

**The Financial Industry and Pension Privatization in Europe**  
**Shareholder Capitalism Triumphant?**

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## **Abstract**

The thesis examines the political dynamics behind the contemporary trend towards pension privatization in Europe. Its aim is to develop a theoretical model that can explain not only why governments have increasingly replaced their public pay-as-you-go systems with private fully-funded schemes, but also why there is considerable diversity both in the extent and in the content of pension privatization. Private pension funds can indeed be governed by a variety of institutional arrangements and can have very different types of links with the financial system. They do not necessarily contribute to a financialization of the economy. The thesis takes issue with the idea that pension privatization would be primarily the result of a new pensions orthodoxy promoted by international organizations such as the World Bank or of an electoral strategy that consists in attracting the votes of the middle class. I argue that the driving force behind the more or less dramatic rise of funded pensions in Europe is a series of lobbying campaigns launched by the financial industry, and their varying influence. Financial firms have a vested interest in the development of a market in private pensions, which should profit them as an industry. However, pension reform is an issue that matters to voters and can therefore prove dangerous for party politicians. Moreover, it involves complex changes that directly affect key material interests of employers and workers. In this context, the success of financial firms' campaign for pension privatization depends on their capacity to forge alliances with a variety of actors. This in turn contributes to limit the influence financiers can exert. The argument is tested using a comparative historical analysis of pension debates in the United Kingdom, France and Poland since the beginning of the 1980s.

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## Introduction

The trouble with public pension systems is that they “rely on much the same principle as the Ponzi scam”. This was the diagnosis established by *The Economist*, a prominent weekly newspaper, in a “survey of pensions” it published in 2002. Ponzi schemes, also called pyramid schemes, are fraudulent investment plans that promise extravagant payouts. The trick is that returns are paid not from the gains made by the fund, but from the savings put by a growing number of investors. Since the Second World War, most public pension systems around the world have been financed on a “pay-as-you-go” basis. This method consists in paying today’s pensions from contributions levied on the earnings of today’s workers. For *The Economist* (2002a), pay-as-you-go pensions could be compared to pyramid schemes because “the first few generations of pensioners received much more in benefit than they had paid in contributions” and because these benefits were “extended to cover more and more workers, and contribution rates kept going up.” In short, they resulted in unfair transfers across generations.

Initially used as a quip by economist Paul Samuelson in a 1967 Newsweek column, the Ponzi scheme analogy is highly controversial. Created and enforced by public authorities, pay-as-you-go systems have benefited millions of pensioners and have been seen by many as a legitimate “contract between the generations”. However, the British magazine, amongst others, has used the metaphor as a rhetorical device to advocate a switch to more “funding” of old-age pensions. “Funded” pensions are paid from savings which are invested in financial assets. They are most often managed by private sector entities, but states can also create pension funds for instance to build reserves for their pay-as-you-go systems.

Whether they are financed on a pay-as-you-go basis or funded, pensions can be calculated in two different ways. Pensioners are either guaranteed a set level of what they used to earn as workers. These are “defined benefit” pensions. Or, they are only offered what they have paid into the system, plus returns. These are “defined contribution” pensions. Traditionally, both public systems and funded company-provided pension plans overwhelmingly offered the defined-benefit type. *The Economist* labelled that situation “another crucial flaw”. This was due to the fact they were expensive for their providers. Moreover, the magazine argued, perhaps less controversially, that such programmes could redistribute income in inequitable ways. If they were based on workers’ final salaries, they benefited those employees “whose salaries go up steeply in their final years at work” and offered only “poor value” to those “whose earnings peak early”. Moreover, employer-sponsored defined-benefit plans favoured “long-standing employees” over “early leavers”, because to become eligible workers often had to complete a certain number of years of service. The survey concluded that both pay-as-you-go and defined-benefit systems were “inappropriate for today’s ageing populations” and that “the only way out of the pension trap” was to reform them and encourage the development of funded defined-contribution plans (*The Economist* 2002b). These would make the link between what people put in and what they get out more explicit and would thereby “allow people to take charge of their own retirement provision”.

What the weekly recommended so vigorously has indeed been one of the major trends in pension reform over the past few decades (Hinrichs and Lynch 2010). In countries that historically had extensive private pension funds, employers have started to close their defined-benefit schemes and have increasingly preferred to sponsor

defined-contribution plans managed by financial firms. This has been the case especially in the United Kingdom and the United States. In countries where pensions were predominantly provided by pay-as-you-go systems, policy-makers have on the one hand tightened the link between public benefits and contributions and on the other hand promoted the development of funded defined-contribution plans. This group includes the vast majority of West European nations, but also countries from the former Soviet bloc and Latin America. These developments clearly point to a global movement towards the privatization and the individualization of pensions.

Yet the timing, the form and the extent of this movement have widely varied across countries. Some governments created incentives for the development of individual retirement accounts much earlier than others. The United Kingdom and Belgium introduced voluntary personal pensions as early as 1986 whereas France or Germany put them in place only at the beginning of the 2000s. Institutional change has also taken on various forms. In many countries, private pension funds were initially established as marginal complements to the pay-as-you-go system, but with time became an alternative source of retirement provision that increasingly challenged the prevalence of public pensions. In other cases, particularly in Central and Eastern Europe and in Latin America, governments decided to cut public pensions more radically and partly replace them with mandatory retirement savings accounts. Analysts of institutional change would refer to the first form of change as “layering” and to the second one as an example of partial “displacement” (Streeck and Thelen 2005). Finally, and related to these varying processes, funded pensions have expanded to a greater extent in some countries than in others. Pension fund assets have grown remarkably in countries like Sweden or Denmark but remain negligible in Greece or France. What

have been the main political drivers of this trend towards pension privatization, and why have its outcomes differed so much across countries? This is the research question this thesis seeks to answer.

But why should we care about these developments? The privatization – combined with the individualization – of pension provision results in a dramatic “risk shift” (Hacker 2006a). Younger generations will not receive as generous pensions as their grandparents did. The move to defined-contribution plans also means a change of expectations as to who is really responsible for pension provision. Under defined-benefit plans, workers were guaranteed a certain level of pension provided they worked long enough. If the plan was in deficit, the taxpayer or the employer would fill the hole. With defined-contribution plans, personal responsibility becomes the guiding principle. What individuals get depends directly on what they contribute. It is ultimately up to them to assess how much they should save and how long they should work in order to have an adequate income at retirement. Moreover, they may now have to bear the risks involved with stock market fluctuations (Burtless 2003).

A second reason why pension privatization is important is its potentially considerable impact on how our economies are organized. The gradual accumulation of financial assets by pension funds makes them major players in the financial system and in the governance of firms (Clark 2000; 2003). Through their countries’ stock exchanges, pension funds become key providers of capital to businesses and often hold a large part of their governments’ debt. If their growth leads them to internationalize their investment strategies, their influence extends to the global stage. Pension funds have also been associated with fundamental changes in corporate governance. Anglo-American pension funds’ activism as shareholders is thought to have contributed to

shifting the objectives pursued by the managers of financial and non-financial firms all over the world. From an orientation towards retention of corporate earnings and reinvestment in corporate growth, businesses have increasingly emphasized the maximization of “shareholder value” as their primary objective (Lazonick and O’Sullivan 2000). The result is a new balance of power within the firm, which may have important implications for how the interests of other corporate stakeholders, such as a company’s workers, suppliers, customers and its local environment are taken into account (Jacoby 2009). Pension privatization may therefore be synonymous with the emergence of a new form of “finance capitalism” (Davis 2009; Cioffi 2010) or, in other words, with a shift from “managerial capitalism” to “shareholder capitalism” (Dore *et al.* 1999).

How can we explain this drive towards pension privatization and its divergent outcomes? The ascendancy of new policy ideas in pension policy-making and changing dynamics in party systems are two factors that have already been considered by political scientists. An important body of literature about pension reform has highlighted the rise of a “new pensions orthodoxy” (Müller 1999). International organizations such as the World Bank (Orenstein 2008), but also many academic economists, have increasingly called into question the traditional instruments used to construct pension systems and have argued that curtailing spending on pay-as-you-go pensions and developing funded defined-contribution plans were the best ways to cope with the financial challenges posed by population ageing. The strongest statement of this paradigm has been the World Bank’s (1994) assertion that pension systems should be built on “three pillars”, including one based on mandatory retirement savings accounts. This new ideational model is believed to have changed the views of key domestic policy-makers such as

party politicians, government officials, business groups and even some trade unions (Weyland 2006; Palier 2007; Palier 2010a).

Another factor that is believed to have contributed to the rise of private pension funds is changes in political parties' electoral strategies. Traditional analyses of the role of parties in welfare state development have assumed that left-wing parties representing workers favour a high degree of redistribution through public social protection, whereas the usually more pro-business right-wing parties prefer market-based arrangements (Korpi 1983; Korpi and Palme 2003). However, in recent pension reforms, the historically pro-welfare Christian- and Social-Democratic parties have often supported partial pension privatization (Seeleib-Kaiser *et al.* 2008). For Häusermann (2010), this shift in parties' policy positions is a consequence of socio-structural change. With deindustrialization and the rise of the service sector, parties' electorates have profoundly changed. Left-wing parties increasingly attract high-skilled middle class voters, a social group that was traditionally considered as a constituency of centrist and right-of-centre parties rather than of the left. Middle-class voters are more willing to support the development of pension funds because their salaries leave more room for savings. Therefore, parties that aim to represent their views or compete for their votes are more likely to promote pension privatization.

Analysing the rise of funded pensions only through the lens of such ideas-based and party-based theories leaves us with unsolved puzzles about the actual behaviour of some political actors, about the content of reforms and about the wider implications of pension privatization for the economic system. First, actors sometimes behave in unexpected ways. It may happen that parties which hold a comfortable parliamentary majority, which call for the development of funded pensions in their election manifestos

and face no public demonstrations, turn out to be reluctant to do so. Why is that the case? Why may employers' organizations publicly support the introduction of pension funds, but lobby against them behind closed doors? Of all the actors that have a stake in the pension system, should we not expect business to be the keenest on pension privatization? In a similar vein, trade unionists, who are concerned about the effects of pension privatization on the adequacy of pensions, may still think it is worth pursuing. Such surprising and contradictory attitudes are in need of an explanation.

A second puzzling aspect relates to the remarkable diversity in the content of pension privatization. Pension funds can have a variety of governance structures that can embody different conceptions of social protection (Ebbinghaus 2011). The philosophy behind occupational funds established for the workers of a firm or an industry differs from that of a personal pension plan, which can be joined by any individual. Whether a fund is managed by an employer, co-managed by trade unions or run by a financial company connotes very different values such as paternalism, solidarity or profit-making and choice. Some pension funds are commercial institutions, while others are run on a not-for-profit basis. How funds are organized and who has decision-making power in them can be very political issues. When do policy-makers prefer one type of pension fund governance over another, and why?

Last but not least, we know so little about the "forgotten link" (Estevez-Abe 2001) between pension reform and its consequences for how firms are financed and governed. Whereas Anglo-American pension funds have traditionally invested their assets on the stock exchange, the Japanese state preferred to channel savings managed by the country's pension funds and insurance companies into the domestic banking system. States also often try to put limits on the types of investments pension funds can make.

For example, some countries put caps on foreign investments. Or, in some countries pension funds must predominantly focus on maximizing their assets, while in others they can take other criteria into account. Do such regulatory differences matter? Are there any political struggles over them? And what is the situation in Europe? In short, to have a better understanding of the political processes leading to pension privatization, of its varying outcomes and of its wider – yet crucial – implications, we need to look at it from a different perspective.

### *Outline of the argument*

In this thesis, I argue that the driving force behind the more or less dramatic rise of funded pensions in Europe is a series of lobbying campaigns launched by the financial industry, and their varying influence. In all market economies, financial firms have a vested interest in the development of a market in supplementary pensions, which should profit them as an industry. However, pension reforms are generally one of the issues most salient to voters and for that reason are eagerly seized upon by political parties. Moreover, they involve technically complex changes that directly affect the interests of workers and employers. These two social groups have high stakes in pension reform, as pensions impact crucial socio-economic parameters such as the living standards of the elderly, firms' production costs, the level of employment and the supply of capital in the economy. Employers and workers often have ambivalent attitudes towards pension privatization, but they are also politically powerful groups because the organizations that represent them can influence voters and turn them against plans to expand funded pensions. Therefore, if financial actors want to succeed in

pushing their agenda for pension privatization, it is vital for them to persuade and form alliances not only with politicians but also with employers' associations and trade unions. The thesis develops a theoretical framework that sheds light, first, on the determinants of the often conflicting *preferences* of financiers, employers and workers and, second, on the political conditions that enable financial lobbies to wield decisive *influence* over the policy-making process.

The first task of my analytical framework is to provide an understanding of the cross-sectoral, cross-national and cross-temporal *variation in the preferences of business and labour* towards pensions. Core to my argument is the idea that socio-economic actors' preferences are defined not only by what I call the "welfare-labour nexus", but also by the "welfare-finance nexus" and the pre-existing public-private mix in pensions.

Dominant approaches in the political economy of social protection – most notably the power resources approach (Korpi 1983) and the varieties of capitalism perspective (Hall and Soskice 2001a) – have considered labour's and capital's social policy interests to be predominantly shaped by their position in the labour market and their production strategies. The primary function of pensions has indeed been to insure workers against the risk of income loss in old age. States and employers often introduced pensions to prevent working-class unrest. Very frequently, firms have also used them to retain staff with valued skills. Decisions about workers' and employers' mutual rights and obligations, and about the costs of pensions, are at the centre of most pension reforms. Nevertheless, old-age pensions are not only characterized by their link with employment relations – or to put it differently the *welfare-labour nexus* – but also institutionalize what Estevez-Abe (2001) has called the *welfare-finance nexus*. Because of the various

techniques available to finance them, social arrangements can fulfil functions beyond the sole protection of work-related risks. When they are funded through savings, they generate capital which can be injected into the financial system. As a result, socio-economic actors' preferences towards pension privatization can be understood only if one takes into account both the welfare-labour and the welfare-finance nexus.

Once this link with the financial system is made explicit, the role of financial actors becomes noticeable. Moreover, it becomes clear that employers and workers may also have interests, which are specifically related to the welfare-finance nexus. Since collecting and managing savings is their core business, *financial firms* have a strong motive for developing a market in funded pensions. This is particularly the case of insurance companies, but banks and mutual funds are interested as well. These industries defend specific interests and therefore have their own business associations. Stock exchanges are another potential beneficiary of pension privatization because, by ensuring additional inflows of capital, pension funds enhance their attractiveness to issuers and investors. Hence, the financial industry should be a key protagonist and should lobby governments to contain public pensions and to secure the entrenchment of funded pensions.

At the same time, the welfare-finance nexus contributes to shaping the interests of *other segments of business and labour*. The main issue for these actors is how the assets of pension funds are going to be used and who has the power to control them. Employers may be keen on having access to new sources of corporate finance but may be anxious about their precise features and the corporate governance demands that might be imposed on them. A key concern for employers – especially for managers of large industrial companies – is whether pension funds will be patient investors that will

protect their firms from hostile takeovers and provide financing for long-term investments. On the other hand, workers and their representatives may have worries about whether the funds will be invested in ways that benefit them. They may consequently seek to promote forms of socially responsible investment to help create and sustain stable jobs. Thus, the expansion of funded pensions may be a matter of concern to employers and workers.

It may also prove costly to them due to *institutional feedback from the pension regime* prevailing in their countries. I argue that a key variable that affects employers and workers' preferences is differences in the existing organization of private pension plans. Historically, employers and trade unions often set up occupational schemes that complemented public pensions. However, these plans were neither always fully-funded, nor always managed by financial sector companies. One might thus expect the financial industry to challenge these schemes. Yet, due to their gradual institutionalization in firms' human resources policies or in collective bargaining, the segments of capital and/or labour involved in their management should defend them and therefore not necessarily support financial firms' conceptions of partial pension privatization.

In a nutshell, when the influence of the welfare-labour nexus, the welfare-finance nexus and the existing public-private mix in pensions is taken into account, it appears that the financial industry is clearly in favour of a partial privatization of pensions, while the preferences of employers and workers are much more indeterminate and may vary across sectors, countries and time, depending on the configuration of these different dimensions.

While the first task of the theoretical framework is to understand how the preferences of financiers and other socio-economic actors are determined, its second

objective is to clarify the mechanisms through which they exert *influence* over policy-making. As an outspoken advocate of pension privatization, the financial industry is very keen on putting it on the political agenda. Nevertheless, since pensions are a vigorously debated and a salient political issue, financiers – and their opponents – cannot simply approach politicians behind closed doors. To gain influence, they need to prevail on larger parts of society and therefore must use a wider range of lobbying techniques, including for instance advertising campaigns. Pension politics is a continuous process in which the associations representing the various segments of capital and labour constantly try to deploy new arguments with the hope to sway public opinion and decision-makers. In this on-going struggle, financial lobbies are very far from always achieving their ends.

Yet, when they do manage to persuade party politicians to take their side, gaining the backing of trade unions or employers' associations may become politically crucial. Both right-wing and left-wing parties may see the expansion of funded pensions as an opportunity to appeal to high-skilled middle-class voters (cf. Häusermann 2010). But pension privatization still involves some political risks, as pensions are a salient issue to voters. With their organizational resources and their access to the media, employers' associations and trade unions hold the capacity to influence public opinion and voters' behaviour. If they campaign against a government's plan to privatize pensions, this may have negative consequences for the governing parties' performance at the next election. Therefore, politicians have strong incentives to accommodate workers' or employers' demands on pension fund regulation or make concessions on other dimensions of pension reform. I argue that parties' responsiveness to different organized interests varies with the nature of party systems. In multi-party systems, the social groups

represented by organized interests usually overlap with parties' core constituencies. Therefore, parties have an incentive to broker compromises with the interest groups that are most closely aligned with them (i.e. employers' associations for right-wing business parties and trade unions for left-wing parties). By contrast, in the more competitive and median voter-oriented two-party systems, linkages between parties and interest groups are less constraining on politicians, but centre-left parties may have an incentive to signal their commitment to defend the interests of the median voter (or the middle class) by showing a certain degree of independence from their trade unions allies and by demonstrating their proximity with employers and the business community.

### *Strategy of research*

Establishing what different interest groups stand for and demonstrating that they have been able to exert influence on the policy-making process are not always an easy task. Very detailed historical evidence may be required. In this thesis, I evaluate my hypotheses using a comparative historical analysis of the last three decades of debates about pension reform in the United Kingdom, France and Poland. Recent policy changes in these three countries illustrate the general trend towards pension privatization, albeit to different extents (Orenstein 2008; Ebbinghaus 2011). Traditionally, the British pension system offered relatively meagre flat-rate state benefits. These were complemented either by employer-sponsored occupational pension funds or by an earnings-related state supplement financed on a pay-as-you-go basis. In the last few decades, this state supplement has been gradually turned into a flat-rate benefit and from 2012 was complemented by workplace funded pension plans via the

automatic enrolment of workers into them. Contrary to the United Kingdom, the post-war French and Polish pension systems offered generous earnings-related benefits that were entirely financed on a pay-as-you-go basis. In both countries, policy-makers have decided to cut them and promote the expansion of private pension funds. However, these institutional changes have assumed very different forms. In France, funded plans have been introduced as voluntary supplements to pay-as-you-go pensions in a very gradual way and to a relatively limited degree. In Poland, public pensions have been cut much more dramatically and have been partly replaced by mandatory retirement savings accounts.

These three countries are selected because they constitute a sample of *diverse* cases, which are representative in a minimal sense of the full variation of the universe of cases (cf. Gerring 2007; Seawright and Gerring 2008). First, they had very different public-private pension mixes prior to recent reforms. The United Kingdom had an extensive network of private pension funds, many of which were administered in-house by employers while others were managed by the financial industry. Although both Poland and France had purely pay-as-you-go systems, their organization differed significantly. Whereas the Polish system was entirely state-managed, part of the French system has been directly controlled by trade unions and employers' associations. Second, the three countries also had very different financial systems. While in the British system the stock exchange was central in corporate finance, France had a credit-based system with a dominant role played by state-owned banks and the Treasury (Zysman 1983). By contrast, Poland was a centrally planned economy until the end of the 1980s and underwent a transition to a market economy at the beginning of the 1990s. Finally, the three countries have had very different party systems: while the

United Kingdom has traditionally had a two-party majoritarian system, France and Poland have had multi-party systems, but Poland's system has been more volatile, because the country emerged as a democracy only in the 1990s.

If it can be demonstrated that in all of the selected countries: a) the financial industry – particularly the insurance industry and stock exchanges – actively and successfully lobbied for the introduction or the expansion of pension funds; b) similar segments of capital and labour had comparable worries about how the governance of pension funds would affect their production strategies or their well-being; c) pre-existing private pensions were crucial in shaping the preferences of employers and/or workers, one should be confident that the argument developed in this thesis can be applied to a broader population of cases. It should be noted here that the argument I advance applies only to countries which have the basic features of a market economy. Functioning capital markets and a relatively competitive banking sector are a precondition for the establishment of pension funds. In that respect, Poland can also be considered a *crucial* case (Eckstein 1975), since, in a context in which liberal democracy, the market economy and private financial institutions were only at a nascent stage, one would least expect the financial industry and the rest of the business community to have had clear views about their interests and to have developed the lobbying capacities that would make them relevant actors in the policy-making process.

To test the hypotheses developed as part of my theoretical framework but also those proposed by rival approaches, I assess whether their observable implications are matched by historical evidence (cf. George and Bennett 2005; Hall 2006). To do so, I trace the political debates about pension privatization that have taken place over the past few decades in each of the country cases. The institutional structure of the pension

system is an object of continuous contention and of on-going debates. Hence, it is necessary to give a “moving picture” rather than a “snapshot” view of these processes (Pierson 2004). Detailed diachronic narratives are most suitable to evaluate which actors have been pivotal in putting pension privatization on the political agenda and in influencing decision-making. However, contrary to widespread practice in studies of institutional change, I focus not only on the debates immediately preceding the enactment of legislation that triggers change. I also study longer spells of time when no political action is being taken although discussions about pensions are still going on. During these periods, the actors involved in pension reform continue to issue public statements about their views. Their analysis is particularly useful to understand which factors contribute to blocking reforms and under which conditions change becomes possible.

In addition to existing studies about pension reform in the selected countries, newspaper articles are the main source of information I have used. For each country, I have systematically researched and analysed articles from mainstream newspapers and from the business press. To do so, I typed the keyword “pension funds” (or related terms<sup>1</sup>) in combination with the names of relevant organizations or individuals in the *Factiva* and *LexisNexis* online databases and in the electronic archives of specific newspapers<sup>2</sup>. In France, I also had access to the press clippings collected by the *Fondation Nationale des Sciences Politiques* on the theme of supplementary pensions<sup>3</sup>.

This empirical material has been complemented by other primary sources such as

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<sup>1</sup> Such as “retirement savings”, “private pensions”, “personal pensions”, etc. In French, I did my searches using primarily the following terms: “fonds de pensions”, “épargne retraite” and “épargne salariale”. In Polish, I typed mainly “fundusze emerytalne” (and its different inflections) as well as “otwarte fundusze emerytalne”.

<sup>2</sup> i.e. *The Financial Times*, *The Times*, *The Guardian*, *The Economist*, *Le Monde*, *Gazeta Wyborcza* and *Rzeczpospolita*.

<sup>3</sup> “Régimes complémentaires de retraite en France : dossier de presse”, France 424/6. Tome 1 : (Archive 10908) : 01/01/1948-31/12/1991 and Tome 2 : (Archive 10909) : 27/01/1992-18/10/2005.

position papers released by the actors involved in the reforms, minutes of parliamentary debates and interviews I have conducted on my own<sup>4</sup>. I have tried to verify all information with at least two different sources. I cite my sources when my evidence relies only on one source or when I directly quote them. I also cite references which allow the reader to get more in-depth information on particular aspects of the story.

### *Contributions of the thesis*

The thesis addresses current academic debates on the *determinants* and the *direction* of institutional change in social protection systems and in the varieties of capitalism. Recent scholarship in comparative political economy has increasingly viewed institutions as the object of a permanent negotiation in which different social groups strive to re-define the functions institutional arrangements perform and to change the way they distribute scarce resources (Thelen 2004; Morgan *et al.* 2005; Peters *et al.* 2005; Streeck and Thelen 2005; Jackson and Deeg 2007; Hall and Thelen 2009; Mahoney and Thelen 2010). Institutions are the product of compromises between actors with very different and often conflicting interests. They change when existing or new coalitions of actors manage to recast their form and redefine the purpose they serve. Studying such *coalitional dynamics* is thus essential to understand institutional change. The analytical approach I develop seeks both to challenge and advance this body of literature in three ways.

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<sup>4</sup> Interviews were conducted at different stages of my research. Those that were carried out at the beginning of my research helped me identify the names of relevant actors. By typing their names in combination with “pension funds” in newspaper archives, I was able to ascertain their role and find direct quotations that I cite in my chapters. I also conducted several additional interviews after having finished my analysis of newspaper archives and other sources, with the aim to verify some of the information that I found in them.

First, I draw attention to the strategies of a neglected segment of capital, i.e. the financial industry. To be sure, a number of political scientists have already pointed to its interest in developing private pension plans, but they have done so only in passing (e.g. Hacker 2002: 49-50, 104-106; Anderson and Immergut 2006; Palier 2007). Scholars who have debated business involvement in the origins and the evolution of the welfare state (e.g. Swenson 1991a; Iversen *et al.* 2000; Martin 2000; Estevez-Abe *et al.* 2001; Hacker and Pierson 2002; Swenson 2002; Mares 2003; Korpi 2006; Emmenegger and Marx 2011; Paster 2011) have focused exclusively on employers' associations and thereby have failed to acknowledge the input of financial lobbies. Over the years, business historians have unearthed the crucial role played by private insurance companies in the development of pension systems, particularly in "multi-pillar" systems such as the United Kingdom (Hannah 1986), the United States (Sass 1997; Klein 2003) and Switzerland (Leimgruber 2008). These studies have shown that, ever since the emergence of the concept of social insurance, life insurance companies have positioned themselves as a major competitor of state pensions by selling group insurance contracts. With this thesis, I shed light on the financial industry's transformational role in the current era of austerity and welfare state retrenchment.

My second contribution is to give further credence to the importance of the multidimensionality of actors' preferences. Because changes in an institution usually affect their interests and well-being on several levels, actors typically have multivariate preference functions (Hall 2010). Häusermann (2010) has shown that pension reforms are driven not only by material considerations but also involve conflicts on cultural values such as gender roles and family patterns. In this thesis, I suggest that another dimension determining actors' preferences regarding pensions is their impact on

corporate finance and corporate governance. This new perspective contributes to bring together welfare state studies and the literature on the politics of corporate governance reforms (e.g. Gourevitch and Shinn 2005; Cioffi and Höpner 2006; Goyer 2011). By highlighting how pre-existing pension institutions partly determine their interests, the thesis also echoes other works showing that actors' preferences are shaped by the institutional environment in which they are embedded (e.g. Martin 2000; Martin and Swank 2012).

Third, I contribute to continuing debates about the power of business. More than three decades ago, Lindblom (1977: 170-200) claimed that business had a "privileged position" in politics and government. Firms could not only wield considerable instrumental power due to their superior capacity to fund electoral and lobbying campaigns. They also held a form of structural power: even without pressuring politicians they were able to keep some issues off the government agenda, because politicians would normally refrain from considering policies that could potentially lead businesses to cut investments and jobs. Yet business is far from systematically winning the day in politics (Smith 2000). Culpepper (2011) has recently argued that corporate power primarily depends on the salience of political issues. The more an issue is salient to public opinion, the greater the incentive for politicians to tackle it. By contrast, the less salient – and the more technically complex – a policy area is, the less politicians should be involved in it, and the greater the power of business should be. This thesis suggests a theoretical model on how business wields influence on an issue where it is almost condemned to seek partners among politicians and other interest groups if it wants to achieve its ends.

While the first three contributions deal with the determinants of institutional change, a fourth contribution has to do with our understanding of the direction of contemporary institutional change. Political economists have shown lately how the decline of manufacturing industries and the rise of the service sector have led to an increased segmentation of labour markets and social protection (Palier and Thelen 2010; Emmenegger *et al.* 2012; Thelen 2012). However, deindustrialization has also been accompanied by the growing role of the financial services industry. Some observers claim that financial firms have striven to become the lead sector of the economy and have gradually imposed their ways of doing business on other industries, thereby leading to a “financialization” of the economy (Boyer 2000; Krippner 2005; Glyn 2006; Dore 2008; Davis 2009; Engelen and Konings 2010). By forming huge pools of financial capital, private pension funds are often believed to have been part of this process. The management theorist, Peter Drucker, highlighted already in the 1970s how pension funds had brought about an “unseen revolution” which resulted in what he called “pension fund socialism” (Drucker 1976). The new financial geography has ever since contributed to our understanding of the functioning of “pension fund capitalism” and of its implications (Clark 2000; 2003; Clark and Wójcik 2007; Dixon 2008; Dixon and Sorsa 2009). With its comparative political economy approach, this thesis attempts to provide an insight into the heated political debates that have accompanied these developments and to show how politics shapes different varieties of pension privatization and different types of pension funds.

### *Structure of the thesis*

Chapter 1 provides the theoretical background to the thesis. The first section explains why financiers should have a strong interest in the development of funded pensions and how they should try to put in the political agenda. The second section of the chapter argues that employers' and workers' preferences may vary depending on their perception of the costs and benefits brought by pension privatization, and specifies how these are shaped by the welfare-labour nexus, the welfare-finance nexus and institutional feedback from pre-existing pension arrangements. The third section of the chapter focuses on the linkages that exist between political parties and organized interests, and proposes a number of hypotheses on the circumstances in which governments are likely to give pension privatization the go-ahead. The fourth and last section of the chapter spells out ideational and partisan theories of pension privatization. These two approaches are currently the main theoretical accounts of the spread of funded pensions and provide strong alternative hypotheses against which the argument advanced in this thesis will be assessed.

Chapter 2 presents an overview of the trend towards the expansion of funded pensions in Europe. It starts by returning to the definition of the key technical terms used throughout this study and by outlining the main structural challenges to which European pension systems have been confronted in recent decades. It then contrasts the current institutional structure of retirement provision in Europe with that which prevailed at the beginning of the 1980s, and shows that countries have followed very different trajectories of pension privatization. To make the comparison meaningful, the chapter develops a novel typology of pension systems, which classifies countries not only according to the statutory pensions they provide, but also according to the dominant forms of supplementary pensions workers are covered by. Finally, the chapter

zooms in on the governance and the regulation of pension funds, and suggests that there is not a single model of pension fund capitalism, but rather a diversity of ways to organize funded pensions.

The rest of the thesis aims to assess the empirical validity of the theoretical claims made in Chapter 1. Chapters 3 to 5 provide detailed country case studies of contemporary pension reform in the United Kingdom, France and Poland. The last chapter brings this material together and discusses its implications.

## **Chapter 1: A Political Economy Model of Pension Privatization**

In this chapter, I put forward a framework for understanding both the trend towards pension privatization in Europe and its uneven advancement across countries. By pension privatization, I mean institutional changes that result in retirement provision being less and less financed on a pay-as-you-go basis and being increasingly funded. I build a political economy model of pension privatization in three main steps. My starting point is that the most important protagonist of the expansion of funded pensions should be the financial industry. Since private pensions can help them expand business, financiers should actively push for the development of retirement savings products, even though they may have different preferences over their technical specifications. Hence, the first step of my theoretical framework consists in presenting a set of hypotheses concerning the preferences of the financial industry and the lobbying strategies it can use to influence politicians and the public (section 1.1).

However, due to the far-reaching socio-economic consequences of pension privatization and the political risk it involves, financiers and the politicians who are in favour of it usually need to build broader coalitions to have a change of introducing reform. Apart from affecting the well-being of retirees, the structure of the pension system also has an impact on firms' production decisions, and consequently on the availability of jobs and capital in the economy. Therefore, not only financiers, but also employers and workers have concentrated interests in the design of pensions. As will become clear from the rest of this chapter, these two socio-economic groups are not necessarily in favour of pension privatization. Employers' associations and trade unions may thus try to persuade governments either to support or to block financiers' attempts

to develop funded pensions. What these two types of organized interests think about pension privatization matters a great deal to politicians because of the salience of pensions as a political issue and of the capacity of employers' and workers' organizations to influence political parties' electoral constituencies. As all citizens with a working career may have to – or at least choose to – go into retirement one day, pensions are a matter of common concern and are generally a high-salient issue to voters. In this context, a public campaign waged by a major organized interest against pension privatization may turn part of the public against the government majority and, as a result, hamper its chances of winning the next election.

Given the centrality of employers and workers to pension reform, the second step of my argument consists in specifying the preferences of these two socio-economic groups (section 1.2). Contrary to the financial industry's unequivocal interest in the development of retirement savings, the preferences of employers and workers may vary by sector, by country and change over time. I argue that these actors' varying attitudes are the result of their embeddedness in the “welfare-labour nexus”, the “welfare-finance nexus” and the pre-existing public-private mix in pensions. Rather than being purely determined by their labour market needs, employers' and workers' preferences regarding pension privatization can *also* be influenced by their concerns about the use and the control of pension fund assets. The way retirement savings are regulated and channelled into the financial system has a crucial impact on state and corporate finance as well as on corporate governance. Moreover, following their gradual institutionalization over the 20<sup>th</sup> century, pre-existing public and private pension schemes are also likely to affect the preferences of businesses and workers, through

“institutional feedback effects”<sup>1</sup>. Thus, when they have to take a stance over the design of the pension system, socio-economic actors calculate both the *costs* and *benefits* of various institutional options, by taking into account their interests resulting from the three dimensions I have identified.

In the third and final step of my theoretical framework, I propose a model of coalitional dynamics which sheds light on the alliances forged by financial lobbies and politicians with other socio-economic groups in order to build support around reform (section 1.3). I argue that the nature of the relationship between organized interests and parties largely depends on the party systems prevailing in different countries. In the relatively segmented electoral markets that distinguish multi-party systems, political parties will not sponsor legislation that expands private funded pensions unless they are backed by interest groups that represent their core electoral constituencies. Consequently, right-wing business parties will not push through pension privatization without prior support of employers’ organizations, while left-wing parties will seek approval of trade unions. In the much more competitive and median voter-oriented electoral markets characteristic of two-party systems, centre-right parties will often bypass organized interests, but centre-left parties have incentives to seek backing from employers’ associations in order to show the median voter that they are not tied to their trade union allies.

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<sup>1</sup> Historical institutionalists have shown that once a new policy or institution is introduced actors can be led to redefine their preferences in response to it (Weir and Skocpol 1985). Policy or institutional “feedback” needs not necessarily constrain actors’ behaviour as is the case with mechanisms of path dependence (cf. Pierson 2000), but at the very least contributes to shape their options. Pierson (1993: 610-611) has argued that policies and institutions exert feedback effects through two main channels. First, they create “powerful packages of *resources and incentives*” which influence actors’ material interests. Second, they have “*interpretive effects*” because they promote certain values over others and provide actors with cognitive shortcuts, which help them deal with complexity and uncertainty. The literature has shown that both public pensions (Pierson 1994; Bonoli and Palier 2000; Myles and Pierson 2001) and private pensions (Hacker 2002) have triggered such processes of institutional feedback.

The last section of the chapter sets out two existing theoretical accounts of pension privatization, which form the background against which I will assess the relevance of my own analytical framework. According to ideas-based approaches, key domestic policy-makers have increasingly changed their cognitive maps starting from the 1990s, because of a new pensions orthodoxy promoted by international organizations such as the World Bank, the OECD (Organization for Economic Co-operation and Development) and the European Commission. By contrast, partisan politics theories argue that the driving force behind political parties' pursuit of pension privatization is their electoral strategies. Partisan approaches have traditionally hypothesized that bourgeois and pro-business right-wing parties should be much more favourable to pension privatization than workerist left-wing parties. However, recent scholarship has also suggested that left-wing parties have gradually shifted their policy positions due to the growing importance of the high-skilled middle class as an electoral constituency.

### **1.1 Why and How Financiers Lobby for Pension Privatization**

The financial services industry has a clear interest in partial pension privatization. Two sets of financial actors can reap benefits from it, and this for different reasons. The first set comprises firms – such as *life insurance companies, mutual funds and banks* – that sell savings products (Kemmerling and Neugart 2009). Creating tax incentives for retirement savings or possibly mandating them stimulates demand for products of which such firms are the main potential suppliers. The second segment of the financial industry that potentially gains is *stock exchanges*. These entities compete with each

other to attract new investors and new issuers of securities (Wójcik 2011). They are also an essential element for any city that aspires to secure a position as an international financial centre, because their strength creates positive externalities for the rest of the local financial industry (Sassen 2001; Cassis 2005; Engelen and Grote 2009; Callaghan and Lagneau-Ymonet 2012). For stock exchanges, the expansion of funded pensions is important because it results in the creation or the consolidation of large institutional investors. These can bring regular inflows of capital on the markets and, by virtue of their size and expertise, can trade more volumes than ordinary individual investors. Pension funds' presence thus increases a stock exchange's appeal to issuers and to other investors, because it reduces their uncertainty as to whether the shares or bonds they sell will indeed find purchasers or will be correctly priced. In the following paragraphs, I present my hypotheses, first, on financiers' preferences towards the reform of public and private pensions and, second, on their lobbying strategies.

Since generous public pay-as-you-go pensions usually crowd out private retirement savings, I hypothesize that financiers should back cost-containment in *public systems*. However, I assume that the institutionalization of pay-as-you-go pensions over time has produced two types of "feedback" effects, which make it unlikely that the financial industry will push for their radical dismantling and their full replacement with private retirement savings. First, given that in pay-as-you-go systems today's statutory benefits are paid from contributions levied on the wages of today's workers, fully substituting funded pensions for the pay-as-you-go system would mean that workers – and firms – would simultaneously have to pay for the public benefits of current pensioners and for their future funded pensions. This "double payment problem" (Myles and Pierson 2001) would not only threaten the material interests of employers and

workers within the welfare-labour nexus, but would also harm the competitiveness of financial firms themselves, since as employers they would be equally affected by this difficulty.

A second feedback effect of pay-as-you-go pensions has occurred both on the “incentive” and on the “interpretive” level. Business historians have shown that the private insurance industry was initially opposed to the introduction of social insurance and public pension schemes, because it considered them as being in unfair competition with its own products (Hannah 1986; Sass 1987; Klein 2003). However, after public pensions were enacted, life insurers gradually came to see them as a platform for – rather than as a hindrance to – the development of supplementary pensions (Hacker 2002; Leimgruber 2008). The reason was that workers would become more conscious of the need to provide for their retirement, while employers could be more convinced to create occupational schemes to retain their workers. According to Leimgruber (2012: 25), the Swiss and later the global insurance industry have been key protagonists in the formulation of the pension “pillars” metaphor and the popularization of the “three-pillar concept”, which “advocates a combination of basic state-based pay-as-you-go pensions (first pillar) and funded occupational and individual supplements (the second and third pillars)”. Hence, due to these institutional feedback effects from pay-as-you-go systems, financiers should accept the persistence of relatively basic public pensions.

Apart from advocating the containment of public pensions, the financial industry should also favour the creation of incentives to boost *private retirement savings*. Tax allowances are the instrument most frequently used for that purpose. However, even though the financial industry as a whole has an interest in partial pension privatization, it is divided into different segments that traditionally compete with each other to attract

individuals' or organizations' savings. Different segments typically offer different types of products: for example life insurance companies can offer annuity contracts, whereas banks or mutual funds manage savings that are generally paid out as a lump sum. State regulations determine whether these segments can enter each other's business or not (Suárez and Kolodny 2011). As a result, I expect the different segments of the financial industry to try to shape legislation in such a way that it gives them a competitive edge. This can be done either by limiting the range of retirement savings products that will be on offer or by introducing more generous tax rebates for specific products.

In short, I hypothesize that the financial industry should push for cost-containment in pay-as-you-go schemes because these can limit the space for the development of funded pensions. However, I do not expect it to advocate a radical dismantling of public systems, particularly because I assume it sees them as a platform for the development of private schemes. I also hypothesize that financiers should call for tax incentives to stimulate retirement savings, but that each segment of the industry should be partial to its own products (for a summary see table 1.1).

To promote pension privatization, financiers can be expected to lobby all governments, irrespective of their political persuasions. In doing so, they can try to influence politicians at different stages of the policy-making process and use a variety of techniques. Lobbying does not limit itself to trying to induce the executive and the legislative to adopt or reject specific policy measures once an issue has already reached the decision-making stage. As has been shown by students of agenda-setting (Baumgartner and Jones 1993; Kingdon 1995; Baumgartner *et al.* 2006; Leech 2010), a crucial part of the lobbying effort is in the first place to manage to attract policy-

makers' attention to an issue and get it on the public agenda<sup>2</sup>. Thus, financiers can already exert influence if they ignite a public debate on pension privatization. They can then work to generate momentum for it, and eventually manage to get it onto the government's or the parliament's agenda.

Financiers can approach politicians behind closed doors (i.e. "inside lobbying") and try to convince them from an ideational point view that pension privatization is the right policy to pursue. But, in order to boost their chances of getting their way, they can also engage in "outside lobbying". This type of activity has been defined as "attempts by interest group leaders to mobilize citizens outside the policy-making community to contact or pressure public officials inside the policy-making community" (Kollman 1998: 3) or in other words "going grass roots". However, taken more broadly, it can mean any type of activity that aims at influencing policy-makers via public opinion. If they manage to shape what public opinion thinks and can demonstrate that the public supports their views, proponents of pension privatization increase their odds of winning the battle. A crucial technique to achieve this is "issue framing". This concept refers to attempts made by policy advocates to shape or reshape the way people conceptualize an issue, using for example slogans or various rhetorical devices. Issues can be framed either positively (Cox 2001) or negatively (Blyth 2001) so as to arouse the feeling that either the status quo or a proposed change is necessary and that it fits with a social group's dominant conceptions. Financial firms have one particularly powerful instrument that allows them to frame the pension debate: they can launch large-scale advertising campaigns for their products. Not only can ads present retirement savings in a good light with very large audiences, but they can also be used to convey pessimistic

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<sup>2</sup> Hacker (2006b: 393) has noted that "many works that stress employers' influence tend to begin the story when reform gets on the agenda, then trace the direct interventions of business on specific policy choices. But this 'snapshot' view makes it nearly impossible to judge the true power of employers".

messages about the future of public pay-as-you-go pensions. Over time, they can produce powerful effects.

## **1.2 Employers' and Workers' Indeterminate Preferences towards Pension Privatization**

Whereas financiers overwhelmingly gain from the development of private retirement savings and can be expected to lobby for it actively, employers and workers are two other socio-economic groups that have very high stakes in the pension system, but they do not necessarily support its partial privatization. Their preferences matter to politicians due to their importance in the production system, but also because of the ability of employers' associations and trade unions to mobilize parties' electoral constituencies. Since pensions are a highly salient issue to voters, any retaliation from these socio-economic groups against a government's reform plan can affect politicians' chances of getting (re-)elected. In this section, I present my hypotheses on how the welfare-labour nexus, the welfare-finance nexus and institutional feedback affect employers' and workers' preferences towards public and private pensions, while in the next section I develop a model of the coalitional dynamics that link interest groups and political parties.

### *Employers and managers*

Employers – or managers – can derive benefits and simultaneously incur costs from pension privatization. In the same way as with financiers, support for cost

containment in public pensions (but not for their radical dismantling) should be relatively consensual among employers. However, the difference between the two segments of capital lies in the fact that employers may have divergent views about how private pensions should be regulated.

Generous *public pensions* represent a cost for employers. Because their competitiveness and their profitability are key concerns for them, I expect them to call for cost-containment in statutory schemes (see also Häusermann 2010; Seeleib-Kaiser *et al.* 2011). There should be a cross-sectoral agreement on this issue, even though small firms have been traditionally more cost-sensitive than large companies owing to their lower ability to bear increases in wages and in the non-wage labour costs generated by social arrangements (Martin 2000; Mares 2003; Culpepper 2007).

Employers should nonetheless be very unlikely to favour a radical dismantling of existing pay-as-you-go pensions, because I assume them to be influenced by institutional feedback. The literature has indeed shown that, whether or not business supported their introduction, public pensions have contributed to shape *positive* expectations among employers in the welfare-labour nexus. On an “interpretative” level, public pension systems have institutionalized retirement as a necessary stage in the life course (Guillemard 1986) and have therefore strongly shaped employers’ human resources policies. Employers have been able to use pensions as a means to ease older (and less productive or less skilled) workers out of the labour force in a peaceful and a socially acceptable way (Ebbinghaus 2006b). A second assumed feedback effect of public pensions is that they have helped standardize employers’ welfare costs. For firms that traditionally ran their own private occupational pension plans, public pensions introduced a level-playing field with employers who had not created such schemes and

were as a result more cost-competitive (Gordon 1991; Swenson 2002). Finally, the institutionalization of pay-as-you-go pensions could result in a “double payment problem” (cf. Myles and Pierson 2001) were they to be radically cut and fully replaced by funded schemes. The resulting increase in firms’ labour costs would harm their competitiveness. Like financiers, I thus expect employers to be more supportive of statutory systems that offer only basic benefits.

However, employers’ preferences regarding the development of *private funded pensions* are theoretically much more indeterminate, because besides bringing some potential benefits pension privatization may be associated with a number of costs. In the welfare-labour nexus, occupational pensions have been generally considered by employers as a useful instrument for attracting and binding their core workforce or skilled staff to the company (Jacoby 1997; Engelen 2006; Sass 2006). With such fringe benefits, employers can credibly claim that they offer an above-market income package and that they help relieve their employees of some of their responsibility to provide for their retirement<sup>3</sup>.

