes were extended to previously excluded groups over the following decades. While Germany included white-collar workers in 1911 and quickly

reached a relatively broad coverage of the population, the most significant extension of Bismarckian pension systems in Europe occurred in the years following the Second World War. For example, France extended its old-age insurance to farmers and white-collar workers in 1946 and Italy included self-employed and farmers between 1957 and 1961.

In addition, pension benefits were greatly increased as the general prosperity was increasing in the post-war decades. While pensions had previously often been too low to cover a person's livelihood, they were now raised in order to work as an income substitute. Old-age insurance was initially based on funded schemes in many Bismarckian welfare states (Werding 2003). However, as economic crises and wars largely devaluated pension reserves and the standard of living increased greatly in the 1950s and 1960s, governments decided to switch to pay-as-you-go financing, so that pensioners could benefit from the economic upswing.

This "generational compact" had some obvious social and political advantages when it was set up or extended in the post-war years in many Continental European countries. It allowed elderly people, who had often lost everything during the war, to maintain a relatively high standard of living when they retired. In addition, the economic and demographic conditions were much more favorable in these days: virtually full employment, increasing rates of participation in the labor market, productivity increases, few pensioners and relatively high birth rates etc. Therefore, pension systems based on the PAYGO principle appeared to be an attractive and viable option: "This was not only the most sensible option under the socio-economic conditions of the 1950s, but it had the additional political advantage that current retirees could already benefit from the system without having contributed to it. The first generation's gift made this choice attractive in electoral terms." (Haverland 2001: 314) The current economic and demographic problems were simply not anticipated during the installation of pension systems based on the PAYGO principle.

The 1970s and 80s: Welfare state expansion as a reaction to economic problems

The first problems for European welfare systems emerged in the 1970s, when oil price shocks in 1973 and 1979 led to severe economic downturns and increased unemployment significantly. The initial reaction by Continental European governments was to extend the social security system in order to mitigate the effects of

these problems. For example, in order to reduce the pressure on the labor market, early retirement schemes were introduced in order to get older workers off the labor market. The result of the extension of welfare provision was obviously higher costs, which were covered through increases in the contribution rates of the social insurance systems. During the 1970s and 1980s, raising contributions, not cutting benefits, was usually the response of governments to increasing pressures on welfare systems. This was the easiest and politically most viable solution, since in these times the population was more inclined to accept contribution increases than benefit cuts. In addition, the state did not have to bear the costs of the extension of welfare systems, as they were entirely covered by contribution rate increases (Palier 2007a: 13). As a result, the contributions paid by workers and employers rose dramatically both in absolute and relative terms. For example, in France the share of social contributions in overall taxation increased from 39 percent in 1970 to 46 percent in 1995 (Palier 2007a: 13). In Germany, the contribution rate rose from 14 percent in 1960 to 18 percent in 1980 and 20.3 percent in 1998 (Bonoli and Palier 2006). Italy adopted a somewhat different solution. Instead of raising contribution levels, deficits in the pension scheme were compensated through higher transfers from the government.

The 1990s: First Retrenchment Efforts

The 1990s saw the first efforts at retrenching Continental European welfare systems. In the words of Giuliano Bonoli, "[w]elfare retrenchment can be defined as policy changes that result in reductions in the generosity, coverage or quality of social programmes." (Bonoli 2000: 35) More radical reforms than before were needed, since the economic and financial problems resulting from the dysfunctional welfare institutions grew larger. In addition, the recession of the early 1990s and the economic constraints resulting from the establishment of the European Stability and Growth Pact and the newly created European Single Market put additional pressure on governments to act (Palier 2007a: 13). Therefore, the old strategy of simply raising contributions was abandoned and governments all across Europe began to adopt measures aimed at containing expenditures.

The most common elements of the reforms adopted during this period were the following:

- Different measures were employed in order to reduce the number of beneficiaries. For one thing, the reference retirement age was raised in a number of countries. This reduces the number of people entering into retirement and raises the number of contributors. For another thing, governments tried to discourage early retirement by setting financial incentives that reward retirement close to the mandatory retirement age and punish earlier retirement through a reduction of the benefits. In view of these incentives, the elevation of the reference retirement age has the additional financial advantage of lowering the pension claims of persons retiring early, as the reference point for calculating the deduction in pension benefits moves further away.
- Other measures intended to lower pension expenditures by reducing the monetary value of pension entitlements. To this end, a variety of changes has been carried out. Indexation mechanisms, i.e. the way of defining adjustments of pension levels to rising prices or incomes, changed in several countries. For example, the reference criterion for the indexation changed from being gross wages to net wages or inflation. Another way to contain pension expenditures was changing from the principle of "defined benefits" to "defined contributions". While in a defined benefits system the benefits received by pensioners are defined on the basis of their prior earnings, in a defined contribution scheme there is no fixed replacement rate, but the benefits are determined on the basis of a worker's contributions over his professional life and sometimes other factors, such as a country's economic performance (Bonoli 2000: 155). Yet another method of lowering pension levels has been modifying the reference year(s) for the calculation of the pension level. For example, France increased the number of years that are considered for defining pension benefits from 10 to 25. Thus, the benefits are now calculated as a percentage of the average of the best 25 instead of 10 years (Frericks et al 2005: 3).
- Many countries have also initiated changes in the financing mechanism of their pension systems. First efforts of creating and promoting complementary individual pension schemes were made in the 1990s. In addition, measures were adopted that shifted part of the funding of pension schemes from contributions to taxes. For example, a new tax was created in France to cover non-contributary social benefits (Palier 2007a: 15). Similarly, the German government introduced

a so-called “Ökosteuer” on energy in 1999, the proceeds of which have been used to alleviate the deficit in the pension funds.

