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**Riester pensions in Germany:
do they substitute or supplement public pensions?
Positions in the debate on the new public
policy on private pensions**

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Abstract

'Privatizing' pension reforms do not imply a simple retreat of the state. Instead, they normally enhance the regulatory function of the state, and regulatory pension policy becomes more important. The overall purpose of this paper is to bring the *public policy on private pensions* to the attention of social scientists. The obvious question to be asked is: what factors determine the public policy on private pensions in the larger context of a strategy of privatization in old-age security? The literature suggests that in social insurance countries where old-age security is dominated by a mature public pay-as-you-go scheme, the public policy on private pensions depends on the function that private pensions are given in relation to public pensions. In Germany, the pension reform of 2001 has introduced subsidies to a particular form of personal pensions (the Riester pensions). On the basis of expert interviews and document analysis, the paper shows that the policy community is divided about the status of the Riester pensions: Some policy makers see it as a *substitute* for public pensions; others see it as a *supplement* to public pensions. The regulation of the Riester pensions depends on which of the two approaches prevails. Ultimately, the divide between supplementing and substituting, and the dispute within the policy community, reveal that the Riester pension is located precisely at the intersection between public and private.

1 Introduction¹

In the past, the focus of social scientific research on old-age security in Germany has primarily been on the statutory pension insurance and the public policy on public pensions. There is an obvious reason for this bias: the statutory pension insurance is by far the most important pension scheme in the German old-age security system. In 2003, its benefits accounted for 79 per cent of all pension benefits paid by the various pension schemes existing in Germany. 96 per cent of all persons 65 years of age or more get at least some benefits from the statutory pension insurance. For 69 per cent of the formerly employed, the statutory pension insurance is the only source of income in old age (Bundesministerium für Arbeit und Soziales 2005).

Compared to the abundance of literature about the statutory pension insurance and the politics of reforming it (see for example Nullmeier and Rüb 1993; von Winter 1997; Richter 2001; and most recently Hegelich 2006), very little is known about policy making in the field of private pensions. For many years, research on private pensions in Germany has almost exclusively been a matter of economics and law, rather than of policy analysis and social policy research. However, the pension reform of 2001 and subsequent reforms have given private pensions a more

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important role in old-age security. As a consequence, the politics and the policies of private pensions have become an interesting and relevant issue for scholars of social policy. For the purpose of policy analysis, I suggest distinguishing between *public policy on public pensions*, which has to do with the design of the pay-as-you-go statutory pension insurance, and *public policy on private pensions*, which is about the design and the regulation of occupational and personal pensions. So far, only few political scientists have pointed to the increasing importance of the political dimension of private pensions. In reference to private pensions, Myles and Pierson predict that “future pension politics will focus on the regulatory role of government, a role, however, that will create no small measure of political conflict around issues of income security” (Myles and Pierson 2001: 331). Nullmeier (2001) and Hinrichs (2000 and 2005) assume that policy makers and interest groups concerned with private pensions will take part in pension policy, introducing their specific interests and procedures of communication and political bargaining to the policy field.

This paper contributes to the study of policy making in the field of private pensions, focusing on the new subsidized personal pensions in Germany, the so-called Riester pensions. The Riester pensions have been created in order to compensate for a relative decrease of public pensions in the future. They are regulated by the *Act on the Certification of Pension Contracts*, an act that was introduced with the pension reform of 2001. The Act on the Certification of Pension Contracts came into effect in 2002 and was reformed in 2004 –private pension policy it is therefore an important object of investigation. The starting point of the study is an assumption put forward by Rein and Turner (2004). Drawing on a large number of studies on pension reforms in different countries, they convincingly argue that in social insurance countries with a dominant public pay-as-you-go scheme, the policy on private pensions and, as a consequence, the design of private pensions depend to a large extent on how private pensions are related to the public pay-as-you-go scheme. With this assumption in mind, looking at the Riester pension reveals a surprising fact: In the policy communities dealing with old-age security there are diverging opinions on whether the Riester pensions are meant to *supplement* lower public pensions, or whether they are meant to *substitute* for a part of the public pensions. If the Riester pensions are considered a replacement for public pensions, a stricter regulation can be justified. Public policy on private pensions will then be more likely to comprise “regulatory efforts to make the private system more similar to the public programme” (Rein and Turner 2004: 258f.).