Pension privatization may nevertheless prove a mixed blessing for employers in the welfare-finance nexus. When managers have to decide about how to finance their companies’ operations, they can choose between two forms of funding: debt or equity. Each form involves a different type of relationship between managers and those who provide this funding (Jensen and Meckling 1976; Aguilera and Jackson 2003). With debt, creditors have very limited control rights over the company and its managers, but

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<sup>3</sup> All other things being equal, occupational plans are the more advantageous to employers the more control they have on their schemes (Mares 2003). In particular, employers should be interested in having discretion over the definition of “vesting periods”, i.e. the amount of time workers need to work in order to secure an absolute right to a pension. The longer such a vesting period is the more powerful a retention tool occupational plans are, since an employee who would leave her employer before reaching the minimum vesting period could lose her right to a pension.

receive a fixed income with interest. On the contrary, equity holders have a right of property – and in theory a right of control – over the company, but face greater financial risks, because they only have a residual claim in the company's assets after all liabilities have been paid. Since pension fund assets are traditionally invested on the stock exchange through financial instruments such as stocks, bonds or derivatives, the development of funded pensions holds the promise of broadening managers' sources of corporate finance, particularly in bank-dominated financial systems.

Employers – especially managers of large corporations that are generally more likely to go public on the stock exchange (Deeg 2009) – may thus be interested in having better access to such instruments. However, they may be anxious about the consequences it has for their decision-making powers within the corporation. First, pension privatization can increase the threat of hostile takeovers for companies that are publicly listed on the stock exchange. If pension funds diversify their investment portfolios, the result will be that they will typically have relatively small stakes in the equity capital of a given company. This means that firms' shareholding will very likely become more dispersed. For managers, dispersed ownership means an increased risk of a hostile takeover of their company. A change of ownership can jeopardize their corporate strategies or even threaten their position as managers of the firm. Second, new owners, including pension funds, may also have specific requirements about how managers should distribute profits. If pension funds focus on maximizing their rate of return in the short run, they may put pressure on managers to distribute more dividends. As a result, managers may be prevented from retaining earnings for financing projects that could promote the firm's growth in the long run. Thus, I expect employers (mainly in large firms) to have concerns about whether pension funds will act as patient

investors who will protect their firms from hostile takeovers and provide financing for long-term investments.

Last but not least, employers may also be reluctant towards plans to expand funded pensions due to institutional feedback from existing supplementary schemes. Even in systems offering generous public pay-as-you-go pensions, many employers and industries set up or maintained supplementary plans for their workers after the Second World War (Ebbinghaus 2011). However, these schemes have not always been fully-funded or managed by financial sector companies. Many have been in part pay-as-you-go, and have been directly controlled by employers or jointly administered by the social partners (i.e. employers and unions). Employers have often shaped them in ways that are beneficial to them in the welfare-labour nexus (for example to allow them to retain skilled workers), and have institutionalized them in their human resources policies. Yet financial firms are likely to challenge such schemes due to their interest in maximizing the potential of the market for private funded pensions. Therefore, if pension privatization poses a threat to their supplementary schemes, I expect employers to protect them and possibly oppose plans to promote funded pensions. It is nevertheless important to emphasize the fact that, since these existing supplementary schemes can themselves be the object of institutional change, the institutional feedback effects that they generate may change over time. Such changes may in turn lead employers to redefine their preferences.

To sum up, employers should favour cost-containment in statutory schemes due to their bottom line concerns, but should be very unlikely to push for their radical dismantling, because I assume they should be influenced by public policy feedback. However, the overall attitude of employers towards the development of funded pensions

is theoretically more indeterminate. Even though employers should consider pensions as a powerful skill retention tool, significant groups of employers may have reservations about pension privatization because of pension funds' uncertain impact on corporate governance and because they may have developed an interest in pre-existing occupational schemes.

### *Workers*

Workers' core interest is to ensure that they receive adequate retirement income. Contrary to financiers' and employers' focus on cost-containment in public systems, workers should primarily seek to protect their statutory rights while potentially trying to revamp them. Simultaneously, they need not necessarily oppose funded pensions, but are also likely to prefer to limit their role and regulate their governance.

Workers should see *public pensions* as a vested social right and therefore defend them, because I assume them to be influenced by institutional feedback. The institutionalization of statutory pay-as-you-go pensions has contributed to entrench two concepts in the labour movement. First, statutory pensions have been perceived as a "social wage". The concept implies that "all citizens ought to have the right to a basic pension to retire in old age and thus share in the economic wealth created during their working life" (Ebbinghaus 2006b: 40). Second, pay-as-you-go pensions have set in stone an "intergenerational contract" according to which the benefits of the retired generations should be paid by the working generations. A radical replacement of pay-as-you-go pensions by funded schemes would severely disrupt this contract and act against workers' material interests, because they would not only have to cover the

expenses of current pensioners' statutory pensions but also save money for their own future benefits (cf. the "double payment problem").

However, although their goal is to provide workers with an income when they become incapable of working due to old age, pension systems can in fact fulfil both an insuring and a redistributive function (Häusermann 2010; Rehm 2011). On the one hand, they can help workers to maintain their income at the level it was during their working career, and thus reproduce wage differentials. On the other hand, they can be used to redistribute money from the rich to the poor, in order to alleviate poverty among pensioners. These two different logics give rise to *intra-labour cleavages*. Income maintenance should be prioritized by workers with higher skills and middle or high incomes. Low-skilled workers and low-income earners should favour more redistributive institutional designs. Depending on which group of workers they aim to represent, trade unions or political parties will put the emphasis on one of these two functions, or will have to make a trade-off between them and seek to recalibrate the pension system.

Workers' preferences regarding the expansion of *private funded pensions* are shaped by feedback from the pre-existing public-private mix in pensions and by their interests in the welfare-finance nexus. Workers do not have to be by definition hostile to the development of retirement savings. Because even generous pension systems often set a ceiling on benefit levels, workers – particularly middle- or high-income earners – may be interested in tax incentives for supplementary retirement savings. However, such tax advantages generally mean a loss of revenue for the pay-as-you-go system. Moreover, plans to expand funded pensions may more openly target existing statutory or supplementary pension rights. In that case, workers can be expected to resist the

development of funded pensions. The more generous their existing benefits, the stronger their opposition should be. An additional institutional feedback effect contributing to such resistance may be the involvement of organized labour in the management or the supervision of existing statutory or supplementary pension schemes.

Finally, workers may see both benefits in and have concerns about the impact of pension funds on the welfare-finance nexus. Although control over the financing and the operations of a company is traditionally exercised by corporate managers and shareholders, workers can also have an influence over corporate governance and the allocation of resources within the firm, either directly through representation on boards or works councils, or indirectly through negotiations on wages and labour contracts (O'Sullivan 2003). The expansion of private pension funds promises to give workers a stake in their companies since as a matter of fact it is synonymous with increased employee ownership.

Nevertheless, workers' retirement savings are usually managed by intermediaries such as specialized pension funds, insurance companies or mutual funds. These organizations' investment strategies may have an impact on workers' position in the company. Workers may have concerns that pension funds' requirements regarding dividend distribution and the increased risk of hostile takeovers might lead to processes of corporate restructuring and threaten their wages and their jobs. As a result, they should seek to secure a more influential position in the governance of pension funds and have a say in their investment practices so as to promote worker-friendly forms of investment (see also Ghilarducci 1992; Pontusson 1992; Ghilarducci *et al.* 1997; Fung *et al.* 2001; Gourevitch and Shinn 2005; Vitols 2011).

In sum, I expect workers to seek to preserve statutory pensions because I assume they should consider them as earned social rights and part of an intergenerational contract. Yet workers may also seek to recalibrate them to strike a new balance between income maintenance and redistribution. Workers' preferences regarding the expansion of private funded pensions should be more indeterminate. Although middle- or high-income earners should favour tax incentives for retirement savings, these can reduce revenues for statutory pensions and thus trigger opposition among workers. Workers should also be interested in regulating pension funds' governance due to their uncertain impact on the position of labour in the welfare-finance nexus.

In this section, I formulated a set of hypotheses about the preferences of employers and workers towards the retrenchment of public pay-as-you-go pensions and the development of private funded pensions. Although I built them on a number of sub-hypotheses (for a recap see table 1.1), I have two overarching expectations. Regarding public pensions, I expect employers to have a similar interest to that of financiers in (limited) cost-containment, whereas workers should on the contrary try to preserve them. The class divide (i.e. capital vs. labour) should thus hold on this dimension of pension reform, although I also expect an intra-labour cleavage on issues of redistribution and insurance between low-skilled workers/low-earners and high-skilled workers/high-earners. As regards private pensions, I argue that, contrary to financiers' strong preference for the development of funded pensions, employers' and workers' preferences are theoretically more indeterminate. These two socio-economic groups should either favour or oppose pension privatization depending on how it affects their interests in the welfare-labour nexus, the welfare-finance nexus and pre-existing pension schemes. Thus, whereas financial lobbies will try to put pension privatization

on the agenda, employers' associations and trade unions may either join them in their effort or, on the contrary, try to prevent the executive or the legislative from working on the issue and ensure that pension privatization does not move to a more advanced stage of the policy-making process (Bachrach and Baratz 1962; Culpepper 2011).

It should be noted that not all discussions on pension privatization – and institutional change in the pension system – need to take place in the political arena. The post-war occupational pension schemes, which were created by employers and/or trade unions and which according to the hypotheses presented in this section should be regulated by the state, were often subject to very limited state supervision and were primarily regulated in the labour market and the industrial relations arena (e.g. Ebbinghaus 2011). This gave rise to a form of “subterranean politics” ignored from the general public (Hacker 2002) and where private actors have played a leading role. Debates on and changes in pre-existing occupational schemes can potentially slip below the radar screen of public opinion, but it is important to analyse them because they can feed into developments occurring in government or parliament. The empirical sections of this thesis will therefore trace relevant developments in the industrial relations arena. The next section, however, focuses on coalitional dynamics on the political stage.

**Table 2.1 Expected positions of socio-economic actors regarding the reform of statutory pensions and the development of private funded pensions**

	For... →	... financiers	... employers	... workers
<b>STATUTORY PENSIONS</b>	Statutory pensions ... →	... should be contained, but not dismantled	... should be contained, but not dismantled	... should be preserved, but potentially recalibrated
	Why? Because they... →	(--) <u>welfare-finance nexus*</u> <ul style="list-style-type: none"> <li>... may limit space for private pensions</li> </ul> (+) <u>institutional feedback**</u> <ul style="list-style-type: none"> <li>... act as a platform for private pensions</li> <li>... may create a double payment problem</li> </ul>	(--) <u>welfare-labour nexus*</u> <ul style="list-style-type: none"> <li>... may affect cost competitiveness</li> </ul> (+) <u>institutional feedback**</u> <ul style="list-style-type: none"> <li>... institutionalize retirement</li> <li>... provide a level playing field on pension costs</li> <li>... may create a double payment problem</li> </ul>	(++) <u>institutional feedback**</u> <ul style="list-style-type: none"> <li>... are a vested social right</li> <li>... may create a double payment problem</li> </ul> (±) <u>welfare-labour nexus*</u> <ul style="list-style-type: none"> <li>... must strike a balance between income maintenance and redistribution</li> </ul>
<b>PRIVATE FUNDED PENSIONS</b>	Funded pensions ... →	... should be expanded	(indeterminate)	(indeterminate)
	Why? Because they... →	(++) <u>welfare-finance nexus*</u> <ul style="list-style-type: none"> <li>... help sell more savings products and increase profits</li> <li>... help attract new investors and issuers on the stock exchange</li> </ul>	(+) <u>welfare-labour nexus*</u> <ul style="list-style-type: none"> <li>... can be used as a tool to retain skilled workers</li> </ul> (±) <u>welfare-finance nexus*</u> <ul style="list-style-type: none"> <li>... provide new sources of corporate finance (particularly for large firms)</li> <li>... may increase danger of hostile takeovers and be short-sighted investors</li> </ul> (-) <u>institutional feedback*</u> <ul style="list-style-type: none"> <li>... may threaten existing employer-sponsored supplementary pensions</li> </ul>	(±) <u>institutional feedback*</u> <ul style="list-style-type: none"> <li>... may help them top up their retirement income (particularly high-skilled workers/middle- or high-income earners)</li> <li>... may threaten their existing statutory and supplementary pension rights</li> </ul> (±) <u>welfare-finance nexus*</u> <ul style="list-style-type: none"> <li>... may give workers a stake in their companies</li> <li>... may be short-sighted investors and threaten workers' jobs</li> </ul>

N.B.: (+) = benefit; (-) = cost; \* = hypothesis; \*\* = assumption

### **1.3 Coalitional Dynamics in Multi-Party and Two-Party Systems**

Let me restate the argument I have presented so far. First, I have argued that the financial industry and the interest groups that represent its different segments should be the main actors asking for pension privatization to be put on governments' agendas. My second contention was that the two other socio-economic groups that have concentrated interests in the pension system, namely employers and workers, may either be for or against the expansion of private funded pensions, depending on how it affects their interests in the labour market and the financial system as well as pre-existing pension institutions. Politicians pay particular attention to employers' and workers' attitude towards pension privatization, not only because these two groups have high stakes in the pension system, but also because their interest groups can turn their members and broader segments of public opinion against government plans to which they are hostile. In this section, I develop theoretical expectations about how the interactions between employers' associations, trade unions and political parties matter to the success or failure of financiers' lobbying campaigns in favour of pension privatization. I argue that these relationships vary across countries, depending on the nature of their party systems and electoral institutions.

Pension reform is an issue that can be considered as quite salient to voters, and therefore matters electorally. Although issue salience is notoriously difficult to measure (Wlezien 2005; Jennings and Wlezien 2011), a number of studies indicate that it is reasonable to assume that pension reform is on average a high-profile political issue. For example, pre-election opinion polls have shown that pensions feature relatively highly in voters' concerns, even though they are not the most important issue (e.g.

Green and Hobolt 2008). By using press coverage from national newspapers as an indicator of salience, Culpepper (2011) has shown that pensions have systematically received more sustained attention than areas like corporate governance or vocational training. Finally, according to studies on the public's perception of the deservingness of needy groups, the elderly consistently score highest (Van Oorschot 2006). These results suggest that there is potential for political mobilization around the issue of pensions.

Politicians may have different motivations for accepting to expand private retirement savings. Central to my argument is the idea that they should be initially persuaded by the financial industry from an ideational point of view. Politicians may thus become convinced that pension privatization is the right policy to pursue, because they may see it as a way of addressing financial imbalances caused by population ageing, or because they may believe that it will increase the supply of capital in the economy, etc. However, once they are influenced by financiers, they may also see electoral opportunities in following this policy agenda. In particular, Häusermann (2010; see also next section) has argued that both right-wing and left-wing parties can see pension privatization as an opportunity to attract the vote of the middle class. Structural changes in the economy have resulted in the growth of a new group of high-skilled middle-class workers whose relatively higher incomes allow them to top up their retirement income with private retirement savings. Politicians may thus consider the development of funded pensions as a major element of a platform that will appeal to this segment of the electorate.

Yet, while pension privatization may present electoral opportunities, it also involves some serious risks for politicians, if their constituents have a negative opinion of this type of reform. Organized interests may play an important role in determining

how the public views politicians' plans to expand retirement savings. Interest groups often provide parties with stronger roots in society (Poguntke 2002). As mass organizations, trade unions and employers' associations command the allegiance of thousands of members. If they have more privileged links with a party, they can serve as recruiting ground for its members, make campaign donations, finance its day-to-day operations<sup>4</sup> or also mobilize their own members on election day (Streeck and Hassel 2003: 366). Through press coverage of their activities and views, organized interests can also send signals to unaffiliated but class-conscious individuals about the desirability of the policy measures that a government adopts or intends to introduce. If a government decided to push through pension privatization despite the fact that unions or employers' associations perceived it as a threat to their interests, these interest groups would likely decide to wage a public campaign against the reform. Since pensions are a high-salient issue, this might in turn damage the governing parties' re-election prospects. Therefore, governments have strong incentives to work out compromises with relevant interest groups before officially deciding to sponsor legislation that promotes the expansion of private funded pensions.

Quite naturally, it is in politicians' and financiers' interest to form as large a pro-reform coalition as possible with the business community or the labour movement. However, the specific composition of the coalitions that are formed is likely to matter to political parties and will depend on the type of party system and electoral institutions that are prevalent in a country. One should thus expect different types of coalitional dynamics in countries which have a multi-party system with a relatively high degree of proportionality of electoral rules and in countries that have two-party majoritarian

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<sup>4</sup> While party financing may be a way in which pressure groups can influence politicians, this technique is not investigated in this thesis, due to the difficulty to trace it and because it may be less relevant if legislation forbids it.

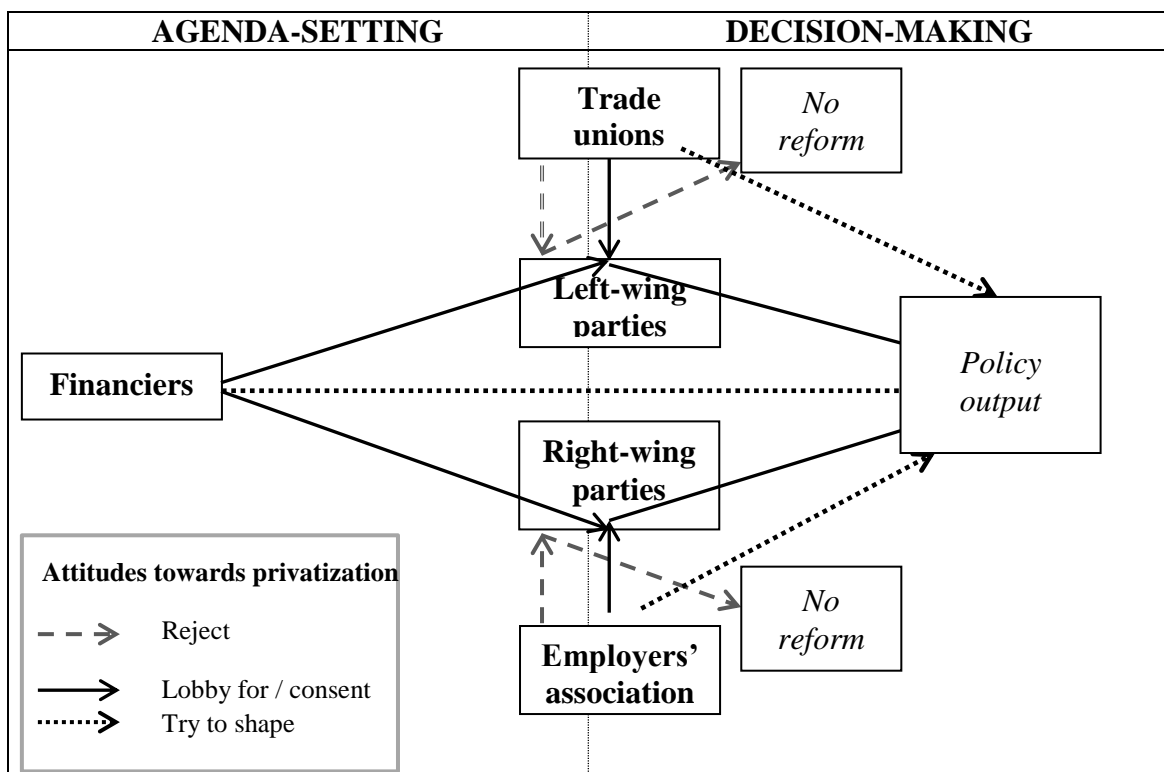
systems (cf. Iversen and Soskice 2006; Cusack, Iversen and Soskice 2007; 2010; Martin and Swank 2008; 2011; 2012).

*Multi-party systems* with proportional electoral rules – e.g. proportional representation or run-off voting – are generally characterized by segmented electoral markets in which parties target their campaigns to specific social groups. Politicians develop strong links with the organized interests representing their target constituencies and are seen as representing their goals in the political system. Indeed, multiparty systems often include dedicated labour or business parties. Parties are deemed to be representative of their core constituencies. Nothing prevents politicians from trying to widen their appeal to other segments of the electorate. But, if a party is seen as doing this at the expense of the interests of the groups to which it is traditionally committed, it faces the risk of diluting their support.

Thus, while even in multi-party systems both right-wing and left-wing parties can see pension privatization as an opportunity to woo high-skilled middle-class voters, it is in their best interest to seek support for reform from those organized interests whose constituencies overlap with their core electorates. I therefore hypothesize that, in this type of party systems, *a governing party should formally sponsor a bill on pension privatization – or, in other words, move from the agenda-setting phase to the decision-making stage – only if it has prior assurance of support from one or several interest groups representing its target constituencies.* Hence, if one assumes that right-wing parties consider employers and the self-employed as their core constituency and that left-wing parties see blue-collar and public-sector workers as their main clientele, right-wing parties should contemplate pension privatization only if they get backing for their plans from an employer organization while right-wing parties will not consider it unless

it is also supported by trade unions (see figure 1.1). To secure their allies' cooperation, parties will either try to satisfy their demands on pension fund regulation or, in the case of trade unions, make concessions on the recalibration of pay-as-you-go pensions. The substance of concessions will depend on the configuration of socio-economic groups' preferences towards pension privatization (cf. section 1.2 of this chapter).

**Figure 1.1 Expected coalitional dynamics in multi-party systems**



Linkages between parties and interest groups will take on a very different character in *two-party systems* – i.e. usually countries with a first-past-the-post voting system. Although there may be organizational links between organized interests and parties, these are much less constraining on party leaders than in multi-party systems. In these countries, electoral markets are much more competitive. In order to win elections,

parties need to attract voters from a variety of social groups and will primarily try to appeal to the median voter or the middle class. Therefore, parties tend to be umbrella organizations with diverse constituencies. While employers have often been dispersed across parties and have had no privileged links with a single centre-right party (cf. Martin and Swank 2012), centre-left parties (such as the Labour Party in the United Kingdom or the Democratic Party in the United States) have nevertheless had traditionally stronger links with trade unions. This creates a situation where centre-left parties in two-party systems may have good reasons to distance themselves from trade unions in order to win elections.

As has been argued by Iversen and Soskice (2006; 2009), middle-class voters tend to believe there is a risk that centre-left governments may be tempted to cater to their left-wing party base and centre-right governments to move right, and thus pursue policies that are detrimental to middle-class interests. Given their traditional links with trade unions, centre-left parties can be thought to be more strongly committed to their party base on economic issues than centre-right parties. To attract the vote of the middle class, leaders of centre-left parties therefore have incentives to demonstrate their independence from these activists. One way to do so is to show greater responsiveness to employers' associations. The implication for the politics of pension privatization in two-party systems is that, *while centre-right parties may ignore pressures both from employers' associations and trade unions, centre-left parties will formally sponsor a bill on pension privatization only if they have prior assurance of support both from trade unions and employers' associations.*

In sum, parties' willingness to introduce legislation leading to the development of funded pensions may depend on the prior support they get from employers' associations

and trade unions. The intensity with which politicians will seek backing from organized interests depends on the type of party system in which they compete.

#### **1.4 Alternative Explanations: Ideational and Partisan Theories of Pension**

##### **Privatization**

While financiers' lobbying campaigns may have been one factor that has driven politicians to promote the expansion of retirement savings, existing political science analyses have considered other factors as the prime movers of the recent wave of pension privatization in Europe. Two dominant explanations can be found in the literature. The first one emphasizes the influence of new policy ideas pushed forward by international organizations. The second one focuses on stability and change in parties' electoral strategies. Although these accounts undoubtedly shed some light on the politics of pension privatization, they also suffer from a number of limitations, particularly when it comes to explaining the timing of relevant reforms and variation in outcomes.

##### *The new multi-pillar pensions orthodoxy*

A number of ideational scholars have argued that the main reason why policy-makers who had previously defended redistributive pay-as-you-go pensions have become more and more convinced of the need to develop private retirement savings is their adoption of a "new pensions orthodoxy" promoted chiefly by the World Bank (Müller 1999; Palier 2007; Orenstein 2008; Seeleib-Kaiser *et al.* 2008). In a high-profile

report entitled “Averting the Old-Age Crisis”, the World Bank (1994) contended that both developing and industrialised countries should move from what it considered as financially unsustainable pay-as-you-go-dominated pension systems towards more sound “multi-pillar” systems with mandatory retirement savings accounts. Such systems would not only help governments to confront challenges on the public finances resulting from demographic ageing, but also promote long-term growth by creating vast pools of capital that could be reinvested in their economies. This new policy model has subsequently been relayed by other international organizations such as the OECD (Armingeon and Beyeler 2004) or the European Commission (Moreno and Palier 2005).

Because of its unmistakable message, the multi-pillar doctrine is believed to have become a new policy “paradigm”<sup>5</sup> that has helped sustain processes of “social learning”, i.e. a mechanism through which policy-makers “adjust goals or techniques of policy in response to past experience and new information” (Hall 1993: 293). Ideas-based analyses generally argue that social learning leads to substantial institutional change when two conditions are met. To begin with, policy-makers must reject their former understanding of the problems affecting a policy sector and the solutions that were offered to tackle them. Such a move may be motivated by the outright failure of past policies or the appearance of anomalies that cannot be explained by the currently prevailing policy paradigm. Second, their views must converge on a new paradigm that is considered more credible and will underpin future decisions. One of the main consequences of such “paradigm changes” is that differences in policy ideas of otherwise ideologically opposed parties or interest groups diminish considerably.

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<sup>5</sup> The concept has been defined as “a framework of ideas and standards that specifies not only the goals of policy and the kind of instruments that can be used to attain them, but also the very nature of the problems they are meant to be addressing” (Hall 1993: 279).

Although ideational scholars broadly agree on the mechanisms through which the new pensions orthodoxy has affected pension policy-making, their interpretations diverge on the nature and scope of the paradigm change it has fostered. Two main hypotheses exist. For Palier, the multi-pillar doctrine is a *broad* intellectual framework that has contributed to encourage “the *principle* of developing supplementary funded pensions” (2007: 97; emphasis added). The paradigm change has resulted in “ambiguous agreements” among key policy-makers (including left-wing politicians and some trade unions) because the form and the content of pension privatization are “not the object of this consensus”. As a cognitive map proposed not only by the World Bank but also by the OECD and the European Commission, the multi-pillar model has had a wide geographic scope of influence, as it has changed policy-makers’ preferences both in developing and in industrialized countries, particularly in Continental Europe (Palier 2010b).

For Orenstein, the World Bank’s model constitutes a much more *specific* blueprint for reform in which pension privatization is promoted through “the partial or full replacement of social security type pension systems by ones based on private, individual<sup>6</sup> pension savings accounts” (2008: 2). His analysis considers only the impact of this well-elaborated policy proposal inspired by the 1980 Chilean pension reform and changes introduced in other Latin American countries at the beginning of the 1990s (Mesa-Lago and Müller 2002; Madrid 2003; Weyland 2006; Brooks 2009), and does not take into account other possible forms of pension privatization. The multi-pillar model has been diffused through an active transnational campaign led by the World Bank and “allied organizations” such as USAID (the U.S. Agency for International

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<sup>6</sup> And in fact mandatory and defined-contribution savings accounts.

Development), other multilateral and bilateral aid agencies, as well as transnational policy entrepreneurs like the Chilean politician José Piñera. Orenstein claims that these actors were the first ones to put privatization on the agenda in a number of middle-income (especially CEE, i.e. Central and East European) countries, which had typically weak domestic policy-making resources and were more willing to undertake risky reforms.

### *Parties' electoral strategies*

While the ideational literature has highlighted the causal impact of new policy ideas on policy-makers' preferences, partisan theories have assumed parties' policy positions to be primarily shaped by their electoral strategies. But this strand of the literature is also divided in its theoretical expectations.

Originally a theory of welfare state development, the power resources approach (Korpi 1983; Esping-Andersen and Korpi 1985) has traditionally expected right-wing and left-wing parties to pursue *distinct* social policy goals due to their different social bases. Right-wing parties have been hypothesized to prefer market-based social provision since historically they have defended the interests of the bourgeoisie, i.e. the social group that owns capital and the means of production, two resources it is assumed to have used to dominate labour in the market arena. On the contrary, the theory has expected left-wing parties to favour a high degree of redistribution through public social arrangements, because their main electorate has been the working class<sup>7</sup>. Power resources scholars assume that workers attempt to overcome their disadvantage in the

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<sup>7</sup> The working class are those individuals who in a capitalist society are forced to sell their labour power to an employer in exchange for a wage.

labour market by entrenching welfare programmes as social citizenship rights which should achieve a high degree of “decommodification”, i.e. help workers maintain an acceptable standard of living without reliance on the market (cf. Esping-Andersen 1990; Palme 1990). A special case is Christian-democratic parties. Inspired by the social doctrine of the Catholic Church, they have traditionally sought to cross the class divide. The theory has therefore assumed them to be favourable to the expansion of public social arrangements, albeit designed in such a way that they should reproduce status differentials (van Kersbergen 1995).

Students of the retrenchment of the welfare state have nevertheless cast doubt on these expectations, by suggesting that partisan differences have been waning over the past few decades due to a climate of economic austerity that has constrained politicians’ policy options (Huber and Stephens 2001; Pierson 2001; Schludi 2005). This contention has been dismissed by Korpi and Palme (2003) as well as by Allan and Scruggs (2004) who have maintained that partisanship is still relevant in the retrenchment context and that the risk of cuts is lowest with incumbency of left-wing parties. These more recent works have focused primarily on the retrenchment of *public* social policies, but their implicit assumption has continued to be that right-wing and left-wing parties should also adopt different stances on the promotion of *private* welfare programmes, with the centre-right likely to champion pension privatization.

Yet no clear consensus has emerged among partisan theorists over this issue. Häusermann (2010) has argued that both the right and the left could support the expansion of funded pensions. She claims that the rise of the service sector and labour market transformation has resulted in the emergence of new post-industrial classes characterized by distinct risk profiles. The changing class composition of society has in

turn led left-wing parties to change their electoral strategies, particularly since the 1990s (see also Rueda 2005; 2007; Pontusson and Rueda 2010; Häusermann *et al.* forthcoming; Lindvall and Rueda forthcoming). Crucial in Häusermann's view is the fact that the high-skilled middle class have become a more powerful constituency that not only right-wing but also left-wing parties try to attract. While "capital accumulators" (such as higher level managers, employers or the self-employed in liberal professions) have been traditionally natural constituencies of the right, post-industrial labour markets have resulted in the growth of a population of high-skilled "sociocultural professionals" typically employed in client-interactive jobs in non-profit or public organizations (e.g. teachers or therapists). With their relatively higher incomes, both social groups are more likely to save for their pensions than the low-skilled whose wages leave little room for additional retirement savings. Hence, as parties of all stripes have increasingly courted their votes, the development of funded pensions has become more prevalent.

To sum up, two schools of thought have been pre-eminent in the literature on contemporary processes of pension privatization. Ideational scholars contend that since the 1990s key policy-makers have been progressively persuaded by international organizations to adopt a multi-pillar approach in pension reform. Nonetheless, their interpretations differ as to the nature of this paradigm change. Some authors have seen the multi-pillar doctrine as a very general concept used to promote the principle of expanding funded pensions. Others have considered it as a much more detailed plan aimed at partly replacing pay-as-you-go pensions with privately managed mandatory retirement savings accounts. Partisan theories assume that political parties' preferences

have depended on the predominantly material interests of their electoral constituencies. But, here too, two different hypotheses have been proposed. The traditional hypothesis has been that right-wing parties should favour private social protection, while left-wing parties should be a staunch advocate of public welfare programmes. Other partisan theorists have suggested that left-wing parties have been led to back private pensions more and more frequently since the 1990s due to the growing influence of the high-skilled middle classes in their electorate<sup>8</sup>. In the chapters that follow, I will evaluate the empirical validity of these two strands of literature and their four competing hypotheses, and simultaneously offer an alternative interpretation.

## **Conclusion**

How do the predictions of these existing theories compare with those of the political economy model of pension privatization I have developed in this chapter? First, the three types of accounts have different expectations as to which actors should put pension privatization on the political agenda and when. Ideational scholars argue that it is international organizations that have made it a public issue in the 1990s. According to partisan scholars, right-wing parties should naturally – and at all times – push for the development of funded pensions because it is attractive to their electorates. By contrast, left-wing parties should have been initially against pension privatization, but may have supported it since the 1990s primarily due to the changing composition of their

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<sup>8</sup> It should be noted that partisan theories have been developed mainly to account for welfare state evolution in affluent democracies. However, similar debates and disagreements exist regarding the policy preferences of the left and the right in post-communist Central and Eastern Europe. For example, Careja and Emmenegger (2009) have argued that left-wing parties have promoted pro-public-spending agenda. On the contrary, Tavits and Letki (2009) found no significant differences in the social policy attitudes of the left and the right. Armeanu (2010) has also argued that in many cases centre-left coalitions supported pension privatization in post-communist countries.

electorates. My expectation is that pension privatization should have been put on the political agenda already in the 1980s (or in the 1990s for post-communist countries) as a result of lobbying campaigns launched by different segments of the financial industry such as insurance companies or stock exchanges. Despite these differences, it should nonetheless be emphasized that these three possible explanations are in fact not mutually exclusive, since politicians may have reacted simultaneously to pressures from financial interest groups, to electoral incentives and to ideological pressures from international organizations.

The second major aspect on which the three theories differ from each other is their way of explaining variations in the extent and form of pension privatization. Ideational scholars' hypothesis that both politicians and organized interests have adopted the same broad policy paradigm has the least to say about these variations. However, the adoption of the very specific blueprint for reform advocated by the World Bank may account for the fact that some countries decided partly to replace their pay-as-you-go systems with mandatory retirement savings accounts, whereas others decided only to introduce tax incentives for voluntary private schemes. For partisan scholars, variations should be primarily explained by differences in the policy preferences of right-wing and left-wing parties. Whether they agree or not that there has been some convergence between the two types of parties, all partisan scholars share two assumptions (cf. Korpi 1983; Häusermann 2010). First, they assume that right-wing parties have generally closer links with business, while left-wing parties are more closely allied with workers and trade unions. Second, they assume that business is generally in favour of private funded pensions, while labour is on the whole more sceptical about them. The responsiveness

of parties to their core constituencies may thus explain some of the variations in the outcomes of reform.

According to the political economy model of pension privatization, what explains variations in the extent and the content of pension privatization is the cross-national differences in employers' and workers' preferences and in the responsiveness of politicians to their concerns. Whereas both ideational and partisan scholars assume that business is in favour of pension privatization, I argue that employers will be against it if they consider that it poses a threat to their pre-existing supplementary schemes and if it increases their exposure to hostile takeovers. If these two conditions prevail, we should thus empirically observe employer opposition to pension privatization. By contrast, while I share partisan scholars' underlying assumption that workers and trade unions will be generally against cuts to existing rights, I also expect them to show an interest in the development of pension funds if it helps workers top up their retirement income and if it allows them to develop socially responsible investors. These concerns are crucial determinants of the cross-national diversity of pension fund governance arrangements.

Finally, I argue that we should see different relationships between parties and organized interests depending on the type of party system prevailing in a country. In multi-party systems, we should observe that a governing party will not officially propose a bill on pension privatization unless it secures prior backing from the interest groups representing its target constituencies. Thus, right-wing parties should not introduce pension privatization if employers' associations are against it, while left-wing parties should abstain from promoting funded pensions if trade unions show hostility towards this type of pensions. By contrast, in two-party systems we should observe that centre-right parties will tend to ignore pressures from organized interests, while centre-

left parties should not sponsor a relevant reform bill unless they have prior assurance of support both from trade unions and employers' associations. These different coalitional dynamics should give us a better understanding of the reasons why some countries have gone further in privatizing pensions than others. The next chapter will try to give the reader a better idea of the cross-national diversity in the extent and form of pension privatization, i.e. of the outcomes the political economy model of pension privatization seeks to explain.

## Chapter 2: Diverse Pension Systems, Diverse Pension Funds

Over the past three decades, European old-age pension systems have been marked by a move away from the pay-as-you-go method of financing, to greater reliance on funding. Nevertheless, different countries also adopted very different forms of pension privatization. The aim of this chapter is to provide a bird's eye view of the recent evolution of European public-private pension mixes and of the diversity of pension fund governance arrangements. However, before I undertake this task, let me, firstly, provide a more precise definition of the key concepts used to characterize pensions and, secondly, outline the main challenges faced of late by pension systems.

By *pension privatization*, I mean institutional changes that result in retirement provision being less and less financed on a pay-as-you-go basis and being increasingly funded. Pension schemes operate on a purely *pay-as-you-go* basis when the contributions or taxes paid by the working-age population are used to finance the benefits of current pensioners, and no reserves or assets are set aside to pay for future benefits. Pensions are *funded* when both current and future pension commitments are covered by real or financial assets (cf. Davis 1995). Benefits are thus fully-funded when assets equal or exceed all liabilities. A third and intermediate form of financing is through so-called *book reserves*. This is when a firm covers retirement benefits through provisions (or “reserves”) set up on the liability side of her balance sheet. Book reserves do not involve the creation of assets, but rather represent a form of loan to the company, because they allow managers to retain corporate earnings within the firm (Jackson and Vitols 2001). The focus of the thesis is thus on changes in the financing of pensions.

However, a parallel trend to privatization is the individualization of retirement provision. Pensions can be individualized either by making coverage increasingly voluntary rather than mandatory, or through changes in benefit formulas. Indeed, retirement benefits traditionally fulfil two potentially contradictory functions. They can focus on *insurance* if they serve mainly to maintain workers' career earnings and are provided according to how long and how much workers contributed to them. Alternatively, they can fulfil a more *redistributive* function when they focus more on poverty alleviation and their level is defined primarily according to pensioners' needs. Pensions are most redistributive when they are *flat-rate*, which means that all pensioners get the same benefit amount. The insurance function is more effectively fulfilled by *earnings-related* benefits, of which there are two main types (Davis 1995: 5-6; 300-301). In *defined-benefit* (DB) schemes, benefits are set in advance and are a function of workers' final or average wage and of their years of service. The level of benefits is nevertheless independent of the contributions paid by workers and, if the scheme is funded, of the returns generated by pension assets. In *defined-contribution* (DC) schemes, only contributions are fixed, whereas the level of benefits varies according to the total amount of contributions paid into the scheme and to the financial or non-financial<sup>1</sup> returns on these contributions. Of the two types of earnings-related benefits, DC pensions are the most individualized because all the investment risk is borne by the worker, while in DB schemes the employer or the state must cover deficits if funds are insufficient.

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<sup>1</sup> In the same way as flat-rate and DB schemes, DC pensions can either be funded or operate on a pay-as-you-go basis. In pay-as-you-go DC schemes (generally called notional or non-financial defined-contribution – NDC), contributions are thus used to finance current benefits instead of being invested. However, workers' contributions are recorded in "notional" accounts. When the worker retires, contributions are multiplied by a notional rate of return, which is usually dependent on the rate of growth within the economy.

Since the abovementioned methods of financing and benefit formulas can be combined in multiple ways, pension systems have very diverse institutional designs. This will become evident in the rest of this chapter. Nevertheless, despite their heterogeneity, European systems have been recently confronted with similar demographic, economic and social challenges. Population ageing constitutes perhaps the most significant problem for retirement provision (e.g. OECD 1998; Bonoli and Shinkawa 2005). Due to rising life expectancy and lower fertility rates, the ratio of the elderly to the working-age population has been constantly increasing in the past few decades and is expected to continue doing so in the future. Structural ageing has been compounded by the fact that a generation of baby-boomers was due to retire from the mid-2000s. Both phenomena pose problems for the financial sustainability of pay-as-you-go systems, since they contribute to reduce the ratio between contributors and beneficiaries. To prevent the accumulation of deficits and debt, policy-makers have had to choose between increasing contribution rates, raising the effective retirement age, or otherwise cutting benefit levels. While the effects of population ageing are apparent for pay-as-you-go systems, funded pensions are not immune to the demographic challenge either, since population decline is generally believed to result in lower growth rates, which in turn leads to lower rates of return on investments (for a discussion, see e.g. Holzmann 2009).

Pension systems have also had to face the economic and social consequences of deindustrialization and the feminization of the workforce (e.g. Iversen and Wren 1998; Armingeon and Bonoli 2006; Lynch 2006; Häusermann 2010; Emmenegger *et al.* 2012). Massive layoffs in the manufacturing industries since the 1970s and their negative consequences for employment rates have compounded the effects of

demographic ageing on the financing of retirement provision. In addition, the increasingly unstable employment patterns that are associated with deindustrialization typically make it more difficult for workers to meet the minimum contributory periods required to get full pensions. This problem is all the more acute for women. Rising female employment and the decline of the male breadwinner model of social organization mean that women increasingly earn their pension rights autonomously rather than indirectly through their husbands. However, working women face a greater risk of temporarily leaving the labour market due to maternity or care, which raises questions about whether such periods should be compensated through specific pension entitlements.

It is against this background of similar structural challenges that pension reform has taken place in Europe. In the first section of this chapter, I will show how pension privatization has progressed over the past few decades and how its extent and form have varied between countries. I will do this by comparing the institutional structures of European public-private pension mixes at the beginning of the 1980s and at the end of the 2000s. In the second section of the chapter, I will then shed light on the considerable diversity in the content of pension privatization, particularly with regard to the governance of pension funds and the linkages that exist between them and the financial system.

## **2.1 Reconfiguring the Public-Private Pension Mix in Europe**

Whether after the Second World War or today, there has always been considerable cross-national diversity in the principles and the specific institutional arrangements

governing pensions. It has been long-standing practice in comparative social policy to classify pension systems based on a distinction between two dominant forms of *statutory* – and usually pay-as-you-go – retirement provision: employment-based social insurance and citizenship-based systems with a universal basic pension (Palme 1990; Hinrichs 2000; Myles and Pierson 2001; Bonoli 2003; Ebbinghaus 2011). In *social insurance* systems, individuals are entitled to receive a pension because they have directly contributed to the statutory scheme while in employment. The primary aim of such schemes is to provide workers with income maintenance (or “insurance”). Benefits are therefore earnings-related and are financed predominantly by payroll taxes. *Universal basic pensions* are guaranteed to all individuals or nationals of a country, regardless of their work record and provided that they have resided in that country for a minimum amount of time. Through redistribution, such systems aim at preventing poverty in old age. As a result, the state guarantees only a very modest flat-rate benefit often financed through general taxation.

It has been generally accepted in the literature that the scope of statutory pension schemes crucially influences the room for the development of private retirement savings: the more generous the statutory pension, the more likely it is that supplementary schemes will be “crowded out”. The most generous social insurance systems have thus been historically associated with more limited coverage of private funded schemes, whereas countries with less generous social insurance or universal basic pensions have seen much greater growth of supplementary schemes (Davis 1995; Ebbinghaus 2011).

Even though it provides a good starting point for a cross-national comparison of pension systems, an exclusive focus on the dominant statutory pension scheme is

insufficient if one wants to understand the contemporary politics of pension privatization. As has been specified in the preceding chapter, one of the central arguments of this thesis is that the pre-existing institutional structure of supplementary pension schemes is a key determinant of employers' and workers' preferences regarding the development of private retirement savings. Differences in pre-existing supplementary pensions have therefore a direct influence on the varieties of pension reform trajectories. Therefore, I will develop a classification of pension systems based on the basic statutory pension *and* the dominant form of supplementary pension workers have access to. Note that supplementary and private pensions are not necessarily synonymous, as in some cases workers have been covered by a second statutory earnings-related pension in addition to their basic pension.

Systems of retirement provision have been constantly evolving ever since their creation. As a consequence, any methodical comparison of pension systems across time can be constructed only by using snapshots of the systems at certain points in time. This section compares European systems as they looked at the very beginning of the 1980s and at the end of the 2000s. The 1980s corresponded to the moment when public pension systems reached the peak of their post-war expansion and when politicians started pushing for their retrenchment (Pierson 1994; 2001). By the end of the 2000s, statutory pensions had become less generous and funded schemes had considerably expanded, although pension reform was also to be strongly impacted by the global financial crisis. The comparison covers the largest European OECD member countries<sup>2</sup>, but also includes the United States, Canada and Japan due to their distinctive pension

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<sup>2</sup> Only those countries that had more than 4 million inhabitants in 2010 are included.

fund governance arrangements and their importance in the study of the varieties of capitalism.

### *Multiple worlds of post-war retirement provision*

During the post-war period, the pay-as-you-go method of financing provided the foundation on which countries both of the Capitalist and the Communist Bloc built increasingly comprehensive systems of retirement provision. If one takes into account the basic statutory old-age pension they provided, countries clustered around three broad types of systems at the beginning of the 1980s: those guaranteeing a universal basic pension, those providing only basic social insurance and those offering generous social insurance. However, within each of these groups, there were important differences as regards the way supplementary pensions were organized (Table 1.1).

The group of countries providing a universal basic pension consisted of the Nordic countries, the Netherlands and Canada. Sweden blazed a trail between 1935 and 1948 by replacing means-tested pensions with a flat-rate pension guaranteed to all its citizens. Other countries followed suit in the 1950s, except for Denmark which gradually introduced its “national pension” in the second half of the 1960s. In all these countries, relatively large segments of the workforce were traditionally covered by defined-benefit occupational pension plans, which benefited from important tax exemptions. However, Sweden, Finland, and later Canada and Norway, all introduced in the 1960s a second statutory social-insurance-type pension to provide better income maintenance to wage-earners. Finland’s statutory earnings-related schemes were established by incorporating existing occupational plans and were generous enough to

crowd out the development of new supplementary schemes (Kangas and Luna 2011). By contrast, occupational plans subsisted in Canada and Norway. In Sweden they were extended practically to the whole workforce by the beginning of the 1970s, thereby entrenching a three-tier pension system. The Netherlands and Denmark followed very different paths from the four other countries. Since the mid-1930s, the Dutch state encouraged employers' associations and trade unions to sign collective agreements and create industry-level defined-benefit pension funds. By the beginning of the 1980s, the system had become so encompassing that it covered more than 80% of the workforce. By contrast, Denmark continued to rely on largely voluntary employer-provided occupational schemes, with very uneven coverage across firms.