Although these reforms often involved significant retrenchment, they did not change the character of Bismarckian pension systems. These rather unpopular measures were justified by emphasizing the need to protect the welfare state against unfavourable external conditions: “In the political discourse justifying the reforms one heard that, if reform was necessary, it was not because the system was dysfunctional but because it was suffering the ill-effects of the current situation. (…) These reforms were not made in the name of criticisms of welfare redistribution, but in the name of the crucial necessity to restore their sustainability.” (Palier 2007a: 14) Thus, these reforms were of a consolidating nature. Radical transformations were not on the table. Most authors agree in that the reforms were undertaken in order to save, not dismantle, the established old-age insurance models. For example, Gøsta Esping-Anderson comments that “[a] common characteristic of cutbacks (...) is that they are explicitly meant to safeguard – not destroy – the existing [welfare state] edifice” (Esping-Andersen 1996b: 84).

The 2000s: Fundamental reforms

Soon after the reforms of the 1990s, it became apparent that these limited reforms would not be enough to prevent future imbalances in old-age insurance systems and other welfare institutions. Therefore, more radical reforms were adopted in the 2000s and in some cases already in the 1990s. In addition to further retrenchment, the reform brought some important structural changes. Most importantly, fully-funded complementary pension schemes were set up. In France, two voluntary old-age savings systems (Plan d’épargne retraite populaire – PERP; Plan d’épargne retraite collective – PERCO) were set up through the 2003 reform, which in addition contained a number of retrenchment measures. In Germany, the so-called *Riester-Rente* was established by the Social Democratic government in 2002. In Italy, a fully funded individual pension scheme was introduced in the early 1990s already and was strengthened through subsequent reforms. Although the take-up rates are still rather low in all of the aforementioned countries, governments increasingly rely on individual and occupational pension funds to make up for the reductions in public pensions (Bonoli and Palier 2006: 13). Moreover, as a response to the decreasing

pension and other welfare benefits, a basic safety net was set up in Germany, providing means-tested, flat-rate benefits to the most vulnerable groups.

These changes moved many Bismarckian welfare states closer toward multi-pillar systems like the Netherlands or the UK. But not only the institutional design has changed. What is even more striking is a change in the underlying principles of the policies. While Bismarckian pension and welfare systems were based on the principle of status maintenance from the start, they have now adopted an approach more in line with the liberal welfare model in many respects. Bruno Palier interprets the reforms of Continental European welfare states as a potential “general paradigmatic change (…), evincing a shift away from systems aimed at income and status maintenance towards activated and employment friendly welfare systems.” (Palier 2007a: 16)

Case study: The German reform trajectory

A more detailed depiction of one particular reform trajectory should enable the reader to understand how exactly the evolution of Bismarckian pension systems looked like in the past half century. Such a typical case can then help us identify the specific feedback mechanisms at work and assess whether and at which points in time Bismarckian pension systems have been characterized by path dependence. The case of Germany seems to be a good choice, because it exemplifies many of the trends in pension reform in Bismarckian countries as the changes of the past few decades mirror the developments in many Continental European welfare states. First of all, because it displays many of the features typical of these systems: PAYGO financing, corporatist structures and strong unions etc. Furthermore, the challenges that Germany has been facing are also very typical: high unemployment, rising life expectancy, very low fertility rates and political pressures for budgetary discipline resulting from the Stability and Growth Pact. Therefore, Natali and Rhodes have called Germany an "example *par excellence* of 'Bismarckian disease'" (Natali and Rhodes 2004: 13) at the beginning of the 1990s. Finally, the reforms that have been adopted include a wide range of the measures adopted in Bismarckian pension systems, e.g. the introduction of a fully funded private pension pillar or the partial substitution of tax financing for contribution financing. Therefore, I think that Germany is a very typical case in many regards. In what follows, the most important elements of German pension politics from the 1950s on will be presented briefly.

The first large pension reform after the Second World War was carried out in 1957. This reform deeply changed the foundations of the German old-age insurance system and defined the path that Germany would follow for several decades. The motivation for the reform was the precarious position of pensioners in these days, which contrasted starkly with the increasing prosperity of the working population. Pension levels had traditionally been rather low and resulted in poverty or dependency on the family. Pensions had been intended to be merely a supplement to the costs of living for elderly people. In addition, the amount of benefits received usually was not adjusted for inflation, so pensions often lost value rapidly. On the other hand, Germany was developing quickly in the post-war years and this so-called "economic miracle" meant higher standards of living for (almost) everyone in a period of full employment, rapid growth and rising wages. The reform was therefore supposed to give pensioners a stake in the general economic upswing (Schmähl 2007: 6). But the reform, which led to a substantial increase in pension benefits, was also motivated by political interests. It was part of a series of electoral presents, which secured the CDU an absolute majority in the parliamentary elections of 1957, the year in which the pension reform was adopted. Although the credit was mainly given to the CDU, the reform was worked out and adopted in parliament by both the CDU and the oppositional SPD. This was the beginning of a consensual style of policy making that should define pension politics until the 1990s (Hinrichs 2003: 6).

The most important elements of the reform were the "dynamization" of pension levels and the switch to PAYGO financing. The level of pensions had been static since the creation of old-age insurance in 1989. The amount of old-age payments was determined at the time of entry into retirement and was usually not adjusted for increases in prices. Pensions were composed of a flat-rate, tax financed element and a top-up payment based on past level of nominal income. The 1957 reform abolished the flat-rate basic pension element and greatly extended the level of the top-up payments. These would no longer be based on the nominal wage level of a worker, but on his or her wage level in relation to the average. In addition, a factor adjusting for increases in the general gross wage was included in the pension formula, so that pensions would increase as wages of the working population rose. On average, pensions rose by 65 percent for (blue-collar) workers and 72 percent for (white-collar) employees (Schmähl 2007: 18).