**Table 1.1 The public-private pension mix in 1980**

		<b>Main supplementary pension</b>			
		<i>Statutory earnings-related</i>	<i>(quasi) mandatory occupational</i>	<i>Voluntary occupational</i>	<i>None</i>
<b>Basic statutory pension</b>	<i>Social insurance (+)</i>			Greece (GR) Spain (ES) Italy (IT) Austria (AT) Portugal (PT) Germany (DE) Belgium (BE)	Poland (PL) Czechoslovakia (CS) Hungary (HU)
	<i>Social insurance (-)</i>	The United Kingdom (GB)* Japan (JP)*	France (FR) Switzerland (CH)	The United States (US) Ireland (IE)	
	<i>Universal basic pensions</i>	Sweden (SE)		Denmark (DK)	
		Finland (FI) Norway (NO)** Canada (CA)**	The Netherlands (NL)		

*Notes:* \*with possibility to opt out from state second pension through voluntary occupational schemes

\*\* voluntary occupational pensions also widespread

*Sources:* Palme (1990); Shalev (1996); Bonoli and Shinkawa (2005); Immergut *et al.* (2006); Ebbinghaus (2011)

The second cluster of pension systems comprised those countries that offered only limited social insurance, i.e. with benefit replacement rates not exceeding 60% of pre-retirement income for an average production worker. Whereas France, Switzerland and the United States granted basic statutory defined-benefit pensions, Ireland, the United Kingdom and Japan provided very meagre flat-rate – yet still employment-based – benefits designed primarily to prevent poverty among pensioners. As regards the organization of supplementary pensions, countries within this cluster formed three subgroups. Both in Ireland and the United States, many employers set up occupational DB schemes on a voluntary basis, but less than half of the workforce was covered by 1980 (Schulze and Moran 2006; Seeleib-Kaiser *et al.* 2012: 157). In France and Switzerland, voluntary occupational pensions also expanded during the post-war period. However, both countries decided to make them mandatory at the beginning of the 1970s, although workers continued to receive different benefit levels depending on the firm or the industry where they were employed. Whereas Swiss supplementary pensions were fully-funded, France's mandatory occupational schemes were exceptional in a cross-national perspective in that all of them were run on a pay-as-you-go basis. The United Kingdom and Japan formed the final subgroup among countries with limited social insurance. In both countries, employer-provided DB pensions were traditionally widespread. Yet, in order to achieve greater equality between workers, the state introduced a statutory earnings-related scheme from which companies offering better occupational benefits could opt out. The Japanese state scheme, created as early as 1944, was funded, whereas the British one, which was introduced in 1959 and was substantially expanded in 1975, was financed on a pay-as-you-go basis.

Social insurance with relatively more generous defined benefits was the building block of the pension system in countries from the West, the South and the Centre of the continent. Supplementary pension schemes were nevertheless much less widespread in this cluster and their development was directly determined by the level of statutory pensions. Replacement rates of about 60%-70% of prior earnings in the Belgian and the German public systems left some room for the development of employer-provided DB occupational plans. Such plans also existed in Austria, Italy, Spain, Portugal and Greece, but coverage was minimal because replacement rates from public pensions often reached 80% or even more. Finally, while Czechoslovakia, Hungary and Poland also provided statutory earnings-related pensions, firms in the Communist Bloc did not offer supplementary schemes for their workers.

In sum, European pension systems formed three broad worlds of public retirement provision by the 1980s. It also appears that there were three main types of supplementary – and generally defined-benefit – plans: second statutory earnings-related schemes, mandatory occupational schemes and voluntary ones. Funded pensions were most developed in Anglo-Saxon countries, Switzerland, the Netherlands and Japan. They were also relatively widespread in Nordic countries, albeit to a much lesser extent. In most Continental countries, the pay-as-you-go method of financing was dominant.

#### *Pension privatization and the new worlds of retirement provision*

The last decades have seen several waves of retrenchment in statutory pensions and an expansion of funded schemes across Europe. Private pensions have also been

marked by a long-term shift from defined-benefit towards defined-contribution plans. A good illustration of this double trend towards privatization and individualization of retirement provision is the rise of DC personal pension plans (Table 1.2). If one looks at the evolution of public pension expenditure in recent years, one might have doubts about whether these transformations are actually taking place. Public pension expenditure has indeed increased on average from 6.4% to 7% of GDP between 1990 and 2007 in the OECD (2011: 245). However, current expenditure data are usually a reflection of the effects of structural factors – such as demographic changes – on which politicians have no influence as well as of the state of previous – and not current – legislation. Indeed, policy-makers usually introduce very long transition periods before their reforms are really implemented (see Bonoli and Palier 2007). Analyses of institutional change therefore better encapsulate the transformations that are underway, and allow capturing the various forms that pension privatization has taken within the different worlds of post-war retirement provision.

Countries that traditionally provided a universal basic pension have followed two distinct paths. Notwithstanding the introduction of some cost-containment in their statutory basic pensions, Canada, the Netherlands, Denmark and, until recently, Norway have decided to preserve the general architecture of their systems. While in all four countries occupational pensions have been increasingly calculated according to the defined-contribution principle, Denmark and Norway have greatly extended coverage of funded schemes. Danish policy-makers have done so by encouraging the social partners to create industry-wide pension funds through collective agreements. In Norway, employers have been obliged since 2006 to contribute at least 2% of wages to occupational pension schemes. In contrast to this first subgroup, Finland and Sweden

have moved away from their universal basic pensions, by making them means-tested and by expanding the role of social insurance. In both countries, statutory pensions will now be based on life-time income. In Finland, the lack of a ceiling on pension contributions and on pensionable earnings continues to hinder the development of voluntary occupational and personal pension plans. On the contrary, Sweden was one of the first European countries to introduce a “paradigmatic” pension reform, which created mandatory individual retirement accounts (the “premium pension”) and transformed pay-as-you-go schemes into a “notional defined-contribution” (NDC) system. Norway has recently joined this second subgroup of nations, since it decided in 2010 to emulate Sweden by replacing existing pay-as-you-go schemes with an NDC-type system.

Retrenchment of statutory pensions has been an almost universal phenomenon in social insurance countries. Be it in systems that offered generous earnings-related public pensions or in those that provided more basic benefits, policy-makers have very frequently made pension indexation less generous, increased the number of years of service required to get a full pension, tightened the link between benefits and life-time earnings, and increased retirement ages. Among countries that offered relatively limited social insurance, Switzerland, Ireland, the United States and Japan have broadly speaking maintained their existing architecture, even though occupational defined-benefit plans have been increasingly replaced by defined-contribution schemes. France and the United Kingdom stand out. Despite conveying a general impression of stability, France is remarkable in that, instead of promoting funded pensions, it expanded its mandatory pay-as-you-go occupational pensions in the 1980s and the 1990s. It was only in 2003 that a stable legislative framework on private pension funds was introduced. By

contrast, British policy-makers decided at the end of the 2000s to loosen eligibility to the basic flat-rate pension, to make the second statutory pension flat-rate and to make contributions to private pension funds quasi-mandatory through the introduction of a system of “automatic enrolment” in workplace pension plans.

**Table 1.2 – The spread of legislation on personal pensions in OECD countries**

		<b>Voluntary</b>	<b>Mandatory</b>
1957	CA	Registered Retirement Savings Plans	-
1974	US	Individual Retirement Accounts (IRAs)	-
1981	US	401(k) plans	-
1985	CH	Third pillar – Gebundene Selbstvorsorge	-
1986	UK	Personal pension schemes	-
	BE	Pensioensparen/épargne pension	-
1987	FR	Plans d'épargne retraite (repealed in 1989)	-
	ES	Planes de pensiones	-
	DK	Kapitalpension	-
1989	PT	Planos Poupança Reforma	-
1992	NO	Egen pensjonsforsikring etter skatteloven	-
1993	SE	Individuellt pensionssparande	-
	IT	Fondi pensione aperti	-
	HU	Önkéntes kölcsönös biztosítópénztárak	-
1994	CZ	Penzijní připojištění se státním příspěvkem	-
	SE	-	Premiepension
1996	SK	<i>Doplňkové dôchodkové poistenie zamestnancov</i>	-
1997	HU	-	Magánnyugdíjpénztárak
	PL	-	Otwarte fundusze emerytalne
	NO	Individuelle Pensjonsavtaller	-
2000	IT	Piani individuali pensionistici	-
2001	DE	Riester-Rente	-
2002	IE	Personal Retirement Savings Accounts	-
2003	AT	prämienbegünstigte Zukunftsvorsorge	-
	FR	Plans d'épargne retraite populaires	-
2004	PL	Indywidualne konta emerytalne	-
	SK	-	Dôchodkové správcovské spoločnosti
2008	UK	-	Auto-enrolment
2009	FI	laki sidotusta pitkäaikaissäätämisestä	-
2011	PL	Indywidualne konta zabezpieczenia emerytalnego	-

Sources: Immergut *et al.* (2006); Ebbinghaus (2011) and own research

Within the group of countries relying on relatively extensive social insurance at the beginning of the 1980s, supplementary pensions have expanded the least in Greece, Austria, Spain and Italy. Statutory pensions in these countries continued to offer

replacement rates above 70% of previous income at the end of the 2000s, even though Mediterranean countries were under pressure to introduce further cuts following the global financial crisis. Retrenchment in Germany, Belgium and Portugal has led statutory pensions in these systems to become increasingly basic: gross replacement rates for a worker who retires after a full career on average earnings are now below 60% of previous income, but net replacement rates remain slightly above this threshold (OECD 2009a). In Germany and Belgium, coverage of occupational pension schemes has increased to over half of the working population.

The so-called Visegrád countries (i.e. Hungary, Slovakia, the Czech Republic and Poland) formed a separate and more unstable subgroup. All of these countries introduced far-reaching pension reforms during the past few decades which led them to offer increasingly basic social insurance by the end of the 2000s. Hungary and Poland enacted paradigmatic reforms at the end of the 1990s, which consisted in diverting a part of social security contributions towards mandatory commercial pension funds (see table 1.2). They were followed by Slovakia in the mid-2000s. By contrast, the Czech Republic maintained a greater role for its pay-as-you-go system, but promoted voluntary personal DC pensions by paying a state subsidy on individuals' contributions. However, the situation reversed following the 2007-08 global financial crisis. Both Slovakia and Poland decided to substantially cut contributions diverted towards private pension funds and to transfer them back towards their pay-as-you-go systems. Hungary went much further by de facto obliging its citizens to move all of the assets they held in mandatory pension funds back to the pay-as-you-go system. The Czech Republic went once again against the tide by introducing the possibility for workers to divert part of their social security contributions towards commercial pension funds.

**Table 1.3 The public-private pension mix in 2007-2008**

		<b>Main supplementary pension</b>			
		<i>Statutory earnings-related</i>	<i>(quasi) mandatory occupational</i>	<i>Voluntary occupational</i>	<i>Mandatory personal</i>
<b>Basic statutory pension</b>	<i>Social insurance (+)</i>			Greece (GR) Austria (AT) Spain (ES) Italy (IT)	
	<i>Social insurance (-)</i>			Portugal (PT) Finland (FI) Czech Republic (CZ) Germany (DE) Belgium (BE)	Hungary (HU)
			Switzerland (CH) The United Kingdom (GB)***	The United States (US) Ireland (IE)	Poland (PL) Slovakia (SK)
		Japan (JP)*		France (FR)	
				Sweden (SE)	
	<i>Basic universal pensions</i>	Norway (NO)			
		Canada (CA)**	The Netherlands (NL) Denmark (DK)		

*Notes:* \*with possibility to opt out from state second pension through voluntary occupational schemes

\*\* voluntary occupational pensions also widespread

\*\*\* also flat-rate state second pension with possibility to opt out from it through defined-benefit occupational plans

*Sources:* Bonoli and Shinkawa (2005); Immergut *et al.* (2006); OECD (2009); Ebbinghaus (2011) and websites of national social security administrations

To sum up, European countries have instituted substantial reforms since the beginning of the 1980s, leading the general pension landscape to evolve quite profoundly (Table 1.3). As a result of the changes introduced in a number of Nordic and continental countries, basic social insurance has become the dominant form of statutory pensions in a growing number of countries. Yet convergence within the European public-private mix has not taken place. Universal flat-rate pensions are still well entrenched in Denmark and the Netherlands, while a number of countries continue to

offer generous social insurance. Moreover, there is wide cross-national diversity in the institutional forms taken by funded pension plans. This is true both with regard to their organizational structure and to the regulation of their links with the financial system. These variations are explored in more detail in the section that follows.

## **2.2 Pension Fund Governance and Regulation**

The institutional design of pension funds has strong implications not only for the quality of the benefits received by pensioners, but also for the functioning of the economy (Davis 1995). Pensions are an important institution both within the labour market and the financial system. As suggested by the political economy model of pension privatization, they affect the interests of various socio-economic groups. Depending on the governance arrangements that are chosen, different sets of actors – financiers, employers, workers or the state – can find themselves in charge of managing or supervising considerable financial assets (Ebbinghaus and Wiss 2011). One can generally distinguish between three types of pension funds: occupational pension schemes, personal pension plans and public pension reserve funds.

Occupational pension schemes are put in place either directly by employers or through collective agreements signed with trade unions and can cover a more or less large category of workers within a firm or an industry. They can be of the defined-benefit or the defined-contribution type. Governance in such schemes comes in various shapes, with different degrees of involvement of employers and workers. Either the pension scheme is entirely run by a financial services company with limited supervision powers of the plan's sponsors. Or it is organized as a separate not-for-profit entity

where a board representing employers and potentially workers sets the fund's investment policy and monitors its performance. The day-to-day operation of the scheme is then taken in charge by managers internal to the firm or to the pension fund, or can be devolved to external service providers (see Clark 2000). In the large majority of European countries, there is a legal obligation for workers or scheme members to have representatives on pension fund boards (Stewart and Yermo 2008: 238-239), particularly if the plan is created through a collective agreement. In Ireland, Canada and the United States, where autonomous occupational pension schemes are traditionally organized around the institution of the "trust" and where trustees have a "fiduciary duty" to serve the best interest of scheme members, there has been no such statutory requirement, except for US multi-employer Taft-Hartley plans. In the United Kingdom, the appointment of at least a third of the trustees by scheme members was made mandatory in 1995. The largest occupational pension funds by assets are found in countries such as the US, Canada, the Netherlands, Sweden, Denmark or the UK, where large collective schemes were created within the private sector but also for public-sector employees (e.g. the Dutch ABP – see Table 1.4; Towers Watson 2011).

The second major type of funded pensions is personal pension plans. These are defined-contribution arrangements that individuals join by signing a contract with a specified pension manager. Scheme members may have a say over how their assets are invested, if the pension provider offers a choice between funds characterized by a different asset allocation. However, their role in the governance of personal pension plans is generally limited, because these institutions are overwhelmingly set up and run by financial services companies such as banks, mutual funds or insurance companies (Stewart and Yermo 2008; Ebbinghaus 2011). While personal pensions have been

traditionally voluntary, Sweden and a number of countries in Central and Eastern Europe have introduced mandatory “second pillar” personal pensions (Table 1.2), which complement or partly replace “first pillar” pay-as-you-go benefits. In this model of pension schemes that was pioneered by Chile in 1981, individuals have to choose a provider from a pool of competing mutual funds or pension fund management companies. In Sweden, some of these pension providers are jointly controlled by employers’ associations and trade unions. A distinctive type of mandatory personal pension plans has also been introduced in a number of South-East Asian countries such as Malaysia or Singapore, where individuals must pay contributions into a single pension provider entirely run by the state. These schemes are usually referred to as a “provident funds”.

**Table 1.4 Largest European pension funds in 2010 (assets in US\$ billions)**

Europe Rank	World Rank	Name	Country	Type	Assets
1.	2.	Government Pension Fund – Global	NO	Buffer fund	\$551
2.	3.	ABP	NL	Occupational	\$319
3.	13.	PFZW	NL	Occupational	\$133
4.	17.	ATP	DK	Statutory funded pension supplement	\$124
5.	25.	National Wealth Fund	RU	Buffer fund	\$88
6.	26.	Fondo de Reserva Seguridad	ES	Buffer fund	\$86
7.	34.	Alecta	SE	Occupational	\$74
8.	38.	Bayerische Versorgungskammer	DE	Occupational	\$65
9.	43.	BT Group	UK	Occupational	\$58
10.	44.	Royal Dutch Shell	NL/UK	Occupational	\$56
11.	50.	Universities Superannuation Scheme	UK	Occupational	\$50
12.	54.	FRR – Fonds de Réserve des Retraites	FR	Buffer fund	\$49
13.	57.	AMF Pension	SE	Occupational and personal pension plans	\$48
14.	63.	PFA Pension	DK	Asset manager for occupational plans	\$45
15.	64.	Varma	FI	Asset manager for statutory pensions	\$44

Source: Towers Watson (2011)

A final type of pension funds is public pension reserve funds (or also “buffer funds”). Such funds accumulate financial reserves for pay-as-you-go schemes, so as to shield them from short-term fluctuations in revenue or expenditure and, more importantly, in order to provide resources to cover long-term growth in public pension expenditure resulting from population ageing. The creation of reserve funds cannot be considered as leading to pension “privatization”, since their aim is to help support the pay-as-you-go system. However, they contribute to the rise of funding as a way of financing pensions. Buffer funds are administered either by social security administrations or by other government departments. Decisions over the funds’ investment strategy are usually made by the state (Yermo 2008). However, in countries such as Sweden or France, private-sector employers and trade unions are represented on the funds’ boards and therefore have a role in decision-making. Alongside occupational schemes, public pension reserve funds rank among the largest pension funds in the world and in Europe (Table 1.4). The largest ones have been the US Social Security Trust Fund, Japan’s Government Pension Investment Fund and Norway’s Government Pension Fund. Whatever their institutional form, pension funds are now central players in the global and in domestic financial systems. A case in point is the Norwegian buffer fund, whose resources have been provided by the Norwegian oil industry and which owned as much as 1 per cent of all global equities by 2012 (*Financial Times* 2012; see also Austvik 2012). It is therefore important to examine how pension funds interact with the financial system.

*Varieties of links with the financial system*

Since the role of pensions is to protect workers against income loss and destitution in old age, comparative political economists have traditionally studied retirement provision in its relation to the labour market and employment relations (e.g. Esping-Andersen 1990). Yet, when they are funded or financed through “book reserves”, pensions have a direct connection with the financial system and corporate governance. A growing number of scholars have recognized this link: some have called it the “welfare-finance nexus” (Estevez-Abe 2001) whereas others have talked about the rise of “pension fund capitalism” (Clark 2000; 2003). The theoretical model developed in this thesis seeks to provide a better understanding both of how this welfare-finance nexus is shaped and of how it affects actors’ preferences.

Private pension funds and large institutional investors have been considered by many as part and parcel of an Anglo-American model of capitalism, whose key characteristics would be the role of markets in the coordination of economic activities, the economic importance of the financial industry and the focus of non-financial companies on generating profits in the short term (e.g. Dore et al. 1999). The rise of funded pensions could thus be seen as paving the way for a convergence of Europe’s economic systems with Anglo-American-style financial capitalism, or in other words their “financialization” (Engelen 2003; Langley 2004; Dixon 2008; Macheda 2012). But is that really the case? This subsection provides a short review of the links that exist between pension funds and different models of capitalism.

A popular framework for the comparison of national economic systems is the varieties of capitalism (VoC) approach (Hall and Soskice 2001a; see also Amable 2003). Arguing that institutions are an important determinant of the way firms structure their activities and of different nations’ comparative economic advantage, it measures

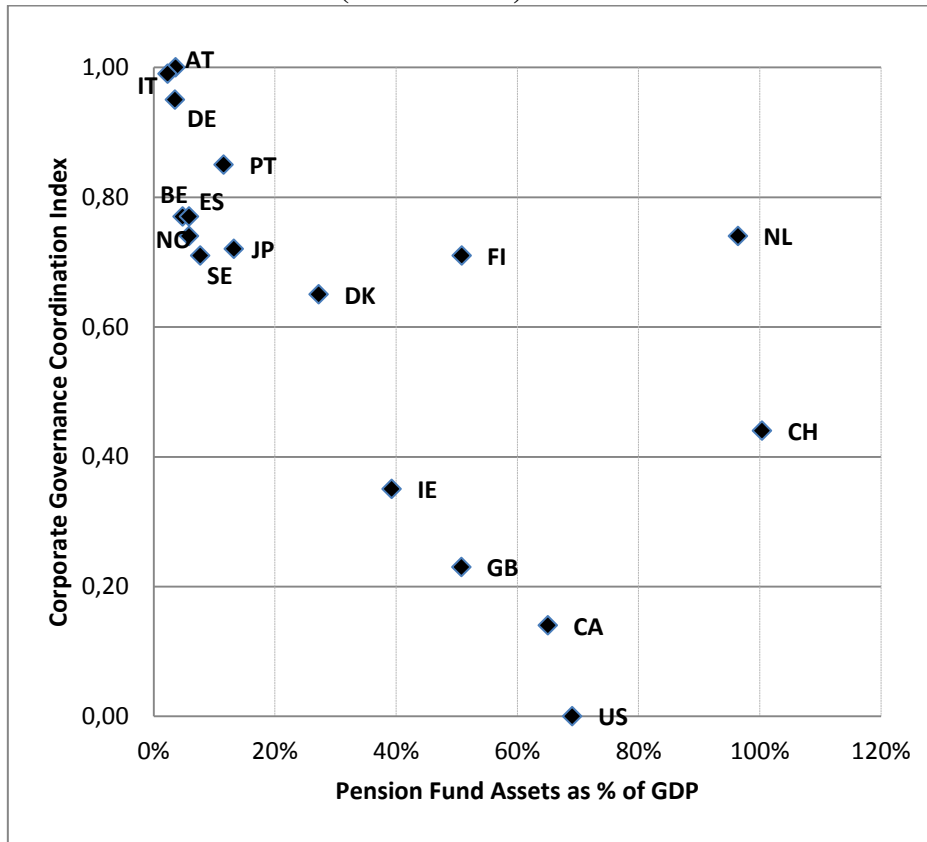
institutional differences between domestic political economies. VoC scholars distinguish between two ideal-typical models of capitalism: liberal and coordinated market economies. In liberal market economies (LMEs), firms “coordinate with other [economic] actors primarily through competitive markets, characterized by arms-length relations and formal contracting” (Hall and Gingerich 2009: 452). The main source of corporate finance is capital markets, which are well-developed and impose relatively stringent disclosure requirements on managers. Because of their dispersed shareholding structures and of a restrictive legal environment, firms invariably face the possibility of a hostile takeover. This forces corporate executives to be attentive to the market value of their company’s shares, which itself depends on the firm’s current profitability. As a rule, management enjoys considerable freedom to implement its strategy and workers have a low degree of employment protection.

What distinguishes coordinated market economies (CMEs) is that firms “typically engage in more strategic interaction with trade unions, suppliers of finance and other actors” (*ibid.*: 452). Individual enterprises are either controlled by a blockholder, or a large portion of their equity capital is held by other firms within a network of cross-shareholding. This type of ownership structure insulates managers from the risk of a hostile takeover, thereby allowing them to focus on the development of the firm in the long run rather than on current profitability and share value. Firms finance themselves primarily through retained earnings or through bank loans. These are granted on the basis of information that, instead of being publicly disclosed like in LMEs, is shared through informal channels. Since they have access to such “patient capital”, firms typically commit themselves to offer long-term employment to their employees and adopt a more consensual style of decision-making. According to Hall and Soskice

(2001b: 36-44), CMEs' comparative advantage lies primarily in the production of capital goods that require incremental forms of innovation, such as machine tools, engines or transport equipment. By contrast, LMEs specialize in industries where radical innovation is prevalent such as biotechnology, semiconductors and software development.

How does pension fund capitalism fit in the varieties of capitalism framework? As proposed by Wiss (2011), an apposite way of measuring that relationship is to plot pension fund assets as a percentage of gross domestic product against indicators of economic coordination developed by Hall and Gingerich (2009). Since this subsection focuses on the welfare-finance nexus, I suggest using Hall's and Gingerich's corporate governance coordination index. This measure is calculated from country scores on three indicators: shareholder power (which assesses the degree of legal protection enjoyed by small shareholders vis-à-vis managers and dominant shareholders), dispersion of control (which gauges whether ownership of firms is widely held or concentrated in the hands of a few dominant shareholders) and the size of the stock market (*ibid.*: 455). Higher values on the general index indicate higher degrees of strategic (or non-market) coordination. A graphic illustration of the relationship between VoC and pension fund capitalism is provided on figure 1.1. Note that data for the two indicators of interest are separated by about a decade (cf. Notes – figure 1.1). However, this should not substantially affect the direction of the results, because historically pension fund assets have grown only in a very gradual way.

**Figure 1.1 – Pension fund assets as a % of GDP (horizontal axis) and corporate governance coordination index (vertical axis)**



*Notes:* Observations for corporate governance coordination index are between 1990 and 1995 while observations for pension fund assets are an average for the years 2001-2003 (i.e. earliest comparative data available; data have been averaged because of the bursting of the dot-com bubble). France missing due to lack of data on pension fund assets, but score on corporate governance coordination is 0.82. Greece and Visegrád countries missing due to lack of data on corporate governance coordination.

*Sources:* Hall and Gingerich (2009: 458) and OECD.Stat (pension funds – autonomous)

As would be expected by the financialization thesis, Anglo-Saxon countries combine extensive pension assets with the market-based forms of corporate governance coordination that are typical of LMEs. On the contrary, countries with a small pension fund industry have high levels of CME-type strategic coordination. There is indeed a negative correlation between the development of pension funds and non-market forms of economic coordination (-.64). Nevertheless, the graph reveals that a number of countries do not fit neatly into this pattern. These include the Netherlands, Finland,

Denmark and to a lesser extent Switzerland, four countries that are traditionally identified as CMEs. In fact, data on figure 1.1 also underestimate the size of pension fund assets in other CME countries such as Japan, Sweden and Norway, because they do not take into account the assets held by public pension reserve funds. The existence of such outliers constitutes a puzzle for the argument according to which pension privatization leads towards a convergence with the Anglo-American model of capitalism. Part of the explanation for this discrepancy might lie in the varieties of regulatory regimes for pension funds' investment portfolios and in the diversity of ways in which pension fund assets can be channelled into the financial system.

Although both of them have sought to ensure that pension funds sufficiently diversify their investment portfolios, there have traditionally been two approaches to the regulation of pension funds' investment policies: the prudent person rule and quantitative asset restrictions (Davis 2002). The first approach is a relatively flexible rule that enjoins asset managers to handle investments in a "prudent" way. The guiding assumption is that, in order to maximise returns within certain risk parameters, investments need to be adequately diversified. In case a scheme member or another entity challenges the pension manager on her portfolio returns, relevant authorities primarily scrutinize the manager's behaviour and whether a due process of decision-making was followed. By contrast, the second approach consists in imposing minimum or maximum quotas on the specific asset classes that can be held within the pension fund's portfolio. Typically, restrictions affect those financial instruments that are considered most risky for example due to their high volatility.

The prudent person rule has been prevalent in the US, the UK, Ireland, but also in the Netherlands. In the Anglo-Saxon world, this regulatory approach can be considered

as an extension of pension fund trustees' fiduciary duty to act in the best interest of scheme members. Most other countries, including those Continental and Nordic European countries that are generally considered as CMEs by the VoC literature, have traditionally applied quantitative portfolio restrictions, with frequent limits on investments in equity or in foreign currency assets (Salou and Yermo 2005). However, an increasing number of countries have liberalized some of these rules since the end of the 1990s (Yermo 2005).

A striking example of how portfolio regulations affect the relationship between pension funds and the financial system is Japan, a country that represents one of the prototypes of a coordinated market economy. As noted in section 1.1, Japanese workers have been covered by a second statutory earnings-related pension scheme, or alternatively by employer-provided occupational pension schemes. A characteristic of both types of schemes is that they have been overwhelmingly *funded* and that, throughout the post-war period, the Japanese state played a very active role in directing the use of their assets (Estevez-Abe 2001; Park 2004). All statutory pension assets were placed in the Finance Ministry's Trust Fund Bureau, which itself channelled them into the Fiscal Investment and Loan Programme, a scheme that helped finance infrastructure development and various public policy objectives. It was only in 2001 that public pension assets were transferred into the Government Pension Investment Fund and started being invested in equity markets (Vogel 2006: 95-98).

Japan's private occupational pension schemes were generally required to place their assets into licensed life insurance companies and trust banks, thereby contributing to the growth of an important financial services industry, which provided long-term credit to firms mostly through loans or bonds. As an alternative, Japanese employers

could finance their occupational schemes through “book reserves” (Manow 2001). Such schemes do not constitute pension funds per se, because they are financed internally by the firm through retained earnings. But they have been widely used by managers as a cheap source of internal finance (or “patient capital”) for business investment. Book reserves schemes have also been traditionally quite common in other CMEs like Germany (Jackson and Vitols 2001), Sweden or Italy. To be sure, the importance of these alternative types of funding arrangements has declined in recent years due to changes in the governance and the regulation of pension funds (Yermo 2005; Ebbinghaus 2011). However, these examples give an indication of why pension privatization needs not necessarily be equated with a convergence towards an Anglo-American model of finance and corporate governance. What matters is how pension funds’ investment portfolios are regulated and where the money goes. As I have suggested in the political economy model of pension privatization, these are issues over which actors such as financiers, employers and workers should contend with each other in the political arena.

## **Conclusion**

This chapter has given a broad overview of the recent movement towards pension privatization and of its diverse outcomes. Funded pensions were already widespread in a number of affluent democracies during the post-war period. Their development has nonetheless been greatly accelerated since the 1980s, after almost all European governments retrenched their statutory pension schemes and decided to increase incentives for coverage of retirement savings plans. Yet the comparative analysis of

pension systems presented in this chapter points to important and puzzling differences in the institutional arrangements that have been retained by policy-makers. First, countries have continued to diverge in the balance they strike between pay-as-you-go and funded schemes. Second, European governments have made different choices as regards the type of pension funds they have promoted. Some have preferred to encourage the expansion of personal pension plans generally managed by the financial industry. Others have assigned a more central role to occupational schemes controlled by labour market actors. A number of countries have also built up vast financial reserves for their pay-as-you-go systems through state-run buffer funds. These decisions arguably have important consequences both for the social adequacy and the financial sustainability of pensions. Last but not least, the analysis has shown that funded pensions are not only found in Anglo-American or “liberal” market economies, but have also sustained the functioning of “coordinated” market economies.

Why has there been a wave of pension privatization in the past three decades? And why has its practical implementation varied so much across countries? These are the two questions that the political economy model of pension privatization seeks to answer. This chapter provided only a snapshot view of the evolution of pension systems. Chapters 3-5 will now concentrate on its more dynamic aspects and try to assess the relevance of the competing theories of pension privatization presented in chapter 1 through in-depth case studies of contemporary British, French and Polish pension debates.

The comparative analysis of pension systems I have just proposed allows us to better understand why I decided to select these three specific countries. Not only have they have followed very different paths of pension privatization, but, more importantly,

they showed significant variation on two variables that play a central explanatory role in my theoretical framework. First, they had very diverse types of pre-existing supplementary pension schemes. At the beginning of the 1980s, the United Kingdom had both a system of voluntary employer-provided funded pension schemes and a mandatory second earnings-related statutory pay-as-you-go scheme. France had a system of mandatory occupational pensions controlled by trade unions and employers' associations, but benefits were financed on a pay-as-you-go basis and could differ from sector to sector. Poland had no supplementary or occupational pensions at all, as it had a relatively generous pay-as-you-go system that was entirely state-managed. These differences are important because I argue that they should be a key determinant of employers' and workers' preferences towards pension privatization. Second, the three countries have also had very different party systems. The United Kingdom has traditionally had a two-party majoritarian system. By contrast, France and Poland have had multi-party systems, but Poland emerged as a democracy only in the 1990s and its party system has been much more volatile than the French one.

Apart from this, it is worth noting that the three countries traditionally had very different financial systems. In Britain, capital markets and the stock exchange has been historically central in corporate finance. At the beginning of the 1980s, France had a credit-based system with a dominant role played by state-owned banks and the Treasury (Zysman 1983). By contrast, Poland was a centrally planned economy until the end of the 1980s and underwent a transition to a market economy at the beginning of the 1990s. Despite these differences, I argue that, in all three countries, the financial industry – in particular, insurance companies and the stock exchange – should have lobbied for the expansion of funded pensions. Moreover, both employers and workers

should have had an interest in the way the assets of pension funds would be used. Employers should have had concerns about whether pension funds would act as patient investors who would protect their firms from hostile takeovers and provide financing for long-term investments. Workers should have lobbied to have a say in pension funds' investment practices so as to promote worker-friendly forms of investment.

### **Chapter 3: From Paternalistic Voluntarism to Individualistic Compulsion:**

#### **Britain's Bumpy Process of Pension Privatization**

In post-war Europe, the United Kingdom was one of the countries with the highest level of private pension fund coverage. Inspired by the 1942 Beveridge Report, a Labour government introduced a contributory “basic state pension” through the National Insurance Act 1946. However, this flat-rate benefit was kept deliberately low and in fact barely reached the level of subsistence. There was therefore a general expectation that British workers would maintain their level of income in retirement either by building up their own savings or by having access to employer-sponsored occupational schemes. Spurred by important tax privileges introduced during the interwar period, occupational pensions expanded considerably in the decades following the Second World War, with coverage rising from 13% of the workforce in 1936 to more than a third in 1956 and about half by the mid-1960s (DHSS 1985: 21; Hannah 1986: 40). Nevertheless, the voluntary character of private retirement provision meant that the British population had become split into “two nations in old age” (Titmuss 1958: 74): whereas one half of workers had the chance to benefit from generous – generally defined-benefit – employer-provided plans, the other half were bound to face poverty in old age.

Following almost two decades of controversy between the left and the right (Baldwin 1990; Bridgen 2000; Pemberton forthcoming), a cross-party consensus was reached over the creation of a pay-as-you-go “state earnings-related pension scheme” (SERPS), which complemented the basic state pension and offered workers about a quarter of their average pre-retirement income between a lower and an upper earnings limit. The plan was legislated in 1975 by a Labour government and was implemented

from 1978. Employers with occupational schemes were nonetheless allowed to “contract out” of SERPS and to pay lower national insurance contributions, provided they offered a guaranteed minimum pension, which would roughly reach the level of SERPS. This specific institutional arrangement was to ensure that funded occupational schemes would continue playing a leading role in the UK pension system.

Yet, over the past three decades, this political compromise has been called into question, and both state and private pension provision have been dramatically restructured. In 1986, the Conservative Thatcher government decided to substantially reduce the generosity of SERPS and made it possible for individuals to opt out either from it or from their occupational schemes by joining defined-contribution “personal pension” plans. At the end of the 1990s, Tony Blair’s Labour government replaced SERPS with an increasingly flat-rate “state second pension” and attempted to extend coverage of funded pensions by creating low-cost voluntary defined-contribution plans called “stakeholder pensions”. Finally, the British public-private pension mix underwent a major overhaul in 2007-2008. On the one hand, Labour decided to improve the quality of the basic state pension and gradually to transform the state second pension into a fully flat-rate benefit. On the other hand, it introduced a system of “auto-enrolment” whereby employers have to enrol their employees automatically into a funded workplace pension scheme, but workers may choose to opt out of it. The upshot of this series of reforms is that state pension provision has turned full circle and is to focus again on keeping pensioners out of poverty, but in a more effective way. By contrast, retirement savings, which were traditionally purely voluntary and predominantly of the defined-benefit type, are now to be based on a regime of “soft compulsion” and are increasingly managed through defined-contribution schemes.

Why has the British pension system evolved so much over the years? Who pushed for these changes? And how can we explain these reforms' specific measures? One source of the move towards greater reliance on funded pensions could have been the ideational influence of international organizations such as the World Bank and the European Commission. However, whereas ideational scholars argue that these actors became actively involved in the pensions area in the 1990s, British Conservatives pushed for partial pension privatization already in the mid-1980s. Orenstein (2008: 160) himself has categorized the United Kingdom as a case of very limited involvement of transnational actors. An alternative account of these reforms would suggest that they originated primarily from party politicians and their electoral motives. According to Pierson (1994), the retrenchment of SERPS and the introduction of personal pensions in 1986 was the manifestation of right-wing parties' ideological assault on the state and on social spending. Because it gave workers a stake in private businesses and could lead them to think more like capitalists, pension privatization could be seen as part of a strategy aimed at altering voters' class consciousness and at reinforcing the social base of the Conservative Party (Bonoli 2000: 52-58; Jacobs and Teles 2007: 160). Likewise, Labour's greater support for funded pensions in the 1990s and the 2000s could be interpreted as a response to the concerns of a growing middle-class electorate.

There is nevertheless a third possible explanation of pension privatization in the UK, namely that it was initially the financial industry which managed to persuade policy-makers to espouse it and that politicians have then had to build coalitions with other organized interests in order to ensure the political viability of reforms. This chapter will explore these three competing theories of the rise of funded pensions. It will follow a broadly chronological structure. The first section focuses on the debates

that surrounded the introduction of personal pensions in the mid-1980s. The second section will show how despite a spate of scandals that rocked Britain's private pensions industry at the beginning of the 1990s the push for pension privatization continued unabated. The final section will study the discussions that led to the introduction of auto-enrolment at the end of the 2000s.

### **3.1 Uprooting Collectivism and Planting the Seeds of Individualism through Personal Pensions**

At the end of the 1970s, Britain's system of occupational pension schemes, and the welfare-labour and welfare-finance nexus it had institutionalized, was subjected to intense scrutiny by the policy-making community, as an unprecedented wave of deindustrialization swept the country. Amid complaints that the City of London was failing to commit adequate resources to industrial development, the left-wing Callaghan government announced in 1977 a review of the role of financial institutions – i.e. pension funds and insurance companies – in the financing of the British economy. Chaired by former Prime Minister Harold Wilson, the review committee highlighted how the rise of institutional investors in recent decades had dramatically changed the structure of ownership of UK plc. Whereas in 1957 two thirds of listed UK ordinary shares were directly held by private investors, the proportion had been reversed by 1978 to half of shares being owned by financial institutions and only a third by individuals (Committee to Review the Functioning of Financial Institutions 1980: 72; see also Minns 1982; Plender 1982). The National Association of Pension Funds, i.e. the body representing occupational pension funds run by employers, predicted that the role of

institutional investors was likely to grow even further in the future (Committee to Review the Functioning of Financial Institutions 1978: 144).

Although the Wilson Committee concluded that the financial institutions could not be held responsible for the country's economic malaise, it suggested that they were not providing enough capital to small and medium-sized enterprises, especially in high-technology sectors (Committee to Review the Functioning of Financial Institutions 1979). The Trades Union Congress (TUC) had nonetheless a more pessimistic view on the investment policies of the City (Committee to Review the Functioning of Financial Institutions 1977: 73-109). As exchange controls were being abolished in 1979 and British institutional investors were allowed to invest abroad freely, the TUC called for limiting the proportion of foreign securities that could be held in their portfolios. Organized labour also launched a crusade to give unions greater representation on pension funds' boards and to force financial institutions to invest a significant part of their assets in a "National Investment Bank", which would help "channel investment funds into the key industries of the future" (FT Conference 1982: 70; *Financial Times* 1982a). The TUC's proposals were to become part of the Labour Party's 1983 election manifesto.

While they were criticized for their lack of contribution to industrial finance, defined-benefit occupational pension plans were also questioned on their compatibility with contemporary labour market trends. Deindustrialization ushered in a period of high redundancy and increased job mobility. Yet company pension schemes traditionally functioned on the assumption that workers would stay with their employer for their whole career. With the regulatory framework of the time, employees who left or lost their job before retirement had to suffer a substantial loss of benefits. Although they

generally preserved their accrued rights, such workers could not count on their revaluation and had no possibility of transferring their frozen contributions into an alternative pension scheme. The “early leaver” problem therefore became a hot topic among pension policy-makers at the beginning of the 1980s (Occupational Pensions Board 1981; FT Conference 1982; Nesbitt 1995; Bonoli 2000: 63-64).

It is in this context that, in April 1983, the Centre for Policy Studies (CPS), a Conservative think tank, published a policy paper suggesting that employees should be allowed to opt out of their company pension scheme and to make their own retirement provision through defined-contribution “personal and portable” pension plans. The proposals constituted a direct challenge to the Britain’s existing nexus between occupational pensions, the labour market and the financial system. By promoting this new type of funded plans, the group was indeed hoping to repair the “grave injustice inflicted on those who change jobs” (CPS 1983: 1). However, another explicit aim of the paper’s authors was to challenge the supremacy enjoyed by occupational pension funds and insurance companies in the management of retirement savings. Ownership of British companies had become increasingly concentrated in the hands of a few financial institutions and threatened to fall under the control of unions if the TUC’s proposals were to go through. In their current form, funded schemes gave individuals only “ownership at second hand” (*Ibid.*: 1). If people were “to have a real sense of involvement in the industrial success of this Country” (*Ibid.*: 1), they were to “be given the chance to run their own personalised pensions as if they were self-employed<sup>1</sup>” (*Ibid.*: 2).

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<sup>1</sup> Because they were covered neither by SERPS nor by occupational pension schemes, the self-employed traditionally built up retirement savings through defined-contribution plans.

The CPS was known for having very tight links with the Conservative Party and particularly with its leader, Margaret Thatcher (Harris 1996), which could suggest that the idea to create personal pensions originated primarily from Tory elites and was driven by a plan to reinforce the social base of the Conservative Party, as could be expected by partisan theories of pension privatization. Nevertheless, the working group which prepared the 1983 policy paper was also very closely associated with the business community, and especially the financial industry. Its chairman was Nigel Vinson, a small entrepreneur who between 1979 and 1984 was deputy chairman of the CBI Smaller Firms Council. The CBI (Confederation of British Industry) is Britain's main employers' association. Since 1982, Vinson was also deputy chairman of Barclays Bank. The other leader of the CPS working group was Philip Chappell, an investment banker. During the preparation of the policy paper, Vinson and Chappell met with Sir Nicholas Goodison, a stockbroker and since 1976 chairman of the London Stock Exchange (LSE)<sup>2</sup>.

In the preceding years, Sir Nicholas had been campaigning for the introduction of tax incentives to promote share buying by individual – rather than institutional – investors (e.g. Committee to Review the Functioning of Financial Institutions, 1978: 233). In his opinion, wider share ownership would “bring us to the desired end of a capital owning democracy” in which workers would identify more closely with industry (*Financial Times* 1982b). The New York Stock Exchange, the LSE's closest rival, had seen a new influx of small investors after Individual Retirement Accounts (IRAs) were introduced in 1974. Stockbrokers, who controlled the Council of The Stock Exchange, also had a material interest in strengthening the position of private investors. Regulators

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<sup>2</sup> Interview, London, 01.08.2012.

were increasingly denouncing the LSE's system of fixed brokerage commissions (Michie 1999: Chapters 11-12). But, in the more competitive system that was likely to replace it, retail investors would have to pay higher charges than wholesale institutional investors and thus would bring greater profits to brokerage houses (Plender and Wallace 1985: 221). The involvement of financiers in these discussions suggests that not only party elites' electoral considerations, but also the financial industry's material interests in developing private retirement savings were the driving forces behind the CPS's attempt to put the introduction of personal pensions on the political agenda.

Published only two months before a general election, the CPS proposals on personal pensions immediately contributed to shape the debate among pension policy-makers. At the annual conference of the National Association of Pension Funds (NAPF), the Conservative Secretary of State for Social Services, Norman Fowler, expressed his interest in the think tank's ideas and declared he would soon call a special conference on the early leaver problem. On the contrary, the NAPF, which defended the interests of existing defined-benefit company pension schemes, described the proposals as "very superficial" and dismissed plans to return to defined-contribution schemes "which most of us abandoned a generation ago because they failed to provide the right answer in times of inflation" (*Financial Times* 1983a).

The 1983 Conservative Manifesto made no mention of personal pensions, nor of any major plan to reform the pension system (Conservative Party 1983). However, the document promised that a new Conservative government would address the early leaver problem. Some of the concerns that led the CPS to draft its policy paper on personal pensions were also echoed in Margaret Thatcher's successful electoral campaign. For example, during a speech in Cardiff, the Prime Minister said:

“It's important that Britain should know what Labour would do to Britain. (...) Of course, they'd re-nationalise everything that has been de-nationalised by this Government. And how will they pay for this vast state grab? Well, they've got their eyes on your pension scheme and your life assurance. They will take your pension contributions and your life assurance premiums and spend them on their Socialist schemes. And there are 11½ million people who are members of occupational pension schemes. It's all here in their Manifesto...” (Thatcher 1983)

As would be expected by partisan theories of pension privatization, the proposal for personal pensions was from the very start developed as an electoral project. Yet representatives of the City had contributed many of the ideas that underpinned the plan. This involvement - but also the cleavages dividing the financial industry - was to become even more evident once personal pensions were put on the government agenda. The next three subsections trace the different stages that led to the adoption of personal pensions and to the retrenchment of SERPS in 1986. Although the Conservative government initially framed individual retirement savings primarily as a response to the early leaver problem in occupational schemes (subsection 1), it subsequently tried to combine their promotion with an ambitious plan to abolish SERPS (subsection 2). In the face of opposition from many segments of the business community, the government decided to go back on its radical plans for pension privatization, but still managed to push through personal pensions and important cuts in SERPS (subsection 3).

#### *The review of the social security system*

In the autumn of 1983, Norman Fowler announced that his department would carry out a comprehensive review of the social security system. As part of the enquiry, he set up a sub-committee whose remit was to investigate the portability of pensions. In

addition to Fowler himself and a Minister of State at the Treasury, the group comprised an academic as well as two private insurers. To the dismay of existing company pension schemes, the Social Services Secretary had failed to appoint a representative of the pension industry's old guard. Moreover, one of the insurers nominated to the subcommittee was Mark Weinberg, the chairman of Hambro Life, a company which specialized in the selling of defined-contribution plans. Weinberg described himself as "commercial and not ashamed of it" (*Financial Times* 1984a). The NAPF believed "he could invalidate the objectivity of the committee" (*The Guardian* 1984). The composition of the subcommittee signalled, first, that Fowler was intent on achieving personal pensions<sup>3</sup>. Second, it suggested that he did not necessarily plan to follow the CPS's plan to transfer the management of retirement savings from financial institutions to individual investors.

In the evidence they gave to the review, both the NAPF and the CBI voiced their opposition to the idea of allowing employees to opt out of their company schemes (*Financial Times* 1984b; 1984c; 1984e). The CPS's proposal constituted a direct threat to existing occupational pension institutions and to employers' interests in the "welfare-labour nexus". Company pensions were traditionally used by companies as a tool for the retention of skilled workers. Giving employees the right to opt out of their company scheme would take away much of the incentive for them to stay with their employer. It would furthermore increase the costs of providing occupational pensions for remaining employees. While managers of occupational pension funds pointed at the relatively high level of charges which could be levied by providers of personal retirement accounts, the NAPF and the CBI nonetheless agreed that such plans could be developed as a top-up –

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<sup>3</sup> In his political memoirs, Norman Fowler argued that he had left the debate open, but he also wrote that this openness "meant that the industry had to justify, under cross-examination, its policies. Opponents of changing the rules on early leavers found it difficult to sustain their case" (Fowler 1991: 205).

and not an alternative – to company pension schemes and that they could benefit from a form of tax relief. The employers' association also conceded that early leavers should be allowed to transfer their dormant contributions from their company schemes into such third-tier personal pension plans.

Although the insurance industry was widely believed to be a potential beneficiary of the introduction of personal pensions, it appeared to be divided. The relatively young unit-linked life companies, such as Saver and Prosper, Hambro Life or Trident Life, actively lobbied for the acceptance of the CPS's proposals (*Financial Times* 1983b). These firms were only marginally involved in occupational pensions and traditionally targeted the self-employed or individual savers. However, pressed by the traditional life insurance establishment, the industry's official representative bodies – e.g. the Life Offices Association (LOA) and the Associated Scottish Life Offices (ASLO) – stated, like the NAPF and the CBI, that compulsory membership of company schemes should be retained and that personal pensions should be developed only as a top-up to state and occupational retirement provision (*Financial Times* 1984d). Because they had substantial stakes in the occupational pensions market, traditional life assurance companies – such as Legal and General or the Prudential – had in fact “a vested interest in maintaining the status quo” (*Financial Times* 1983b). The chairman of Legal and General wrote that “any legislation which would undermine ‘final salary’ schemes in favour of ‘do-it-yourself’ arrangements ... could leave millions of employed people and their families worse off” (Legal and General 1984: 6-7). These reactions suggest that, just as much as employers, part of the insurance industry was influenced by an institutional feedback effect from pre-existing supplementary pension schemes. The insurance establishment was at the time under great pressure, because in the spring 1984

the Treasury scrapped the long-established tax relief on life assurance premiums and there were strong rumours that an abolition of occupational pensions tax relief could follow.

In spite of the numerous criticisms expressed by the business community, the Department of Health and Social Security (DHSS) published in July 1984 a report – entitled “Personal Pensions: A Consultative Document” – which confirmed its determination to push through personal pensions and to take legislative action on the portability of occupational pension rights. Since the document contained the possibility of opting out of company schemes, the NAPF spoke of an “error of judgment”. The Labour Party called the proposals “damaging and retrogressive” (*Financial Times* 1984f). In the autumn of 1984, the government proposed a first package of reforms in a draft Social Security Bill. The bill stipulated, firstly, that all newly accrued occupational pension rights would have to be revalued each year in line with price inflation up to a limit of 5%, and this including for employees who would change jobs. Secondly, the bill proposed to give workers the right to transfer their accrued rights into their new company scheme or into a life annuity plan. Thirdly, employees would have to be given better access to information on their benefits and on the financial details of their pension scheme. The measures were eventually enacted in the summer of 1985 through the Social Security Act 1985.

#### *Towards radical pension privatization?*

After the publication of the government’s consultative document, the insurance industry changed tactics and adopted a more cooperative stance. The Life Offices

Association described the proposals as “a constructive way forward” (*Financial Times* 1984e). Companies such as Save and Prosper or Sun Alliance started posting advertisements for their individual retirement savings products in mass newspapers such as *The Times* (July 19<sup>th</sup> 1984: 9; July 21<sup>st</sup> 1984: 21), *The Observer* (July 29<sup>th</sup> 1984: 11) or *The Guardian* (September 7<sup>th</sup> 1984: 5). In an official joint response to the government’s proposals, the LOA and its Scottish counterpart, the ASLO, welcomed the broad principle of developing personal pensions and focused their comments on the regulatory framework that would need to be introduced. Most significantly, both trade associations argued that only life insurance companies should be allowed to run the new plans, as was already the case with the existing defined-contribution schemes for the self-employed. They argued that the regulations and controls to which their industry was subject would provide the best protection to investors (*Financial Times* 1984g; 1984h). Other segments of the financial industry – such as building societies or unit trusts (i.e. mutual funds) – naturally protested against the idea of providing insurers with a monopoly over this potentially lucrative market. This provides evidence for my hypothesis that each segment of the financial industry should be partial to its own products.

The largest insurance companies and the rest of the business community nonetheless continued to have strained relationships with the government. As fears were growing that the Treasury would try to abolish tax relief on occupational pension contributions, the CBI, the NAPF, insurance companies and even trade unions waged an intensive lobbying campaign throughout winter 1984/1985 to prevent the government from doing so (e.g. *Post Magazine* 1985). In a clear attempt at “outside lobbying”, Britain’s largest life insurance company, the Prudential, distributed over 300,000

booklets in which it explained the government's intentions on pensions and encouraged its clients to ask questions to their MP. The company wrote that there were many "snags" in "portable" pensions (Prudential 1985: 9) and that any changes in taxation policy towards pensions would be a "socially retrograde step in rational and human terms" (*Ibid.*: 12). After being confronted with "the most astonishing lobbying campaign of [his] entire political career" (Lawson: 368), the Chancellor of the Exchequer finally ruled out any taxation of pension funds (*Financial Times* 1985a).

Yet, in the spring 1985, the Conservative government was to put forward an even more radical proposal, namely that the pay-as-you-go State Earnings Relation Pension Scheme should be abolished and replaced with funded personal or company pensions. During the winter 1984, the DHSS had made projections, which showed that the costs of SERPS would dramatically increase in the future due to demographic ageing. At the same time, polls had shown that "a pension of your own' could have the same kind of appeal as 'a house of your own'" (Fowler 1991: 211-212). Most likely influenced by a study trip to Switzerland (cf. *Ibid.*: 216), the Social Services Secretary had started talking in private about the necessity to introduce a "twin-pillar system" with an "explicit recognition that social security is not just the state alone" (*Ibid.*: 212; emphasis added). The "three pillar" concept had been formulated by the Swiss insurance industry in the 1970s (see Chapter 1 of this thesis; Leimgruber 2009; 2012) and was ever since used extremely rarely in British debates about pensions<sup>4</sup>.

When Norman Fowler's novel idea of scrapping SERPS was privately debated within the Cabinet, Margaret Thatcher decided that, in order for its abolition to be accepted by the public, SERPS would have to be replaced with mandatory private

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<sup>4</sup> A search in the Factiva archives of the *Financial Times* (between January 1981 and August 2012) using the combination "(pillar OR pillars) AND pensions" yielded only 331 articles, with many (if not a majority) of them covering developments overseas.

pensions (Fowler 1991: 215-216; Lawson 1992: 588-592). The Prime Minister's suggestion may have been driven by a strategy to use personal pensions to expand the middle class and the Conservative Party's electoral base. However, the Prime Minister's and the Social Services Secretary's plans were vehemently opposed by the Chancellor, Nigel Lawson. The Treasury was worried that the abolition of SERPS and the concomitant introduction of personal pensions would force the government to increase taxes, instead of reducing them as was the Tories' objective. Nigel Lawson also feared that the measures would draw opposition from the business community. Thatcher and Fowler decided to make no concessions, apart from excluding the self-employed from the reform. Small entrepreneurs, who were one of the core constituencies of the Conservative Party (Grant 1980: 152-154), were not covered by SERPS. Since the introduction of compulsory personal pensions would add to their costs, small business associations would very likely fight the reform and thus jeopardize the political viability of the reform. At the same time, Margaret Thatcher decided to stick to the spirit of her plan, despite potential opposition from large employers represented by the CBI. As I have argued in the third step of my political economy model of pension privatization, in two-party systems employers tend to be dispersed across parties and therefore right-wing party leaders may decide to ignore their preferences when deciding to put forward pension privatization.

The proposal to end SERPS and replace it with compulsory funded schemes was officially announced in a Green Paper on social security reform published in June 1985. The government spoke of its ambition to build a "twin pillar" system in which social security would be "a partnership between the individual and the state" (DHSS 1985a: 1). Reforming SERPS was presented as inevitable because "to leave the extra large bill

involved in SERPS to the coming generations would be irresponsible (*Ibid.*: 23). The introduction of mandatory private pensions would help “replace the two nations in pensions – those with their own pension provision and those dependent on the state – by a nation in which everyone is saving through their job for a better retirement” (*Ibid.*: 26). The Green Paper recommended introducing a minimum private pension contribution of 4% of salary, of which at least two percentage points would be paid by the employer. The document also proposed eventually to suppress the notion of “contracting out” of SERPS and to introduce a single rate of national insurance contributions which would be 16.5% instead of 19.5% (traditionally reduced by 6.25 percentage points for contracted out schemes).

The Green Paper drew heavy criticism from organized labour and from the Labour Party, which had contributed to establish SERPS and announced it would reverse the reforms if it returned to power (Pierson 1994: 61-62). The government’s plans were also denounced by the occupational pensions industry. However, from the point of view of the Conservative Party, the most serious opposition to the project was mounted by organized business (Lawson 1992: 592). Both the CBI and the Engineering Employers Federation (EEF), a group that represents Britain’s manufacturing industries, were hostile to the increase in labour costs the proposed measures would impose on companies. These criticisms highlighted an inconsistency in the policy of a government which presented itself as a champion of British business and of Britain’s economic competitiveness. Employers concurred that the costs of state pensions needed to be reduced, but they argued that, instead of abolishing SERPS, Margaret Thatcher’s administration should scale it down. Very shortly after Norman Fowler was vehemently criticized at the annual conference of the CBI (*Financial Times* 1985b), the business

group hinted that the Tories would backtrack from their proposals and put forward changes that would be more in line with its own preferences (*Financial Times* 1985c).

### *The Social Security Act 1986*

Having given up his ambition to phase out SERPS, Norman Fowler announced a new blueprint for reform in December 1985 (DHSS 1985b), which formed the basis for what was eventually to become the Social Security Act 1986. The government decided that, instead of replacing 25% of a contributor's best 20 years of earnings, SERPS benefits would in the future be based on 20% of average wages earned by workers over their entire working life. To make these pension cuts more palatable to the electorate, the state would implement them only gradually between 2001 and 2010 and protect the rights of all people retiring before the end of the century.

Yet, despite the NAPF's and the CBI's hostility to private personal pensions, Conservatives did not waver in their commitment to introduce this type of plans as they considered them as a vote winner<sup>5</sup>. From 1988, all employees would have the right to opt out of their employer's scheme or from SERPS and to save for their own personal pension. The new retirement savings plans could be contracted out of SERPS if they provided a minimum level of contributions that was equal to the traditional rebate on National Insurance (NI) contributions for contracted-out occupational schemes (i.e. 6.25% of gross wages). The government also suggested simplifying arrangements for the contracting out of company schemes. It proposed to introduce a new and less

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<sup>5</sup> A Tory MP, who was a parliamentary adviser to the British Insurance Brokers' Association, wrote that the introduction of personal pensions could be seen as a "further move towards the classless society or, as the Prime Minister describes it, the property-owning democracy" and that "this and share ownership through privatisation form[ed] the cornerstones of Mrs Thatcher's appeal for a third term in 1987" (McCrimble 1986).

stringent test for defined-benefit plans. But, more importantly, employers were also to be allowed to contract out their employees through *defined-contribution* occupational plans, provided they guaranteed a minimum level of contributions. Last but not least, in order to encourage private retirement provision, the government proposed to offer an extra 2% NI contribution rebate to all new contracted-out occupational schemes and personal pension plans opened during the five years from 1988.

According to *The Times* (1985), the announcement that SERPS would be only scaled down and not abolished was received with “an audible sigh of relief” in the pensions industry and the business community. By contrast, the introduction of personal pensions got an enthusiastic welcome from the insurance industry, as long as the government “got the small print right” (*Financial Times* 1985d). When the reform bill was discussed by Parliament between January and August 1986, private insurers expressed complaints on a number of issues. One of them was the government’s decision to allow banks, unit trusts and building societies to provide personal pension plans (*Financial Times* 1985e). Even though on retirement the savings would have to be converted into an annuity bought from a life insurance company, the government’s project implied the end of the industry’s monopoly in individual defined-contribution pension plans. Some MPs tabled amendments to limit the building societies’ ability to provide the new plans (*Financial Times* 1986b), but all four types of financial firms were eventually allowed to participate in the market (*Financial Times* 1986e). Another issue about which the industry was worried was plans to impose a statutory limit of 5% on the distribution fees that companies would levy on personal pension premiums. The Conservative majority eventually decided to rely primarily on market discipline and the

mandatory disclosure of fees, but it gave the government the power to control charges if competition failed to do so (*Post Magazine* 1986).

Nevertheless, the greatest political controversy over the Social Security Bill centred on the 2% NI contribution rebate for those who would join a personal pension plan or a newly created company scheme. The Labour Party called it a “bribe”, which it pledged to repeal (*Financial Times* 1986a). However, the term was soon to be borrowed by the NAPF and the CBI (*The Sunday Times* 1986; *Financial Times* 1986c; 1986d). Both organizations protested against the fact that the 2% incentive was also offered to workers who would decide to leave their contracted-out company scheme and to opt for a personal pension. As the subsidy could threaten existing final-salary schemes, employers and the occupational pensions industry lobbied hard for its extension to all those who would contract out of SERPS. Yet Margaret Thatcher’s government was determined to promote the personal pension concept and did not give in to these demands.

After a three-year debate, the Conservatives finally managed to push through “personal and portable pensions” at the end of the summer 1986. The ideas initially put forward by the Centre for Policy Studies had generated much opposition from the occupational pensions industry and from employers’ associations. However, Norman Fowler’s radical proposal to abolish SERPS and Margaret Thatcher’s suggestion to make personal pensions mandatory had contributed to change the terms of the debate and had to a certain extent forced business to accept the introduction of personal pension plans. Despite the serious disagreements that arose between employers and the government over pensions, the CBI nonetheless decided to offer the Conservative Party its full endorsement prior to the 1987 General Election, which illustrates the role

organized interests can play in the mobilization of political parties' electoral constituencies. The organization's director-general, Sir Terence Beckett said that even though he had had "differences... over things like pensions... this government must be credited with effecting some tremendous changes for business. We believe in its strategy, although not always in its tactics" (*Financial Times* 1986f). The CBI also warned that the election of a Labour government might put Britain back into "the mayhem of the 1970s" (*The Times* 1986). For their part, insurers announced that they would try to persuade Labour politicians to uphold the legislation on personal pensions introduced by Conservatives (*The Times* 1987).

### **3.2 Scandals and Further Privatization**

Personal pension schemes started operating in July 1988 and enjoyed considerable success in the following years. However, pension reform reached once more the top of the political agenda at the beginning of the 1990s after two major scandals shook the foundations of the British system of supplementary pensions and of the regulation of the domestic welfare-finance nexus. In November 1991, it emerged that the recently deceased UK media magnate, Robert Maxwell, had plundered the pension funds of one of his businesses, the Mirror Group (e.g. *The Independent* 1991). In order to support his failing and debt-ridden private companies, the businessman had made the pension schemes invest in their equity capital. Moreover, he "borrowed" stock from the Mirror Group's pension funds without providing them with any collateral and used it as security for raising loans from UK and international banks. The manoeuvre, as a result of which the pension funds were unable to meet their liabilities, contravened standard

stock lending practices and failed to be reported by accounting professionals and City regulators. It was made possible because the trustees of the pension funds were all linked to the Maxwell family. Moreover, Robert Maxwell owned the investment management company that administered the majority of the schemes.

A second scandal that was slowly brewing was the “mis-selling” of personal pensions by the insurance industry (e.g. *Financial Times* 1992a; 1992c; *The Observer* 1992). When Margaret Thatcher’s government put in place personal pensions, it predicted that 500,000 people would join the schemes. Nevertheless, four years after their implementation, it turned out that more than four million people had opted for them (Jacobs and Teles 2007: 170). With the help of the generous NI contribution rebates introduced by the government and of massive promotional campaigns spearheaded by private insurance companies, commission-driven salesmen managed to convince a huge number of people to transfer into relatively risky personal pensions even though they would have done better to stay in their defined-benefit occupational scheme or in SERPS. From 1992, regulatory authorities such as the Life Assurance and Unit Trust Regulatory Organisation or the Securities and Investments Board launched a series of investigations into the marketing practices of various insurance companies.

Both the Maxwell affair and the mis-selling scandal dealt a severe blow to the system of self-regulation with statutory backing to which the UK financial industry was subject since the mid-1980s (Moran 2003). The cases revealed that the regulatory bodies which watched over pension fund managers and life insurers had very limited administrative capacities and that, while they were generally effective at enforcing clearly written rules, they were much weaker at sanctioning perhaps less well defined unethical behaviour. In addition, the Maxwell scandal highlighted the deficiencies of the

institution of the trust, which governed company pension schemes since the 1920s. Pension fund trustees had in principle a legal obligation to act in the best interests of scheme beneficiaries and to invest assets in a “prudent” way. However, the dominance of pension fund boards by trustees appointed by company managements created important conflicts of interest and gave corporate executives excessive discretion over the administration of the funds.

To address the issues raised by the two affairs, the state updated the regulatory framework of funded pensions, in particular that of occupational pension schemes (subsection 1). Yet, paradoxically, while they could have raised doubts as to the reliability of funding as a method of financing pensions, the scandals did not prevent policy entrepreneurs of all political stripes from promoting the idea that funded pensions should be developed even further (subsection 2). Most significantly, the Labour Party changed its stance over pension reform. When it returned to power in 1997, it decided not to go back on the Thatcher government’s retrenchment of SERPS, but instead tried to address the deficiencies of personal pensions, by introducing low-cost defined-contribution stakeholder pensions (subsection 3).

### *Responses to the scandals*

In the wake of the Maxwell and mis-selling scandals, a general consensus emerged that the regulation of the UK pension fund industry should be radically overhauled. The main reaction to the pensions mis-selling scandal was the imposition of fines on the pension providers that were to blame and the reinforcement of state supervision over the insurance industry through the creation of the Financial Services

Authority in 1997 (Jacobs and Teles 2007). By contrast, the Maxwell affair gained much greater attention and elicited both short-term and medium-term political responses, as it had more far-reaching implications for the welfare-finance nexus and the British system of corporate governance.

The immediate reaction of John Major's Conservative government to the Maxwell affair was to bring forward the implementation of a 5% ceiling on "self-investment" by pension schemes in securities issued by their parent company. The principle of such a restriction had already been ratified by the Social Security Act 1990. However, the government had failed to introduce regulations that would set the precise level of the limit and allow its implementation. The revelation that the Mirror Group's pension funds had invested in the assets of the Maxwell family's failing private companies put pressure on the government to adopt the missing regulations.

Self-investment had in fact been a contentious issue within the pensions policy-making community for more than a decade. The problem had been raised at the end of the 1970s by the Wilson review of the functioning of financial institutions. Most corporate managers agreed at the time that the practice should be limited. Nevertheless, a number of managers, particularly from large companies such as the industrial conglomerate GEC, argued that it should actually be encouraged in some circumstances because it provided an efficient way of channelling the money held by pension funds back into the company (or in other words it constituted a source of "patient capital"; *Financial Times* 1987a). The attitude adopted by these industrialists confirms the expectation of the theoretical model developed in Chapter 1 that managers of large firms may have concerns about whether pension funds will act as patient investors who will provide financing for long-term investments. By giving employees a stake in the

equity capital of their company, self-investment could also help motivate workers and increase their productivity. Given the lack of consensus within the business community, the Wilson committee did not recommend any stringent legal guidelines on the matter.

Self-investment became nonetheless a more burning issue – albeit still confined to expert circles – in the second half of the 1980s after a number of non-financial firms used it as a means to fight off hostile takeover bids. By committing a relatively substantial percentage of their in-house pension fund’s assets to their own equity capital, companies could indeed become virtually bid-proof. The practice caused controversy with City managers, who argued that it damaged shareholder value and their investment returns. Since on the other hand managers of industrial companies continued to accuse fund managers of not providing enough financing to industry and of “short-termist” behaviour, the CBI created in 1986-1987 a City-Industry Task Force to address unresolved issues between the two segments of business (*Financial Times* 1987b).

In parallel, the NAPF established a working party to study the issue of self-investment. Although it warned its members against its use, the pension fund lobby did not require them to abandon it and did not recommend any statutory changes. Instead, it drafted an informal and non-binding code of best practice for trustees, according to which schemes that insisted on investing in their parent companies’ shares would have to seek independent professional advice and make full disclosure of the relevant shareholdings to their members (*Financial Times* 1988a). However, as fears were growing that such an informal approach might be insufficient to prevent malpractice, the Conservative government decided to push through the introduction of a statutory limit via the Social Security Act 1990. But parts of the business community (including

the CBI) still resisted the measure due to their interests in the welfare-finance nexus (e.g. *The Independent* 1990) and it was only after the Maxwell scandal that relevant government regulations were adopted (e.g. *Financial Times* 1992b).

Apart from this short-term political response, the Maxwell affair triggered a broader re-assessment of the legal framework under which pension schemes operated. Following a General Election that was won by the Conservative Party in spring 1992, the new Social Security Secretary, Peter Lilley, set up an independent enquiry into the regulation of occupational pension schemes, especially as regard to who should control the funds' assets. The committee, which comprised representatives of the fund management industry and was chaired by law professor Roy Goode, published its report in early autumn 1993. While company schemes had until then been governed by trust law, the group suggested that their regulation should be tightened up through the drafting of a separate pensions act (Pension Law Review Committee 1993).

As a follow-up to the Goode committee's recommendations, the Department of Social Security published its own White Paper in June 1994, which formed the basis for what became the Pensions Act 1995 (Schulze and Moran 2006: 74-76). This piece of legislation introduced important changes in the regulation and the governance of occupational pension schemes. First, it improved the accountability of pension fund boards, by requiring that at least one third of trustees be elected by scheme members. Second, it defined more clearly the civil and criminal penalties incurred by trustees for the mismanagement of a scheme's fund. Third, it established a new Occupational Pensions Regulatory Authority and a Pensions Ombudsman with greater powers to police pension funds. To ensure that defined-benefit occupational schemes would have enough assets to meet their liabilities, the government also introduced a minimum

funding requirement for all such plans<sup>6</sup>. Finally, the act set up a compensation fund, which would indemnify scheme members in case their pension scheme was to become insolvent as a result of fraud or theft.

Although the Goode committee had primarily called for a consolidation of UK occupational pension law in a single pensions act, the Conservative majority extended the scope of its bill, by incorporating changes in state benefits and the pattern of contracting out. Thus, the Pensions Act 1995 required the equalization of men's and women's statutory retirement age at 65 years between 2010 and 2020. Through technical changes in the calculation of SERPS benefits, it also aimed further to cut spending on pay-as-you-go pensions (*Money Marketing* 1995; *Post Magazine* 1995). Last but not least, the Conservatives introduced a new form of age-related national insurance rebates for personal pensions, whose goal was to avoid that employees opt back into SERPS as they got closer to retirement age. The system had been suggested ten years earlier by the Legal and General insurance company (*Post Magazine* 1993). These additional measures showed that, despite the scandals that hit the UK private pensions industry, political elites continued to push for the retrenchment of earnings-related pay-as-you-go pensions and for further expansion of funded defined-contribution schemes.

### *Democratizing retirement savings?*

The events of the beginning of the 1990s prompted a number of actors to have a fundamental rethink of UK pension policy. This was most evident in the case of the

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<sup>6</sup> Whenever the pension scheme's coverage ratio (i.e. the proportion between assets and liabilities) would fall below 90%, the employer would have to increase the assets of the fund.

Labour Party. In 1990 Labour was still openly hostile towards personal pensions and was promising to restore – and even expand – SERPS. The party’s relationship with the private insurance industry was a stormy one, so to speak (*The Guardian* 1990). By 1996, New Labour would officially put forward the introduction of fully-funded defined-contribution “stakeholder pensions” to remedy the deficiencies of personal pensions and would seek the cooperation of insurance companies for the implementation of its plans (*The Sunday Times* 1996a).

The Labour MP Frank Field played a crucial role in bringing his party to alter its stance on pension privatization. Field chaired the Social Security Select Committee at the House of Commons since 1990 and was closely involved in all the policy discussions that followed the Maxwell affair. Soon after the scandal broke, he wrote in an op-ed that in its existing shape the UK pension system had not given “us as individual policy holders any control over our pension investment” and “the next big leap forward” would be to ensure that it did (Field 1991). Field cited a presentation given by Philip Chappell – i.e. the investment banker who had co-authored the 1983 CPS paper on personal pensions and who became the director of the Association of Investment Trust Companies in 1986 – and Lord Vincent at the Social Security Select Committee as an inspiration for this idea, and argued that instead of “howling with horror” the left “ought to see the opportunity for us to go on the attack”. In his opinion, Labour had “far more to gain than [had] the right from making a reality of popular capitalism” because it had “a chance to realign the boundaries between individual and collective action by offering a new form of economic independence operated within self-run institutions”, a programme that “could prove very popular with voters”. Field also suggested that more democratically controlled pension ownership could help put an

end to City short-termism and to its negative consequences for the financing of British industry.

Over the following years, Field campaigned relentlessly to make the left change its attitude on pension reform. After Labour lost the 1992 general election, he argued that it was crucial for the party to be able to show to floating voters that it would cater to their financial self-interest, and that it had to make the consumer “the cornerstone, particularly in respect of the control over income and capital” (Field 1992). As has been underlined by partisan theories of pension privatization, the expansion of retirement savings can be seen by politicians as a way of attracting the vote of the middle class. When the Labour Party created a Social Justice Commission to review its position on social policy issues, the MP submitted as evidence a pamphlet entitled “Private Pensions for All” (Field and Owen 1993). Field urged his party to “start thinking the unthinkable” (Field 1993) and proposed to make it compulsory for employers to contribute at least 6% of gross earnings to private funded schemes on their employees’ behalf. Field went as far as to suggest that the basic state pension might eventually be transformed into a means-tested benefit, as the government would be paying contributions to the private schemes for groups unable to earn income in the labour market – e.g. the disabled, the unemployed and full-time or part-time carers. Senior Labour politicians described Field as a “maverick” and rejected the idea of turning state retirement provision into a mere safety net for the poorest. By contrast, the Conservative Social Security Secretary, Peter Lilley, welcomed the proposals, but also hastened to add that he thought that the basic state pension should remain the “building block” of the British pension system (*Financial Times* 1993b).

Calls for the introduction of compulsory retirement savings also started coming from the occupational pensions industry. In 1994, the NAPF set up and sponsored an independent review body (called the “Retirement Income Inquiry”), which was asked to make recommendations on how to improve the adequacy of UK pension provision and on how to ensure the financial sustainability of the system in the face of demographic ageing. As a result of the Thatcher government’s decision to shift the indexation of state benefits from wage inflation to price inflation (Pierson 1994), the value of the basic state pension had fallen from 20% of average earnings late in the 1970s to 15% in the mid-1990s. Moreover, coverage of occupational pension schemes had decreased since the mid-1980s (*The Times* 1994). NAPF officials warned that in its current shape the British pension system risked creating “a socially and economically dangerous pensioner underclass” and that “an element of compulsion” in retirement savings had become “inevitable” (*Post Magazine* 1994; see also *Pensions & Investments* 1995). Like Frank Field, the organization suggested that SERPS should be superseded by mandatory funded schemes with a minimum level of contributions. However, the NAPF thought that the basic state pension should be retained and be made more generous to prevent pensioner poverty. Rather than giving employees greater control over their retirement savings, the lobby called for occupational schemes to be able to require employees to join. Details of the proposals were spelled out in a report published in January 1996 (Retirement Income Inquiry 1996).

That same month, Labour’s leader, Tony Blair, confirmed the change in his party’s thinking about pensions in a high-profile speech he gave in Singapore on his vision for a socially cohesive, high-productivity “stakeholder” economy (*The Guardian* 1996; see also Field 1996a; Hutton 1996; McRae 1996). Blair said that his party was

studying the possibility of introducing a British version of Singapore's Central Provident Fund, a state-run defined-contribution pension fund to which all workers were compelled to contribute. Labour's social security spokesman, Chris Smith, wrote that an incoming Labour government could not "restore SERPS to its former glory" but would "need to look at a funded mechanism" (Smith 1996). However, in a manner reminiscent of Margaret Thatcher's attacks on Labour in the 1980s, John Major's Conservative government accused the left-wing party of planning to nationalize the assets of the UK private pension fund industry and of wanting to re-establish trade union dominance in the country (*The Times* 1996). One of the main sources of inspiration for Tony Blair's "big idea" of stakeholding was a bestseller entitled *The State We're In* in which the journalist Will Hutton (1995) praised the German and East Asian models of capitalism for their firms' greater concern for long-term – rather than short-term – profitability and for worker participation in corporate governance, given workers' interests in the welfare-finance nexus. The TUC had set up a "stakeholder task group" to devise a strategy on how workers could be empowered within the company and on how unions could wield greater influence over the management of pension fund assets (*Financial Times* 1995b; Monks 1996; TUC 1996; Williamson 1997).

As the 1997 general election was approaching, Tony Blair was trying to appeal to middle-class voters, since Britain's electoral system puts a premium on the votes of the median voter (cf. see section 1.3 of this thesis). In these circumstances, being too closely identified with trade unions and with excessive economic interventionism carried political risks. Thus, New Labour decided to kick the idea of introducing a state-controlled funded scheme into the long grass. The opposition party also shifted the emphasis away from *compulsory* retirement savings for two reasons. First, there were

worries that the Tories might accuse it of wanting to impose new taxes upon workers. Second, the workerist wing of Labour waged a campaign to force the party to commit itself in its electoral manifesto to keep SERPS and to restore wage indexation of state pensions (*The Independent* 1996d). From late 1996, the opposition party officially defended a proposal to promote low-cost, easy-to-understand “stakeholder pensions” for those workers who had no occupational scheme (*The Observer* 1996; see also *The Independent* 1996b; *The Sunday Times* 1996a). The schemes would be *voluntary* and of the defined-contribution type. Like personal pensions, they would be managed by the financial services industry, but could be operated in partnership with trade unions or friendly societies. There would be strict limits on the level of charges. Labour’s new proposals were especially welcomed by insurance companies. The industry and its lobby, the Association of British Insurers (ABI), had established a close working relationship with the party, including with Frank Field (see article by the director-general of the ABI: Boléat 1995). The Prudential had in fact been working on similar plans for standardized and low-cost personal pension plans (*The Independent* 1996a).

Pension reform became one of the most hotly debated issues in the run-up to the 1997 general election. Only a few weeks before election day, Peter Lilley announced a far-reaching reform plan called “Basic Pension Plus” (*Financial Times* 1997b). Although he had previously declared that the flat-rate pay-as-you-go basic state pension was the “building block” of UK pension provision, the Tory Social Services Secretary proposed to turn it into a system of privately-managed individual retirement savings accounts, with a guaranteed minimum level of benefits. Moreover, SERPS would be suppressed and future generations of workers would be encouraged to save for a second pension through an increased national insurance contribution rebate. Lilley, but also

Frank Field (1996b), had met a number of Chilean policy-makers who were taking part in the transnational campaign for radical pension privatization that has been documented by ideational scholar Orenstein (2008; *The Independent* 1996c; *The Sunday Times* 1996b; *The Times* 1997)<sup>7</sup>. Having pledged to protect SERPS and the basic state pension (Labour Party 1997), Labour politicians seized the opportunity to lambast the Conservative Party and tell voters they could “not trust the Tories with [their] pension when their pension is to be privatised” (*PR Newswire Europe* 1997). The attacks were crucial in bringing a Labour victory. John Major (1999: 717) later described how: “reports came in from all over the country of [Labour’s] activists warning elderly voters that their pensions were at risk. Our private polling left us in no doubt that this attack worked.”

#### *Labour in power: stakeholder pensions*

Very shortly after Labour returned to power, the new Minister for Welfare Reform, Frank Field, tried to put compulsory pension savings back on the party’s political agenda. Pension policy entrepreneur José Piñera was invited to London to talk about Chile’s experience of introducing mandatory personal pensions both at informal seminars and at a formal conference of the NAPF (*The Sun* 1997). The visit was co-sponsored by three British insurance companies (*The Observer* 1997). As there was no consensus within the government over the exact course of action that should be taken, Field’s superior, the Social Security Secretary Harriet Harman, announced a pensions review, but added that it would be constrained by manifesto commitments to improve the

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<sup>7</sup> While these meetings are evidence that transnational ideational entrepreneurs did in fact try to influence UK pension reform in the 1990s, it must be emphasized that they were invited to the UK by politicians who were already convinced, for other reasons, that pension privatization should be pursued.

basic state pension and to retain SERPS (*The Economist* 1997). The Department of Social Security also appointed an independent group of experts to write a report about current and future trends in the level of pension provision in the UK. The “Pension Provision Group” was chaired by the then vice-chairman of the NAPF, Tom Ross, and was comprised of academics, a TUC official, an insurer and a representative of engineering firms’ lobby, the EEF.

In the autumn 1997, the Confederation of British Industry made it clear to the government’s pensions review that it would not support *compulsory* retirement savings. The employers’ association argued that compulsion would act against its interests in the welfare-labour nexus, since it would result in “significant increases in non-wage costs” and “prove damaging to both competitiveness and employment”, particularly in small and medium-sized companies (*Financial Times* 1997c). Even though Labour’s trade union allies were signalling their interest in making supplementary funded pensions compulsory, the CBI’s announcement contributed to crystallize the government’s position on pension policy. As part of his strategy to attract the middle class and to have Labour move to the centre of the political spectrum, Tony Blair had striven to present himself as a “friend of business” (*Financial Times* 1995a; 1997a; *The Times* 1996). Trying to push for compulsion would have been viewed as a betrayal of the business community and could have alienated the middle class, whose vote was crucial for Labour to win in Britain’s two-party system. Soon after the business group’s announcement, the government held a round of consultations on its plan for *voluntary* low-cost “stakeholder pensions” (DSS 1997). In June 1998, the Pension Provision Group published a report, which focused primarily on rising inequalities between pensioners. The group’s chairman, Tom Ross, said: “The low paid (and those not in

paid work) cannot be expected to provide for themselves. This means that the state has an essential redistributive role. Compulsory private pensions – which some people are suggesting – are by no means the whole answer” (*Financial Times* 1998).

After the Prime Minister rebuffed his idea of introducing compulsory retirement savings and refused to promote him as successor to Harriet Harman in a government reshuffle, Frank Field decided to resign (Blair 2010: 217). In December 1998, the government published a green paper on pensions, which outlined its proposal to introduce stakeholder pensions but also to replace SERPS with a “state second pension” (S2P) that would be better targeted at lower earners. By introducing a flat-rate component in this new second statutory pay-as-you-go pension, people on low income or with broken work records, such as carers or the disabled, would see the level of their pension double compared to what they would have received under SERPS (DSS 1998: 39-44). Stakeholder pensions, which could be used to contract out of SERPS or the S2P, would be primarily aimed at middle-income earners without existing private provision or for whom personal pensions were too costly. However, all workers – with the notable exception of those covered by an employer-provided final-salary scheme – would have the right to use the plans to top up their other sources of retirement income. Employers would have a statutory duty to offer their employees access to a stakeholder pension. The schemes would have to be established under a trust, thereby ensuring board representation for scheme members.

Stakeholder pensions were enacted in late 1999 through the Welfare Reform and Pensions Act 1999. During negotiations over the technical details of the plans, some of the main bones of contention proved to be the employer access requirement and the relationship between stakeholder pensions and defined-benefit schemes (*Financial*

*Times* 1999). As the CBI and federations representing small business asked for small firms to escape the duty to provide access to the plans, the government conceded to exempt employers with fewer than five employees from the requirement (*Financial Times* 2000a). Employers and the occupational pensions industry also feared that the impossibility for workers to hold a stakeholder pension in parallel with a final-salary scheme could create a risk of mis-selling and therefore undermine occupational pensions. After a heavy lobbying campaign of the NAPF, the Labour government decided to allow concurrent membership of defined-benefit and stakeholder schemes, for all but about 1.2 million of very high earners (*Financial Times* 2000b). Stakeholder pensions officially started being offered in April 2001, but employers had to register with a pension provider by October 2001. By contrast, the state second pension was enacted in 2000 and implemented from 2002.

### **3.3 Dealing with Britain's Pensions Crisis**

Before the Labour government even had the time fully to implement its reforms, a number of actors started warning policy-makers and the public about a looming “pensions crisis” (Pemberton *et al.* 2006). At the beginning of the 2000s, a combination of factors created a mood of pessimism around the UK system of private pension provision. First, a spate of high-profile closures of generous final-salary schemes contributed to highlight the steady decline in coverage of occupational pensions and the fact that defined-benefit schemes were being increasingly replaced with defined-contribution ones. Employers blamed new “fair value” accounting standards (Bridgen and Meyer 2005; Dixon and Monk 2009) and regulatory changes such as the abolition

by the Chancellor Gordon Brown of a tax credit on dividend payments received by pension funds. Since the Conservatives had increased the portability of company pensions in the 1980s, final-salary schemes had also lost some of their effectiveness as a skill retention tool. Employers had therefore less interest in maintaining them.

Second, it rapidly became clear that stakeholder pensions would have a slow take-off. A large number of employers who were required to make the schemes available to their employees had failed to do so (*The Daily Telegraph* 2002). Moreover, stringent regulatory requirements prevented employers and the financial industry from advising employees on their pension schemes and from encouraging them to join (*Pensions Week* 2001b). A third factor that contributed to the sense of crisis over private pensions was a relatively steep increase in the value of means-tested pensions. While the Labour government had continued to link the basic state pension (BSP) to price inflation, it had decided to link means-tested pensions (the so-called minimum income guarantee - MIG) to earnings. This policy had led the value of the MIG to overtake that of the BSP and, if continued, it threatened to suck even those – low- or middle-income – individuals who had good private pension coverage into means-tested provision.

Just before the June 2001 General Election, senior figures in the pensions policy-making community argued at the annual conference of the NAPF that employee and employer contributions to stakeholder pensions would have to become *compulsory* (*Pensions Week* 2001a). In the autumn 2001, the re-elected Labour government appointed the former chairman of the NAPF, Alan Pickering, to undertake a comprehensive review of private pension legislation and to propose a package of options for reducing the costs of running occupational pension schemes. As the former head of the Lloyd's insurance market, Ron Sandler, was conducting a similar review of

the life insurance and long-term savings industries, the ABI started talking of an annual £27 billion retirement “savings gap” (e.g. *The Guardian* 2001; *The Independent* 2002; *The Times* 2002b). Given people’s rising life expectancy and the steadily decreasing generosity of state pensions, the insurance lobby argued that there was a growing difference between the amount that low- and middle-income earners generally saved and what they actually needed to save in order to secure an acceptable level of retirement income (see Oliver Wyman 2001). The organization’s director-general said there were three ways of increasing the proportion of people saving through the private sector: “generosity, the fear factor, or compulsion” (*Sunday Business* 2001).

The campaign to alarm public opinion about the “crisis” of UK private pension provision grew even stronger, after it emerged in the winter 2002 that a number of firms, including accounting group Ernst and Young, were planning to close their final salary pension schemes not just to new members but also to existing ones. The Conservative Shadow Secretary of State for Work and Pensions, David Willetts, said this was a “tipping point” (*Financial Times* 2002b). The Labour MP, Frank Field, described the trend as a “mega-tragedy” (*Financial Times* 2002c) and called for an abolition of the Treasury’s £5billion-a-year tax raid on dividends received by occupational schemes (*The Times* 2002a). Organized labour also started putting pressure on the Labour government to change its course of action. The general secretary of engineering and white collar workers’ union Amicus wrote to the Prime Minister and toured the television studios to call on the government to stop the “great pension robbery” (*Money Marketing* 2002). In the spring 2002, the national executive of the TUC decided to embark on a great crusade to introduce compulsory minimum pension contributions from employers (Monks 2002; TUC 2002). Just before divulging his

proposals for a simplification of occupational pension legislation, Alan Pickering suggested the reinstatement of pre-1988 regulations that allowed employers to make membership of their pension scheme a condition of employment (*Financial Times* 2002d). Both the NAPF and the TUC welcomed the idea.

While the Department of Work and Pensions (DWP) had previously shown reluctance to reconsider its stance on pension reform (*Financial Times* 2002e), the growing sense of crisis and the newly emerging consensus between segments of business and of labour over the need to act led it to announce that it would publish a new green paper in the autumn 2002 (*The Times* 2002c). As part of the submissions to the government, the NAPF put forward another radical proposal. Since the public pension system had slowly drifted from contributory provision towards means-testing and therefore provided disincentives for people to save, the occupational pensions lobby called for all existing state benefits to be combined to create a Nordic-style universal “citizen’s pension” of about 22% of average earnings. This flat-rate pension would rise in line with earnings and would be available from age 70, rather than 65 (*The Times* 2002d). On top of that, workers would *have* to save for retirement via private funded schemes.

By the end of 2002, it was thus clear that the insurance industry, the occupational pensions industry and organized labour were all pressing Tony Blair’s government to put a radical overhaul of the pension system on its agenda and that they could potentially support the introduction of a form of compulsion in private retirement savings. The great unknown was whether the rest of the business community, i.e. employers, would support such plans and whether the Tories would not attack Labour for introducing another “stealth tax”. An expert of the ABI wrote that “compulsion...

has a number of drawbacks. Chief among them is the danger that it could be seen as an additional tax, either on individuals or employers. The political fall-out might prove too great for any government to consider” (Segars 2002). The next subsection describes how the government tried to coax employers into joining a coalition for reform. The second subsection will show how, despite its failure to convince the CBI, Labour managed to build a cross-party consensus with Conservatives over the introduction of a form of “soft compulsion”.

### *The “Last Chance Saloon for Voluntarism”*

In December 2002, a new green paper on pensions was published (DWP 2002). Given the intensity of interest groups’ push for change, the Labour government recognized that people were not saving enough for their retirement. However, as he had been approached by the CBI ahead of the publication and had been told that compulsion would be “all about punishment” (*Financial Times* 2002f), the work and pensions secretary Andrew Smith decided to argue that the voluntary system of private pension provision had to be given one last chance (*Financial Times* 2002g). Moreover, he rejected the NAPF’s view that the state pension system required an overhaul. Maintaining good relations with the CBI was important for Labour. As the party had been seen for a long time as an ally of trade unions, showing responsiveness to employers’ demands could allow left-wing politicians to signal to middle class voters that they defended broader societal interests than exclusively those of organized labour. To prop up private – and especially occupational – pension schemes, Andrew Smith proposed to introduce a simplified single tax regime for all schemes, to make it easier

for defined-benefit plans to contract out of the state second pension<sup>8</sup> and to raise awareness about the savings gap by sending people forecasts about the level of their future pensions. However, the government made a concession to advocates of compulsion and appointed Adair Turner, a former director-general of the CBI, to head a standing commission that would monitor whether progress was being made on private pensions and report whether there was a case for moving beyond the voluntarist approach.

Organized labour initially questioned whether it was wise to put a former CBI chief at the head of the “Pensions Commission” and successfully pressed the government also to nominate a trade union representative<sup>9</sup>. A struggle ensued between Turner and the Treasury both over the remit of the Pensions Commission and the timing of the publication of its assessments. First, Turner argued that, in order to establish whether a voluntary system of private provision could work successfully, the Commission also had to understand how the state system worked (*Financial Times* 2003). The Chancellor Gordon Brown was particularly unwilling to accept any critical enquiry into public pensions, because he was the mastermind behind the dramatic revaluation of means-tested pensions (Peston 2005: Chapter 8). Second, Adair Turner announced his intention to produce a first report about the issue of compulsion within the following two or three years. But Treasury and DWP officials said that the evaluation process would have to take longer since the measures suggested in the green paper would not be implemented before 2004 (*Financial Times* 2002h). In reality, the government also wanted to make sure that the commission would not suggest

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<sup>8</sup> In particular, the government wanted to allow schemes to provide pensions based on career average earnings, rather than on final salary.

<sup>9</sup> Apart from Adair Turner, the two other members of the Pensions Commission were the Deputy General Secretary of the Communication Workers Union, Jeannie Drake, and John Hills, a professor of social policy at the London School of Economics.

potentially unpopular increases in pension contributions immediately prior to the 2005 General Election. Eventually the Treasury gave up on the issue of the remit (Peston 2008: 242-244). The Pensions Commission was also given the possibility of writing an interim report before the election, but the document had to be confined to an analysis of the nature of the problem and could not make any specific recommendations on policy.