A second profound change was the shift from a funded system to the PAYGO principle. As contributions had been quite low in the past and the pension reserves had been devalued by hyperinflation and war, a substantial increase in pension levels was only possible if pension payments were financed through the contributions of current pensioners. Therefore, the PAYGO system that has characterized the German pension system ever since was adopted through the 1957 reform. As mentioned above, this measure might have been sensible in these days, but it is the origin of today's problems.

In the following decades, pension expenditures rose, particularly in the 1970s, when due to the economic recession unemployment increased significantly. As in other European countries, these financial problems were largely countered by increasing contribution rates. Retrenchment was carried out only in a limited and incremental manner after a pension reform aimed at cutting benefits failed due to public protests in 1976: "Impressed by what became known as the pension debacle, policy-makers switched to incremental, relatively invisible, ad hoc measures for the next decade. Annual pension adjustments were postponed; the calculation base for adjustments was changed several times; eligibility criteria for the disabled and older unemployed were tightened; and in a number of years the government deviated from the principle of gross-wage adjustment by setting pension increases at discretionary lower rates." (Haverland 2001: 317)

The 1980s saw a shift in the perception of the pension system and economic and social politics in general: "Whereas social spending was long conceived as favorable to economic growth (under the Keynesian macro-economic paradigm), one of the main new orientations is now to reduce public social spending in order to boost economic activity by bringing back firms' profitability." (Palier 2007a: 8) The first result of this development was the pension reform of 1989, which came into force in 1992 and is therefore often referred to as the 1992 Pension Reform Act. The reform contained a number of measures intended to contain pension expenditure. The indexation mechanism of pension benefits was changed to net wage adjustment, so that pensioners would also bear a part of the increases in contributions and taxes. Moreover, replacement rates were lowered, the reference retirement age was elevated to 65 for all employment categories and some incentives for early retirement were abolished (Haverland 2001: 317).

Soon after the 1992 reforms, it became apparent that these measures would not be enough to ensure the sustainability of the system. The imbalance in pension funds further increased as a result of the external shock of German reunification and the increasing number of early retirees due to the continuing and worsening problems on the labor markets. In 1996, another reform therefore further reduced early retirement incentives and certain non-contributory entitlements (Hinrichs 2003: 8). Only one year later, a controversial reform was enacted that introduced a demographic factor in the formula for calculating benefits that would lead to reductions in the level of pensions as life expectancy rises. According to Hinrichs (2003), the 1996 and 1997 reforms constituted the end of the pension consensus that had existed for decades and marked the beginning of more adversarial pension politics.

The promise of repealing the 1997 reform was one of the central elements of the SPD's campaign for the parliamentary elections in 1998. After winning the elections, the SPD government fulfilled its promise and repealed those elements of the reform that would have resulted in a reduction of pensioners' benefits. However, as the responsibility shifted from the CDU to the SPD, so did the positions on pension reform. The SPD government now saw itself under pressure to reform the pension system more radically, while the CDU "'acted' as the defender of the welfare state" (Haverland 2001: 319). Despite the resistance by the oppositional CDU, parts of his own party and the unions, Chancellor Schröder managed to get the reform adopted in May 2001. The so-called "*Riester-Reform*" contained some cost containment measures, such as a reduction in the replacement rate from 70 to 64 percent until 2030 and the establishment of a ceiling on contribution rates in combination with a commitment to reduce expenditures if the ceiling is violated (Bonoli and Palier 2006: 11). However, the reform also encompassed some more fundamental changes in the structure of the German pension system. For one thing, a supplementary private pension fund was set up. This scheme was designed as voluntary, capital funded pension fund supposed to come up for past and future reductions in public pension generosity. Although take-up of this scheme has been relatively low so far and the scope of this instrument as compared to the public pension scheme is rather low, the reform signified a shift from the one-pillar system to a multi-pillar approach characterized by a mix between individual and collective pension schemes. For another thing, a basic pension scheme was introduced for elderly people whose contri-

bution record does not ensure them a sufficient benefit level. These means-tested benefits to a certain extent made up for the cuts implemented in other areas of the pension system. Another important change adopted by the SPD government even before the Riester-Reform was a partial substitution of contributions with taxes in the financing of public pension. To this end, a so-called "Ökosteuer" on energy was introduced and the revenues generated were destined to go into the pension funds.

The last reform of the pension system dates back to 2005, when the new grand coalition government of CDU and SPD decided to raise the reference retirement age from 65 to 67 years between 2012 and 2029. As Bonoli and Palier demonstrate, this equals to a 5 percent increase in contribution rates and a 13 percent decrease in benefits and thus constitutes a substantial retrenchment (Bonoli and Palier 2006: 11).

The concept of path dependence

Path dependence is a concept that originated in economics (cf. Arthur 1994; David 1985), but has been employed by other disciplines as well, for example in political science and sociology. It is a very prominent concept within historical institutionalism, which is a comparative approach that aims to explain the divergence of national development paths by examining the respective institutional structure and its influence on and interaction with the socio-economic and political environment at different points in time (Kay 2003: 407). Thus, contrary to other approaches that focus on ideas, agency etc, historical institutionalism analyzes institutions as independent variables. According to North, institutions can be defined as "the rules of the game in a society or, more formally, (…) the humanly devised constraints that shape human interaction" (North 1990: 3). Public policies, such as pension policies, fall in this definition, because "policies clearly do establish rules and create constraints that shape behavior" (Pierson 1997: 44).