In view of employers' stiff resistance to the concept of compulsion, the Department of Work and Pensions asked in spring 2003 the CEO of retail firm J Sainsbury plc and former head of Prudential, Sir Peter Davis, to chair an "Employer Task Force on Pensions". The group was drawn from large and small firms from a range of sectors but it also comprised representatives of organized labour, including the Amicus union which was battling for mandatory employer contributions. Its role was to identify how employers, particularly those in small and medium-sized companies, might increase pension provision within a voluntary framework and to advise the DWP on the role employers should play in the pensions partnership. The task force was due to publish a report only after 18 months, but its creation clearly put pressure on the business community to start acting on the issue of employer pension provision.

Meanwhile, trade unions stepped up their campaign to try to force compulsion onto Labour's policy agenda. Since organized labour was directly affiliated with the party, the four biggest unions (GMB, Amicus, Unison and the T&G) used Labour's 2003 annual conference to pass a motion in favour of the introduction of compulsory employer contributions to pension funds. The move was seen as a major blow to the party's leadership, which was trying to avoid having to take a clear political stance given the CBI's hostility to compulsion. However, some people in government, particularly at Number 10, started considering the issue more seriously. By spring 2004,

the chief executive of the NAPF, Christine Farnish, said: “This side of the general election, the government can’t do a U-turn on pensions policy. But our soundings indicate that parts of the government are privately very sympathetic with the suggestions we have been making” (*Pensions Week* 2004). To influence what would happen after the election, the NAPF assembled a team of experts – which also included insurers such as Legal & General and Scottish Equitable – to work out a practical plan and timetable for the implementation of a “citizen pension” and to assess to what extent means-tested benefits would still be needed. Christine Farnish entertained the hope that Labour’s next election manifesto would include “words which really are fudgy and give the government room for manoeuvre” (*The Observer* 2004).

Labour’s 2004 Labour Annual Conference was to give a broad outline of the party’s policy agenda for a third term in office. Prior to the event, the TUC general secretary, Brendan Barber, warned the government that it would have to “pay a heavy electoral price” if it did nothing on supplementary pensions. “Unions will fight to defend pension benefits. We will negotiate, we will campaign and if we have to we will strike” (*Financial Times* 2004b). In his conference speech, Tony Blair stated that, if it won the election, Labour would “design a pensions system that has the basic state pension at its core” and would provide greater incentives to save “for hard-working families whatever their wealth or income” (*Financial Times* 2004c). The announcement signalled a shift from the government’s policy to rely on means-tested rather than on contributory pensions, but the Prime Minister did not commit himself to introduce compulsory employer contributions. The CBI had also recently recommended increasing the basic state pension to the level of means-tested benefits and had called for

a new tax credit to encourage smaller companies to sponsor private schemes (*Financial Times* 2004a).

The Pensions Commission published its interim report shortly after the Labour Party's conference. The document provided a detailed analysis of the UK pension system of the challenges it had to meet, but, as agreed, it made no specific recommendations on policy. However, it suggested that, to achieve better adequacy of pensions, there were three possible ways forward: revitalising the voluntary system and/or reforming the state system and/or "increasing the level of compulsory private pension saving beyond that already implicit within the UK system" (Pensions Commission 2004: xiii)<sup>10</sup>. In December 2004, the Employer Task Force on Pensions published its own report (ETF 2004; see also *Financial Times* 2004d). While presenting the document to the press, the group's chairman, Sir Peter Davis restated his belief in the existing voluntary approach to provision, but bemoaned the fact that employers were abdicating their responsibilities and said:

"Make no mistake, we are in a 'last chance saloon' for voluntarism and unless we can reverse the current decline in adequate employer-led pension provision... the Government may be forced to look at more drastic solutions" (Central Office of Information 2004)

### *Towards soft compulsion*

The Labour Party's 2005 Election Manifesto stated that, while the government's priority since 1997 had been to tackle pensioner poverty, its new focus would be on

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<sup>10</sup> The CBI's director-general reacted to the report by writing that: "We don't believe compulsion is the answer, as that is likely to be seen by business and employees as another backdoor tax... There should be no sacred cows and the Government must be ready to think the unthinkable, but there are really only three options: work longer, save more privately or increase the state pension (Jones 2004).

achieving a “national consensus – cross-party, cross-generation” for “tomorrow’s pensioners, combining public and private pension schemes to build security in retirement” (Labour Party 2005: 69). But it did not supply any details apart from the fact that a reformed system would have to “tackle poverty, provide everyone with the opportunity to build an adequate retirement income, and be affordable, fair and simple to understand” (*Ibid.*: 71). The Conservatives accused Labour of having a “secret agenda” that would result in “more stealth taxes” (*Daily Mail* 2005) and said the left-wing party “couldn’t be trusted” over pensions (*The Guardian* 2005). In addition to pledging to “reverse the spread of means-testing” by increasing the basic state pension in line with earnings rather than prices (Conservative Party 2005: 4), the Tories proposed to offer low- and middle-income earners a tax credit of £10 for every £100 they saved for their retirement (*The Times* 2005a). During the campaign and following his re-election, Tony Blair made repeated calls for a political consensus over pension reform (e.g. *The Times* 2005b). The shadow pensions secretary, Sir Malcolm Rifkind, ruled out any cross-party support for mandatory private pension contributions saying that: “All my instincts tell me that compulsion is another form of general taxation” (*The Independent* 2005). Organized business continued to resist any such move (*Financial Times* 2005a).

Nevertheless, in the autumn 2005, Britain’s second largest employers’ associations, the Engineering Employers’ Federation, broke ranks by announcing that voluntarism no longer worked and that compulsion had become necessary (*Financial Times* 2005b). The manufacturing lobby also said it supported the phasing out of the state second pension and its replacement with a more generous basic state pension. The EEF’s stance was driven by its members’ interests in the welfare-labour nexus. The

group represented industries where coverage of occupational pension schemes was higher than average. Firms running their own schemes worried that they were less cost-competitive than those which did not contribute to private plans. Compulsion would thus introduce a level playing field. Given its long-standing campaign for reform, the TUC described the report as “hugely significant”. Its general secretary, Brendan Barber said: “For the first time, an important employer organisation has broken ranks and come out as a supporter of pensions compulsion. No longer can other employer organisations pretend that business is united” (*The Economist* 2005).

The Turner Commission published its official report on pension reform in November 2005 and made recommendations that could lead to a sea change in British pensions policy (Pensions Commission 2005). Regarding private pensions, the group recommended “strongly encouraging” retirement savings by automatically enrolling employees into funded savings schemes. Workers would however have the right to opt out. This meant that the proposals could be considered as a form of “soft compulsion”. To ensure that all firms and employees would have access to good-quality and low-cost funded arrangements, the commission proposed to create a state pension provider, the National Pension Savings Scheme. Minimum contributions would be set at about 8%, out of which 3 percentage points would be paid by employers. To support this new regime of private pension provision, the state pension system would have to become less means-tested. The Turner commission suggested accelerating the evolution of the state second pension (S2P) into a flat-rate benefit and relinking the basic state pension (BSP) to earnings starting in 2010. Eligibility to the basic state pension should ideally become universal, i.e. based on residency rather than on individuals’ work record. In the long term, the BSP and the S2P could be potentially merged. Finally, the group called

for a gradual increase in the statutory retirement age in order to help fund increased expenditure on state benefits.

The proposals were welcomed by the majority of organized interests with the exception of the CBI which condemned automatic enrolment as “wrongly founded and muddle-headed”. The heads of the ABI and of the EEF decided to issue a joint statement of support for the proposals. The insurance lobby’s director-general said: “We thought it important to point out that not all the business community is in the same place (as the CBI)” (*Financial Times* 2005c). This initiative highlights how crucial it had become for Labour to gain the backing of at least one major employers’ association. Without it, the Conservatives could have argued that the government was ready to introduce a project that would harm the competitiveness of British firms. Moreover, given how salient the pensions issue was to voters, business opposition to auto-enrolment would have added ammunition to Conservatives’ claim that Labour was introducing another stealth tax. However, the EEF’s move was equally important in shaping the position of the Conservatives, since they had for a long time been considered as the party of business. Referring to research done by the EEF, the shadow work and pensions secretary, Philip Hammond, announced in spring 2006 that the Conservative Party would back the plan to introduce compulsory employer contributions worth 3% of gross earnings and the general architecture proposed by Adair Turner (*Financial Times* 2006; see also Hammond 2006). By working out a cross-party agreement, New Labour and Conservatives were minimizing the risk that they could be accused of increasing the tax burden on businesses and the public.

A last obstacle to reform that had to be overcome was internal opposition from Gordon Brown. The Chancellor raised concerns about the impact of the changes for the

sustainability of public finances. To secure his support, Tony Blair agreed to delay the restoration of the link between earnings and the basic state pension until at least 2012. Moreover, the statutory retirement age was to be increased at a more rapid pace than suggested by the Pensions Commission. Labour eventually introduced the reforms in two stages. State pensions were reformed through the Pensions Act 2007. In addition to reintroducing earnings uprating, the act also reduced the number of qualifying years needed for a full basic state pension from 39 for women and 44 for men to 30 for both men and women starting in 2010. By contrast, auto-enrolment was introduced through the Pensions Act 2008 and started being implemented in October 2012. The technical details of the new system were still to be discussed and negotiated over the following years, but remarkably politicians had managed to reach a cross-party consensus around the broad architecture of the UK pension system.

### **Concluding remarks**

The extensive historical material presented in this chapter has provided a first test of the hypotheses that make up my political economy model of pension privatization. The starting point of my theory was that, rather than international organizations or party politicians, it was the financial industry which was likely to be the first actor to put pension privatization on the political agenda. The evidence shows that representatives of the City played a key role in formulating the Thatcher government's proposal to introduce personal and portable pensions. The same network of lobbyists also seems to have influenced some Labour politicians in their decision to endorse personal pensions in the 1990s and to improve their regulation via the introduction of stakeholder

pensions. In the 2000s, the Association of British Insurers pushed together with the National Association of Pension Funds for the introduction of government measures that would induce more people to save for their pensions through private sector schemes and reduce Britain's retirement "savings gap".

At the same time, some of my findings are also surprising in view of my theoretical model's expectations on financiers' preferences. Thus, although I expected stock exchanges to lobby for pension privatization in order to create large institutional investors that would fuel the domestic capital market, the London Stock Exchange lobbied for personal pensions because it wanted to decrease the role of institutional investors and enhance that of individual investors. Moreover, while unit-linked insurance companies supported the Conservative government's plans to develop personal pensions and to suppress SERPS in the 1980s, much of Britain's insurance establishment was opposed to it. Some insurance companies had a substantial share in the existing market for occupational pensions and considered that the reforms would pose a threat to their interests. Institutional feedback from pre-existing supplementary pension schemes thus also shaped the preferences of some parts of the insurance industry.

Apart from the trips made in the 1990s by the Chilean pension policy entrepreneur José Piñera, I have found no evidence of any role played by international organizations in UK pension debates. However, it would be wrong to claim that politicians' electoral considerations did not matter. The proposal for personal pensions resulted from a collaboration between financiers and the Conservative Party. By extending share ownership through personal pensions, the Tories were hoping to create a form of "popular capitalism" where an increasing number of people would identify with

business and would also be more likely to vote for the Conservative Party (see also Chappell and Vinson 1985; Letwin and Letwin 1985). Similarly, New Labour's decision to endorse personal pensions seems to have been driven by its attempt to attract the vote of the middle-class. Before being hit by the mis-selling scandal, personal pensions were very popular with consumers. Calling their existence into question could have sent a negative signal to large chunks of the electorate.

My second main theoretical claim was that employers and workers could either support or oppose pension privatization, depending on their interests in the welfare-labour nexus, the welfare-finance nexus and on feedback from pre-existing pension schemes. These two socio-economic groups' preferences fluctuated over time. In the 1980s, plans to replace SERPS with mandatory personal pensions were opposed not only by organized labour, which had contributed to establish SERPS so as to extend coverage of defined-benefit schemes to the whole working population, but also by employers' associations. Although the CBI and the EEF were in favour of a retrenchment of SERPS, they feared that its abolition would increase non-wage labour costs and thus hit their interests in the welfare-labour nexus. Moreover, employers as well as the NAPF were deeply sceptical about personal pensions, because they posed a threat to pre-existing company schemes. Employers traditionally saw final-salary pensions as a tool for the retention of skilled workers. Some firms also used them as source of patient capital through self-investment. With such vested interests in the preservation of these schemes, they were led to oppose the Thatcher government's plans for reform.

Workers' and employers' preferences changed in the 1990s and in the 2000s. For example, the TUC supported the Labour Party's moves to target SERPS (renamed the

state second pension) on low-income earners and to expand coverage of funded schemes to a greater proportion of workers through stakeholder pensions. Organized labour also showed renewed interest in trying to transform private pension funds into patient and socially responsible investors that could promote good working conditions. Given the gradual decline of occupational schemes, the NAPF started campaigning for compulsory retirement savings in the 1990s and was joined by the TUC at the beginning of the 2000s. Although many of its members had occupational schemes and wanted to preserve them, the CBI opposed compulsion because it would result in significant increases in non-wage costs and thus damage its members' – particularly small and medium-sized firms' cost-competitiveness.

The final step of my theoretical model was to argue that, due to the salience of the pensions issue to voters, left-wing parties in two-party systems would seek prior support both of trade unions and employers' associations, whereas right-wing parties would be more likely to ignore pressures from organized interests. In the 1980s, Conservatives decided to introduce personal pensions despite strong opposition from the CBI and the EEF. However, Margaret Thatcher's government was also forced to back out of its most radical proposals for the privatization of SERPS after they were resisted by business. Moreover, Conservatives felt the need to make the pre-emptive move of excluding the self-employed from their reform blueprint, in order to avoid any opposition from federations representing small business. Regarding centre-left parties, the chapter has shown that one major reason why New Labour initially decided not to go for the replacement of SERPS with compulsory retirement savings was opposition from its workerist wing, which included segments of organized labour. However, once the TUC decided to campaign for compulsion, the Labour government resisted unions' demands

because of *business* opposition. These contradictory findings can be explained by the fact that Tony Blair was openly trying to appeal to a middle-class electorate and that in doing so he found it important to cultivate his proximity with the business community.

## **Chapter 4: Business Divided: Conflicts between Business Associations as a Brake for Pension Privatization in France**

Among European welfare systems, France stands out as a country that still places a relatively limited reliance on private retirement savings. When measured in relation both to gross domestic product and to domestic stock market capitalization, French pension fund assets rank lowest in Europe after Greece and Luxembourg (OECD 2009b). This might seem unsurprising since funded plans were traditionally almost non-existent in France. After the Vichy regime depleted the financial reserves of largely funded social insurance, post-war policy-makers had indeed deliberately shunned retirement savings in favour of pay-as-you-go pensions (Hesse and Le Crom 2001; Palier 2005). Whereas public-sector employees were given access to generous final-salary statutory schemes, private-sector employees were entitled to a mere 50% of past earnings, which were themselves calculated only up to a social security ceiling that roughly equalled the average gross wage. However, what was remarkable from a cross-national perspective was that, by 1972, French private-sector workers were also covered by *mandatory pay-as-you-go occupational* schemes called *ARRCO* and *AGIRC* (see Reynaud 1997; Naczyk and Palier 2011). While the first scheme covered all private-sector employees, the second one offered benefits only to “cadres”, i.e. white-collar employees (Boltanski 1987). On top of that, the majority of French senior executives were covered by an additional pay-as-you-go occupational scheme called *T3*. All three schemes had been established through collective agreements signed by trade unions and employers’ associations.

Despite this dominance of the pay-as-you-go method of financing in the post-war French pension system, the relative underdevelopment of funded pensions in recent decades remains intriguing. Since the beginning of the 1990s, French statutory pension schemes have undergone several waves of retrenchment (Mandin and Palier 2005; Schludi 2005; Conceição-Heldt 2006; Bonoli and Palier 2007; Häusermann 2010; Vail 2010: 118-131). These reforms could have presumably opened some space for personal or occupational pension plans. Yet, instead of actively promoting their expansion, government policy sent contradictory signals to individuals and companies. In 1987, a right-wing government introduced a law that created tax incentives for individual retirement savings accounts, but the left repealed it two years later. Right-wing parliamentarians managed to pass a similar bill in 1997, but again a left-wing coalition government that came to power that year refused to implement it. Instead, it created a public pension reserve fund in 1999 and introduced its own type of pension savings product in 2001. It was only in 2003 that a stable legislative framework for funded pensions was introduced by a new right-wing administration, thereby giving a boost for their development.

The first political science accounts of contemporary French pension reform highlighted a left-right divide as regards the introduction of funded pensions (Bonoli 2000). This cleavage became manifestly less marked at the beginning of the 2000s as the left assented to give funding a greater role in the pension system. According to an ideational interpretation (Palier 2007), politicians of all hues were persuaded to support the principle of expanding funded pensions after a series of reports was published in the 1990s by international organizations such as the World Bank or the European Commission. Partisan theories of pension privatization provide an alternative

explanation of the left's changing stance. According to Häusermann (2010), French socialists have become more supportive of retirement savings because of the growing importance of middle-class voters in their electorate.

By contrast, I will argue that parties' changing attitudes – and more generally the bumpy road to pension privatization in France – can be understood only if one takes into account the central role played by different organized interests. The French financial services industry – in particular life insurance companies – campaigned for the development of funded pension plans since the end of the 1970s. Not only did it have allies among right-wing parties, but it also had close links with some politicians of the left. However, the introduction of retirement savings plans met for a long time with considerable resistance both from trade unions *and* from important segments of French business. A first reason was that they perceived insurers' pro-privatization campaign as a threat for the existing pay-as-you-go occupational schemes in whose management they were involved. From the mid-1980s until the mid-1990s, the ARRCO, the AGIRC and the T3 schemes were subject to serious financial imbalances that resulted from their specific institutional structure. As long as these problems were not solved, organized labour and a number of employers' associations lobbied against any legislation on funded pensions. This in turn led left-wing and right-wing parties to put pension privatization on the back burner.

A second impediment to partial pension privatization was disagreements over the institutional design of pension funds, which arose in the mid-1990s. Interested in finding new sources of corporate finance, managers of large firms favoured a design that would allow pension commitments to be reinvested into their companies and thus provide patient capital. Their propositions, which were put forward in a context of

intense debates among the French business and political elites about the future of the French model of capitalism (Schmidt 1996: 167-175), gradually gained endorsement from reformist trade unions. Nevertheless, financial lobbies were unwilling to back an internal management of pension savings. The introduction of a stable legislative framework for funded pensions became possible only once a compromise was found between the different parts of the business community and with segments of labour at the beginning of the 2000s.

The rest of the chapter is organized as follows. The first section traces the factors that led to the adoption and later to the repeal of a 1987 piece of legislation on individual retirement savings plans. The second section shows how the legislative process reached a stalemate in the 1990s due to developments in the occupational pay-as-you-go schemes and because of disagreements within the business community over the design of private pension funds. The final section then reveals how a consensus was gradually reached within the business community and between the social partners, culminating in the adoption of pension savings programmes in the 2003 pension reform.

#### **4.1 Pension funds versus the pay-as-you-go occupational schemes**

From the end of the 1970s, a number of actors linked with the insurance industry launched a debate about the introduction of funded pensions. In 1978, Prime Minister Raymond Barre declared that France would “not be able to continue to design [its] system of social benefits on the basis of the pay-as-you-go mechanism” and that it would “be necessary, like in other countries, to arrive at mechanisms of funding” (*L'Express* 1978). A conservative economist, Barre (Hall 1986: 187-188) had also been

the first president of the International Association for the Study of Insurance Economics between 1973 and 1976. This organization – also known as “the Geneva Association” – has been founded and funded by senior executives and directors of major European insurance companies. Ever since the 1970s, the Geneva Association has played the role of a think tank for the global insurance industry and has been a major proponent of the “three-pillar doctrine”, primarily through the publication of papers on pension policy (Leimgruber 2009; 2012).

The association financed a study written by two junior French economists – Dominique Strauss-Kahn and Denis Kessler – which received considerable public attention after it was published in the form of a book (Kessler and Strauss-Kahn 1982). The essay was one of the first public reports to call for the development of funded pensions in France. Kessler and Strauss-Kahn were invited to present their proposals at internal seminars organized by various insurance companies<sup>1</sup>. The two men would later become central actors in pension reform, through the involvement of the first in organized business (Quenel 2003) and the activities of the second in the political arena. Some French insurers were also approached by their foreign counterparts – for instance German insurer Munich Re – to develop private pension plans<sup>2</sup>.

The debate about funding was encouraged at a time when the French pension system – and the welfare-labour nexus it institutionalized – was starting to confront significant structural challenges and when the French system of corporate governance was undergoing profound transformations. One major structural challenge was demographic ageing. Proponents of pension privatization pointed up that the changing balance between the elderly and the working-age population was pushing up the costs of

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<sup>1</sup> Interview senior executive in the French insurance industry, London, 22.01.2011.

<sup>2</sup> Ibid.

pay-as-you-go pensions, and argued that funded schemes were much more resistant to these pressures (e.g. Barre 1984: 306-317). Insurance companies used this argument very willingly in their advertising campaigns. For example, the UAP (*Union des Assurances de Paris*) – France’s largest state-owned insurance company – came up with the slogan “Babies born in 1949, don’t count too much on babies born in 1979 to pay for your pensions” (own translation).

Closely related to the demographic challenge were the problems posed by deindustrialization. The effect of massive layoffs in the manufacturing industries was to further disrupt the balance between the active population and pensioners. Private-sector workers’ occupational pay-as-you-go schemes were one type of schemes that experienced particular financial difficulties as a result of deindustrialization. And this for two reasons. First, contrary to ARRCO and the AGIRC, participation in the T3 scheme – which offered additional benefits to senior executives – had not been made compulsory for all companies. Because coverage was highest in large industrial companies, deindustrialization contributed to shrink the scheme’s contributory base very rapidly.

Second, all French pay-as-you-go occupational schemes offered the possibility for companies to decide about the rate at which they would contribute and consequently about the level of pension entitlements they would offer<sup>3</sup>. Contribution rates could vary between a minimum and a maximum (4%-8% in the ARRCO and 8%-16% in the AGIRC and the T3 scheme). As was the case with coverage of the T3 scheme, it was traditionally large manufacturing firms that offered maximum contribution rates. However, corporate downsizing in the 1980s meant that the number of contributors was

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<sup>3</sup> The level of benefits in the supplementary schemes was indeed determined by the amount of contributions paid by workers and their employers (for more details see Naczyk and Palier 2011).

diminishing as a proportion of pensioners in many of the more generous companies. As they were well aware of these developments, insurance companies emphasized the financial imbalances faced by the pay-as-you-go occupational schemes when promoting funded pensions (*Le Monde* 1984). In fact, the AGIRC sued the UAP for its 1979 advertising slogan and obtained its prohibition.

In addition to being presented as a response to the challenges affecting the welfare-labour nexus, commercial insurers' push for pension privatization was launched at a time when France's post-war mixed economy was being radically reformed. After the Second World War, France had gradually put in place a system of indicative planning in which the state tried to spur industrial development by directing resources towards favoured industries both in the public and the private sector (Hall 1986). Civil servants in the Finance Ministry's *Direction du Trésor* had the capacity to force banks to offer cheap loans to firms through selective credit regulation (Zysman 1983; Quennouëlle-Corre 2005). However, in the 1970s, this *dirigiste* system was increasingly criticized for propping up "lame ducks" in declining industries (Berger 1981) and for stifling the development of small- and medium-sized enterprises. In order to loosen the ties between government and industry, liberal politicians such as Valéry Giscard d'Estaing and Raymond Barre attempted to expand the role of the stock exchange in the financing of companies and created incentives for households to invest in shares (Zysman 1981: 260-264).

Despite being initially reversed by the left in 1981 (Stoffaës 1985; Fabra 1985), the transformation of the traditionally state-controlled and bank-based financial system into an increasingly asset-based one was continued after Socialists made a spectacular U-turn in 1982. State's control over the allocation of credit was gradually lifted, while

equity financing was made more readily available for large firms by the deregulation of capital markets (Cerny 1989; Loriaux 1991; Levy 1999; Thatcher 2007: Chapters 3 and 5). After they returned to power in 1986, right-wing politicians started denationalizing state-owned companies. Privatization met with considerable success among small shareholders. Yet, apart from a nascent mutual fund industry, domestic institutional investors were almost non-existent on the Paris *Bourse*. In order to prevent French companies from falling into foreign hands, the government fostered the formation of networks of cross-shareholding between large private and state-owned firms, centring them around two “hard cores” (*noyaux durs*) (Schmidt 1996). It is against this background that financiers as well as *Trésor* and *Banque de France* officials<sup>4</sup> saw the development of pension funds as a way of creating a new welfare-finance nexus and of generating domestic capital for what many politicians described as France’s “capitalism without capital.”

The next subsection will show how a first personal pension product was introduced in 1987 and explain why it was surprisingly criticized by the insurance industry. The second subsection will analyse how a major conflict arose between commercial insurers and the social partners over reforms of the pay-as-you-go supplementary schemes. The last subsection will trace the circumstances in which individual retirement savings plans were repealed by a left-wing government in 1989.

#### *The creation of the first retirement savings plans*

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<sup>4</sup> Interview former Director of the *Trésor*, Paris, 06.01.2011

In October 1986, the Gaullist Minister of Finance Edouard Balladur announced that his administration was preparing a bill on savings (*loi sur l'épargne*) with the aim to stimulate French households' investments in domestic assets and to protect French companies from hostile takeovers. Most notably, the reform package contained a defined-contribution personal pension plan modelled on American "individual retirement accounts" (IRAs). The PER (*plan d'épargne pour la retraite* - "retirement savings plan") would offer tax deductions for investments made in bank accounts, life insurance contracts, equities and bonds. The savings would be taxed when paid out. However, a tax penalty would be levied if the funds were withdrawn before the age of 60, whereas bonuses would be offered if the account was kept until the age of 63 or 65. The objective of this tax mechanism was to increase the level of households' long-term savings but also to provide an incentive for workers to postpone retirement after the age of 60. The statutory retirement age had been decreased in 1983 from 65 to 60 by a Socialist government in 1983, a measure that was opposed by right-wing parties.

Insurance companies had – as expected by the political economy model of pension privatization presented in Chapter 1 – played a key role in putting the development of funded pensions on the political agenda. Yet, paradoxically, the French Federation of Insurance Companies (*FFSA*) received the government's project with dismay and criticized the PER for "confusing savings with old-age pensions" (*Le Monde* 1987a). Insurers disagreed with the way retirement savings would be paid out. Although they argued that retirement savings plans should be offered only in the form of a life annuity, the government opened up the possibility for the PER to be paid out in the form of a lump sum. According to the *FFSA*, old-age pensions should be secure products that people should be able to draw until their death. On the contrary, lump sum

payments carried the risk that individuals' savings would be squandered before their death.

Insurers' emphasis on life annuities stemmed from two factors<sup>5</sup>. First, by providing regular income for an unlimited period of time, life annuities most closely resemble social security pensions, thus giving them more legitimacy in the eyes of customers. Second, the industry was increasingly under pressure in its core market of life insurance. Banks had entered that market by creating special subsidiaries and had managed to dominate it by the mid-1980s due to better distribution networks. However, most annuities paid through life insurance were not lifetime annuities, but were offered for a limited number of years. Capital requirements for life annuities are more stringent compared to other savings products. Life annuities also necessitate extra expertise, since complex calculations have to be made by actuaries. Insurance companies were ready to sink the required capital and possessed those skills, which was not always the case for banks<sup>6</sup>. Moreover, the banks' life insurance subsidiaries were not contributing members of the FFSA, a situation which intensified tensions between the two industries.

The government's proposal was discussed in the Parliament between April and June 1987. Socialist and Communist parliamentarians accused the right of trying to damage the pay-as-you-go system and of launching an attack on people's entitlement to a full pension at the age of 60. Furthermore, they contended that the tax advantages provided by the PER would favour savings only by the better-off. However, the Socialist Party was split on the issue. Even though they had not branded them as a retirement savings product, Socialists had already introduced tax-favoured "share savings accounts" (*Comptes d'épargne en actions*) in 1983 to encourage household

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<sup>5</sup> Interview senior executive in the French insurance industry, London, 22.01.2011.

<sup>6</sup> Interview former president of the FFSA, Paris, 17.09.2009.

investments in equities. As part of the discussions on the bill on savings, several Socialist MPs backed an amendment that was put forward by right-wing MPs against the will of the government and which stipulated that 75% of savings should be invested in French securities.

While the right-wing majority itself generally approved of the introduction of the PER, it was divided over its precise institutional design. Gaullist MPs from the RPR (*Rassemblement pour la République*) supported the government project as it stood, but centrist UDF (*Union pour la Démocratie Française*) MPs considered as close to Raymond Barre lambasted the government for mixing up a “logic of savings” with a “logic of pensions” (*Le Monde* 1987b) and unsuccessfully tried to push through the FFSA’s request to make it possible to benefit simultaneously from the tax advantages given by the PER and life insurance products (*Le Monde* 1987c, 1987d). Yet, instead of satisfying insurers’ demands, the government accepted to grant other institutions, such as the national postal service or the central bank, the possibility of selling the PER. The bill on savings was passed in June 1987 and the PER was offered from January 1<sup>st</sup> 1988.

#### *Rising tensions over the pay-as-you-go occupational schemes*

Although the PER drew heavy criticism from the left-wing opposition, it was introduced in a relatively favourable political climate for the right. To be sure, interest groups representing different segments of the financial industry lobbied heavily for favourable regulations. More importantly, though: employers’ associations had failed to raise major objections to the government’s plan. The political economy model of pension privatization advanced in this thesis holds that in multi-party systems

employers' assent is a necessary condition for the expansion of funded pensions to be considered as politically viable by right-wing parties that aim to represent the business community. However, the coalitional dynamics behind pension privatization – and especially employers' stance towards it – were about to change in a dramatic way because of parallel developments in the industrial relations arena and due to the institutional feedback effects exerted by existing supplementary pay-as-you-go pension schemes.

At the end of the 1980s, a consensus emerged between trade unions and elements of the business community that an expansion of the contributory base of the pay-as-you-go occupational plans would be necessary to improve their financial situation, which had been destabilized by deindustrialization. Within France's peak employers' association (the CNPF), the main proponent of this strategy was the Union of Metallurgical and Mining Industries (UIMM). This organization had contributed to the creation of the supplementary schemes<sup>7</sup>, but it was also historically the dominant federation in the CNPF both in financial terms and in policy terms (Ehrmann 1957; Marseille 2000; Offerlé 2009). Since the Second World War, all presidents of the CNPF had been elected with its consent and the metal industry's lobby was recognized as the leading voice in the CNPF's social committee, which set the organization's position on social policy issues. However, within the CNPF, the UIMM's plans for the supplementary schemes' expansion were vehemently opposed by insurers' FFSA,

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<sup>7</sup> The AGIRC was created through a nationwide collective agreement signed between the cadres' union CGC and the CNPF in 1947. However, the CNPF's main negotiators were representatives of the UIMM (Friot 1996; Marseille 2000). By contrast, the ARRCO originated from various firm- and industry-level agreements. The first pay-as-you-go scheme for workers was established in 1955 at Renault, one of the largest companies in France. This collective agreement positioned the automaker "at the cutting edge of social advances" (Freyssenet 1998: 369) and stimulated further industry-level agreements, including an agreement signed in 1957 between the UIMM and metalworkers' unions which created the UNIRS, the first and largest industry-level supplementary scheme. The ARRCO was founded in 1961 by unions and the CNPF to serve as a federation and a clearing house between the various schemes.

which argued that they would harm one of its core businesses. While marketing individual retirement savings was one part of insurers' strategy, company-level pension plans were indeed another target for the industry, with the implication that they could become direct competitors of the supplementary pension schemes managed by the social partners.

The voluntary T3 scheme was first in line for an expansion. By 1987, it covered only 50,000 senior executives out of a potential population of 90,000. In November 1987, the scheme's managers officially suggested – with trade unions' and the UIMM's support (Marseille 2000: 222) – to make T3 coverage compulsory in all French companies and to merge it with white-collar employees' AGIRC. According to the proposal, companies already covered by the scheme would keep existing contribution rates (12% on average) while newly participating companies would contribute 8% of gross wages. This proposal created serious tensions within the CNPF and was most fiercely resisted by representatives of the insurance sector. Jacques Lallement, the president of the FFSA, declared that “mandatory social protection should look a bit more after the socially excluded” and that “it should give the most privileged a bit more freedom” (*Le Monde* 1987c). The plan posed a threat to group insurance contracts for senior executives that had already been signed in a number of firms. Claude Bébéar, CEO and chairman of France's largest private insurance company AXA, threatened to substantially decrease his company's CNPF membership fees, if the measure was introduced. Other insurers were less virulent, because their companies participated in the optional pay-as-you scheme and their financial sustainability was also threatened. Within the CNPF, the project was also combated by small companies which criticized it for raising contribution rates to a level deemed unacceptable. Despite this opposition,

the proposal was supported by the CNPF's executive council at the end of November 1987.

A negotiation on the integration of the T3 scheme into the AGIRC started in March 1988. Trade unions and the peak employers' association agreed on the principle of rendering the T3 scheme mandatory, but the social partners diverged on the definition of the minimum mandatory contribution rate. While trade unions wanted to increase it to 12%, the *patronat* wanted to keep it at 8%. Keeping the minimum contribution rate low was particularly important for CNPF negotiators, who were under pressure from the insurance industry and from small and medium-sized enterprises. To counteract insurers' hostility, some union representatives threatened to outsource the management of the ARRCO and AGIRC buffer funds to banks instead of insurance companies. In June 1988, an agreement was reached between the social partners to set the minimum contribution level at 8%, but in compensation employers agreed to integrate companies which had hitherto not been covered by the T3 scheme within 3 years instead of the 5 years they suggested at the beginning of the negotiation. Despite the mandate which had been given to the CNPF, the FFSA's president decided to resign as vice-president of the peak employers' association and chairman of its economic committee. The resignation, which was unprecedented in the CNPF's history, was a protest against the result of the negotiation, but also against suggestions by the social partners that they would do their utmost to encourage companies to pay "voluntary contributions" (i.e. above the minimum mandatory rate) within the T3 *as well as* within the ARRCO and the AGIRC.

#### *The repeal of retirement savings plans*

While tensions between insurers and the social partners had been barely visible at the time of the PER's creation, they had metamorphosed into an open conflict within only a few months. Trade unions and important segments of business had now turned increasingly hostile to insurers' campaign for the development of funded pensions. As the Socialists returned to power in spring 1988, the first evaluations of the PER became available and showed that it did not develop according to the right-wing government's plans (e.g. CNC 1988). The new minister of Finance Pierre Bérégovoy branded the PER as a failure and announced that a reform would be undertaken.

A year after its introduction, the PER had attracted about 1.2 million subscribers, a number that fell short only by 100,000 people from the right-wing government's initial target (*Le Monde* 1988). However, the amount of premiums that were paid into the plans was lower than expected. The stock market crash of October 1987 contributed to investors' cautiousness. But the plans' design also had the unintended consequence of drawing a disproportionate number of investors who were close to retirement age and who used the PER to benefit from generous tax deductions. This meant that instead of promoting long-term savings by younger generations, individual retirement accounts had become a short-term investment. While the PER had not entirely fulfilled policy-makers' objectives, the financial industry was also sceptical about the product. Insurance companies most strongly disapproved of the retirement savings plans because they had become a direct competitor of life insurance. Moreover, 80% of the plans had in fact been opened in banks rather than through an insurance company.

Within the Socialist party, one faction wanted to maintain personal savings accounts, but proposed to make them socially fairer, by replacing the tax deductions which mostly advantaged high earners with a tax credit that would allow low-earners to

invest as well. Dominique Strauss-Kahn, chairman of the National Assembly's Finance Commission, called for the creation of a "long term savings book" which would possess the traits of a "genuine" old-age pension because it would be paid out only in the form of a life annuity. Strauss Kahn's proposal was publicly supported by Jean Peyrelevade, the CEO of the UAP insurance company (*Le Monde* 1988). The main factors behind some Socialists' support for funded pensions seemed to be close links with the financial industry and a desire to reform the financial system, rather than an electoral strategy designed to attract middle-class voters – as partisan theories of pension privatization would predict. Other Socialist MPs indeed argued that retirement savings should also be paid out as a lump sum (*Le Monde* 1989). The Association of French Banks (AFB – *Association Française des Banques*) signalled it could accept changes in the tax incentives of the PER, but insisted on preserving the product itself.

Nevertheless, a very sizeable faction of Socialist activists and MPs was decidedly hostile to pension funds. A member of the party denounced retirement savings as "a fatal mechanism that will drag us towards social-liberalism" (*Le Monde* 1989). The Socialist Party was thus clearly split over the issue. Since organized labour was now also openly hostile to funded pensions and the financial industry proved incapable of settling its disagreements, the left-wing government opted for the replacement of the PER by a "popular savings plan" (PEP – *plan d'épargne populaire*). This product would not be a retirement savings product per se, but it would block savings for at least ten years and, through tax incentives, it would promote savings among middle- or low-earners. Its introduction in January 1990 meant another setback in insurers' campaign for funded pensions, after their defeat in the negotiation over the T3 scheme.

## 4.2 A decade long stalemate

Yet it would not take long before the debate about pension privatization would find its way back to the top of the political agenda. In July 1990, the publication of a journal article by France's National Institute of Statistics sparked off a fresh controversy on pension reform. In the paper, economist Denis Kessler (1990) argued that in the face of demographic ageing pay-as-you-go pension systems were locked in a "doomed triangle" with only three possible ways out of the problem: increasing payroll taxes, raising the retirement age or otherwise decreasing benefits. In the author's opinion, "social laissez-faire" through constant increases in social contributions was no longer a viable option. Therefore only the latter two solutions would be practicable. Moreover, the development of funded pensions would have to become part of the policy mix. As the article received wide press coverage (e.g. *Le Monde* 1990a; *L'Humanité* 1990), the suggestion that the pay-as-you-go system might be "doomed" prompted an immediate outcry from representatives of the ARRCO and the AGIRC (*Le Monde* 1990b), but also from politicians of the left and of the right-wing RPR party. A random academic article might not have unleashed such a political storm. However, Denis Kessler had been freshly elected chairman of insurers' lobby, the FFSA, and was to take up his post in January 1991. His declarations were thus interpreted by the pensions policy-making community as a signal that insurers were stepping up their campaign for funded pensions and against the supplementary pay-as-you-go schemes.

Soon after the publication of Kessler's article, the Socialist Rocard government commissioned a white paper about pensions, which was published in April 1991. The document made a number of proposals for the retrenchment of the statutory pay-as-you-

go schemes (Commissariat général du Plan 1991), which later served as inspiration for a major reform introduced by a right-wing government in 1993 (Bonoli 2000: 135-141). The FFSA took advantage of the appearance of the government's white paper to present a report that laid out its own vision of the future of the French pension system (FFSA 1991). When presenting it to the press, insurers tried to warn against the social partners' plans to increase contribution rates in the mandatory occupational pay-as-you-go schemes, an aspect which had not been dealt with by the government's document. The head of private insurer AXA, Claude Bébéar, denounced the "consensus between employers and trade unions who manage the supplementary schemes" (*Le Monde* 1991).

At the same time, insurers tried to frame their case for private pension funds in such a way that it would sound more acceptable to the public and to different stakeholders in the pension system. In its 1991 report, the FFSA emphasized that funded pensions would not act as a substitute for the existing pay-as-you-go system, but would only add a new layer to it. In fact, the insurer's federation called for the creation of "*fonds de pension à la française*" (i.e. French-style pension funds). "One had to call them *à la française*, because, if they were called *à l'anglaise* [i.e. English-style], it was immediately dead. I had invented that term. I was doing some marketing."<sup>8</sup> The funds would be established mainly through firm- or industry-level collective agreements and the social partners would exercise supervision over their financial and administrative management. While in many countries the insurance industry exerts direct control over private pension plans (Chapter 2 of this thesis; see also Ebbinghaus 2011), French insurers offered to give a substantial role to social partnership.

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<sup>8</sup> Interview former president of the FFSA, Paris, 17.09.2009.

Besides these on-going manoeuvres by insurers, another source of pressure for pension privatization and for the reform of the supplementary pay-as-you-go schemes came from the European Economic Community. In November 1990, the European commission announced a proposal for a directive on the freedom to provide services, which was immediately interpreted as a possible threat for the existence of the ARRCO and the AGIRC. It was believed that they could lose their mandatory character and be forced to compete with insurance companies. The social partners unanimously adopted a motion saying that supplementary pay-as-you-go schemes could not be covered by a directive regulating the insurance sector and launched an intensive lobbying campaign with the government and European institutions (*Le Monde* 1990c). The president of the European commission, Jacques Delors, soon announced that the French pay-as-you-go supplementary schemes would not be affected by the directive (*La Tribune de l'Expansion* 1990). Concerns about a possible integration of the ARRCO and the AGIRC into the competitive sector were rekindled in autumn 1991 after the European Commissioner for Competition, Leon Brittan, proposed to create a Pan-European pension fund market (*The Economist* 1991; *Financial Times* 1993), an idea which was eventually blocked by a number of EU member states (Hennessy 2008a; 2008b). Thus, as argued by ideational theories of pension privatization, the European commission had an impact on the French debate about pension reform. However, rather than exerting its influence at the end of the 1990s and on an ideational level, it did so at the beginning of the decade and by threatening to use its powers in the regulation of the internal market in financial services.

While insurers' – and to a certain extent the European commission's – goal was to build a stronger coalition in favour of the development of funded pensions, the main

effect of their activism was that the social partners, who were still influenced by institutional feedback from the pre-existing supplementary ARRCO and AGIRC pension schemes, started talking about the need to “define the scope of the pay-as-you-go system”. But it was well understood that they thought this should be done by inducing companies that had so far paid lower contribution rates in the ARRCO and the AGIRC to increase their “voluntary contributions”. This section shows how the political process reached a stalemate in the first half of the 1990s. Against the will of insurers and other segments of business, the CNPF and trade unions signed agreements that increased and standardized contributions rates in the supplementary pay-as-you-go schemes, thereby contributing to limit the scope for the development of private retirement savings (subsection one). In parallel, business elites held discussions about the shape that should eventually be taken by pension funds and by the welfare-finance nexus they would create. Financiers and industrialists found it nonetheless difficult to reach a consensus, as they disagreed over whether pension funds should be managed externally by the financial industry or internally by the sponsoring companies (subsection two). Divisions within business both over the supplementary pay-as-you-go schemes and over the institutional design of funded plans led to a lingering uncertainty in the political arena (subsection three).

### *The end of voluntary contributions in the ARRCO and the AGIRC*

At the beginning of the 1990s, both trade unions and the segments of business that were traditionally involved in the management of the ARRCO and the AGIRC agreed that across-the-board increases in social contributions would be necessary to sort out the

schemes' finances, which were in deficit due to deindustrialization and a legacy of voluntary contributions. The idea met with fierce opposition not only from insurers, but also from sectors which traditionally paid lower contribution rates (e.g. small and medium-sized firms in the retailing and hospitality industries) and from sectors which were in a more fragile economic situation (e.g. the textiles and leather industry). Because the CNPF was governed by the majority rule, the UIMM and its allies were able to impose their line of thought on the rest of the business community. However, as divisions between its members were sharp, the peak employer's association was under pressure to keep any payroll tax hikes to a minimum and to push for reductions in the generosity of pensions.

In December 1992, the social partners opened a peak-level negotiation to renew the national ARRCO agreement. Organized labour argued that in the name of solidarity one had to give textile workers the right to benefit from higher pensions and demanded to increase the mandatory contribution rate from 4% to 6%. Pressed by insurers and textile companies, the CNPF announced it would not accept any increase in "social security burdens". From the start, it was also clear that the social partners concurred that the generosity of pensions would have to be reduced through changes in their indexation. However, employers proposed to reduce it to a larger extent than trade unions. The negotiation was adjourned at the end of December, but it was resumed and concluded with success in February 1993. Employers and unions found a middle ground between their proposals concerning the extent to which the generosity of pensions should be reduced, but the CNPF made the main concession by assenting to a gradual increase of the mandatory contribution rate from 4% in 1996 to 6% in 1999, accompanied by an immediate abolition of voluntary operations (i.e. above 6%). Having

had to overcome strong internal resistance, employers' lobby declared it had made "considerable efforts" (*Le Monde* 1993) to reach the agreement.

Following the negotiation over the future of the ARRCO, the social partners opened similar talks in the AGIRC in December 1993. From the start, trade unions announced they would not sign an agreement unless employers accepted to increase the mandatory contribution rate to 16%. At the time, companies paid on average 14%. One of the unions which were traditionally most involved in the management of the AGIRC, the cadres' union CGC, exerted pressure on employers by sending a letter to CEOs of large companies and declared it hoped that "the CNPF would not put the cadres' scheme in jeopardy by bowing to the mercenary interests of one of its industry associations" (*Les Echos* 1993b). Given the FFSA's outright hostility towards further increases in contribution rates, the CNPF made clear that the maximum increase it would accept would be up to 14% and that the newly negotiated rate would be the "ultimate" one in AGIRC.

Employers' priority was to obtain as much retrenchment as possible. The CNPF proposed a multi-year pension freeze, cuts in various social programmes such as retirement homes and holiday centres, decreases in widow(er)s' pensions and child bonuses as well as an increase in social contributions which would not translate into increased pension rights<sup>9</sup>. While unions agreed to the last proposal and to the changes in social programmes, they rejected the other proposals. To overcome their opposition, the employers' association negotiated a quid pro quo. Under a mandate they obtained from

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<sup>9</sup> Since the level of ARRCO and AGIRC benefits is directly determined by the amount of contributions that employees pay into the schemes, the social partners have distinguished between a "nominal contribution rate" and an "effective contribution rate." Pension rights are calculated only on the basis of the first one (see Naczyk and Palier 2010: 15-20). Thus, in the case of the AGIRC, while the social partners negotiated on an increase of the "nominal" rate to 16%, the "effective" contribution rate would actually be 20%.

their executive council in January 1994, the CNPF's negotiators gave their nod to a gradual increase in the mandatory contribution rate to 14% in 1997 and to 16% by 2003. In return, unions accepted to decrease the value of child bonuses to 80% of their value by 1997 and to tighten eligibility for widow(er)s' pensions.

After the agreement was signed, the CNPF's internal disagreements were made public. Claude Bébéar sent a letter of protest to the lobby's president, François Périgot, objecting to an agreement, which "would generate additional expenses of 80 to 90 billion francs over 10 years in exchange for savings of at most 11 billion francs on benefits" (*Le Monde* 1994b). AXA's president denounced the contradiction between employers' demands for the state to decrease social security contributions and their own decisions in the occupational pay-as-you-go schemes. Bébéar also questioned the validity of the agreement on the grounds that it had not complied with the CNPF's rules of conduct and asked for the negotiators of the employers' association, including the chief negotiator Pierre Guillen – the UIMM's and the CNPF's vice-chairman – to be dismissed from their duties. Périgot did not respond positively to the request, but Bébéar's intervention raised questions about a possible restructuring of the CNPF and even a possible break-up of the organization in case it could not reform itself.

The decision to increase and standardize contribution rates in AGIRC marked the defeat of insurers' decade-long strategy to develop employer-sponsored pension funds, by directly competing with the supplementary pay-as-you-go schemes. After the extension of mandatory coverage in senior executives' schemes, the ARRCO and AGIRC agreements were widely recognized as limiting the room for the expansion of funded pension arrangements (e.g. Babeau 1997: 297-298, 305). The standardization of contribution rates was to be fully enshrined and accelerated in a further agreement

negotiated simultaneously for the two supplementary schemes in 1996 (Naczyk and Palier 2011).

The UIMM's and trade unions' attachment to a web of institutions it had contributed to create and which had allowed its constituents to offer generous fringe benefits provides an empirical illustration of how institutional feedback shapes the preferences of employers and workers towards pension privatization. Partly supported by federations representing small and medium-sized companies, the FFSA denounced a system of transfers "from young industries to old industries, from the service sector to manufacturing"<sup>10</sup> but was unable to assemble a sufficiently powerful coalition against the traditional cross-class alliance between organized labour and the metal industry lobby. Disagreements within the CNPF over the design of pension funds contributed to weaken insurers' case for pension privatization when they defended it in the political arena.

*An "Anglo-Saxon" or a "Rhenish" model of pension funds?*

In parallel with the developments that occurred in the occupational pay-as-you-go schemes, various business associations set up working groups to draft proposals concerning the design of funded pensions and the "welfare-finance nexus" they would institutionalize. A key issue became the impact pension funds would have on corporate finance and whether their time horizon would make them providers of "patient capital" that would help sustain long-term industrial development. Since industrialists suspected that insurance companies' plans might lead to "Anglo-Saxon" short-termism, some of

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<sup>10</sup> Interview former president of the FFSA, Paris, 17.09.2009

the most important French insurers showed support for a “Rhenish” model of capitalism. Various projects were put on the table both by financiers and managers, but the CNPF proved unable to forge a compromise that would satisfy all its constituents.

In the midst of the controversies surrounding the ARRCO and AGIRC schemes, the UIMM backed in its 1990 annual report the principle of developing private retirement savings, since they “could only be beneficial for the economy and consequently for investments and employment” (UIMM 1990: 156). In 1991, the *Institut de l’Entreprise*, a corporate think tank funded by large firms, convened a working group to draft a report about needed changes in the capital structure of French companies. The group, one of whose co-chairs was the UIMM’s president Arnaud Leenhardt, included managers of large non-financial companies and representatives of the financial industry, except insurers. French business leaders worried that, apart from the networks of cross-shareholdings that had been built in the 1980s, large French companies lacked “antibodies” against acquisitions by foreign competitors. Increasing investment in domestic equities should therefore become an economic priority for the nation. However, while French mutual funds (OPCVM) were a growing force on the Paris stock exchange, the report denounced their equity stakes for being structurally volatile and for fostering purely financial and impersonal links with companies. Instead, the authors called for promoting shareholder loyalty so as to provide the stability needed by managers to implement their companies’ strategies. In their words: “the company is *a project*” and “the realization of that project is necessarily *a long-term undertaking*” which “entails a succession of actions, each of which requires time” (Institut de l’Entreprise 1991: 15-16).

The think tank insisted on the need for companies to secure access to different sources of patient capital, one of which could be private pension funds, and cited existing company savings plans (*plans d'épargne d'entreprise - PEE*) as a potential vehicle for retirement savings. Closely related to other employee savings schemes (*épargne salariale*) such as profit-sharing (*participation*) or bonuses linked to company performance (*intéressement*), PEEs traditionally allowed workers to build up tax-free savings that were matched by employer contributions. Companies used such plans to encourage employee loyalty, but also as a source of patient capital since PEE assets could be reinvested in the company's share capital. The development of *épargne salariale* was promoted since the mid-1980s by *Fondact*, an influential lobby created by a group of employers who saw salary savings schemes as well as employee stock ownership as ways of overcoming the conflict between labour and capital (see e.g. Talagrand *et al.* 1993).

Whereas the Institut de l'Entreprise advocated the expansion of fully-funded pension plans, some industrialists entertained the idea of developing German-style book reserves. This financing technique consists in reporting pension liabilities on a firm's balance sheet and means that the company promises to meet the costs of a pension from its own assets (see also Chapter 2 of this thesis). Because book-reserve schemes provided large German firms with internal finance for capital investments (e.g. Jackson and Vitols 2001), they were considered by French industrialists as one of the pillars of post-war German industrial power. Moreover, as they were defined-benefit schemes with long vesting periods, they served as an effective tool to retain skilled workers in the firm. This type of institutional design for supplementary pensions was backed in

October 1992 by the AFEP (*Association Française des Entreprises Privées*), a lobby that represents only a few dozens of the largest French companies<sup>11</sup>.

The possibility of internal financing of pensions was opposed by insurers who argued that it could put workers' savings at risk. This type of institutional design of supplementary would have in fact limited the market for funded pensions. However, as was already demonstrated by Denis Kessler's concept of "fonds de pension à la française", insurance companies tried to present their proposals as a response to managers' concerns about the risk of hostile takeovers and the need to have better access to patient capital. The presidents of the two largest state-owned insurance companies, Michel Albert (AGF) and Jean Peyrelevade (UAP) stressed that pension funds could privilege the long-term perspective demanded by industrialists. In his book *Capitalism Against Capitalism*, Michel Albert wrote that pension funds should be introduced in France "on the condition that [they] are managed with the 'creative caution' typical of the Alpine model (whose institutional investors provide stability, unlike those in America and elsewhere who have succumbed to the lure of short-term speculation)" (Albert 1993: 98). Jean Peyrelevade wrote about his own company that it was there "to make sure that long-term concerns (*souci du long terme*) prevail" and that "[the UAP's] expectation of profits, always expressed in a long-term perspective, comes second after [its] concern for preserving the independence and stability of the structures in which [it] invests the assets that [it] manages" (Peyrelevade 1993: 66-67).

Denis Kessler also continuously endeavoured to rally the business community behind insurers' plans. During a study trip organized by the FFSA to Japan, he lauded the country's financial system, saying that "the Japanese accumulation economy has

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<sup>11</sup> On the role of the AFEP in corporate governance, see also Culpepper 2011: 64, 69-74.

helped solve the problem of industry financing” largely through the “funds collected by insurers<sup>12</sup> [which] have solidified businesses by providing common equity (*fonds propres*)” (*Les Echos* 1993a). For the president of the insurers’ federation, pension funds would provide the “sinews of war in modern capitalism” and “lay the basis for a kind of modern *colbertisme*” which would help French companies face their foreign competitors (*Le Monde* 1994c).

Considering the multiplicity of projects defended by the business community, the CNPF took the initiative to set up an internal working group on funded pensions in 1993 (see Charpentier 1997: 305-328). As had already been the case with the 1987 retirement savings plans, insurers and bankers continued to oppose each other over whether funded pensions should be paid out as a life annuity or as lump sum. Contrary to insurers, bankers signalled they accepted the possibility of investing part of the funds in companies’ balances sheets on the condition that risks were properly spread. The CNPF issued an official project for retirement savings in November 1993. However, instead of adopting a clear stance towards one of the projects, the peak association allowed for the different designs to co-exist (see Table 4.1). This “lowest-common-denominator” solution did not satisfy its members who, consequently, lobbied politicians in different directions.

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<sup>12</sup> For a description of the role of pension funds and insurance companies in sustaining the Japanese coordinated market economy, see Estevez-Abe 2001 and Chapter 2 of this thesis.

**Table 4.1 Business associations' pension fund proposals**

	<b>FFSA 1991</b>	<b>AFB 1993</b>	<b>AFEP 1992</b>	<b>CNPF 1993</b>
<b>Name</b>	Pension funds ( <i>Fonds de pension</i> )	Retirement savings funds ( <i>Fonds d'épargne retraite</i> )	Book reserves for supplementary pensions ( <i>Provisions pour retraites complémentaires</i> )	Retirement funds ( <i>Fonds de retraite</i> )
<b>Creation</b>	Firms; occupational bodies (including organizations of the self-employed)	Firms or approved institutions	Firms	Firms or approved institutions
<b>Management</b>	External. By insurance companies, mutual aid societies, paritarian institutions	External. Would favour investments in equities	Internal. Book reserve on balance sheet.	Internal for savings constituted by the firm; external for workers' contributions; minimum percentage of investments in equities
<b>Pay-out</b>	Life annuity. Widow(er)'s pension in case of death	Life annuity or lump sum	Annuity. Rights vested after seniority of 10 years; no portability of rights	Life annuity or lump sum
<b>Tax regime</b>	Exemptions from corporate income taxes and social contributions.  Exemption from personal income tax, with ceiling. Income tax to be paid at pay out.	Exemptions from corporate income taxes and social contributions.  Exemption from personal income tax, with ceiling. Income tax to be paid at pay out for life annuities but not for lump sum.	Book reserves deductible from corporate income tax.	Exemptions from corporate income taxes and social contributions.  Exemption from personal income tax, with ceiling. Income tax to be paid at pay out.

Source: Charpentier 1997

*Parties' unwillingness to break the taboo*

Pension privatization had supporters on both sides of the political spectrum already since the 1980s. Nevertheless, the cacophony of voices that came from various segments of business and labour proved to be a major stumbling block for those

politicians who wanted to move the issue from the agenda-making phase to the decision-making stage. Both the CNPF and the UIMM had officially declared they supported the principle of developing funded pensions. Yet, together with organized labour, both business groups petitioned senior government officials not to introduce retirement savings plans<sup>13</sup>.

“I remember [the Socialist Minister of Finance and later Prime Minister] Pierre Bérégovoy telling me in 1992 that he found my ideas interesting, but that the president of the CNPF as well as other people had come to see him. And he told me: Give me good reasons to do it only for you”<sup>14</sup>.

The anti-privatization crusade led by trade unions and the main employers’ associations made it difficult for left-wing and right-wing party leaders in France’s multi-party system to endorse projects against which the interest groups representing their respective core constituencies could mobilize public opinion.

Within the Socialist Party, some politicians tried to move the issue forward. After he became Minister of Industry in the spring 1991, Dominique Strauss-Kahn commissioned a report, whose official aim was to examine the role PEEs might play in the financing of industry, but whose informal goal was to gauge how well they could serve as a left-wing model of retirement savings plans. As reformist unions such as the cadres’ CGC, the Christian-Democratic CFTC and the social-democratic CFDT signalled they might back the expansion of PEEs, the report’s authors recommended the creation of “authentic” employee savings plans (*PES - Plan d’épargne salariale* – see Pastré and Moscovici 1992), which, instead of being established unilaterally by employers as was traditionally the case, would have to be set up via collective

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<sup>13</sup> Interview former adviser to Prime Minister, Paris, 17.09.2009; Interview, Paris, 05.01.2011

<sup>14</sup> Interview former president of the FFSA, Paris, 17.09.2009

agreements. But, since unions simultaneously lobbied against the introduction of private pension funds, left-wing politicians could fear a political backlash if the expansion of employee savings plans was seen as back door pension privatization.

Right-wing parties were on the surface stronger advocates of pension privatization. In their common platform for the 1993 legislative election, the Gaullist RPR and the centrist UDF suggested creating a space for funded pensions by switching the financing of family allowances from payroll taxes towards general income tax. A group of right-wing senators even brought in a bill on the creation of “English-style” (i.e. with external management) pension funds just before the parliamentary election. Nevertheless, the RPR and the UDF showed much more cautiousness on the issue once they formed a ruling coalition in March 1993. In the spring, the Balladur government put forward a reform proposal that led to retrenchment in private-sector employees’ statutory pension scheme (e.g. Bonoli 2000; Palier 2005a: 230-235). Yet, as the government was seeking the endorsement of the CNPF and of reformist unions (i.e. the CFDT, the CFTC and the CGC) for the reform, it left funded pensions out of its blueprint<sup>15</sup>, and this despite commanding an overwhelming majority in the National Assembly.

Given the government’s vacillation, UDF MPs submitted their own parliamentary bills on retirement savings plans in the winter of 1993 and the spring of 1994. The different drafts contradicted each other on issues such the self-investment of pension fund assets by the sponsoring company or the pay-out of benefits (*Le Monde* 1994a; Charpentier 1997), and thus largely reflected the divisions that existed within business over the design of supplementary schemes. But, as the 1995 presidential elections were

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<sup>15</sup> Interview former adviser to Prime Minister, Paris, 17.09.2009.

approaching, the leaders of the RPR-UDF coalition preferred to avoid any controversies and prevented the bills from being debated in the National Assembly's plenary session.

It was only once the standardization of ARRCO and AGIRC contribution rates was confirmed and set in stone through a collective agreement signed in April 1996 that the political deadlock over pension privatization could be broken. The UIMM and the CNPF considered that pension funds no longer posed a threat to pre-existing pay-as-you-go supplementary and therefore stopped opposing their introduction. This in turn helped right-wing politicians in their task of selling pension privatization to the public and particularly to their specific electoral constituencies, since there was no longer a risk that employers' associations could mobilize public opinion against their projects. Moreover, insurers had given in to bankers' demands of paying out retirement savings at least partly as a lump sum, with Denis Kessler declaring that it was "proof that the industry is not 'psychorigid'" (*Le Monde* 1995).

A month after the ARRCO-AGIRC agreement was signed (*Le Monde* 1996a), the UDF parliamentary group unanimously decided to bring a draft pension bill before the National Assembly with the hope that it would drive the government to take a stance on the issue. Prime Minister Juppé consulted the social partners during the summer (*Le Monde* 1996b), but the government did not submit its own project and decided to allow the parliamentarians' text to be debated and possibly voted in November 1996. The bill, which was prepared by UDF MP Jean-Pierre Thomas, planned the creation of defined-contribution "retirement savings plans" (*plans d'épargne retraite*) based on voluntary individual contributions matched by employer contributions. Benefits would take the form of life annuities, but up to 20% of the savings could be paid out in a lump sum. The funds would have to be managed externally, but at least half of the members of the

funds' supervisory boards would have to represent the insured. As regards the corporate finance aspects of the bill, parliamentarians initially introduced a minimum requirement for equity investments (60%), which was opposed by insurance companies (*Les Echos* 1996b) and was subsequently replaced with a cap on investments in bonds. Inspired by UK regulations adopted after the Maxwell scandal, the bill allowed a maximum of 5% of assets to be invested in securities issued by a single company.

Within the business community, the bill was welcomed both by the financial industry (see Bollon and Cossic 1997) and by employers' associations, including the UIMM (Marseille 2000: 228). Nevertheless, the parliamentary debate on the project happened to coincide with a major development in the French system of corporate governance. At the beginning of November 1996, Claude Bébéar announced the takeover of the UAP by AXA. The merger was widely interpreted as sounding the death knell for the system of cross-shareholdings that had protected France's largest firms against hostile takeovers since the 1980s (Izraelewicz 1999; Culpepper 2005; O'Sullivan 2007). Since foreign investors controlled at the time around 35% of French stock market capitalization (Morin 2000: 41), the loss of this form of patient capital meant that French companies might increasingly fall under the influence of Anglo-American institutional investors and of their specific norms of company management centred on the pursuit of shareholder value. In this context, one of France's most senior industrialists – Jean-Louis Beffa – publicly criticized the bill on pension funds for contributing to greater corporate short-termism:

“Pension funds are important only because they establish a French institutional presence in companies' capital. There is no way [they] will provide support for strategies different from those of Anglo-Saxon pension funds. There are only two groups of shareholders that can espouse a different strategy: these are small

shareholders and groups of stable shareholders who have an ‘*affectio societatis*’ and are capable of seeing things in a long-term perspective.” (*Les Echos* 1996c)

Beffa was the head of St-Gobain, an industrial conglomerate that stood at the heart of one of the French networks of cross-shareholdings. Because his criticism was not relayed by the main employers’ associations, it did not threaten the political viability of the bill. However, Beffa’s statement indicated that parts of French corporate elites were not satisfied with the right-wing majority’s project because it would not generate the type of long-term investors that they had hoped for.

A much more active resistance to the bill was nonetheless mounted by trade unions and by left-wing parties (see also Conceição-Heldt 2006: 185-186). Although some unions had signalled they were not against the principle of introducing funded pensions (*Les Echos* 1996a), organized labour concurred that the project could result in “draining the resources” both of the basic and the supplementary pay-as-you-go systems (*Les Echos* 1996d). As an incentive for firms to contribute to the new schemes, parliamentarians introduced exemptions from employer social contributions on the matching contributions paid by sponsoring companies. After the National Assembly adopted the bill in November 1996, trade union leaders sent letters to PM Juppé in protest. In an attempt to broker a compromise, the Senate’s Commission of Social Affairs proposed significantly to reduce the payroll-tax exemption by putting a ceiling on it. The amendment was ratified and the Thomas Law was eventually passed in the National Assembly in February 1997. Nevertheless, organized labour remained dissatisfied with the solution. After the law was adopted, Socialist and Communist senators seized the Constitutional Council, but their challenge was rejected. The Socialist Party announced it would repeal the law were it to return to power. The

unexpected dissolution of the National Assembly by right-wing President Jacques Chirac in April 1997 and the resulting change in parliamentary majority gave the left such a possibility.

### **4.3 Neither Anglo-Saxon, nor Rhenish: The rise of French-style pension funds**

During the 1997 electoral campaign, the leader of the Socialist Party Lionel Jospin initially confirmed that the Thomas Law would be repealed, were his party to win the election. However, various socialist parliamentary candidates hastened to add that they did not exclude the introduction of a retirement savings product, albeit in another form than that proposed by their right-wing competitors. In the on-going struggle over pension reform, pension privatization was not going to disappear from the political agenda. As early as July 1997, the new Socialist Minister of Finance, Dominique Strauss-Kahn, announced his intention to launch a series of consultations on the introduction of funded pensions (*La Tribune* 1997). The statement was made at the annual conference of *Paris Europlace*, an organization formed in 1992 by major financial institutions (such as the Paris stock exchange and the *Banque de France*), business groups and the Paris local authorities in order to promote Paris as a leading financial centre in Europe. The lobby had argued forcefully for the development of domestic pension funds ever since its creation.

Because funded pensions were still far from being consensual on the left of the political spectrum and within the labour movement, Socialist politicians who were intent on pushing through partial pension privatization began a lengthy campaign to assemble a coalition for reform. In December 1997, as it was becoming clear that the

AXA-UAP merger had made French companies much more vulnerable to hostile takeovers, both Strauss-Kahn and President Chirac tried to highlight the risks faced by France's "capitalism without capital" and talked about the need to introduce "fonds de pension à la française" (*Le Monde* 1997a; *Le Monde* 1997b). The Minister of Finance asked a group of parliamentarians to help him prepare a bill. This move was aimed at helping overcome reluctance among MPs from the left-wing majority, particularly from communists. While accepting to preside over the working group, Socialist MP Didier Migaud declared that his colleagues "would not support a system of pension funds that could pose a threat to the pay-as-you-go system" (*Les Echos* 1997).

In order to build up momentum, senior Socialist politician Laurent Fabius put forward a possible left-wing alternative to the Thomas Law. The president of the National Assembly (and former prime minister) advocated the establishment of "partnership retirement funds" (*Fonds partenariaux de retraite*), which would be put in place by extending the investment period of existing company savings schemes (PEE). Fabius proposed to revise tax incentives so that the funds would not threaten the pay-as-you-go system. He also called for greater involvement of unions in their establishment and their management and said that the plans should preferably cover all workers of a company or a branch. Dominique Strauss-Kahn concurred with his party colleague and underlined that pension funds should be "more collective, include more solidarity and be more focused on retirement. These are the principles that will allow us to overcome the deficiencies of the Thomas Law" (*La Croix* 1998).

Yet, the discussion prompted by the Ministry of Finance was by no means confined to the parliamentary arena. In January 1998, Strauss-Kahn asked François Morin, a respected economist, to write a report about the consequences of the changes

occurring in French firms' ownership structure. Presented five months later, "Morin's report bemoaned the loss of coordination, which AXA's steps to dissolve the ownership networks had signified" (Culpepper 2011: 63). However, the document also suggested a way to protect French companies from the "diktat" of foreign institutional investors (Morin 1998: 6-10). Having met with key stakeholders in the pension debate, Morin called for the negotiation of a "new social contract" between the social partners to create domestic pension funds. Instead of adopting what he described as the "aggressive" behaviour of defined-contribution pension funds, the funds would have to privilege a "longer-term" perspective more akin to that of defined-benefit schemes. With a greater involvement of the social partners in the definition of the funds' investment strategy, French pension funds could embody the concept of "citizen savings" and promote broader objectives than shareholder value like for instance more sustainable environmental and employment practices. This path was already being explored by reformist unions and by a large segment of the business community, but discussions were still at their early stages.

In the meantime, the government decided to press ahead with an alternative plan. In order to ease the stress of demographic ageing for private-sector workers' statutory pay-as-you-go scheme, the Socialist Minister of Social Affairs Martine Aubry recommended setting up a pension reserve fund (*FRR – Fonds de réserve pour les retraites*; see Davanne *et al.* 1998). The funds' assets would be provided by the proceeds of the privatization of state-owned companies and by surpluses in the pension system. The idea was officially put forward in September 1998, when the privatization of a banking group was made known. The plan sparked immediate outcry from Communist politicians who were opposed both to the privatisation of state-owned firms

and said that the buffer fund was just “a foretaste of pension funds *à l’anglo-saxonne*” (*Les Echos* 1998a). Martine Aubry defended her project in the National Assembly, by saying that the fund would consolidate the social security system which was “threatened by private insurance companies” (*Le Figaro* 1998). The government also offered officially to repeal the Thomas Law, even though it was not being implemented. Nevertheless, the Communist Party urged its parliamentarians to abstain. The law creating this state-controlled institutional investor was enacted, but the Communists’ attitude still showed a lack of acceptance of funding in the pension system.

### *Constructing consensus*

In the context of the rise of foreign institutional investors, the development of alternative pension funds through salary savings schemes (*épargne salariale*) began to attract increasing support from unions, employers and even the right-wing opposition. In March 1998, the head of the social-democratic CFDT union, Nicole Notat, signalled to the government and to the CNPF that she was ready to enter talks about the introduction of pension funds. These “would help guarantee a good level of retirement income beyond the pay-as-you-go system” (*Le Monde* 1998a). The cadres’ union CGC soon organized a conference about the possibility of creating “paritarian pension funds” (*Fonds de retraite paritaires*) and suggested that they should become mandatory in order to ensure equality between workers. The two reformist unions’ greater willingness to discuss funded pensions could be explained by the fact that the social partners had “defined the scope” of the ARRCO-AGIRC schemes through the 1993, 1994 and 1996

agreements. Private pension funds therefore represented less of a threat to the supplementary pay-as-you-go schemes than they did in the past. Thus, institutional feedback from these pre-existing supplementary schemes played a lesser role in defining these unions' preferences on pensions.

Yet the major reason that union leaders cited to justify a debate about funded pensions was the “massive entry” of Anglo-Saxon pension funds to France (*Les Echos* 1998b) and their “exorbitant demands” on shareholder value (*Libération* 1999a). By creating domestic institutional investors and institutionalizing a new welfare-finance nexus, unions were hoping to counteract foreign investors' growing influence in French corporate governance. Nicole Notat said that she “prefer[red] to talk of *épargne salariale*, an old idea of the CFDT” (*Le Monde* 1998a). The reformist union evinced interest in promoting “solidaire” investment that would “support job-creating companies” (*Le Monde* 1998b). Given the importance of the changes that were taking place in the French system of corporate governance, even the communist CGT union indicated its readiness to take part in the debate (*La Tribune* 1998c; see also Le Duigou and Toulisse 1999). Organized labour nevertheless had reservations about some of the uses that were made of *épargne salariale* by managers of large companies. Since the mid-1980s, trade unions had fought for the introduction of limits on the amount of assets that could be reinvested in the shares of the sponsoring company. The aim was to reduce workers' dependence if the firm went bust. Trade unionists acknowledged they were sometimes “overwhelmed by these techniques characteristic of the financial industry” (*Le Monde* 1998b).

Businessmen also continued to justify the creation of pension funds by a form of economic nationalism. For AXA's Claude Bébéar, the lack of French pension funds

meant that there was “a heightened risk firms’ decision bodies might leave France” (*La Tribune* 1998a). While praising Anglo-Saxon pension funds’ principles of corporate governance for introducing much needed transparency into French management, Jean Peyrelevade deplored “a new economy that experiences inflation only on financial assets.” The financier who now headed the *Crédit Lyonnais* wrote that “having the weapons that our rivals already have” would “at last allow us to open a substantive debate against new-fangled ideas” (Peyrelevade 1998a: 690-691; see also Peyrelevade 1998b). Apart from seeing salary savings schemes as a defence against hostile takeovers, managers of large firms increasingly stressed the plans could have for fostering better relations between labour and capital. A forum for discussion was provided by the *Fondation Saint-Simon*, a think tank gathering intellectuals, businessmen, but also leading figures of the CFDT. In a note written for the foundation, Saint-Gobain’s Jean-Louis Beffa and his co-authors contended that workers’ involvement in companies’ capital could “protect the employment relationship from the vagaries of finance” (Beffa *et al.* 1999: 3). They proposed to “develop original wage-earner funds whose objectives could incorporate other criteria than financial performance in a narrow sense” (*Ibid.*: 34). For Beffa, *épargne salariale* could sustain a new and much more cooperative production regime, radically opposed to the taylorist methods still predominant in French industry (*Le Monde* 1998c).

Representatives of the financial industry showed openness towards some of these ideas. Concerning the development of socially responsible investment, Pierre Bellon, the director of the association representing the interests of the French asset management industry (AFG – *Association Française de la Gestion Financière*) declared that “people in the trade would be able to respond to market demand” (*Le Monde* 1998d). Denis

Kessler said he was “favourable to all methods that allow to associate workers to the company’s performance, be it *intéressement*, stock options (which should be diffused very widely and not only to senior management), pension funds and employee stock ownership. These would allow the whole staff to benefit from wealth accumulation by the company and from the evolution of the share price” (Kessler 1999: 21-22).

The nascent consensus between the business community and organized labour on the design of pension funds contributed to a gradual change in the positioning of right-wing parties. After the change of government, the opposition, especially liberal MPs, criticized the left for not allowing the implementation of the Thomas Law. President Chirac also repeatedly called on the government to introduce pension funds. However, in November 1998, the new president of the RPR Philippe Séguin said his party did not support the introduction of “the copy of Anglo-Saxon pension funds.” The Gaullist politician pleaded for pension funds “adapted to the specific characteristics of French social protection” and for “a management arrangement with more involvement of the social partners.” Pension funds should “constitute hard cores of loyal shareholders” which would be “well informed and would care about participating in [the firm’s] management and sharing profits” (*La Tribune* 1998b). In January 1999, a number of right-wing MPs submitted a new bill on pension funds. Although the bill was still inspired by the Thomas Law, its author said he would be in favour of a “progressive generalisation” of the funds via collective agreements signed at the firm or industry level. The left-wing majority blocked the voting of the text, but Dominique Strauss-Kahn welcomed the fact that a consensus seemed to be gradually emerging (*Les Echos* 1999a).

### *Reconciling shareholders and stakeholders through salary savings*

All the signs thus pointed to the possibility of a cross-class agreement on the development of French retirement savings plans. Nevertheless, the lack of unanimity within the left-wing parliamentary majority still posed an obstacle. Actors in favour of institutional change used the *Affaire Michelin* (see Thiberghien 2007: 96-97) as a focusing event to mobilize support for their ideas and to put them on the government's official agenda. At the beginning of September 1999, tyre manufacturer Michelin simultaneously announced a substantial rise in half-year profits and its intention to lay off 7,500 workers in order to improve its competitiveness in continental Europe. As the announcement was followed by increases in the company's share price, unions and left-wing parties immediately denounced a layoff plan designed only to increase shareholders' profits. The head of the communist CGT union partly blamed the incident on Anglo-Saxon pension funds and their "lack of morals" (*La Tribune* 1999a). However, a few days later, Prime Minister Jospin was interviewed on a primetime news programme and declared that his government would not intervene on the issue, saying that "one could not expect everything from the state and the government" (*La Tribune* 1999b). Instead, he called on unions to mobilize against the company. The declaration aroused strong emotions within the ranks of the parliamentary majority.

The reformist first secretary of the Socialist party, François Hollande, seized this moment to say that his party would put forward measures on salary savings schemes "in order to empower wage-earners, by giving them shares in their company" (*Le Monde* 1999). At the end of September, the government announced its intention to introduce an ambitious reform of salary savings schemes coupled with measures aimed at expanding

stock options to a much larger part of the workforce (see also Thiberghien 2007: 93-94). According to Dominique Strauss-Kahn, developing employee stock ownership through these two mechanisms would help change the way wealth created in the company is shared between labour and capital. To defend his project against sceptics in the left-wing majority, he argued that “workers, when they are shareholders, do not exploit themselves, but it does not mean that they are capitalists either.” For the Minister of Finance, *épargne salariale* stood in fact “at the heart of the [Socialist] project” (Assemblée Nationale 1999: 7912) and could boost its electoral appeal.

The CFDT contributed to give more impetus to the government’s idea by organizing a conference about globalization and its effects in October 1999. Nicole Notat publicly endorsed employee stock ownership and called on her union to explore ways of allowing employees-shareholders to be better organized (*Les Echos* 1999b)<sup>16</sup>. Jean-Louis Beffa, who was invited to the conference, argued that employee stock ownership would establish a new form of co-management and that it would also have an “influence on the market’s main sanction that is the hostile takeover” (*Libération* 1999b). Another seminar was organized by Fondact, the employer-funded association for the promotion of *épargne salariale* and employee stock ownership. For its new president, Michel Albert, the fact that a consensus between the social partners was about to be reached and that even the CGT was no longer opposed to salary savings was “a historical moment” (*La Tribune* 1999c; see also Albert 2000). The communist union

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<sup>16</sup> Throughout the debate around *épargne salariale*, organized labour sought to develop their capacities so as to carry more weight in corporate governance. The *Institut de Recherches Economiques et Sociales*, which serves as a think tank for trade unions, carried out research about the functioning of *épargne salariale* (apRoberts *et al.* 2001) as well as about American pension funds and the strategies pursued by unions to have a say in the management of “workers’ capital” (Montagne 2000; Sauviat and Pernot 2000; Sauviat 2001). Nicole Notat also made study trips to the US and to Canada. In 2000, Nicolas Théry, a civil servant from the *Trésor* who had been an advisor to Dominique Strauss-Kahn, left the Ministry of Finance and started to work for the CFDT to develop union’s organizational capacities in the field of corporate governance (*La Tribune* 2000).

confirmed it would take part in the process, provided the debate about salary savings was clearly distinguished from that about pensions (*Libération* 1999c; Le Duigou 2000). This decision was crucial for the political viability of the project because of the close links that existed between the union and the Communist Party, Socialists' coalition partner.

The scope of the government's initial project was nonetheless restricted following the resignation of Dominique Strauss-Kahn due to corruption charges and after the publication of an official government report on employee share-ownership (de Foucauld and Balligand 2000). Although it was strongly in favour of expanding *épargne salariale*, the report suggested that stock options should not be extended beyond senior management and that the issue should be regulated at the European level. During consultations with the authors, trade unions had expressed doubts or even opposition to the expansion of stock options (*La Tribune* 1999d). Part of the Socialist Party's leadership questioned the fact whether a "société du tout actionnaire" (i.e. shareholder-dominated society) should be "at the heart of [their] project" and decided to give the project a much lower profile than what was envisaged by Dominique Strauss-Kahn (*Libération* 2000). This shows that electoral considerations – and the idea of using pension privatization as a means to broaden the left's appeal to the middle class – were much less central to French Socialists' support for salary savings than would be expected by partisan theories of pension privatization.

The Ministry of Finance launched consultations on a draft bill in the spring of 2000. Following unions' demands, the government proposed the creation of "multi-company savings plans" (*PEI – plans d'épargne inter-entreprise*) in order to extend coverage to small- and medium-sized firms and the introduction of long-term

“voluntary partnership salary savings plans” (*PPESV – plans partenariaux d’épargne salariale volontaires*). Like the existing company savings plans (PEE), the new schemes would be based on workers’ voluntary contributions potentially supplemented by employer matching contributions. Several aspects of the government’s project were nonetheless criticized by organized labour for making it too close to pension funds. First, the new Minister of Finance Laurent Fabius initially suggested blocking savings in the PPESV for at least 15 years. Due to unions’ criticisms it was decreased to 10 years. A second bone of contention was the proposed choice between a lump sum payment and annuities. Unions, and particularly the CGT, argued that: “If salary savings and pension funds are to be clearly distinguished, one should keep it to a lump sum payment” (*Les Echos* 2000a). Exemptions from social security contributions on the matching contributions paid by employers were a final point raised by unions, since they considered them as a threat to the pay-as-you-go system. While welcoming the overall project (*Les Echos* 2000b), employers’ umbrella organization (rebranded into MEDEF in 1998 – see Woll 2006) argued on the contrary that these exemptions were a *sine qua non*. The MEDEF also emphasized that these were “not pension funds” and complained that France was “still deprived of them” (*Le Monde* 2000b).

Laurent Fabius did not budge on the second and the third point and submitted his bill to the National Assembly in the autumn. However, following protests from its parliamentary majority, the government backtracked. It suppressed the reference to annuities and introduced a special contribution of 8.2% on employer matching contributions which would be used to feed the FRR, i.e. the newly created pension reserve fund. The right-wing dominated Senate attempted to introduce the term of “pension funds” in the bill. This move met with a sharp rebuff from the Minister of

Finance who declared that “[the PPESV] is not a Trojan horse aimed at destroying the pay-as-you-go system” (*Le Monde* 2000c). The final version of the Fabius Law on *épargne salariale* was passed in February 2001 with the support of the left-wing majority and the abstention of the right-wing RPR and UDF parties<sup>17</sup>.

The enactment of the Fabius Law marked a new phase in French pension privatization. For the first time, the equivalent of a retirement savings plan was endorsed by the most important stakeholders in the debate. The financial industry approved of a product it would contribute to market. However, insurers still hoped to introduce voluntary personal pensions. Employers, particularly managers of large firms, were content with an instrument they could use for skill retention and to build a stable shareholder structure. Although it still refused to call them “pension funds”, organized labour supported the development of “salary savings” to support the creation of socially responsible investors which could serve as a counterbalance to Anglo-American pension and mutual funds. The new law forced indeed the funds managing *épargne salariale* to report annually about their taking into account ethical, environmental and social criteria<sup>18</sup>. The Socialist government gave another boost to this strategy by deciding that the FRR would invest all its assets in a socially responsible way<sup>19</sup>.

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<sup>17</sup> Both parties had indeed signalled that they supported the expansion of employee savings plans (*Le Figaro* 2000; *Le Monde* 2000a).

<sup>18</sup> In 2002, several unions launched an “inter-union committee on salary savings” (*Comité intersyndical de l'épargne salariale* – Théry 2002) through which they have pressed for socially responsible investment and made recommendations on the funds’ voting policies. After she left the presidency of the CFDT in 2002, Nicole Notat (2003: 24-26) created *Vigeo*, a non-financial rating agency whose shareholders have been a number of European trade unions, but also asset managers and major French companies.

<sup>19</sup> Unions and employers obtained representatives on the buffer fund’s board. Jean-Louis Beffa and the CGT’s pensions expert, Jean-Christophe Le Duigou, were nominated vice-chairmen in 2002 (see Beffa *et al.* 2005). It was decided that, rather than managing assets on its own, the fund would issue mandates to private asset managers, which would all have to pursue a socially responsible investment strategy. This initiative acted as a catalyst for the development of SRI in France and secured support for the FRR by right-wing parties and business which had initially warned against the dangers of state interference in financial markets (Kessler 1999: 28-29) and a possible “renationalisation” of the French economy (Arthuis *et al.* 2000).

### *From salary savings to retirement savings*

The Fabius Law was a decisive, yet not the final step in the development of funded pensions in France. During the 2002 legislative and presidential campaign, reformists within the Socialist Party started to talk more openly of retirement rather than simply salary savings. Some even mentioned voluntary personal pensions (*La Tribune* 2002). Tipped as a potential Prime Minister, Dominique Strauss-Kahn (2002: 327-330) still insisted on the need to counterbalance the massive presence of foreign institutional investors in French companies' capital and suggested creating a tax credit in order to provide an incentive for low earners to contribute to salary savings schemes (*Le Monde* 2002a). However, the elections were won by the incumbent president Jacques Chirac and the right. Chirac had called for the introduction of "fonds de pension à la française." Under that slogan, right-wing politicians meant the introduction of individual retirement savings plans (*Le Monde* 2002c). To mount pressure, the MEDEF – i.e. employers' peak association where both the FFSA and the UIMM now agreed that retirement savings should be developed – released a poll which showed that approximately 70% of the population were in favour of such voluntary plans (*Le Monde* 2002b).

Following the election, the new government made it clear that a reform of all statutory pension schemes would soon be put in place. The reform was announced in January 2003 by a presidential speech in which Jacques Chirac emphasized that the bill would most of all aim at preserving the pay-as-you-go system (Conceição-Heldt 2006). The plan was officially presented by the Minister of Social Affairs François Fillon in May 2003 and discussed in Parliament from June. Throughout the debates, a number of unions – i.e. the formerly communist CGT, the social-democratic FO and civil servants'

union UNSA – staged demonstrations and organized strikes against the reform. On the contrary, the leadership of reformist unions – the social-democratic CFDT, the cadre’s CGC and the Christian-democratic CFTC – refused to take part in the protests, but some public-sector unions affiliated with those confederations joined the marches. The CFDT considered that the pension system had to be reformed in order to guarantee its future (*La Croix* 2002) and preferred to enter into a negotiation with the government (Conceição-Heldt 2006; see also Häusermann 2010: Chapter 6). The union managed to obtain some concessions and together with the CGC officially supported the government’s final reform plan which was passed by the Parliament in August 2003.

The Fillon reform included measures aiming at the development of funded pensions. As announced during the electoral campaign, the government put forward the creation of a voluntary “individual retirement savings plan” (PEIR – *Plan d’épargne individuelle pour la retraite*). But it also proposed to transform Fabius’s PPESV into a PPESVR, the “R” standing for “retraite”, that is retirement. Despite their earlier rhetoric, right-wing politicians did not use the term “pension funds” and preferred to talk of “retirement savings.” Fondact called for maintaining the distinction between “salary savings” and “retirement savings”, because they had different objectives and this could cause “confusion” among the social partners who had to negotiate their introduction within companies (*L’AGEFI Actifs* 2003).

Despite this change of name, the right-wing government did not question the role to be played by the PPESV in social dialogue and in corporate governance. However it reinforced its retirement aspects by blocking savings in the scheme until retirement instead of 10 years, and by introducing the possibility of getting benefits in the form of a life annuity. The government decided to maintain the special contribution of 8.2% on

employer matching contributions in the PPESVR, but only on contributions above 2,300 euros. The PPESVR was eventually called “collective retirement savings plan” (PERCO – *Plan d’épargne pour la retraite collectif*). The PEIR which was renamed “popular retirement savings plan” (PERP – *Plan d’épargne pour la retraite populaire*) could be paid out only as a lifetime annuity. Bankers and insurers had campaigned for their preferred type of pension pay-out, as they had done for almost two decades (*La Tribune* 2003). The financial industry also approached the government concerning the new tax regime for retirement savings. The AFG, the lobby of the French asset management industry, tried to design a powerful incentive for pension savings and drafted an amendment creating a tax credit or a state contribution of 150 euros per year. The association unsuccessfully tried to have it added in the National Assembly and in the Senate (*Les Echos* 2003). Instead of opting for a tax credit, the government decided to privilege tax deductions, the details of which were spelled out in the 2004 budget law.

Less noticeable in the reform package, but as significant as the introduction of the PERP and the PERCO, was the creation of a mandatory pension fund for civil servants. A key proponent of this idea was Claude Bébéar (Bébéar 2002: 68). The fund called ERAFP (*Etablissement de retraite additionnelle de la fonction publique*; see Dixon 2008) provides income maintenance for the variable part of civil servants’ pay. Half of the fund’s board members are appointed by unions, while the other half represent the state as an employer. In line with the policy adopted in *épargne salariale* and the FRR, the fund pursues a strategy of socially responsible investment.

## Concluding remarks

The story of pension privatization in France provides further empirical evidence for the hypothesis that the financial industry has played a crucial role in putting the development of funded pensions on European governments' agendas (cf. first step of my theoretical model). Through the networks created by the Geneva Association, life insurers were able to launch a debate about pension privatization already at the beginning of the 1980s. As suggested by the examples of the conservative Prime Minister Raymond Barre and of the socialist politician Dominique Strauss-Kahn, the industry had found trusted allies on both ends of the political spectrum. At the time, international organizations had not started promoting the multi-pillar doctrine and Socialists were not openly trying to attract a middle-class electorate. As the Socialists abolished the PER retirement savings plans in 1990 and the social partners were planning to expand existing occupational pay-as-you-go schemes, insurance companies waged a vigorous and constant campaign for pension privatization. By coining phrases such as "French-style pension funds", the head of the French Federation of Insurance Companies, Denis Kessler, made deliberate attempts to frame the debate in such a way that it would strengthen insurers' case. Other segments of the financial industry also lobbied for pension privatization. For example, the Paris stock exchange did so through the *Paris Europlace* lobby, which was created in 1992.

Why did financiers' campaigns fail for so long? As hypothesized by my political economy model of pension privatization, this had to do with employers' and workers' preferences towards funded pensions (cf. the model's second step) and with the way political parties reacted to pressures from employers' associations and trade unions

(third step of the model). From the end of the 1980s, private retirement savings came to be seen as a threat to pre-existing supplementary pension institutions not only by trade unions but also by France's largest industry-level employers' association, the UIMM. The specific institutional design of the ARRCO and the AGIRC – i.e. partly mandatory, partly voluntary pay-as-you-go occupational pensions managed by the social partners – resulted in serious financial imbalances that the social partners decided to solve by extending mandatory coverage of the schemes. These decisions were strongly criticized by insurers who openly challenged the financial sustainability of pay-as-you-go schemes in their advertising campaigns. Both organized labour and the UIMM therefore started lobbying against the introduction of private pension funds. The empirical evidence thus shows that institutional feedback play from pre-existing supplementary schemes plays an important role in shaping the preferences of workers and employers. However, once they introduced institutional changes that solved the financial problems faced by the pay-as-you-go occupational schemes, employers' associations – and later some trade unions – stopped seeing funded pensions as a threat. Both managers of large industrial companies and segments of the labour movement also had concerns about the welfare-finance nexus and sought to develop French-style pension funds that would help protect companies from hostile takeovers and would invest their assets in a socially responsible way.

Finally, the chapter has demonstrated that coalitional dynamics in France's multi-party system have differed significantly from those encountered in the British two-party system. In the United Kingdom, Conservatives had decided to ignore employers' opposition to personal pensions in the 1980s, while the Labour Party refused to introduce compulsory retirement savings without employers' consent and this despite

support of trade unions. By contrast, French right-wing parties accepted to pass legislation on pension funds only when they had unequivocal support from the business community. So long as the CNPF and the UIMM lobbied to block pension privatization, right-wing politicians refused to sponsor a bill that would allow the expansion of funded pensions. Even though some of their members openly supported pension privatization, left-wing parties were also very reluctant to introduce legislation on funded pensions so long as unions such as the CFDT or the CGT were hostile to them. Once reformist Socialists managed to convince organized labour that salary savings could be used create patient and socially responsible investors, the left-wing government had the assurance that trade unions would not campaign against its plans and therefore not turn public opinion against it. These examples confirm my model's expectation that in France's more segmented electoral markets, governing parties would formally sponsor a bill on pension privatization only if they had prior backing from the interest groups representing their target constituencies.

## **Chapter 5: Pension Privatization in Poland, or the Difficult Reconciliation of Neo-Liberalism and Neo-Mercantilism**

At the end of the 1990s, Poland became, together with Sweden and Hungary, one of the first European countries to introduce what many commentators have termed “paradigmatic pension reforms” (e.g. Holzmann *et al.* 2003). Instead of gradually “layering” new voluntary supplementary schemes onto the existing public pension system, such reforms have consisted in cutting pay-as-you-go pensions more radically and in partly replacing them with mandatory retirement savings plans. Initially pursued in Latin America (Mesa-Lago and Müller 2002; Madrid 2003; Weyland 2006; Brooks 2009), this strategy for institutional change became widespread in Central and Eastern Europe in the early 2000s (Müller 2003; Orenstein 2008; Armeanu 2010; Guardiancich 2012).