There are many different definitions of what path dependence means, but most of them essentially revolve around the idea that institutions evolve along specific trajectories or paths, and once an institution is set on a particular path, it will stay on that path because of certain feedback mechanisms that constrain the relevant actors in their choices and thereby make path departure difficult. Paul Pierson, one of the most distinguished scholars writing on path dependence, notes that there is a broader and a narrower conception of path dependence. The broader conception merely pos-

tulates that earlier events influence later developments, which, according to Pierson, does not have much utility, since it is only a way of stating that in some way "history matters" (Pierson 2000: 252). The narrower conception, on the other hand, provides a more rigorous construct. Following this narrower conception, path dependence exclusively refers to processes marked by increasing returns, i.e. the phenomenon that over time an institution delivers ever higher benefits compared to its alternatives and change therefore becomes more and more unlikely (Pierson 2000: 252). While I agree with Pierson in that the term path dependence should not be used too loosely, I find his definition too narrow. In my opinion, there are other mechanisms that can cause path dependence. It is very important, however, to explicitly identify these mechanisms in path dependent analyses.

An important concept related to path dependence is the so-called *punctuated equilibrium model*, which is based on the notion of long periods of institutional stasis disrupted by short periods of radical institutional innovation (Krasner 1988: 77). Periods of institutional innovation are called critical junctures. These periods are characterized by contingency, i.e. "the inability of theory to predict or explain, either deterministically or probabilistically, the occurrence of a specific outcome" (Mahoney 2000: 513). Critical junctures are caused by exogenous factors and therefore cannot be explained by the model. On the other hand, periods of institutional reproduction are assumed to be "marked by relatively deterministic causal patterns or what can be thought of as 'inertia'" (Mahoney 2000: 511). Sometimes this phenomenon is referred to as "lock-in" of a particular policy. The stable reproduction and thus the path dependence of institutions are caused by self-reinforcing feedback mechanisms (Krasner 1988: 83). These mechanisms are at the center of path dependence studies. Some of them shall be explained in the next section.

Mechanisms of path dependence

As mentioned above, Paul Pierson (2000: 252) claims that path dependence is brought about by processes called "increasing returns". The concept of increasing returns is based on the assumption that a particular institutional arrangement will deliver increasing relative benefits over time. As he puts it: "In an increasing returns process, the probability of further steps along the same path increases with each move down that path. This is because the relative benefits of the current activity

compared with other possible options increase over time. To put it a different way, the costs of exit – of switching to some previously plausible alternative – rise." (Pierson 2000: 252) Therefore, it is difficult to reverse the original decision, even if the alternative would have been more efficient (Mahoney 2000: 508).

Increasing return constitutes a reproduction mechanism based on utilitarianism. Institutions persist because they serve the relevant actors' interests more than alternative solutions. Apart from utilitarian arguments, Mahoney presents functional, power-based and legitimacy-based explanations in his typology of path dependent explanations of institutional reproduction (Mahoney 2000). According to functional explanations, institutions exist and persist because of the function they perform for an overall system. The problem with this approach is that many path dependent institutions are characterized by their dysfunctional nature. While the function they were supposed to perform at the time of their creation might explain why they were established, path dependence assumes initial choices to be contingent (Mahoney 2000). Therefore, functionalist explanations do not seem to have much utility in path dependence studies.

Power explanations of institutional reproduction rely on the assumption that institutions are reproduced because they are supported by a powerful group of actors that has been empowered through the institution itself. Major public policies allocate resources to different groups of actors and this allocation will influence the incentive structure as well as the power relations within a society, as it may "facilitate or inhibit the formation or expansion of particular groups" (Pierson 1993: 599). In other words, institutional arrangements "affect the capabilities of various groups to achieve self-consciousness, organize, and make alliances" (Skocpol 1996: 47). The power structure generated by a policy might then ensure the latter's endurance, since those benefiting from the "spoils" generated through the policy will be eager to mobilize in support of it (Pierson 1993).

Finally, legitimacy explanations imply that institutions are reproduced because they are perceived to be legitimate and the relevant actors therefore choose to maintain it: "legitimation explanations assume the decision of actors to reproduce an institution derives from their self-understandings about what is the right thing to do, rather than from utilitarian rationality, system functionality, or elite power." (Mahoney 2000:

523) Legitimacy, in turn, is created by institutions themselves as they influence people's "subjective orientations and beliefs about what is appropriate and morally correct" (ibid.).

Pension Politics and Path Dependence

Path dependence approaches have been quite popular in explaining the development of European welfare states and particularly pension systems. As Pierson states, "social policy remains the most resilient component of the postwar order" (Pierson 1997: 5). The reform resistance of welfare states has led many commentators to speak of a "'frozen' welfare state landscape" (Esping-Andersen 1994: 58). Bismarckian pension systems display many characteristics and symptoms we would ascribe to a path dependent policy, most importantly their stickiness and strong lock-in effects. They have therefore been called a "locus classicus" of path dependence studies (Myles and Pierson 2001: 306). The concept of path dependence is so commonly used because, contrary to other approaches (such as functionalism), it provides an explanation for why welfare states and pension systems (particularly of Bismarckian type) are so dysfunctional and difficult to reform despite considerable pressures for change. Several studies have identified mechanisms responsible for the path dependence of pension politics. However, the changes that have taken place in all Bismarckian pension systems over the past 20 years have often been substantial and therefore challenge the notion of inertia that is often associated with path dependence. Do the reforms constitute path dependent evolution or path breaking change? And what utility does the concept of path dependence have for explaining the process and content of these reforms?