A distinctive feature of paradigmatic reforms is that they entrench a new conception of private retirement provision. Contrary to occupational schemes in whose governance employers or the social partners play a central role, mandatory personal pensions put more emphasis on individual choice and market mechanisms. In these new markets for supplementary pensions, it is up to the workers to select a pension manager from a pool of competing pension funds. Due to mandatory participation, paradigmatic reforms also lead to a more rapid expansion of funded pensions. Under communism, Poland’s pension system relied solely on the pay-as-you-go method of financing (Inglot 2008: 91-96), but, by 2009, i.e. ten years after the implementation of the reform, Polish pension funds accumulated assets reaching as much as 15.8% of the country’s gross domestic product (OECD 2011). For a decade, this new institutional framework

remained relatively stable. However, following the financial crisis, cash transfers to private pension funds were significantly reduced, while contributions to the pay-as-you-go system were raised. This marked a partial withdrawal from the increased involvement of the private sector in the Polish pension system.

What type of coalitional dynamics allowed radical pension privatization to go through in Poland? And what led to the subsequent cutback in mandatory pension funds? A dominant strand of the comparative politics literature has seen pension privatization in Central and Eastern Europe primarily as the result of an *ideational* campaign led by international financial institutions (IFIs). Orenstein (2008) has argued that the World Bank as well as “allied” organizations such as USAID or the OECD have been key in putting pension privatization on the political agenda in these countries and in reshaping domestic policy-makers’ preferences. According to Müller (1999), the main transmission belt of this “new pension orthodoxy” at the domestic level has been Ministries of Finance which are often staffed by free market economists. While the literature on pension reform in CEE countries has been less concerned about its *partisan* determinants, Armeanu (2010) has argued that radical restructuring of pensions has been championed both by liberal parties and by social democratic parties, whereas nationalist parties have been among its main opponents.

The central argument of this thesis is that the driving force of the expansion of private retirement savings in Europe is lobbying campaigns of the *financial industry*, and their varying influence, which depends on financiers’ capacity to build alliances with party politicians and with employers’ associations or trade unions. Poland provides a useful – if not a crucial – case to determine the scope of the hypotheses developed in chapter 1. As a former communist country, Poland underwent a double transformation

from, on the one hand, a centrally planned economy to capitalism and, on the other hand, from an authoritarian regime to liberal democracy. Given the destabilizing effects of these processes on social groups and an initially non-existent private financial industry, the role of economic – and particularly financial – lobbies could be expected to be much less influential or relevant in Poland than in affluent democracies such as the U.K. and France.

With its emphasis on the lobbying strategies of the financial industry, this chapter thus proposes a re-interpretation of the politics of paradigmatic pension reform in Poland. As will become clear, it does not refute the important role played by IFIs, but it adds a qualification to arguments that put them at the centre of Central and East European pension reforms. The chapter is structured into two parts. The first section analyses the debates about partial pension privatization that started at the beginning of the 1990s and led to the paradigmatic pension reform legislated in 1997-1998. It shows that, although the development of funded pensions was initially suggested by individual policy entrepreneurs, the financial industry was a key protagonist in putting the idea on the political agenda and increasing its momentum. Given that no private pension funds existed in Poland and that they could potentially serve as a skill retention tool and provide new sources of corporate finance, employers were also in favour of their creation. Yet, while financiers and the business community lobbied for *voluntary* occupational and personal pensions, a number of state actors, influenced by the World Bank's three-pillar model, suggested in the mid-1990s the more radical strategy of introducing *mandatory* pension funds. Because these two different visions were eventually reconciled and because partial pension privatization also attracted support

from segments of organized labour, the 1997-1998 reform was introduced in a climate of relative consensus.

The chapter's second section then traces the developments that occurred in the decade following the reform. It shows how, in addition to becoming an important actor in the regulation of the private pension sector and in Poland's system of corporate governance, a newly created pension fund lobby allied with employers' associations to press for a "completion" of the paradigmatic pension reform throughout the 2000s. As the diversion of contributions from the social security system towards private pension funds resulted in a growing public deficit, organized business repeatedly called for cuts in social expenditure. This campaign focused especially on the farmers' social insurance scheme, which had been left out of the paradigmatic reform in order to secure support from agrarian parties. The offensive of financiers and employers resulted in growing tensions with parties representing farmers' interests, which gradually became a force against the reformed pension system. In the aftermath of the 2008 financial crisis, social security deficits and the weaker investment performance of mandatory pension funds were thrust into the limelight and were used as an argument to scale back the privatization of the pension system.

## **5.1 Privatizing pensions to save them from "collapse" and to support nascent Polish capitalism**

Rather than being stirred by the financial industry or by IFIs, the political debate about partial pension privatization was initially encouraged by the first head of Poland's

Social Insurance Institution (*ZUS - Zakład Ubezpieczeń Społecznych*) to be appointed following the collapse of the communist regime and the rise of the Solidarity-led opposition to power. Ever since he took office in early 1990, Wojciech Topiński created a sense of crisis by alarming public opinion about the financial difficulties faced by the social security system. At the time, expenditure on old-age and disability pensions increased very rapidly because they were used to smooth out the surge in unemployment resulting from Poland's transformation into a market economy (see Golinowska and Żukowski 2002; Vanhuysse 2006). Topiński said that workers' contributions "were leaking where they should not" (*Gazeta Wyborcza* 1990) and repeatedly warned against the possibility that his institution might soon be unable to continue paying pensions.

Together with academic economist Marian Wiśniewski, Topiński went in December 1990 on a study trip to Chile, where they met state and corporate actors involved in the 1981 Chilean pension reform. Chile had fully replaced its state-run pay-as-you-go system with privately administered individual retirement accounts. According to its proponents, this new system had many advantages such as blocking pressures on politicians to increase benefits, dampening the negative effects of population ageing and accelerating economic growth (Weyland 2006). These arguments struck a chord with the two Polish policy entrepreneurs who also became convinced that private pension funds would serve as ideal institutional investors to buttress the privatization of the overwhelmingly state-owned Polish economy. On their return, Topiński and Wiśniewski drafted a reform blueprint they presented to the Social Policy Committee of the Parliament's Lower House in January 1991. In contrast to the Chilean model, they did not propose to substitute entirely pension funds for the pay-as-you-go system, but

suggested to base both old-age and disability pensions on two mandatory “pillars”: a first pillar working on a pay-as-you-go basis and a second one functioning on a funded basis. The transition towards the new system would be financed on the one hand by the proceeds of privatization, given the “historical opportunity” offered by economic transformation (Topiński and Wiśniewski 1991; quoted in Gesell et al. 1998: 13; Topiński and Wiśniewski 1993: 9). On the other hand, the newly created pension funds would buy bonds issued by the state in order to cover the pay-as-you-go system’s deficit.

The project, which was thus linked both to the welfare-labour and the welfare-finance nexus from the very start, was not favourably received within the Solidarity-led government. Politicians were reluctant to envisage reductions in state benefits at a time when their priority was to tackle huge rises in unemployment and pensioner poverty resulting from a lack of automatic price indexation of benefits (Inglot 1995; Müller 1999: 95-102). Topiński resigned in the summer of 1991, denouncing the government’s “myopia” and saying that “[Poland] cannot afford to increase benefits, [and that it] cannot even afford to maintain their level” (*Gazeta Wyborcza* 1991). Topiński’s plan was also considered radical because of immature domestic capital market institutions, an undeveloped insurance market and the government’s alternative blueprint for the privatization of state-owned companies.

First, Polish capital markets were not considered ready for a Chilean-style pension privatization. When it was created in April 1991, the Warsaw stock exchange had only five listed companies, whereas the Polish Securities and Exchange Commission (SEC) held its first meeting only in May 1991 (KPWiG 2001). Second, insurance companies which could be expected to be in charge of managing pension funds had no experience

in asset management. Under communism, insurance premiums were all deposited in the monopolistic National Bank of Poland. Although the Polish insurance market was penetrated by foreign insurers such as the French AGF, the American AIG and the UK's Commercial Union as early as 1991 and 1992, it was *de facto* controlled by a quasi-monopolistic company, the PZU. Last but not least, the idea of using the proceeds of the privatization of state-owned companies for setting up pension funds went against privatization plans simultaneously developed by Janusz Lewandowski, the liberal-democratic Minister of Property Transformation. Inspired by Thatcherite "popular capitalism", Lewandowski proposed to implement a "mass privatization programme" in which all citizens would receive vouchers they could exchange for shares in specially created asset managers called "national investment funds" (see Błaszczyk and Dąbrowski 1993; Lewandowski 1994; Stark and Bruszt 1998: 94-96). Topiński's project was thus condemned for excluding current pensioners and workers close to retirement from the benefits of privatization.

Despite being dismissed by the government, the development of retirement savings continued to attract interest from different circles in Poland. In the spring of 1992, Michał Boni, a liberal-democratic MP, assembled a team of experts which put forward a programme that closely resembled that of Topiński and Wiśniewski, with the difference that not only future but also current pensioners would get shares in privatized companies. Topiński and Wiśniewski themselves worked as experts for a senatorial group working on a draft proposal for a reform of social security. Topiński invited several times David Callund, a British pension fund consultant who had advised the Chilean government during the 1978-1980 pension reform (Callund 1999), and

encouraged him to give an interview to one of the main Polish dailies in order to generate momentum for pension privatization (*Gazeta Wyborcza* 1993a)<sup>1</sup>.

The *financial industry* also became an important protagonist in the debate around that period. The handful of foreign insurance companies that had entered the Polish market started selling more aggressively pension products to companies, arguing that they would help them retain staff. However, personal or group life insurance did not benefit from any form of deductions from income or payroll taxes. As a result, insurers called for social security reform and for the creation of tax incentives to encourage the development of group insurance plans (e.g. *East European Insurance Report* 1993; *Business Insurance* 1994), although it seems they did so through inside lobbying rather than on the public stage. The industry had created its own lobby, the Polish Insurance Association (PIU – *Polska Izba Ubezpieczeń*), as early as 1990.

Apart from insurers, stock market professionals also expressed their interest in the development of funded pensions. From spring 1992, Lesław Paga, president of the Polish SEC and one of the founders of the Warsaw stock exchange, called insistently for the development of institutional investors, particularly pension funds and mutual funds, arguing that their absence was a barrier for the expansion and the stability of the domestic capital market. Paga publicly called on the Ministry of Social Affairs to prepare a bill on the regulation of private pension funds, but the minister in charge, Jacek Kuroń, said an overall vision of the reform of social security was required beforehand.

Initially put forward by two policy entrepreneurs and later championed by the nascent domestic financial industry – as would be expected by the political economy

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<sup>1</sup> Interview, David Callund, Maidenhead, 25/01/2011

model of pension privatization presented in chapter 1, the development of private retirement savings was thus very well on the political agenda by 1992/1993, and this without the intellectual intervention of IFIs such as the World Bank. This was best illustrated by the suggestion of a white paper on social security reform of the Ministry of Social Affairs (MPiPS 1993) to develop voluntary personal pensions and occupational pension plans, through the creation of a social security contribution ceiling. The proposed measure could nonetheless not be implemented, because parties linked with the Solidarity movement were defeated in the parliamentary election of September 1993 won by the ex-communist Democratic Left Alliance (SLD – *Sojusz Lewicy Demokratycznej*). The next four subsections trace how in the following years financiers, employers, state actors and trade unions built momentum and a relative consensus around a paradigmatic pension reform, and how they tried to shape its specific provisions.

### *Building momentum*

When the SLD formed a coalition with the Polish Peasant Party (PSL – *Polskie Stronnictwo Ludowe*) in the autumn of 1993, questions were raised about the new government's dedication to the market economy and particularly about its attitude towards welfare state reform and the privatization of state-owned companies. However, the SLD, which had built its electoral strategy on cross-class appeals, sent signals that it would continue with market-oriented reform (Cook and Orenstein 1999; Grzymala-Busse 2002). The new government announced it would not slow down the “mass privatization programme” which had been adopted by the Parliament in May 1993. In

fact, it vowed to support the expansion of Polish capital markets and indicated that more companies needed to go public in order to allow pension funds and mutual funds to operate (*Gazeta Wyborcza* 1993b). In his inaugural speech, PM Waldemar Pawlak (PSL) declared that the government would present a programme of social security reform in June 1994. Nevertheless, by the spring, the government had not taken action on the issue.

A new stimulus came from a cabinet reshuffle in April 1994, as part of which economist Grzegorz Kołodko (SLD) was appointed Finance and Deputy Prime Minister. During the few weeks following his nomination, Kołodko decided to draft, with the help of trusted colleagues, a new programme of economic reform for the coalition government, which came to be known as the *Strategy for Poland* (Kołodko 1994). During the preparation of the document, Marek Mazur, a senior civil servant in the Ministry of Finance, suggested to put pension privatization on the agenda. But it is unclear what influenced him to do so. The authors of the *Strategy* wrote that the current state of social security could lead to a “state budget crash” and that the system was both “inefficient” and “unfair” from the point of view of citizens. They called for the replacement of the existing “redistributive (pay-as-you-go)” system with pensions based on “the insurance principle, with elements of redistribution”. A basic earnings-related pension would be supplemented by savings managed by private pension funds (Kołodko 1994: 55-57). In autumn 1994, Kołodko succeeded to have his strategy accepted as the official economic program of the government. The Minister of Labour and Social Affairs, Leszek Miller (SLD), was tasked with preparing a more concrete proposal for social security reform.

Kołodko's plan was welcomed by the financial industry, which in fact pressed more and more for the rapid introduction of a regulatory framework on pension funds. Leaders in the insurance industry (e.g. Commercial Union's head – Miziołek 1994) started to warn publicly about the dangers posed by demographic ageing for the pension system. In January 1995, the Parliament approved the introduction of deductions from corporate income tax for firms' contributions to group insurance products. However, both individual and group life insurance premiums were still subject to personal income tax, a situation criticized by insurers. Newly created mutual funds such as *Pioneer* also advertised their products as vehicles for personal and occupational pension savings plans (e.g. *Reuters* 1994b). Stock exchange professionals continued to call for the creation of domestic institutional investors to encourage the development of the Polish capital market (*Reuters* 1994a). In March 1995, during a visit of freshly appointed Prime Minister Józef Oleksy (SLD) to the Warsaw stock exchange, its head, Wiesław Rozłucki, reminded him that there was still no legislation on the functioning of pension funds and closed investment funds (*Gazeta Wyborcza* 1995a).

Another source of support for Kołodko's plan came from employers' associations. During the 1993 electoral campaign, nascent employers' associations such as the *Business Centre Club* (BCC)<sup>2</sup> called for social security reform and for the creation of pension funds (BCC 2005: 20-21). Employers increasingly complained about the level of social security contributions, which, set at 45%, was seen as posing a threat to the competitiveness of Polish companies. For BCC (2005: 37), "the anachronism of the existing system [was] obvious." "The scope of the state's social obligations should be adapted to the level of Polish economic development. We consider systems of

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<sup>2</sup> For a presentation of the main Polish business associations, see McMenamin 2002.

individual insurance fairer and more cost-effective than social insurance schemes financed by the state budget” (BCC 2005: 42). However, like the financial industry, the employers’ organization favoured the development of voluntary occupational pensions which would help companies stabilize their workforce and adapt contribution rates to their own financial situation (BCC 2005: 55). Since there were no pre-existing supplementary pension schemes in Poland, employers had no vested interest in preserving existing institutions. Polish employers’ support for pension privatization was thus driven by their interests within the welfare-labour nexus – i.e. mainly containing non-wage labour costs within the public system and creating occupational schemes that would serve as a skill retention tool.

The Minister of Social Affairs presented a blueprint for pension reform in April 1995 (MPiPS 1995). Yet his approach proved to be at odds with that championed by Kołodko. Instead of reinforcing the insurance principle, Leszek Miller proposed to strengthen redistribution by basing the pay-as-you-go system on two tiers: a tax-financed flat-rate civic pension of 30% of the average wage and a contribution-financed earnings-related pension. Seeing the plan as a contribution to the presidential campaign of SLD candidate Aleksander Kwaśniewski, Miller argued that it had the advantage of leaving both budget expenditure and payroll taxes untouched and of not leading to cuts in benefits (*Gazeta Wyborcza* 1995b; 1995c). Overall, his proposals could appeal both to low-income earners and the middle class. Supplementary pensions would be developed on a voluntary basis, either through individual savings or through firm- and industry-level occupational plans. In order to encourage the development of pension funds, Miller recommended, firstly, introducing a contribution ceiling of 250% of average earnings, whereas social contributions were levied so far on the whole wage.

Secondly, he suggested that contributions should be exempt from payroll taxes and from personal income tax, thus meeting the demands of the financial industry. The Ministry of Social Affairs urged for the preparation of regulations to ensure the safety of pension savings and suggested that these could be managed by a variety of institutions, such as insurance companies, banks, but also by not-for-profit mutual-aid societies or possibly by large firms through German-style book reserve schemes.

Miller's plan met with strong opposition from the Ministry of Finance which argued that it would in fact increase social expenditure. Politicians from the agrarian PSL also expressed strong reservations because of a suggested hike in the social contribution rates paid by farmers who were covered by a separate social security scheme. Despite a resignation threat from Grzegorz Kołodko, the blueprint was initially approved by the government. But it attracted more criticism during consultations with the social partners. The two largest employers' organizations, the BCC and the Confederation of Polish Employers (KPP – *Konfederacja Pracodawców Polskich*), denounced it for being far too redistributive and, even though they approved of the creation of voluntary pension funds, they said that without a decrease in contribution rates the “state's monopoly in old-age insurance” could not be broken. A similar rhetoric concerning the state's role in pension provision was used by the *Solidarność* union which was increasingly sympathetic to the development of pension funds (see next subsection). In the autumn of 1995, the BCC and the KPP as well as the Polish Business Roundtable (*Polska Rada Biznesu*), a network of prominent businesspeople, called on presidential election candidates to promise a more comprehensive reform of social security (see BCC 2005: 72-74).

However, the largest opposition to the programme continued to come from within the government. Holding the electoral concerns of Miller's reform plan in contempt (Kołodko 1995: 11), Grzegorz Kołodko charged his advisor, Marek Mazur, with drafting the Ministry of Finance's own reform blueprint. Ever since the preparation of the *Strategy for Poland*, Kołodko and his team had got in touch with Michał Rutkowski, a young Polish economist employed by the World Bank. The international financial organization was at the time finalizing the publication of *Averting the Old Age Crisis*, an influential report that set out its official approach to pension reform<sup>3</sup> (World Bank 1994; see also Orenstein 2008: 76-80). Rutkowski travelled to Poland regularly and promoted the introduction of *mandatory* individual retirement accounts in private discussions with the President, PM Pawlak and key ministers<sup>4</sup>. Marek Mazur was closely involved in these discussions and made a study trip to Latin American countries that had or were about to introduce mandatory personal pensions. He was directly in contact with people involved in these reforms such as pension consultant David Callund.

In the spring of 1995, Mazur quickly drafted a proposal which closely resembled that of the World Bank. Thus, while financiers and employers' organizations were pushing for the development of *voluntary* occupational pension plans, the Ministry of Finance had become the proponent of an alternative model of pension privatization. Mazur's project, but also the organization of conferences about the Latin American

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<sup>3</sup> Critical of existing state-run pay-as-you-go schemes and of employer-provided defined-benefit plans, the report exhorted policy-makers to rebuild pension systems on two mandatory pillars: a flat-rate pay-as-you-go pension and a mandatory funded pillar, preferably based on individual savings accounts. The World Bank argued that personal pensions would be the most effective and the fairest means to privatize the system, because they could ensure a larger coverage and bigger economies of scale than patchy occupational plans.

<sup>4</sup> Interview, Kraków, 25/02/2010.

reforms<sup>5</sup>, generated momentum for a more radical reform of the pension system. Using his influence as deputy prime minister, Kołodko succeeded in obtaining a revision of Miller's proposals. After the November 1995 presidential election was won by the SLD candidate, the Ministry of Labour accepted to abandon its idea of introducing a civic pension and to further tighten the link between contributions and benefits in the state pension. However, the Finance Ministry remained unsatisfied, because it did not make sufficient room for pension funds. In late 1995, the pension debate reached an impasse.

#### *Towards a cross-class agreement*

A government reshuffle which took place in January 1996 broke the deadlock. After President Kwaśniewski took office, Leszek Miller was promoted Minister of the Interior. His deputy, Andrzej Bączkowski, replaced him as Minister of Labour and Social Affairs. A supporter of pension privatization, Bączkowski had also been an activist in the Solidarity union. This link with Solidarity was important for two reasons. First, beginning in 1996, the union appeared as a possible source of support for a more radical reform of the pension system. Solidarity increasingly perceived the existing system both as unable to provide socially adequate pensions and as financially unsustainable in the long term. At the beginning of the nineties, the union had organized a series of seminars on the functioning of foreign pension systems, with the help of Dutch pension experts. The Dutch system of occupational pension funds with quasi-universal coverage had caught unionists' attention<sup>6</sup>. With its governance based on not-

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<sup>5</sup> E.g. José Piñera, the former Chilean minister of social affairs and now staunch proponent of Chilean-style pension privatization, gave a talk at the Adam Smith Centre, a Warsaw-based think tank in June 1995.

<sup>6</sup> Interview former employee of Solidarity, 16/02/2010.

for-profit industry-level pension funds managed by the social partners, this system could provide an alternative model of pension privatization to that advocated by the World Bank. In reaction to Kołodko's reform guidelines formulated in the *Strategy for Poland*, Solidarity created an internal working group on the reform of the social security system. By the end of 1995, it became clear that this group favoured a tighter link between contributions and benefits in the pay-as-you-go system and was interested in the idea of introducing mandatory pension funds (Müller 1999: 106).

Second, Solidarity was also an important negotiation partner regarding the privatization of state-owned companies (Orenstein 2001: 111-124), which would be a crucial supply of financial assets for pension funds and which could help the state to finance the loss of revenue generated by the transfer of social security contributions towards private pension funds. Despite its initial announcement that it would proceed with the "mass privatization programme" devised by its predecessors, the SLD-PSL coalition government greatly limited its extent and privatized firms on an *ad hoc* basis, including by selling them to foreign investors. Solidarity denounced that situation. The union was a staunch supporter of mass privatization, because it considered that state-owned companies were the "result of the work and ideas of all generations of Polish citizens, who, therefore, [were] the legitimate heirs of these assets and should receive 'enfranchisement vouchers'" (Gesell *et al.* 1998: 14). In the summer of 1995, the leader of the union, Marian Krzaklewski, announced he would stage a campaign against the government's conception on privatization, saying that "Poland was entering a battle for ownership" (*Gazeta Wyborcza* 1995d). Together with right-wing politicians and with support from former President Lech Wałęsa, Solidarity pushed through the organization

of a referendum on privatization in February 1996. Partisans of mass privatization secured a majority, but the referendum was declared invalid due to low turnout.

This defeat meant that those actors who wanted to link the privatization of state-owned firms with that of pensions gained the upper hand. During the celebrations of the fifth anniversary of the Warsaw Stock Exchange, the Polish SEC's president Lesław Paga declared that "the setback faced by the mass privatization programme [was] a blessing in disguise for the stock exchange" because it was technically too complex. Financiers suggested that, if pension funds could be attracted to Poland, Warsaw could become the leading financial centre in Central and Eastern Europe (*Gazeta Wyborcza* 1996a). The Business Centre Club had criticized the referendum for its "poorly phrased questions" and argued that the best way to use state property would be "to strengthen pension funds" (BCC 2005: 85). Meanwhile, within the government, the Ministries of Finance and the Ministry of Property Transformation had started to devise plans on how the assets of privatized companies could be used to facilitate the creation of pension funds (Orenstein 2001: 123; Epstein 2008: 93-96).

Some actors within the government were still hostile to the development of pension funds. The Democratic Left Alliance (SLD) strongly relied on activists and parliamentarians linked to the former communist trade union OPZZ (*Ogólnopolskie Porozumienie Związków Zawodowych* – All-Poland Alliance of Trade Unions). The union was a leading opponent of pension privatization and one of its heads, Maciej Manicki, was deputy minister of Labour. This resulted in serious tensions between Manicki and his superior Bączkowski. In order to have more leeway to act, Bączkowski arranged to be appointed as "Government Plenipotentiary for the Reform of the social

security system” in August 1996. By the autumn of 1996, he assembled a task force whose purpose was to prepare a draft proposal on the reform of the pension system.

Headed by World Bank economist Michał Rutkowski, the *Office of the Plenipotentiary* comprised Polish academic economists as well as a civil servant seconded from the Ministry of Property Transformation. The team was given considerable autonomy in its work<sup>7</sup>. With financial support from organizations such as the World Bank, the U.S. Agency for International Development (USAID) and the Swedish International Development Cooperation Agency, the task force drew on the expertise of people involved in pension reforms in Latin America and Sweden. The Office of the Plenipotentiary also organized study trips to the United States and to Latin America. Participants included government officials, unionists and journalists. Representatives of the financial industry were also invited, but had to cover their travel expenses<sup>8</sup>. The study trips helped forge a consensus on pension privatization and enabled the task force to collect feedback on different institutional arrangements.

An initiative launched by some of the business community and of the trade union movement helped achieve an even broader agreement on pension reform. In the autumn of 1996, the founder and president of the Business Centre Club, Marek Goliszewski, and the leader of Solidarity’s Warsaw federation, Maciej Jankowski, created a “Forum for Dialogue” (*Forum Dialogu*) aimed at building cross-class and cross-party agreements on major economic and social issues. Although members joined the Forum as individuals, the group comprised businessmen and activists from the Solidarity union as well as journalists and intellectuals. The president of the Polish Business Roundtable and that of the Confederation of Polish Employers (KPP) both expressed their interest in

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<sup>7</sup> Interview, deputy head and later head of the Office of the Plenipotentiary, 15/05/2006.

<sup>8</sup> Interview, former Minister of Social Affairs, 19/02/2010.

participating in the group's meetings (*Gazeta Wyborcza* 1996b). In its declaration of intention, the Forum called for the establishment of a form of "universal capitalism" (*kapitalizm powszechny*) in which private ownership would benefit not only the elites but would spread to all social groups (BCC 2005: 106). Pension privatization was one of the most important matters taken up by the group. The proposals on pension reform drafted by Solidarity, which by 1996 explicitly endorsed the introduction of mandatory pension funds (NSZZ Solidarność 1996), served as a basis for discussion. When Andrzej Bączkowski died unexpectedly in November 1996 at the age of 41, the Forum insisted on the need to appoint a new plenipotentiary (*Gazeta Wyborcza* 1997a). At that point in time, the socialist-agrarian government knew that, if it was to sponsor a bill on pension privatization, it could count on the backing of a large part of the business community and of a major trade union. Jerzy Hausner, a former advisor of Grzegorz Kołodko, was succeeded by Bączkowski in February 1997 (Hausner 2001: 219).

### *"Security through Diversity"*

The Office of the Plenipotentiary unveiled its own pension reform proposals in February 1997, in an official report, entitled *Security through Diversity*. The task force criticized the existing system for being "costly, opaque and unfair" and on the brink of "collapse" (Biuro Pełnomocnika 1997: 1) and proposed a double shift from a purely pay-as-you-go system to a "multi-pillar" one and from the defined-benefit principle to defined contributions (see also Chłoń *et al.* 1999). The team suggested significantly limiting the role played by the statutory pay-as-you-go scheme and complementing it with a mandatory second "pillar", managed by commercial "open pension funds"

(*otwarte fundusze emerytalne*). Moreover, the reform would allow employers to create firm-level or multi-company “employee pension programmes” (*pracownicze programy emerytalne*), thereby forming a third pillar.

In all three pillars, benefits would be calculated according to the defined-contribution principle. This means that only the level of contributions is set in advance, while the level of the pension is a function of three variables: the total amount of contributions paid by a worker during their career, the rate-of-return on these contributions and the worker’s life expectancy at retirement. In the “notional defined-contribution” pay-as-you-go scheme, the “rate-of-return” on contributions would be determined by the state, according to the evolution of the average wage in the economy. In the funded pillars, the rate-of-return would depend on the investment performance achieved by the private pension managers. In order to create an incentive for the creation of occupational pension plans, contributions to the first and the second pillar would be capped at 250% of the average wage.

The reform package outlined by the Office affected only the general statutory pension scheme (ZUS), which covers the vast majority of private-sector and public-sector employees. Workers up to 30 years old at the time of the reform would automatically participate in the new multi-pillar system whereas those aged 50 or more would remain in the existing pay-as-you-go system. Those aged between 30 and 50 would have their statutory benefits transformed into notional defined-contribution pensions, but would be given the right to choose whether or not to join the second pillar.

However, crucial from a political point of view was the fact that the pension scheme of farmers (KRUS – *Kasa Rolniczego Ubezpieczenia Społecznego* – Agricultural Social Insurance Institution) would be left untouched. Farmers were the core electoral

constituency of the SLD party's coalition partner, the agrarian PSL. The KRUS was overwhelmingly financed by the state budget. Due to the difficulty of assessing their income, farmers were also largely exempt from paying personal income tax and their social security contributions were flat-rate. This social group was large, since around 19% of the active population was still employed in the agricultural sector<sup>9</sup>. And it was well organized, because, unlike in other communist countries, Polish peasants managed to resist sweeping collectivization and to preserve many of their local institutions. Although many PSL politicians officially expressed support for changes in the farmers' scheme (*Gazeta Wyborcza* 1997c), its exclusion from the reform proposal ensured that the agrarian party would not act as a veto player.

*Security through Diversity* was soon adopted as the government's official plan for pension reform. The objective was to have it implemented from January 1999. Because parliamentary elections were scheduled for the autumn of 1997, the government decided to prioritize the passing of three bills related to the regulation of the fully-funded second and third pillars, and to the use of privatization proceeds to cover the loss of revenue for the pay-as-you-go system. The Parliament voted the bills almost unanimously during the summer. The only opponents to the reform were a group of Christian national MPs with links to the Solidarity movement. The "outsourcing" of the preparation of the reform to the Office of the Plenipotentiary as well as the efforts of the Forum for Dialogue to build a consensus over the reform had helped the government to gain backing from opposition parties such as the liberal-democratic UW (*Unia Wolności* – Freedom Union). It also helped the SLD to stifle opposition to pension privatization coming from its workerist wing and from the OPZZ union. Polls commissioned by the

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<sup>9</sup> Own calculation based on Eurostat data (cf. Agricultural Labour Input Statistics and Active Population - age 15-64 – Labour Force Survey 1997).

Office of the Plenipotentiary had shown that a majority of individuals distrusted the existing pension system and supported the development of private retirement savings (Biuro Pełnomocnika 1997: 203-205; Hausner 1998: 46-47).

Following the SLD's defeat at the 1997 elections, the laws overhauling the pay-as-you-go system were to be enacted by a coalition formed by the right-wing Solidarity-supported AWS (*Akcja Wyborcza Solidarność* – Solidarity Electoral Action) and by the liberal-democratic UW. This part of the reform proved more controversial for two reasons. First, politicians from the AWS challenged the way in which the assets of privatized companies would be used as part of the reform and pressured the government to bring it in line with Solidarity's original plans on mass privatization. Second, unions representing industries that had special pension rights mobilized against their abolition. A compromise with the government was found on the eve of the implementation of the reform. The following sub-section analyses the role of financial lobbies, business associations and trade unions during the legislative process.

### *Negotiating the details*

Overall, the reform package was very well received by financial firms, which quickly began gearing up to join the business (*Wall Street Journal Europe* 1997). The introduction of mandatory pension funds was undoubtedly a huge boon to the industry (Grabczan 1998; Hadyniak and Monkiewicz 1999: 149-161). Major disagreements over who would manage the open pension funds (OPFs) were avoided due to the “level-playing-field” approach taken by the government. As a matter of fact, state licenses to manage an OPF could be applied for by any type of organization, be it financial

companies, non-financial firms or even non-profit associations. Each OPF would be an independent legal entity set up and managed by a joint-stock company, whose owners would have to fulfil a number of capital and corporate governance requirements. Regarding the more precise regulations on the structure of the funds, the Office of the Plenipotentiary was given advice by pension consultants such as David Callund or the Chilean firm *PrimAmérica*. A second factor which prevented major disagreements within the financial industry such as those encountered in France was the government's decision to postpone the introduction of legislation on how second pillar pensions would be paid out.

Nevertheless, as has been hypothesized by the political economy model of pension privatization, various segments of the financial industry pressed for more favourable institutional arrangements. The mutual fund industry, which now numbered six firms, heavily lobbied MPs to get the right to run open pension funds without having to apply for a special state license (Hausner 1998: 42). Its representatives argued that the existing funds had already demonstrated their professional skills and were safe enough to run pension funds. They suggested that the capital requirements imposed on the pension management companies would lead the OPFs to charge exorbitant administrative fees. The deputy CEO of *Pioneer* contended that “no highly developed country” had introduced this type of system and warned against a “latinization of the economy”. He urged policy-makers to rely on the experience of more “normal” countries like the United States, where mutual funds are in charge of running retirement savings accounts (Żytniewski 1997; see also *Parkiet* 1998).

Mutual funds also allied with the insurance industry to ask for different tax incentives in the third pillar. According to the government's plan, contributions to the

employee pension programmes would be exempt from social security contributions and from corporate tax, but would be subject to personal income tax. The savings would then be exempt from income tax, at retirement. Financiers wanted the contributions to be exempt and the savings to be taxed, because this would create a stronger incentive for workers to save. Finally, PIU, the Polish Insurance Association, lobbied to have the third pillar extended to all types of group insurance products (Sejm 1997). However, all of these demands were resisted by the government, on the grounds that they would compromise the safety of the new system or that they would cause too high a loss of revenue for the state budget.

Employers' associations and trade unions gave their nod to the general reform plan in April 1997 at a meeting of the Tripartite Commission for Social and Economic Affairs, which gathers the social partners and the state. Apart from the introduction of pension funds, the move to the defined-contribution principle was a decisive factor in persuading employers to support the reform. This meant that the state committed itself to maintain pension contribution rates at a stable rate in the future<sup>10</sup>. The mounting deficits in the pay-as-you-go system, due in no small part to its partial privatization, would have to be covered by the proceeds from enterprise privatization or by other means. Had the reform led to an increase in payroll taxes and threatened their interests in the "welfare-labour nexus", employers would have publicly opposed the reform, and politicians would have had a harder time defending it. An approval from organized business was thus of paramount importance, particularly for the liberal-democratic UW party, which presented itself as pro-business. In addition, employers had thus far not created their own occupational pension schemes and therefore had no entrenched

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<sup>10</sup> Contribution rates were eventually fixed at 12.22% for the first pillar and 7.3% for the second pillar.

interests in existing private pension institutions, which could potentially bring them into conflict with financial companies. As a result, the BCC and the KPP did not actively participate in discussions about the technical design of the funds.

However, some large state-owned firms, which had been selected for privatization, approached the government about the third pillar “employee pension programmes” (Golinowska 1999: 187). These included KGHM, one of the world’s largest copper producers (*Gazeta Wyborcza* 1997b). As part of the privatization agreement, employees would receive 15% of their firms’ shares. The firms successfully lobbied to have the possibility of requiring their employees to freeze part of their shares in the employee pension programmes to be eligible for them. The companies’ managers and trade unions feared that employees would sell their shares next to nothing on the stock exchange and make their firms vulnerable to hostile takeovers by foreign investors. Some Polish companies were thus influenced by their specific interests in the “welfare-finance nexus” and had plans to create a form of “patient capital” which bore a strong resemblance to the French “employee savings plans”.

Solidarity’s support for the paradigmatic reform had to a certain extent weakened the SLD’s natural ally in the trade union movement, the OPZZ. Initially opposed to pension privatization, the post-communist union faced the prospect of being sidelined in the debates due to Solidarity’s involvement and to party discipline within the SLD. The possibility for unions to set up their own OPFs contributed to convince it to back the reform. During the legislative process, union leaders demanded additional rights for their organizations. They obtained the creation of an advisory committee with union representation in the Pension Fund Supervisory Authority (UNFE). The government also granted privileges on voting rights and dividends to trade unions or business

associations holding shares in an OPF. In order to protect the Polish financial industry from “the expansion of financially strong Western companies”, the OPZZ asked to limit foreign investors’ stakes in an OPF to 49%. The idea was rejected by the government’s plenipotentiary, Jerzy Hausner, who argued that Poland had to comply with its “international obligations” (Sejm 1997a). Poland had indeed opened its banking and insurance markets to foreign firms since the very beginning of the 1990s. However, the reform introduced significant limits on OPFs’ foreign investments, which guaranteed that the savings would be overwhelmingly invested in Polish assets.

As one of the main advocates of pension privatization, Solidarity played an active role in negotiations over the details of the reform. The union abandoned its original plan to set up the mandatory funds at the industry or the firm level (NSZZ Solidarność 1996: 15), an idea that would have made the second pillar more akin to the Dutch pension funds, which are controlled by the social partners. It was more resolute in defending its ideas about mass privatization. Instead of using the proceeds of privatization to finance the deficits in the pay-as-you-go system, Solidarity preferred to distribute companies’ assets through “enfranchisement vouchers” which would serve as an initial capital for workers covered by the new pension funds. In the autumn of 1997, the union’s leader Marian Krzaklewski and allied AWS politicians, particularly those from its Christian National wing, called on the AWS-UW coalition to revise the bills passed by the SLD-PSL government. The existing legislation was nevertheless upheld by UW politicians, including Finance Minister Leszek Balcerowicz, as well as by Ewa Lewicka, the government’s new plenipotentiary who had coordinated Solidarity’s working group on pensions and was a member of the Forum for Dialogue.

Henceforth, the union's efforts focused on the reform of the pay-as-you-go system. One of Solidarity's priorities was to transform the social insurance institution (ZUS) into a non-state body supervised by the social partners. The union also obtained that the retirement age for women would remain stable at 60 years, instead of the 65 proposed in *Security through Diversity*. Solidarity's and the OPZZ's unions also mobilized against the loss of early retirement privileges for workers employed in "special conditions", such as miners, rail workers, steelworkers or artists. In concession, the AWS-UW government pledged to introduce "bridging pensions", but based on new criteria to be defined in the future by experts in occupational medicine. Sceptical about the promise, miners staged dramatic protests in December 1998 to ensure that their own occupational rights be preserved by statute. Due to this protracted conflict with organized labour, President Aleksander Kwaśniewski signed the laws reforming the pay-as-you-go system on December 29<sup>th</sup> 1998. Notional defined-contribution pensions were implemented from January 1<sup>st</sup> 1999 while the new private pension fund management companies started receiving their first contributions in April 1999.

## **5.2 How the Solution Became the Problem: From the Pensions Crisis to the Global Financial Crisis**

Despite the active lobbying that accompanied its enactment, the paradigmatic pension reform had thus benefited from a broad agreement between major political parties and the social partners. To promote the new pension system and facilitate its implementation, the government launched a massive public relations campaign financed with the help of USAID (Orenstein 2008: 127). This was complemented by advertising

from aspiring pension fund management companies. Whereas policy-makers expected around 6 or 7 million people to join the second pillar (Hausner 2002: 355), the number actually reached about 10 million (i.e. approximately 58% of the active population<sup>11</sup>) by early 2000 and 14 million participants by 2009 (81% of the active population) following the gradual entry of new participants in the labour market. Similarly to the United Kingdom, sales agents' high-pressure marketing tactics initially persuaded many individuals to join the second pillar, even though it was not in their material interest. But these numerous instances of "mis-selling"<sup>12</sup> did not create a major political scandal. Much more attention was devoted to the repeated failures of the social insurance institution to transfer all employee contributions into the newly created private retirement accounts because of glitches in its computer system (Chłoń-Domińczak 2002: 140-151; Guardiancich 2012).

By September 1999, 21 pension fund management companies had received a license to operate a second pillar open pension fund (OPF). Although non-financial entities such as the Polish Episcopate, the Solidarity union or copper maker KGHM initially participated in the creation of OPFs, the market was rapidly dominated by the financial services industry and particularly by the so-called "Big Four" comprised of multinationals Commercial Union (later rebranded as Aviva), ING, AIG and Polish insurer PZU. The Solidarity union sold its 1.1% stake in the Zurich Solidarni Pension Fund at the end of 2000, while a pension fund management company in which the OPZZ held a 5% stake was denied a license by the pension fund supervisory authority in 1999, leading the trade union to become more openly hostile to the paradigmatic reform. By 2008, only one non-financial company, the Polish media conglomerate

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<sup>11</sup> Own calculation based on KNF (Polish Financial Supervisory Authority) and on Eurostat data.

<sup>12</sup> Interview, CEO of an open pension fund, Warsaw, 23/06/2006.

Polsat, continued operating one of the 14 remaining OPFs. With their assets growing to 4.2% of GDP in 2001 (Stańko 2003), 12.2% in 2007 (OECD 2009b: 257) and 15.8% in 2009 (OECD 2011), the open pension funds became the largest pool of assets under management in Central and Eastern Europe (*IPE* 2010). Collectively, OPFs owned considerable minority stakes (often ranging between 10% and 20%) in many of the largest firms listed on the Warsaw stock exchange (Kerner and Reinhardt 2010).

This section focuses on the politics of pension privatization that followed the paradigmatic reform and explains why on-going policy debates culminated in a substantial cut in the contributions paid into the mandatory second pillar as of May 2011. The first subsection depicts how, soon after the 1997-1998 reform was enacted, OPFs created an interest group which became a central actor in the new – and relatively subterranean – regulatory politics of the second pillar. The second subsection shows that, in order to plug a hole in public finances largely resulting from the diversion of social contributions towards the OPFs, business groups campaigned for almost a decade to cut other social expenditure and incorporate into the new pension system occupations that were covered by separate public schemes. As it targeted particularly the state-subsidized farmers' scheme (KRUS), the campaign led to mounting tensions between parties representing rural constituencies and those representing the urban middle class. The final subsection shows how in the wake of the global financial crisis OPFs came under growing criticism for their weak investment performance and for contributing to increase state deficits and public debt. Despite their continued support for the mandatory second pillar, financiers, employers' associations and the Solidarity union proved unable to stop a plan by a liberal-agrarian government coalition to reduce the role played by the mandatory pension funds.

### *The new regulatory politics of the mandatory second pillar*

While the law introducing the OPFs was enacted in 1997, the official licensing process started in August 1998. A number of prospective pension fund managers decided at the time to get together in order to analyse market regulations and the questionnaires prepared by the pension fund supervisory authority (UNFE – *Urząd Nadzoru nad Funduszami Emerytalnymi*)<sup>13</sup>. Because of the small size of the local capital market, Polish asset managers knew each other quite well and found it easy to cooperate. The informal group signed a “declaration of fair competition”<sup>14</sup> and established an official body in spring 1999.

Relations between the state and the Polish Chamber of Pension Funds (IGTE – *Izba Gospodarcza Towarzystw Emerytalnych*) were initially strained. One bone of contention was the compensations sought by the pension fund industry for the uneven inflow of contributions from the ZUS. A second source of tension was the reluctance of the UNFE to allow mergers between OPFs because about 70% of pension fund assets were managed by the “Big Four”, (UNFE 2000; *Polish News Bulletin* 2000). From 2000, the IGTE started lobbying public authorities to relax restrictions on foreign investment, which were set at a maximum of 5% of assets. According to fund managers, the securities market was too shallow and did not allow them to keep their investment portfolios sufficiently diversified (*Parkiet* 2000). Some started warning that the imbalance between supply and demand could fuel a “speculative bubble” (e.g. *Parkiet* 2002). Nevertheless, state actors were reluctant to ease foreign investment limits as they

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<sup>13</sup> Interview, CEO of an open pension fund, 2006/06/23.

<sup>14</sup> Retrieved from <http://www.igte.com.pl/standardy/standardy01.htm#bm> on July 30<sup>th</sup> 2012.

shared the neo-mercantilist belief that the assets of the OPFs should be invested on the Polish capital market and stimulate the development of domestic industry (*The Economist* 2001). During accession negotiations with the European Union, Poland tried to obtain that contributions towards OPFs be recognized as “public funds”, a definition that would allow the country to circumvent EU directives on the free movement of capital.

Given their growing presence in the equity capital of domestic companies and their limited exit options, OPFs became key players in Polish corporate governance and the welfare-finance nexus. The funds headed campaigns to strengthen minority shareholder rights in listed firms, including in formerly state-owned companies that had become subsidiaries of western multinationals (e.g. Michelin’s Stomil Olsztyn and ING’s Bank Śląski – see *Financial Times* 2001; 2002a). Together with representatives of the stock exchange, employers’ associations and various organizations representing the Polish financial industry, OPF managers took part in the drafting of a non-binding set of corporate governance principles (*Parkiet* 2001; Forum Corporate Governance 2002; Dzierżanowski and Tamowicz 2003; Rozłucki 2003). The Warsaw stock exchange constantly tried to develop new financial instruments to help absorb the funds’ growing assets and, together with the IGTE, worked on the State Treasury (the former Ministry of Property Transformation) to step up the privatization of state-owned companies. The close ties existing between the stock exchange, the OPFs and the state were best symbolized by the adoption in 2004 of a strategy called “Agenda Warsaw City 2010” whose aim was to transform Warsaw into Central and Eastern Europe’s pre-eminent financial centre (MF 2004; *Rzeczpospolita* 2004a; *Parkiet* 2004).

The first major legislative change in the second pillar was introduced in the summer of 2003. In spring 2002, an SLD-PSL coalition government had launched a review of existing regulations on OPFs. While the IGTE had outlined its own reform proposals during the 2001 legislative campaign and focused on reducing administrative burdens on the OPFs (*Reuters* 2001; *Parkiet* 2001), a social-democratic deputy minister of Labour, who had been a member of the Office of the Plenipotentiary during the preparation of the paradigmatic reform, prioritized a reduction in the fees collected by the funds. Pension fund management companies earned profits by charging two main types of fees. First, they charged distribution fees, i.e. a fixed charge imposed directly on contributions each time they were paid into individual retirement accounts. The 1997-1998 reform had given fund managers full discretion over their level and by early 2002 they charged on average 8.5%<sup>15</sup>. Second, OPFs imposed management fees, i.e. a monthly levy of 0.05% on the total assets of the fund. Although seemingly insignificant, both types of fees could substantially reduce the level of future benefits (Fultz 2012).