In what follows, I will first explain in which way pension politics have been characterized by path dependence by presenting some of the feedback mechanisms present in (Bismarckian) pension systems. Thereafter, the reforms of the 1990s and 2000s will be analyzed and I will try to answer the questions posed above, i.e. whether the recent reforms set Bismarckian pension systems on a new path or not and in what way path dependence can help us understand these change processes.

Pioneering the application of path dependence arguments in welfare state research has been Paul Pierson. In his seminal work "Dismantling the Welfare State" of 1994, he analyzes the welfare state reform efforts of President Reagan in the US and

Prime Minister Thatcher in the UK. The main puzzle Pierson intends to resolve through his study is the fact that both of these conservative governments fundamentally transformed the economies of their countries, but were unable to implement substantial reforms in the respective welfare systems despite their belief in small government and the consequent will to substantially cut back the welfare state. Pierson argues that the politics of welfare state retrenchment are fundamentally different from those of welfare state expansion, since both the political goals of policy-makers and the political context have changed. Therefore, explanations for retrenchment do not simply mirror those for its expansion. The political goals of policymakers have changed because while the expansion of the welfare state followed a logic of "credit claiming", retrenchment is an "an exercise in blame avoidance", characterized by very different goals and strategies of the actors involved in it (Pierson 1997: 18).

The political context has changed because the creation of the welfare state itself has generated feedback mechanisms that constitute considerable obstacles to reform. With reference to a dictum by Schattschneider, he notes that "policies produce politics" in that "major public policies (…) constitute important rules, influencing the allocation of economic and political resources, modifying the costs and benefits associated with alternative political strategies, and consequently alter ensuing political development" (Pierson 1997: 30-40). Pierson stresses four kinds of policy feedback: the effect of public policies on interest groups; learning effects; lock-in effects; and information effects. Interest group effects have been explained in the preceding chapter. Learning effects occur when policy-makers recur to tried and tested solutions in the face of complexity and uncertainty. However, he assumes these learning effects to have only a negligible effect on welfare politics. Lock-in effects, according to Pierson, refer to situations in which policies generate certain structures that are effectively locked in, because the cost of switching to alternative structures would be too high: "Major policy initiatives have major social consequences. Individuals make important commitments in response to certain types of government action. These commitments, in turn, may vastly increase the disruption caused by new policies, effectively locking in previous decisions." (Pierson 1997: 42-3) Information effects are somewhat similar to the legitimacy-based reproduction mecha-

nisms explained above. They occur when policies influence how people perceive their own interests and the potential strategies to achieve them.

Through this path-breaking work, Pierson profoundly influenced the study of welfare politics and especially the politics of retrenchment. The way in which he identified several feedback mechanisms as the reason for the difficulty of policy-makers to reform European welfare states is very convincing and many scholars have adopted this approach in their analyses of the welfare state. Policy feedback and the resulting path dependence have indeed characterized European welfare states - pension systems in particular – over the past decades. There are strong mechanisms reproducing established paths and inhibiting radical reforms.

Probably the most important reproduction mechanisms are those based on utility. Increasing returns dynamics (or "lock-in", as Pierson has often called them) seem to affect pension systems a great deal. As Pierson notes, "[l]ock-in effects are likely to be important when public policies encourage individuals to make significant investments that are not easily reversed, or when individuals face strong incentives to coordinate their activities with other social actors and adopt prevailing or anticipated standards. Policies that involve high levels of interdependence, and in which intervention stretches over long periods, are particularly likely sites for lock-in effects." (Pierson 1997: 45) Pension systems display all of these factors: they require people to make considerable investments, they involve high levels of interdependence and they constitute a long-term intervention. Bismarckian pension systems require workers (and their employers) to invest a substantial proportion of their wages into old-age insurance schemes and thereby create immense commitments. In contrast to fully-funded systems, however, these commitments are not covered by savings, because in PAYGO systems contributions are immediately paid out to current beneficiaries. As a PAYGO pension system matures, switching to the alternative solution of a capital funded pension scheme becomes more and more costly, because the accumulated commitments would create a double-payment problem, as workers would have to continue alimenting pensioners while at the same time saving for their own retirement (Pierson 1993: 609). This problem has certainly limited the options available to policy-makers in a substantial manner. Therefore, even after the demographic transition led to a rising awareness that PAYGO pension systems are not

sustainable in their current form, reform steps toward funded schemes have been quite limited in their scope.

This feedback mechanism alone would suffice to explain the persistence of Bismarckian pension systems, but I would like to present one other reproduction mechanism: the effect of pension policies on interest groups. As mentioned above, institutional arrangements, such as public policies, "affect the capabilities of various groups to achieve self-consciousness, organize, and make alliances" (Skocpol 1996: 47). Pensioners constitute one of the strongest political lobbies and electoral forces today. Whereas in other countries, elderly people aliment themselves either through their own savings or some kind of basic pension paid through taxes, pensioners in Bismarckian countries feel *entitled* to receive a pension from the state, because they have paid into a public pension fund during their active life and therefore feel they acquired certain rights. In this way, the PAYGO-based financing mode of the policy has increased pensioners' self-consciousness and their disposition to mobilize against changes. It has led to the emergence of special interest groups and the strengthening of existing ones. Most importantly, unions have been given certain powers and influence in most continental European pension systems. They are often involved in the management of pension schemes and have an interest in maintaining that power. They are a major player in the politics of pension reform, trying to impede any changes that might threaten their influence, such as a (partial) privatization of pensions or a change in their management structure.