The Ministry of Labour and Social Affairs proposed to introduce a percentage cap on the distribution fee and a flat-rate cap on the management fee. It also suggested splitting the management fee into a fixed part and a variable component whose level would depend on the funds' relative investment performance (so-called "success fee")<sup>16</sup>. However, OPFs mobilized against the project and were able to obtain significant concessions from the government. While the draft bill initially restricted the distribution fee to a maximum of 2.5%, the government gradually backtracked and eventually set it

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<sup>15</sup> Unweighted average – own calculation based data collected by IGTE (data for March 2002) and retrieved from <http://www.igte.com.pl/notowania/OFE%20opl%20dyst%20rynek.xls> on August 8<sup>th</sup> 2012.

<sup>16</sup> The pension management company that would achieve the best rate-of-return during a certain period of time would have the full percentage of the variable component, while the worst-performing pension funds would be left with nothing.

at a maximum of 7% as of 2004 with the provision that it would be gradually decreased from 2011 to reach 3.5% by 2014. Similarly, the government had proposed to split the management fee evenly (i.e. 0.025% per month for both the fixed and the variable component), but it was led to reduce the success fee to a monthly rate of 0.005% and to keep the fixed component at 0.045% per month.

In the relatively more technical and less salient area of pension fund regulation where political parties, employers' associations and trade unions were less involved, the pensions industry wielded significant influence. "Pension funds were very well organized. They lobbied hard. They always tried to reach different levels of power ... I have been told that they hired a PR firm whose mission was do its utmost to stop the project"<sup>17</sup>. The OPFs' bargaining power was enhanced by the fact that the state was a debtor to the industry as a result of the ZUS's initial inability to transfer all contributions to the funds. The compensation issue was settled only one month before the new regulations on fees were adopted.

During the campaign led against the government's plan, the Polish Chamber of Pension Funds recruited Ewa Lewicka, the former pension expert of the Solidarity union and former government plenipotentiary for reform, to be its director-general. As debates on pension reform would be recurrent during the 2000s, the IGTE would commission expert opinions from former members of the Office of the Plenipotentiary and invite them as speakers at its conferences. During one of them, the former government plenipotentiary, Jerzy Hausner, said that the policy-makers involved in the paradigmatic reform had "managed to maintain a sort of alliance in favour of the reform ... in this hall, there are people who have dealt with it [in the past] and who, although

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<sup>17</sup> Interview, former Minister of Labour, 19/02/2010.

they [now] have different sorts of institutional and organizational affiliations, [still] act together in different roles” (IGTE 2005). The IGTE also maintained good relations with *Gazeta Wyborcza* and *Rzeczpospolita* journalists<sup>18</sup>, many of whom had participated in the Latin American study trips organized by the Office of the Plenipotentiary.

*“Completing the pension reform”*

The first stages of the implementation of the paradigmatic pension reform had been marked by organizational problems in the transfer of second pillar contributions from the ZUS towards the OPFs. However, it also turned out that the reform created a bigger shortfall in revenue for the pay-as-you-go pension system than had been anticipated. The Office of the Plenipotentiary’s simulations had estimated the gap to amount to 0.68% of GDP in 2000 and to increase to 1.39% by 2017 (Biuro Pełnomocnika 1997: 26). Yet, the diversion of a portion of social security contributions towards the OPFs reached 1.4% of GDP already by 2000 and was set to increase in the following years (Chłoń-Domińczak 2002: 168). Reformers believed the missing revenues for the pay-as-you-go system would be financed in the short term from the proceeds of the privatization of state-owned companies and in the long run by the shift towards notional defined contributions in the public pension system. Nevertheless, the “funding gap” in the first pillar risked being financed mainly through increased fiscal deficits and public debt (Drahokoupil and Domonkos 2012; Fultz 2012).

A few months after the OPFs started operating, the Business Centre Club acknowledged that the paradigmatic reform had put a serious strain on public finances

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<sup>18</sup> Interview, Polish Chamber of Pension Funds, 16/02/2010.

(BCC 2005: 270), but the employers' organization argued that "higher expenditure on pension reform is not so dangerous ... subsidies for the second pillar are different from other expenditure, because they reduce future expenditure" (BCC 2005: 327). Over the following years, the business lobby called in all its comments on the state budget for cutting other items of public expenditure. Some of its key requests were to abolish state subsidies for the pension "privileges" of occupational groups such as miners or the uniformed services, to end "irrational subsidies" for farmers and to "increase the participation of wealthy farmers in the financing of their own pensions", (BCC 2005: 271; 282-283; 312; 322; 351; 368; 380-381; 383; 393). The BCC's demands were particularly targeted at farmers, because more than 80% of their social insurance scheme (the KRUS) was financed by the state budget, while farmers were largely exempt from paying personal income tax and paid only flat-rate social security contributions. Similar spending cuts were suggested by the Forum for Dialogue at a 2000 conference (BCC 2005: 302-305) and were discussed during meetings of the Polish Chamber of Pension Funds (IGTE 2001; Hausner 2007: 174; 227), although the organization did not campaign publicly for their introduction.

The reform of the KRUS scheme reached the political agenda at the end of 2001. Poland experienced at the time a sharp drop in its economic growth rate with negative consequences for government finances. During negotiations for the accession of Poland to the European Union, the European commission recommended that Poland cut expenditure in KRUS (Rzeczpospolita 2001). In the following months, Ministers of Finance made regular suggestions to include a reform of the KRUS as part of austerity plans. However, the government was built on a coalition between the post-communist SLD and the agrarian PSL, and agrarian politicians successfully blocked the plans.

After the coalition fell apart in spring 2003, the newly appointed Minister of Economy, Jerzy Hausner, proposed a new package of cost-cutting measures. At a meeting with a coalition of business groups called the Council of Entrepreneurship (*Rada Przedsiębiorczości*)<sup>19</sup>, he pledged to “complete the pension reform” and to pare back the KRUS (*Rzeczpospolita* 2003a; see also *Rzeczpospolita* 2002; *Polish News Bulletin* 2003; Goliszewski 2003).

Discussed with the social partners from October 2003, Hausner’s “plan for the rationalization of public finances” was presented to the Parliament in February 2004. The package focused mainly on trimming Poland’s administrative apparatus, but it also contained cuts in social expenditure. The main measures were a less generous indexation of social security benefits, the introduction of tighter eligibility requirements for invalidity pensions and sickness leave, cuts in early retirement benefits, a gradual harmonization of women’s retirement age with that of men from 2014, a reform of KRUS benefits and the introduction of earnings-related social contributions for farmers. At the end of the winter 2004, the Ministry of Economy also announced it would work on legislation regarding the pay-out of second pillar pensions. OPFs were only in charge of investing workers’ pension contributions during the accumulation phase, but the paradigmatic reform had failed to define how private pensions would be calculated and who would pay them out, although the first cohort of women covered by the new system was due to retire in 2009.

While Hausner’s austerity plan was welcomed by international organizations such as the World Bank, the IMF and the European Commission, it was drawn into a lengthy wrangle at the domestic level (Hausner 2007). Within the SLD, the plan encountered

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<sup>19</sup> The Council of Entrepreneurship functioned between 2003 and 2007. It was composed of a dozen of business groups, including Poland’s three largest employers’ associations: the BCC, the KPP and PKPP Lewiatan, i.e. a body established in 1999 to represent private-sector companies.

resistance from the OPZZ union and from politicians who considered it would hit the party's core electoral constituencies (e.g. *Rzeczpospolita* 2003b). After some of them left the party, which was mired in a high-profile corruption scandal, the government lost its parliamentary majority. Hausner and the Council of Entrepreneurship (*Rzeczpospolita* 2004b) unsuccessfully tried to convince the pro-business Civic Platform (PO – *Platforma Obywatelska*) to support the plan, especially the reform of KRUS. In compensation, the PO, which grouped politicians who had left the liberal Union of Freedom (UW) and the Solidarity Electoral Action (AWS) after their electoral defeat in 2001, wanted to obtain an overhaul of the tax system with the introduction of a 15% flat tax. The demand was deemed unacceptable by the left-wing SLD. Moreover, the party's leader, Donald Tusk, was reluctant to back unpopular measures such as the increase in women's retirement age, because it could mean "political suicide" (*Reuters* 2003). The Civic Platform feared it could lose votes to the Christian-conservative Law and Justice party (PiS – *Prawo i Sprawiedliwość*), whose leader Jarosław Kaczyński called the plan "socially unfair, ineffective and terribly drastic" (*PAP* 2004). In the autumn 2004, it became clear that the key social policy elements of the Hausner plan – except for changes in the indexation of benefits and cuts in early retirement – would not be enacted.

The SLD government also proved unable to arbitrate between different possible solutions to the pay-out of second pillar pensions. Some civil servants suggested the ZUS should be put in charge of the pay-out phase. They argued that the choice of a single state provider would avoid both adverse selection and the fees related to the marketing of private annuities. According to the IGTE, the Polish Association of Insurers and employers' organizations, such a design would mean that, if the ZUS was

to make errors in mortality estimates or in the calculation of benefits, the taxpayer would have to foot the bill, whereas in the case of a decentralized system the costs would be borne by the market. Moreover, business groups warned against the concentration of pension assets in a single state entity and the risk of a politicization of the investment process.

The reform of farmers' pension scheme and the retrenchment of other social security benefits, for which employers' associations continued to campaign tirelessly, were stalled following the 2005 parliamentary and presidential elections, which changed the Polish political landscape dramatically. With the huge drop in popularity of the SLD and the left, the Kaczyński twin brothers' conservative PiS party strengthened its ties with the Solidarity union (NSZZ Solidarność), decided to attack the Civic Platform for embodying a "liberal Poland" and presented itself as the party of "solidair Poland" (see Markowski 2006; Szczerbiak 2007). While prior to the electoral campaign the two parties were seen as allies, the victorious PiS decided to form a coalition with the agrarian-populist Samoobrona (Self-Defence) party and the far-right catholic League of Polish Families (LPR), and vowed to defend the welfare state. The government nevertheless continued working on a project for the pay-out of pensions. As the controversy over possible designs persisted, the government proposed to introduce the market solution, but with a public option. However, the plan did not come before Parliament, because the coalition fell apart and an early election was called in autumn 2007.

Having won the election this time, the PO teamed up with the PSL to secure a parliamentary majority (Markowski 2008). Since the Civic Platform had close links with business and had called for a major reform of the KRUS both during the 2005 and

the 2007 election campaigns (PO 2005; 2007), the two parties signed a coalition agreement which emphasized that the farmers' scheme should be maintained and that any changes to it should be introduced on the basis of social dialogue. As the 2009 deadline for the pay-out of the first second-pillar pensions was looming, the new government adopted legislation on the issue in December 2008 with one bill defining the annuity products that should be offered and a second one establishing a regulatory framework for private-sector pension annuity companies (for more details see Naczyk 2010). Whereas the first bill was fully passed, the second one was vetoed by President Lech Kaczyński because it excessively favoured a market-based design. As a result of the presidential veto, regulations regarding the pay-out of private pensions were only temporary and would need to be reworked in the future. The "completion" of the paradigmatic reform was thus once again prevented, at a time when the new pension system was put to the test by the Great Recession of the end of the 2000s.

### *Pension privatization under pressure*

Although Poland was the only EU member state to experience economic growth in 2008, the country and its pension system were not spared by the global financial crisis. Mandatory pension funds posted negative rates of return. Simultaneously, the hole in public finances grew ever larger. These developments contributed to create a more hostile political climate around the Polish pension system. Instead of moving ahead with business groups' demands to cut other items of social expenditure, the Civic Platform gradually joined critics of the paradigmatic reform – which included its coalition partner, the PSL – and assented to reduce both the distribution fees charged by

the OPFs and the diversion of social security contributions towards private pension funds.

In the context of a deteriorating investment performance of OPFs, the traditionally pro-reform *Gazeta Wyborcza* (2008a) initiated in spring 2008 a public campaign calling for an immediate decrease in the “distribution fee” to 3.5% instead of the 7% charged by most funds. The newspaper blamed the charge for eating up a very large part of the profits generated by the pension managers<sup>20</sup> and reported that out of 15 funds 14 charged the maximum distribution fee and only one levied 4%. Opposition parties were prompt in seizing the problem and in trying to demonstrate their concern for the well-being of future pensioners. Both the SLD and the PiS immediately submitted draft bills in the Parliament with plans to reduce the charge to 3.5% in January 2009. The moves were strongly opposed by the IGTE (*Gazeta Wyborcza* 2008b).

The ruling liberal-agrarian coalition decided to hold a review of the regulation of pension funds from the autumn 2008 and suggested that in return for a decrease in the distribution fee it could respond to long-standing demands of the OPFs, such as the introduction of changes in the funds’ investment limits (*Parkiet* 2008). Yet the PiS party raised the stakes by proposing that workers be allowed to transfer all their contributions to the pay-as-you-go system. Within the government itself, the agrarian Minister of Labour, Jolanta Fedak, hinted she might allow trade unions to have seats on the boards of the OPFs so as to increase beneficiaries’ control over their functioning. To prevent further controversy, the government decided in spring 2009 to push through a decrease in the distribution fee to 3.5% as of January 2010 as well as changes in the management fee, and this without any compensatory measures for the pensions industry. The IGTE

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<sup>20</sup> By June 2009, the press showed that, when the fees paid by OPF members were taken into account, the real rate of return of the funds since their inception was approaching zero compared to 34.6% in June 2008 (*Parkiet* 2009b).

was unsuccessful in its attempts to block the plans. The lobby even met with the EU Commissioner for Internal Market and Services who expressed his concern about the reform in a letter sent to the Polish government (*Parkiet* 2009a). A tangible result of that meeting was nevertheless that, in April 2009, the European commission sued Poland over the limits it imposed on OPFs regarding foreign investments.

The referral of this issue to the European Court of Justice (ECJ) was significant not only because it could affect the way OPF assets were invested, but also because it could have consequences for Poland's public finances. During EU accession talks, the country had tried to convince European authorities to consider second pillar contributions as lying inside the general government sector. Such a definition would allow Poland to keep full control over the regulation of OPFs. But defining pension fund contributions as state assets would also decrease the nominal level of government debt. In 2009, Poland's budget deficit was about to rise to 7.4% of GDP compared to 3.7% in 2008, thereby increasing the risk that a constitutional limit of 55% of GDP would be exceeded.

In this context, the impact of the pension system on the state budget became a pressing issue once more. In November 2009, Labour Minister Jolanta Fedak (PSL) and Finance Minister Jacek Rostowski (unaffiliated, but close to PO) proposed to reduce the share of contributions going to the OPFs from 7.3% to 3% in order to break the vicious circle in which OPF assets were used to finance the deficits caused by the diversion of social security contributions towards the mandatory second pillar. According to Jacek Rostowski, it was "absurd" that pension funds, which were forced to invest 60% of their assets in bonds, could charge a fee for that (*Rzeczpospolita* 2009b), while Prime Minister Donald Tusk declared that "pension contributions were not there for some

financial institutions to rake it in” (*Rzeczpospolita* 2009a). Jolanta Fedak argued that, instead of using Latin America as a model, Poland should take inspiration from countries that are “culturally closer” such as Sweden “where only a 2% contribution rate is invested in mandatory pension funds” (*Parkiet* 2009c).

The proposal, which was considered “a big step backwards” by *Gazeta Wyborcza* (2009), was bitterly denounced by employers’ associations such as the BCC and PKPP Lewiatan. The IGTE’s Ewa Lewicka described it as “the beginning of the nationalization of retirement savings”, an attempt to grab “the living money of more than 14 million citizens” and “a breach of the intergenerational contract” (*Rzeczpospolita* 2009c). Whereas the OPZZ union expressed its support for the plan, a representative of Solidarność said that “the pension system was based on a social consensus” and that the changes had been proposed only “in order to temporarily save the budget”, and not in order to improve “the welfare of future pensioners” (*Rzeczpospolita* 2009d).

In addition to stirring controversy within the pension policy-making community, the proposals opened up a rift within the parliamentary majority, with PO MPs openly blaming the PSL for blocking any reform of the state-subsidized KRUS. The Prime Minister’s chief adviser and previously an adviser to the PKPP Lewiatan, Michał Boni, managed to convince Donald Tusk to reconsider his support for the plan (*Reuters* 2009). In January 2010, they presented a fiscal consolidation package that set four priorities for the government: introducing a golden rule in fiscal policy, “completing” the pension reform, enlarging the state budget’s tax base and accelerating the privatization of state-owned companies (KPRM 2010). The completion of the pension reform was to include a tightening of the link between the taxes paid by farmers and their earnings. Jan

Krzysztof Bielecki, a former Prime Minister and now head of the Prime Minister's Council of Economic Advisers, was entrusted with carrying out a general review of the functioning of the second pillar.

Infighting within the government and tensions between the agrarian Minister of Labour and partisans of the paradigmatic reform continued throughout 2010<sup>21</sup>. Yet, in December 2010, Donald Tusk altered course, and announced that the government would decrease the second pillar contribution rate after the PM's team of economic advisers decided to recommend that solution (Bielecki 2010; *Rzeczpospolita* 2010). There were two reasons for that. First, simulations carried out by the Ministry of Finance had shown that, since the beginning of its implementation, the paradigmatic pension would on the whole contribute to increase public debt by 93.8% of GDP by 2060 (cf. Kempa 2010)<sup>22</sup>. Second, the State Treasury was increasingly unwilling to privatize the limited number of companies that remained in its portfolio, because firms such as KGHM, the PZU or various energy sector companies were considered strategic for the Polish economy and were not to fall into foreign hands.

In March 2011, the government eventually passed a law as a result of which the OPF contribution rate was cut from 7.3% to 2.3% of gross wages as of May 2011 and was to be gradually increased to 3.5% by 2017. First pillar pension contributions were increased by the same amount and were recorded on a special individual ZUS account that was to be indexed to GDP growth. In an attempt to placate the private pension fund industry, the government created new voluntary "individual accounts of retirement

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<sup>21</sup> During the winter, Jolanta Fedak accused the OPFs of anti-competitive practices. The IGTE retorted that "the Ministry was controlled by a coalition member, whose electorate [had] nothing to do with the reformed pension system. Attacking the OPFs is to defend the KRUS from changes" (Parkiet 2010; see also Mordasewicz 2010). PSL leaders, on the contrary, presented the KRUS as a "more modern" arrangement than the OPFs and as "reminiscent of Swedish or Canadian arrangements with their flat-rate basic citizen pensions" (*Gazeta Wyborcza* 2010).

<sup>22</sup> The Minister of Finance would later call the second pillar "a cancer that [had] grown to gigantic proportions and was destroying the whole pension system" (Rostowski 2011).

security” (*indywidualne konta zabezpieczenia emerytalnego*), where contributions could be tax deductible, as opposed to existing third pillar plans such as the “employee pension plans”. The law also introduced a gradual increase in the investment limit on equities from 40% to 90% of assets, but did not change restrictions on foreign investments as the government was awaiting a ruling from the ECJ.

The reform plan was nevertheless strongly and unsuccessfully opposed by the IGTE and employers’ associations. Together with the BCC, the IGTE launched a one-week media campaign to defend the open pension funds. It also circulated a petition, but only 80,000 people signed it. The reform led to an intense public debate between pension policy-makers (e.g. Chłoń-Domińczak *et al.* 2010; Lewicka-Banaszak 2010; Bielecki 2011; Gomułka 2011; Hausner 2011; Petru 2011; Rostowski 2011; Wiktorow 2011), including a prime time televised debate between Jacek Rostowski and former Minister of Finance – and architect of the paradigmatic reform – Leszek Balcerowicz. Despite waging almost a decade-long campaign to introduce reforms that would have allowed to finance the transition costs of the new system and that would have “completed” the paradigmatic pension reform, financiers, employers’ associations and the Solidarity union proved unable to stop a plan by a liberal-agrarian government coalition to reduce the role played by the mandatory pension funds.

### **Concluding remarks**

This case study of Polish pension reform reveals both the strengths and the limits of the theoretical framework developed in chapter 1. While the political economy model of pension privatization sheds important light on the processes that led to the creation of

the mandatory open pension funds, it has more limited explanatory power regarding policy-making after the 1997 reform. First, the chapter has shown that the financial industry played an important role in putting the development of funded pensions on Poland's political agenda. To be sure, financiers were not the first actors to put forward plans for pension privatization, since a number of policy entrepreneurs influenced by free market ideas did so in 1990. However, as early as 1992/1993, the Warsaw Stock Exchange as well as insurance companies lobbied the executive and helped build momentum for the introduction of regulations and of tax incentives that would allow the development of private pension funds. The Polish case shows that domestic policy-makers sought the World Bank's advice only after they had already become convinced to introduce funded pensions. These findings thus contradict Orenstein's general claim that pension privatization was first suggested by the World Bank in Central and Eastern Europe. The chapter has also found no empirical evidence that electoral considerations – such as an attempt to attract the vote of the middle class – were the prime mover behind Polish politicians' interest in pension privatization.

Second, the chapter's findings confirm my model's predictions on the determinants of employers' preferences towards the development of pension funds. Whereas British and French employers initially opposed financiers' plans for pension privatization, Polish employers provided unequivocal support for reform. I argue that a major reason for their positive attitude is the fact that they were not affected by institutional feedback from pre-existing supplementary pensions. Since Polish firms had not created occupational schemes under communism, employers had no entrenched interests in the preservation of existing pension institutions. Employers' organizations such as the BCC were primarily motivated by their interests in the welfare-labour

nexus. They called for the retrenchment of pay-as-you-go pensions and the concomitant development of occupational pensions, because they wanted to cap statutory pension contributions and to create instruments that would allow them to retain skilled workers. The chapter has also provided further evidence for the hypothesis that managers of large firms would try to influence the regulation of pension funds so that it provides them with a source of patient capital. Thus, copper producer KGHM and a number of other firms lobbied for regulations that would allow them to use “employee pension programmes” as a protection against hostile takeovers.

By contrast, the evidence is more mixed regarding the determinants of workers’ preferences towards pension privatization. Organized labour was split between opponents and supporters of radical reforms. The OPZZ’s initial resistance was motivated by the union’s will to preserve workers’ vested social rights, which would suggest that it was influenced by institutional feedback from the pre-existing pay-as-you-go system. However, Solidarity’s very positive attitude towards pension privatization is puzzling from that regard. It is also difficult to explain it by the skill composition of the union: Solidarity’s membership was not more biased towards high-skilled workers than the OPZZ’s (Gardawski *et al.* 2012). Solidarity activists were primarily influenced by a loss of confidence in the existing pay-as-you-go pension system and were thus more receptive to free market ideas defended by political and managerial elites and by international organizations. Pension privatization also provided the opportunity to implement a form of mass privatization of state-owned companies that would spread share ownership to wider segments of the population.

Third, my theoretical framework has allowed us to gain a fuller account of how relationships between parties and organized interests sustained the 1997 paradigmatic

pension reform. In chapter 1, I hypothesized that in multi-party systems governing parties would not officially sponsor a bill on pension privatization unless they had support from the organized interests that overlapped with their core constituencies. This chapter has shown that the left-wing SLD party's capacity to push through the reform depended to a large extent on the reaction of organized labour. The OPZZ initially proved an important obstacle for proponents of pension privatization. However, once the Solidarity union rallied behind the paradigmatic pension reform, the SLD was able to bypass the OPZZ's internal opposition and was thus ready to move the issue from the agenda-making phase to the decision-making stage. At the opposite end of the political spectrum, the liberal UW party's wholehearted support for the 1997/1998 reform can be explained by the fact that employers' associations were also generally content with it.

The relevance of the political economy model of pension privatization proves nevertheless much more limited when it comes to accounting for the political dynamics that followed the enactment of the paradigmatic reform. The chapter has shown that, following the reform, the new open pension funds created a lobby to defend the interests of their industry. Over the years, the IGTE developed close links with the actors who had contributed to introduce the reform. Together with employers' associations and the Solidarity union, private pension funds formed a stable alliance in favour of the preservation of the new system. However, the specific institutional design of the new pension system created an important shortfall for the state budget. To plug this gap, employers' associations – and it is unclear to what extent pension funds too – campaigned for cuts in other items of social expenditure. This activity created tensions with other social groups, particularly with farmers. The theoretical framework

developed in chapter 1 did not incorporate this social group and has therefore difficulties in explaining the most recent trends in Polish pension privatization.

## **Conclusion**

Over the past three decades, European countries have substantially reformed their pension systems. While they have been cutting public benefits, policy-makers have also increasingly tried to encourage the expansion of private pension provision through defined-contribution retirement savings plans. The extent, the form and the content of pension privatization have differed from country to country, but the rise of private pension funds has been a near universal phenomenon in Europe. These changes are significant for two reasons. First, they are synonymous with a major shift in responsibility for retirement provision. During most of the post-war period, the state and firms offered workers a guaranteed level of benefits provided that they had a sufficient service record or that they met a minimum residency requirement. With the rise of funded defined-contribution plans, workers' benefits depend to a greater extent on the total amount of contributions they pay into their pension schemes. But, more importantly, they are also a direct function of the returns generated by pension fund managers. The financial crisis has reminded us that the level of investment returns is never guaranteed.

A second and related reason why pension privatization is significant is that it contributes to the growth of capital markets and therefore may change the way companies are financed and governed. While a number of social scientists have argued that pension privatization contributes to the financialization of the economy, the preceding chapters have shown that this is not necessarily the case. By influencing the regulation of retirement savings, different social groups can shape the way pension funds' assets are invested. Rather than being short-sighted in their investment decisions,

pension funds can sometimes act as a buffer against hostile takeovers. They may also be used to promote socially responsible investment.

The aim of this thesis has been to provide a better understanding of the politics behind these major developments. My central hypothesis has been that the first and main proponent of pension privatization is the financial industry. However, I have argued that financial lobbies' influence on governments and the willingness of party politicians to push through relevant legislation depend on the way employers' associations and trade unions react to the issue. These two types of organized interests often have conflicting preferences over the development of pension funds, but they also have a capacity to mobilize voters, which can either boost or compromise politicians' electoral chances. To shed light on these various actors' interests and on the coalitional dynamics that determine the financial industry's influence, I have developed a comprehensive political economy model of pension privatization. I have then tried to test its propositions through case studies of pension reform in the United Kingdom, France and Poland. Both my theoretical framework and my empirical evidence constitute a challenge to two existing political science explanations of the rise of funded pensions. According to the first – ideational – account, the driving force behind pension privatization has been a new pensions orthodoxy promoted by international organizations. By contrast, partisan scholars have argued that these changes have been mainly the product of political parties' electoral strategies and their attempts to attract the votes of the bourgeoisie or of the middle class.

In these concluding remarks, I will summarize the main findings of the empirical chapters and will try to show how they confirm or contradict my initial theoretical expectations. The first section focuses on the preferences of financiers, employers and

workers. The second section evaluates the evidence regarding socio-economic actors' influence. The final section discusses the role of parties and ideas.

### *Findings on socio-economic actors' preferences*

The starting point of my theoretical model was that the *financial industry* has an interest in the development private pension provision and therefore in putting the issue on the political agenda. I hypothesized that both stock exchanges and firms which specialize in selling savings products – i.e. life insurance companies, mutual funds and banks – would lobby for the expansion of funded plans, the reason being that it profit them as an industry. The case studies of British, French and Polish pension reform provide ample evidence that this has been the case. However, financiers' specific preferences do not always necessarily go in the direction that I expected. Whereas I hypothesized that stock exchanges would lobby for the expansion of funded pension because they wanted to see an inflow of institutional investors, the London Stock Exchange participated in the formulation of the project to introduce personal pensions, because it wanted to *reverse* the trend towards the growth of institutional and collective investment. The TUC's and the Labour Party's plans to divert the resources of private pension funds and insurance companies towards a National Investment Bank constituted a threat to the existence of the stock exchange. The LSE was interested in expanding individual share ownership, because personal investors were a much less vulnerable target than large collective funds. The plan for personal pensions imagined by the Centre for Policy Studies could provide a means to achieve this end.

The specific nature of the Thatcher government's proposals on personal pensions also explains why a large segment of the British insurance industry initially *resisted* the Thatcher government's proposals. In a situation where the largest life insurers – the Prudential and Legal and General – controlled a substantial chunk of the market for defined-benefit occupational pension schemes, the Conservatives' plans to introduce defined-contribution pensions – be they managed by individuals or by financial institutions – constituted a direct threat to these insurers' leading position. One might thus argue that institutional feedback from pre-existing private pensions affected these segments of the insurance industry just as much as it influenced employers' preferences. However, the British insurance industry's later acceptance of personal pensions – to the extent that it was accused of mis-selling – also shows financial firms' capacity to adapt to new institutional or market conditions. In France and Poland, financial actors showed preferences that were more in line with my predictions. The Warsaw Stock Exchange and the Paris Bourse (through the *Paris Europlace* lobby) called for pension privatization, because they saw the creation of large domestic institutional investors as a crucial element of their competitiveness as financial centres. French and Polish insurers lobbied for the introduction of specific tax incentives for retirement savings plans. French insurers also openly lobbied for the retrenchment of pay-as-you-go pensions to open some space for private plans. Overall, the evidence confirms financiers' interest in the development of funded pensions. However, my findings also suggest that the financial industry should not be treated as a single block with unified preferences.

While I placed the financial industry at the centre of my theoretical framework, I also argued that it is necessary to take into account and to understand the preferences of two other major socio-economic groups, i.e. employers and workers. I contended that

these actors' interests are embedded in the welfare-labour nexus, the welfare-finance nexus and the pre-existing institutional mix of public and private pensions. Let me first assess the relevance of these predictions for *employers*. The three country chapters have provided ample evidence that employers' preferences are determined by considerations such as cost competitiveness, skill retention, access to corporate finance or also the impact of new legislation on pre-existing company pension schemes. For example, it is remarkable that in all three countries, managers of non-financial companies – particularly of large manufacturing firms such as GEC in Britain, Saint-Gobain in France or KGHM in Poland – lobbied governments to allow occupational pension funds to reinvest (or “self-invest”) part of their assets into the sponsoring companies. This type of arrangement provides corporations with a stable source of “patient” capital and allows managers to protect themselves against hostile takeovers.

However, although I had clearly separated the impact of the welfare-labour nexus and of institutional feedback on employers' preferences in my analytical framework, the empirical evidence suggests that in reality these two dimensions are closely intertwined. In the United Kingdom, the CBI and the NAPF opposed the introduction of personal pensions because it endangered existing employer-sponsored defined-benefit pension schemes. Yet their interest in preserving these schemes had very much to do with the embeddedness of the latter in the welfare-labour nexus. Due to their limited portability, occupational pensions provided employers with a very powerful tool to retain skilled employees. In France, the UIMM's and the CNPF's long-standing opposition to funded pensions was also determined by the combined impact of institutional feedback and of labour market incentives. All those companies that had traditionally paid voluntary contributions within the pay-as-you-go occupational schemes saw the cost of these

arrangements soar as a result of deindustrialization and demographic ageing. The UIMM decided to oppose pension funds not because of an emotional attachment to the ARRCO and the AGIRC, but because the expansion of private retirement savings could have endangered manufacturers' plans to socialize the costs of their more generous pay-as-you-go schemes. After these problems were solved, this institutional feedback effect became marginal: The UIMM and the CNPF started supporting funded pensions and have ever since pushed for the retrenchment both of statutory and of pay-as-you-go occupational pensions in order to avoid any increases in non-wage labour costs.

Polish employers' unequivocally positive attitude towards pension privatization stands in sharp contrast to that of British and French business. As there were no pre-existing supplementary pension schemes in Poland, employer groups such as the BCC had no vested interests to defend. Voluntary occupational pensions – be they of the defined-benefit type or of the defined-contribution type – were seen both as a skill retention tool and as a potential source of corporate finance. All in all, the three country chapters have confirmed that there may be important variations in employers' attitudes towards pension privatization. To understand these differences, one needs to take into account the multivariate aspect of their preference functions.

What about the preferences of *workers* and of the organizations that represent them? The welfare-labour nexus and institutional feedback generally lead trade unions to fight for the preservation of the generosity of pensions. However, this does not mean that they oppose change. Organized labour represents different parts of the workforce (low-skilled and high-skilled workers / low-income and middle-income earners) and therefore needs to find a middle ground between these segments' potentially conflicting interests. This leads unions to accept changes in the balance between public and private

pension provision or between insurance and redistribution. For example, whereas the TUC fiercely resisted the scrapping of the State Earnings Relation Pension Scheme in the 1980s, it supported the Labour Party's plans to improve this state scheme for low-income earners through its replacement with the state second pension in the 1990s. Similarly, the TUC's decision to support compulsory employer contributions for all workers was to a large extent driven by its defence of high-skilled workers whose final-salary schemes were very rapidly declining. In France, organized labour initially fought against funded pensions to safeguard the existence of the pay-as-you-go supplementary pensions. But, once they were preserved, unions representing more high-skilled segments of the labour force – such as the CFDT or the CGC (see Häusermann 2010) – were the first ones to support the expansion of “salary savings” schemes. The Polish case is exceptional in that one union – Solidarity – accepted the development of funded pensions as a partial replacement of the existing public pay-as-you-go system. Rather than being driven by interests, this decision had to do with the ideological background of the union (see Ost 2005). Solidarity lost confidence in a system that had been inherited from a communist regime it had fought against.

A final and important hypothesis of my framework was that workers' and unions' preferences towards pension privatization could also be influenced by the welfare-finance nexus. In particular, I have argued that unions could have concerns about the impact of private pension funds' investment policies on workers' position in the firm. The British chapter has demonstrated that organized labour had a clear corporate governance agenda already in the 1970s and the 1980s. At the time, the TUC called for pension fund assets to be invested in a National Investment Bank so as to support industry. In the 1990s, unions were influenced by the concept of stakeholding and

shifted their agenda towards greater emphasis on socially responsible investment and shareholder activism (see also Bridgen and Naczyk 2012). The same type of agenda was pursued by French organized labour, particularly by the CFDT. In fact, French unions' interest in developing a new form of "patient capital" proved crucial in pushing them to support the development of "salary savings" plans. The Polish case provides less conclusive evidence for the relevance of the argument about the role of the welfare-finance nexus. The Solidarity union's support for pension privatization had to do with its campaign to give Polish workers a stake in formerly state-owned companies. However, contrary to their Western counterparts, Polish unions did not develop an agenda for socially responsible investment. This can be explained by their relatively weak administrative resources (Gardawski *et al.* 2012).

#### *Findings on socio-economic actors' influence*

Understanding financiers', employers' and workers' preferences was important because these socio-economic groups have the highest stakes in pension privatization. However, the other dimension of my theoretical framework was to explain their influence on the policy-making process. Chapters 3-5 have provided many examples of the capacity of interest groups to change the position of governments or more generally of political parties on the pensions issue. Their influence derives from the effectiveness of their lobbying campaigns, but, in the case of employers' associations and trade unions, it also stems from their capacity to mobilize parties' electorates.

The financial industry has used a variety of lobbying techniques in its attempts to induce politicians to expand – or sometimes preserve – funded pensions. Much of its

influence has been exerted through inside lobbying. For example, a former head of the FFSA openly talked about his meetings with a Prime Minister. In the mid-1990s, British insurers wrote about the links they had established with specific politicians within the Labour Party (cf. Boléat 1995). The head of the Warsaw Stock Exchange would use the visit of a new Prime Minister to his institution to remind him about the need to introduce regulations on pension funds. Such examples might seem to provide only anecdotal evidence of the influence of financial lobbies, but, when one adds them up, one gets a clearer picture of the relationship that exists between politicians and interest groups.

The other major type of strategy used by financiers has been outside lobbying. By this, I mean any attempt to influence policy-makers via public opinion. One way to do this is to go “grassroots”. In the UK, the Prudential called on its clients to contact their MPs and tell them about their worries regarding occupational pensions. In Poland, the IGTE tried to persuade thousands of pension scheme members to sign an online petition against government plans to reduce contributions to open pension funds. But a more important aspect of outside lobbying by financial firms is issue framing. By coining phrases such as “Britain's £27bn savings gap” or “French-style pension funds”, the heads of the ABI and of the FFSA were clearly trying to shape the public debate about pensions. The aim of such slogans – which are disseminated more widely by the media – is to arouse feelings of fear or of sympathy within the public. They can help build momentum for interest groups’ plans. In the French case, *fonds de pension à la française* was even used as a slogan by President Chirac during his re-election campaign.

But, if financiers' lobbying strategies have been so comprehensive, why have they so often failed to achieve their aims? The third major claim of my theoretical model was that politicians' willingness to push through pension privatization would depend on their interactions with employers' associations and trade unions. I argued that these relationships would vary across different types of party systems. In multi-party systems, right-wing parties' readiness to pursue pension privatization was hypothesized to depend on the prior backing of organized business, whereas left-wing parties were expected to sponsor relevant legislation only if they could count on the support of trade unions. The French case confirms these expectations most fully. The 1987 piece of legislation on retirement savings plans was introduced by a right-wing government at a time when the conflict between insurers and the social partners over supplementary pay-as-you-go schemes had not yet become evident. Once the CNPF and the UIMM started lobbying against pension privatization, the Gaullist RPR – and to a lesser extent the liberal-democratic UDF – became unwilling to support it. By contrast, the French Socialist Party – and its coalition partner, the Communist Party – accepted to bring forward a bill on “salary savings” only once it became clear that organized labour was also well disposed to it. In Poland, a cross-party consensus over the 1997 paradigmatic reform went together with a cross-class coalition between Solidarity and employers' associations. However, the political economy model of pension privatization can only partly account for the more recent developments in Polish pension reform. Pension privatization has been under pressure due to the specific design of Poland's multi-pillar system and to the importance of agrarian interests in the country's politics.

In two-party systems, centre-right parties were expected to be more likely to ignore pressures both from employers' associations and trade unions, whereas centre-

left parties were expected to formally sponsor a bill on pension privatization only if they had prior assurance of support both from trade unions and employers' associations. Evidence on British coalitional dynamics largely corroborates these predictions. In 1985-1986, the Conservative Party – which was traditionally considered as the party of business – decided to push through personal pensions even though it faced fierce resistance from the CBI, the EEF and the NAPF. Historically, British employers had not developed privileged links with a single “pro-business” right-wing party (Martin and Swank 2012). In the 1980s, Conservatives' disregard for employers' preferences was most probably motivated by the belief that Britain's most competitive sector was the financial industry and that as a result its development was more important than that of manufacturing industries. At the same time, Conservatives continued to be attentive to what employers thought. For example, Margaret Thatcher's government backtracked on its plan to scrap and fully privatize SERPS after the CBI campaigned against the proposal. More recently, the Tories' decision to accept to build a cross-party consensus about compulsory employer savings came after the EEF had signalled it supported compulsion. A striking finding is the degree to which New Labour was responsive to employers' preferences. Although organized interests such as the NAPF, the ABI and even the TUC all waged campaigns in favour of the expansion of funded pensions, Labour resisted their demands due to the opposition of the CBI to greater compulsion. It was only once the EEF broke ranks that Tony Blair's government committed itself to introduce auto-enrolment.

In sum, the empirical evidence presented in the three country chapters confirms that the financial industry has played a key role in putting pension privatization on the political agenda. Over the years, financiers have built close relationships with

politicians both on the right and on the left of the political spectrum. However, despite having had such allies, they have often had to wait for years before their demands were met. Governments' cautiousness in passing legislation that would promote funded pensions was more often than not the result of employers' or unions' opposition to such changes.

### *Findings on the role of parties' electoral strategies and of ideas*

Throughout this thesis, I not only tried to test the validity of my own model's predictions, but I also attempted to assess how their relevance compared with that of existing partisan and ideational theories of pension privatization. This last section will therefore discuss my findings, first, on the role of parties' electoral strategies and, second, on that of the policy ideas promoted by international organizations.

Politicians' electoral considerations undoubtedly mattered in the politics of pension privatization. Governments' efforts to build relatively large coalitions in favour of reform were generally motivated by their desire to avoid retaliation on the issue from organized interests or from competing parties, as this might have had a negative influence on public opinion and harmed their re-election prospects. The evidence also suggests that parties have indeed often seen pension privatization as a way to attract middle-class voters. However, there are fewer indications that such a strategy has been the driving force behind pension privatization. I found the least evidence on the importance of parties' electoral motives for the Polish case. The leadership of the post-communist SLD party was initially split over pension privatization. While some politicians proposed to target low-income earners by strengthening redistribution in the

existing pay-as-you-go system, those who advocated the introduction of mandatory retirement savings seemed to be convinced about the case for pension privatization more from an ideational point of view than on electoral grounds.

In France, the 1987 piece of legislation on private retirement savings was introduced at a time when right-wing politicians started privatizing state-owned companies and extolled the virtues of “popular capitalism”. Although funded pensions were not openly presented as part of a platform to attract the middle class, it would be reasonable to assume that they were. However, electoral considerations were not the reason why pension privatization initially reached the political agenda. The first senior right-wing French politician to talk about the need to develop funded pensions was Raymond Barre, a politician who had developed very close connections with the financial industry over his career. Similarly, on the left of the political spectrum, one of the main proponents of the expansion of funded pensions was a politician with similar links to the insurance industry, Dominique Strauss-Kahn. Although at the end of the 1990s Strauss-Kahn argued that “salary savings” and the concept of the “worker-shareholder” should stand “at the heart of the Socialist project”, the leadership of the Socialist Party preferred to give much less political salience to the issue, which shows that they saw only limited possibilities in capitalizing on it from an electoral point of view.

It is in the British case that I have found the most compelling evidence for the hypothesis that parties’ electoral strategies were one of the primary motives behind pension privatization. While the Centre for Policy Studies developed its proposal for personal pensions in collaboration with a number of people within the financial industry, its aim was also to elaborate a plan that would allow spreading equity

ownership to larger parts of the British population. In addition to a strategy to woo the vote of the middle class, Conservative elites wanted to expand the middle class in order to reinforce the social base of their party and to halt socialism<sup>1</sup>. Similarly, New Labour's decision not to repeal personal pensions was largely motivated by the necessity to appeal to the median voter in order to win elections in the UK's first-past-the-post system. Since, by the early 1990s, a large part of the population – and especially the middle class – relied on occupational or personal pensions for their retirement provision, it was in Labour's electoral interest not to attack these schemes to show its commitment to maintain them and even expand them. Thus, in the British case, the financial industry's lobbying campaigns and parties' electoral strategies complemented each other to create a powerful push for pension privatization.

Ideational theories of pension privatization were the other major set of alternative hypotheses that served as a background for this thesis. According to ideational scholars, European policy-makers have expanded funded pensions because they have been progressively persuaded by international organizations and transnational actors to adopt a multi-pillar approach in pension reform. These factors have been shown to have played a marginal role in the United Kingdom. Although ideational scholars have argued that international organizations became involved in the pensions debate in the 1990s, pension privatization was already on the British political agenda in the early 1980s. To be sure, British policy-makers had meetings with the policy entrepreneurs involved in the transnational campaign for pension privatization in the mid-1990s, but

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<sup>1</sup> Just after the 1983 election, the chair of the Conservative Party, Cecil Parkinson, declared: "Now we must launch our second drive. It must be to make Britain a true property-owning democracy, a democracy in which people not only own their own home but have a stake in the businesses in which they work (...) We have transformed the attitude to home ownership. Now we must transform the attitude to private enterprise. That is what we are after. When we have got these things we shall have a country that really is strong against socialism and then we really will have won the battle for Britain."

these meetings were organized by politicians – such as Frank Field or Peter Lilley – who had already been campaigning for pension privatization for a number of years. The “pension pillar” concept was in fact almost never used in British discourse about pensions. The only major exception was Norman Fowler’s proposal to develop a “twin-pillar” system, but his use of the concept seems to have been influenced by a trip to Switzerland where insurers promoted a “three-pillar” system (cf. Leimgruber 2008; 2012).

Poland provides the clearest example of intervention by transnational actors. As has been shown by Orenstein (2008), the World Bank provided both organizational and financial support for the drafting and the implementation of the mandatory individual retirement savings accounts it advocated in developing countries. However, the evidence provided in this thesis provides a qualification to the interpretation according to which the World Bank was the central actor in Polish pension privatization. Indeed, the development of private retirement savings – in the form of occupational pension schemes – was on Poland’s political agenda already at the beginning of the 1990s, largely due to lobbying from the financial industry. Moreover, the Solidarity union’s relatively early interest in pension privatization (i.e. before the publication of the World Bank report) suggests that an important reason for Polish policy-makers’ adoption of the multi-pillar paradigm was the country’s transition from communism to market economy and democracy.

In France, I found no evidence of direct involvement of the transnational policy entrepreneurs associated with the World Bank’s campaign for pension privatization. Actors who had links with the financial industry were the first ones to put pension privatization on the agenda. Moreover, like in the United Kingdom, the concept of

pension “pillars” has been very rarely used in French discourse on pensions, which casts doubt on the influence exerted by the World Bank’s 1994 report. One international organization played nonetheless an important role in the French debate on pensions: the European Economic Community. Announcements by Commissioner Leon Brittan that it he would propose a directive on the freedom to provide services and the creation of a Pan-European pension fund market were considered as an attack on the existence of the French pay-as-you-go occupational schemes. Yet, rather than persuading French policy-makers to pursue pension privatization, the European Commission’s announcements elicited a hostile reaction from domestic political elites. Further research will have to investigate to what extent the debates at the European level were influenced by interest groups such as insurers’ Comité Européen des Assureurs, occupational pension funds’ European Federation for Retirement Provision and the social partners’ European Association of Paritarian Institutions.

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