Now, while these arguments suggest that path dependence has indeed played a strong role in the evolution of Bismarckian pension systems, the question is whether this claim can still be made for pension politics in the 1990s and 2000s. As was shown in chapter 2, reforms of increasingly radical character were passed in these decades. While rising expenditures had previously been compensated through contribution increases, governments now turned to substantial retrenchment and later to even more fundamental changes that in some cases seem to have changed the logic of the system. Can these changes be reconciled with path dependence, which is usually employed to explain institutional inertia? What does path dependence have to say about change?

Mainstream path dependence literature can go a long way toward explaining institutional continuity, but it does not provide as many explanations for institutional change (Hering 2003: 5). Most of the path dependence literature focuses on lock-in and institutional stasis and neglects the issue of change. The so-called punctuated equilibrium model, a concept from evolutionary biology that has been adopted by many historical institutionalists, assumes little or no change to take place during periods of institutional reproduction and contingent, unpredictable changes during critical junctures. Consequently, some authors have criticized the punctuated equilibrium model: "The implication is that institutions, once created, either persist or break down in the face of some kind of exogenous shock. (…) [However], there often seems to be too much continuity through putative breakpoints in history, but also often too much change beneath the surface of apparently stable formal institutional arrangements." (Thelen 2003: 209-11) This is exactly what has happened with Bismarckian pension politics: despite the strong pressures resulting from changes on labor markets and in the global economic environment, European integration, and unification in the case of Germany, pension systems remained *relatively* unchanged, but at the same time the change that *did* happen was too significant to speak of institutional stability.

The *static* version of path dependence, in which institutional reproduction is characterized by a high degree of determinism and institutional innovation by contingency, therefore does not really help us understand European pension politics since the 1990s. Change simply cannot be explained through this rigid notion of path dependence, as during periods of institutional reproduction it is not supposed to happen and when it does happen at critical junctures, it cannot be explained by the concept, because it is assumed to be contingent.

However, there are other, less rigid notions of path dependence. For example, Andersen and Larsen (2002) present two further types of path dependence. A *dynamic* version allows for some change, but this change occurs along the specific path. As Pierson states, path dependence does not necessarily mean lock-in and total stasis during institutional reproduction: "[P]ath dependent analyses need not imply that a particular alternative is permanently locked in following the move onto a self-reinforcing path. (…) Asserting that the social landscape can be permanently frozen

hardly is credible, and that is not the claim. Change continues, but it is bounded change – until something erodes or swamps the mechanisms of reproduction that generates continuity." (Pierson 2000: 265) For example, a constant expansion of benefits in a universal welfare state would not contradict the idea that it is path dependent if the path dynamic characterizing universal welfare states is one of welfare expansion.

A *martingale* notion of path dependence, on the other hand, implies that an institution gradually departs from its previous part through incremental changes that might not be perceived to cause a path departure at first: "The basic idea is that some small change which may for long go unnoticed gradually accumulates so that beyond a point of no return which is not always recognized, it becomes both irreversible and self - reinforcing, with the result that a new underlying dynamic is taking over." (Andersen and Larsen 2002: 6)

Can this classification of path dependent change help us understand the reforms of continental European pension systems in the past two decades? Do these different types of path dependent changes reflect the changes that have been taking place? With regard to welfare state arrangements in general, some authors have claimed that the changes that have taken place over the past decades did not cause a path departure, but rather followed distinct path dynamics within each group of welfare systems. For example, Pierson (2001) argues that each of the three different worlds of welfare has reacted differently to the challenges faced by their social protection systems. While liberal welfare states have engaged in recommodification, social democratic welfare states have focused on cost-containment and the continental welfare regimes on re-calibration (Pierson 1999: 13). According to Bruno Palier, these reforms are therefore "seen as merely reinforcing the logic of each welfare system" (Palier 2006: 363). However, with regard to pension politics these arguments appear to be questionable, since the reforms that have been implemented in many Bismarckian countries have not reinforced that particular logic, but introduced elements that make Continental welfare systems more similar to liberal or social democratic ones, e.g. the partial shift to tax financing or the introduction of supplementary private pension schemes. In addition, Jochem (2005: 31) argues that empirical results

show that there are large differences in the way in which the different countries within the same cluster of nations have adapted to the changing conditions.

A tool that might help us assess whether the reforms should be considered path dependent or path breaking is the typology of policy change proposed by Peter Hall. He distinguishes between three orders of changes in policy: "We can call the process whereby instrument settings are changed in the light of experience and new knowledge, while the overall goals and instruments of policy remain the same, a process of first order change in policy. (…) [W]hen the instruments of policy as well as their settings are altered in response to past experience even though the overall goals of policy remain the same, [these changes] might be said to reflect a process of second order change. [S]imultaneous changes in all three components of policy: the instrument settings, the instruments themselves, and the hierarchy of goals behind policy (…) occur relatively rarely, but when they do occur as a result of reflection on past experience, we can describe them as instances of third order change." (Hall 1993: 278-9) Thus, an increase in contribution rates would constitute a first order change, the introduction of a funded pension scheme would be an example of second order change and the transformation from system based on the principle of status maintenance to one aimed at poverty alleviation would be third order change. First and second order changes are usually considered to be path dependent, while third order changes are seen as path-breaking events (cf. Palier and Bonoli 2000; Natali and Rhodes 2004).

Applying this framework, the measures adopted during the 1970s, 80s and 90s would mainly be first order changes, as the initial contribution rate increases and the later benefit cuts merely changed the settings of pension instruments. The more profound changes that took place in the 1990s and 2000s mainly changed the instruments of Bismarckian pension systems. For example, new instruments were introduced in Germany in form of an energy tax contributing to pension funds and of a private, fully funded second tier. No third order change has occurred so far, because the underlying goals of Bismarckian old-age insurance systems have not been changed. Income maintenance rather than poverty alleviation or universal old-age provision remains the highest priority of most continental European pension sys-

tems. Hence, an analysis guided by Hall's typology of change would indicate that no path cessation has happened.

However, the question is whether the focus on the goals of policies is appropriate in this case. The series of incremental reform steps that have been implemented in order to preserve Bismarckian pension systems in their current form might eventually lead to a departure from the original path. Therefore, other scholars have emphasized institutional design and the (anticipated) outcomes of pension reforms. For example, Martin Hering argues that "if Continental and social democratic welfare states partially privatize welfare state programs, the outcome is path-departure. (…) [Furthermore,] if Continental welfare states, especially those which rely almost exclusively on contribution-financing for their major welfare programs, shift from contribution- to tax-financing, they depart from their path or deviate further from it." (Hering 2003: 19) In the German case, Hinrichs and Kangas (2003: 580-1) list three elements of the pension reforms that they believe to have changed the basic logic of the German pension system: the shift to a revenue-oriented expenditure policy associated with the introduction of a contribution rate cap; the introduction of a basic security scheme for the elderly; and the introduction of a supplementary, fully-funded second pillar. Indeed, these new elements of the German pension system (and I would add the gradual shift toward tax financing) are fundamentally different from the traditional ones. However, their impact is still fairly limited. For example, the private pension scheme still faces a rather low take-up rate and its scope in terms of contributions and expected benefits is small in comparison with the public pension scheme. The public scheme will continue to be the most important source of retirement income for the foreseeable future.

Do these apparently marginal changes in the German and other Bismarckian pension systems justify speaking of paradigm shift and path departure, as many authors have done? In my opinion they do. As explained above, small incremental changes might eventually lead to a dynamic that brings about a path departure. This martingale dynamic seems to be happening at the moment. Public pensions will probably be retrenched further, leading to an increasing reliance on private provision and ultimately the establishment of a true multi-pillar pension system.

A similar concept to the martingale notion of path dependent change that illustrates one way in which path dependent institutions change is that of *institutional layering*. According to Thelen (2003), institutional layering is a strategy that enables the transformation of an established institution by adjusting only those parts of the institution that are not subject to lock-in while leaving the core intact. This way, institutions can be adapted to changing external conditions despite strong obstacles to reform. She explicitly mentions pension politics as an example: "[E]ven though conservative parties my be incapable of (or uninterested in) dismantling the old system, in some cases they can effect changes in the overall trajectory of social security by actively promoting the development of privately funded pensions alongside the public system." (Thelen 2003: 226-7)

This explanation appears to be quite plausible. It does indeed seem like new layers have been added to many continental European pension systems, in this way "working around those elements [that] could not [be] changed" (Thelen 2003: 226). The most reform-resistant and path dependent element of Bismarckian pension systems has certainly been PAYGO-financed public pension schemes. Knowing that it would be extremely costly both in economic and political terms to turn away from this element, governments have layered new financing instruments and private pension pillars on top of the PAYGO-financed public ones.

As the in the martingale version of path dependent change, institutional layering might also lead to path departure in the long run. Again with regard to pensions, Thelen states that "[t]he 'layering' of an alternative private system onto an existing public system can affect the interests of key constituents, with enormous implications for the overall trajectory of social security in a given country" (Thelen 2003: 227). In fact, a possible consequence of the introduction of private pension schemes might be that large parts of the middle class will increasingly rely on private provision in the expectation of continuing benefit cuts in the public pillar. As their dependence on the public pension pillar weakens, so will their support for it. Waning support, in turn, will enable increasingly radical reforms that set the institution on a whole new path.

In sum, path dependence offers compelling explanations for institutional inertia. In addition, more open conceptualizations of path dependence, such as those presented

above, provide interesting insights into *how* path dependent systems like pension schemes actually change despite mechanisms favoring the status quo. However, these versions of path dependence do not offer any explanation for *why* and *when* change happens. Indeed, no such explanation has yet been given for any change in a path dependent institution and it is doubtable whether path dependence will ever be able to explain the causes of institutional change. Structures are assumed to be inherently stable and are therefore unable to explain change. In addition, the self-reinforcing reproduction mechanisms at the heart of path dependence would suggest that institutions continuously evolve in one direction. Many path dependence scholars have therefore recurred to the punctuated equilibrium model, in which change is assumed to be contingent, i.e. outside the scope of the theory. Change is not impossible, but it is treated as a "*deus ex machina*", which means that it is caused by exogenous factors and therefore cannot be understood through the logic of path dependence.

In addition, there is the question of whether the concept of path dependence should be stretched so much that it can explain processes of institutional transformation as well (Jochem 2005: 31). For one thing, scholars seem to accommodate reality to their theories quite often. This is what Ian Shapiro criticizes in the following words: "It seems to be an endemic obsession of political scientists to believe that there must be general explanations of all political phenomena, indeed to subsume them into a single theoretical program. Theory-drivenness kicks in when the pursuit of generality comes at the expense of the pursuit of empirical validity." (Shapiro 2002: 605) For another thing, the concept risks loosing of its analytic bite (Thelen 2003: 221) through these extensions. More open versions of path dependence do not provide causal explanations, but merely descriptive accounts of the evolution of path dependent systems. Moreover, the concept has often been adjusted as fits the specific circumstances to be explained, in many cases ignoring or misapplying the basic tenets of path dependence. The concept of path dependence is therefore in danger of degenerating into a simple metaphor implying that "history matters" (Pierson 2000: 252) and path dependent analyses may become purely descriptive narratives of individual cases without any explanatory power and broader significance.

Now, a theory postulating a strict dichotomy between periods of deterministic path reproduction and contingent innovation is of course very elegant and therefore attractive. However, the restrictive assumptions of the punctuated equilibrium model call into question its usefulness for explaining real-world phenomena. While the determinism assumed to characterize periods of institutional reproduction is, to a certain extent, necessary for the argument to work, the requirement of total contingency at critical junctures is rather unrealistic. It would imply a tabula rasa situation in which existing institutions break down and new ones are created from scratch. As Thelen (2003) notes, outright institutional breakdown is rare and critical junctures are often characterized by a considerable degree of continuity. Thus, what is the value of a theory that is elegant, but so restrictive that it only applies to a very limited number of cases? I would say that it is not very high. Theories should not be developed for their own sake, but to help us understand the real world. In my opinion, path dependence-inspired approaches can provide interesting insights into processes of institutional change in a number of ways.

For example, an interesting approach to the explanation of institutional change is that followed by Ebbinghaus (2005). Similar to Mahoney (2000), Ebbinghaus turns the mechanisms sustaining path dependent institutions upside down to hypothesize about the causes of institutional transformation. Thus, institutions sustained by utility-based reproduction mechanisms might undergo path departure when coordination effects wane, for example in the form of declining economies of scale. Institutions that are based on particular power configurations are likely to change if the underlying power relations change or new interest groups emerge. In the case of institutions that are reproduced due to the function they perform for other institutions in a system, path departure could occur when the complementarities between these interdependent institutions diminish. Finally, a change in the normative or cognitive scripts sustaining institutions which are reproduced on the basis of their legitimacy can lead to their path departure. Of course, these are only immediate causes and as such cannot fully explain why path dependent institutions change. However, they might help us identify the root causes that are ultimately responsible for path departure.

Nevertheless, it is necessary to look not only at institutions as the structure within which politics takes place, but also at issues of political agency. As Jochem states, "[i]n, so to say, "settled" times, structure and functionalism may dominate the political logic of development. In "unsettled" times, however, agency is more decisive for continuity and change." (Jochem 2005: 9) Path dependence as an institutionalist concept focuses mostly on structure, while largely neglecting agency and is therefore less suitable for explaining mostly agency-driven change. For that reason, Thelen combines structure and agency in the concept of institutional layering in order to explain how change happens in path dependent systems. Institutional layering is a strategy that actors adopt in order to transform a path dependent policy (agency) and which then creates feedback mechanisms that gradually lead to a rupture of the old reproduction mechanisms (structure). As it does not provide explanations as to why actors intend to change established institutions, institutional layering is indeed merely descriptive. But as empirical categories, concepts such as institutional layering can help us understand how change happens in path dependent institutions and distinguish between different forms of change. Other theories have to explain *why* change happens, but it is also important to answer the question of *how* it happens, i.e. how reproduction mechanisms can be broken.

Conclusion

Bismarckian pension systems have been under intense pressures from the 1970s on. Demographic changes as well as decreasing growth rates and increasing unemployment have caused enormous financial strains for governments and increased labor costs considerably. Despite these serious challenges, pension systems have proven to be surprisingly reform resistant. The initial reaction of governments toward these problems was to increase contribution rates and sometimes cut back benefits moderately. Pension politics were clearly marked by path dependence in these days. The stable reproduction of Bismarckian pension systems was caused by a number of feedback mechanisms. Most importantly, the PAYGO principle created a dynamic of increasing returns which made path switch prohibitively costly. In addition, public pension arrangements had an effect on interest groups, mostly pensioners and unions, in that they empowered these groups by providing them with resources and helped them achieve self-consciousness. These interest groups, in turn, worked hard to inhibit any changes that would weaken their economic or political position.

The reforms that have been implemented since the late 1980s have brought more far-reaching changes. On the one hand, significant retrenchment has occurred as politicians have tried to contain the costs of public pension systems. On the other hand, the institutional design of many Bismarckian pension systems was modified through the introduction of private pension pillars, a partial transition from contribution- to tax-financing, a shift from the defined-benefit to the defined-contribution principle etc. Although the scope of these changes might seem rather limited and their current outcomes negligible, they introduced new paradigms that will ultimately bring about path departure. As regards the way in which pension systems have actually been transformed, the reforms seem to be an illustrative example of institutional layering. The solutions that have been adopted are rather marginal and they do not touch the core of the policy, i.e. the PAYGO principle. However, as the elements layered on top of existing institutions become more and more important, a new dynamic is taking over and the old path is eventually abandoned.

As a concept that was developed to explain institutional inertia, path dependence has considerable difficulty in explaining institutional change. In fact, some of its theoretical foundations, such as increasing returns and the supposedly contingent nature of institutional innovation, seem to suggest that the concept is entirely unable to comprehend change. Nevertheless, a number of authors has tried to modify path dependence in order to accommodate change, for example by including elements of agency. These more open versions of path dependence are less theoretically rigorous and may sometimes degenerate into mere storytelling. They cannot explain *why* change happens or determine *when* it is likely to happen, but some of them can help us understand *how* institutions change. In my opinion, it would therefore be a mistake to assume that path dependence does not have any utility in periods of institutional change. Instead, we should try to enhance our understanding of the interplay between structure and agency in these transformation processes. The concept of institutional layering seems to be a promising starting point. However, institutional layering is probably not the only strategy adopted by actors interested in transforming path dependent institutions. More research needs to be done on how reproduction mechanisms can be overcome and which strategies are best suited for this end.

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