On a more general level, the introduction of subsidized private pensions and the reform of their regulation raise questions on the development of the German welfare state. Shortly after the pension reform of 2001, Lamping and Rüb (2004) posed that same question. In their opinion, the German welfare state has departed from the conservative regime to an “uncertain something else” (Lamping and Rüb 2004: 186), recombining elements of all three welfare regime types described by Esping-Andersen (1990). A partial answer is: the pension reform of 2001 indicates that the regulatory function of the German welfare state is becoming more important (Leisering 2006). However, a regulatory regime can either be more oriented towards social policy goals and less liberal, or it can be less oriented towards social policy

goals and more liberal. My assumption is that if the subsidized private Riester pensions are considered a *substitute* for a part of the benefits provided by the public scheme, their regulation is likely to become stricter. If, on the other hand, the subsidized private pensions are considered only *supplemental* to the public pensions, a more liberal regulatory policy will be pursued.

The paper has two parts: the first being rather theoretical and descriptive, and the second analytical. In the descriptive part, I first outline different ways in which public and private pensions can be linked (section 2). Then, in section 3, I give a short overview of the pension reform of 2001 and a description of the new subsidy for personal pensions. I will show that the reform has left unclear whether Riester pensions are substituting or supplementing public pensions. The subsidy can only be drawn for personal pensions fulfilling certain requirements; the certification of these private pensions is regulated by the Act on the Certification of Pension Contracts. In section 4 I describe the act, the way it was first introduced, as a part of the pension reform of 2001, and how it was amended in 2004. The main argument is developed in the sections 5 and 6, the analytic part of the paper. The analysis relies on 26 personal interviews - with policy makers and experts in the field of old-age security - that were conducted in 2004 and 2005, and on the analysis of documents. First, I reconstruct the political debate and arguments on three controversial issues of the reform of the Act on the Certification of Pension Contracts. It becomes evident which role the dualism of supplementing versus substituting played in the reform of the act (section 5). The debate can be put in the wider context of two ideal types of ideological positions that structure the public policy on private pensions: the assimilation approach and the distinctiveness approach (section 6). In the conclusion I argue that the dualism of public versus private underlies the whole debate about substituting versus supplementing.

2 Different forms of pension privatization

International comparisons of old age security systems have demonstrated that the relation between public pensions and private pensions can be designed in very different ways (Turner and Rein 2004; Kangas and Palme 1991). Privatizing pension reforms, as adopted in many Western-European welfare states in the past decade, differ in respect to how the link between public and private pensions has changed. The various possibilities of designing the link between public pensions and private pensions form a continuum, with no formal link at all between public and private pensions at the one end of the spectrum, and a very strong link between public and private pensions at the other end.

At the one pole of the continuum there is political 'non-coordination' between public and private pensions, with only an implicit link between them (Kohl 1988). Until the end of the 1990s, Germany, for example, had an old-age security system with no formal relation at all between the different forms of pension provision. The public pay-as-you-go statutory pension insurance, as it was established in 1957, provided a large proportion of the income in old age for the vast majority of the population,

often sufficient to maintain the beneficiary's living standard. Private pension provision has always been voluntary. For most people, additional income from private provision was nice to have, but not really necessary. Every now and then, policy makers have pleaded for more private provision for old age and pointed to the fact that old-age security was meant to rest on the well-known 'three pillars', but a full fledged 'three-pillar' pension policy has never been institutionalized. In theory, such an uncoordinated pension policy is likely to induce a 'creeping privatization' (Kuptsch 2001) or 'passive privatization' (Hyde et al. 2003; Marschallek 2004): benefit cuts or more restrictive eligibility criteria in public schemes create a 'social protection gap' (Bonoli et al. 2000) and thus indirectly increase the demand for private pensions.

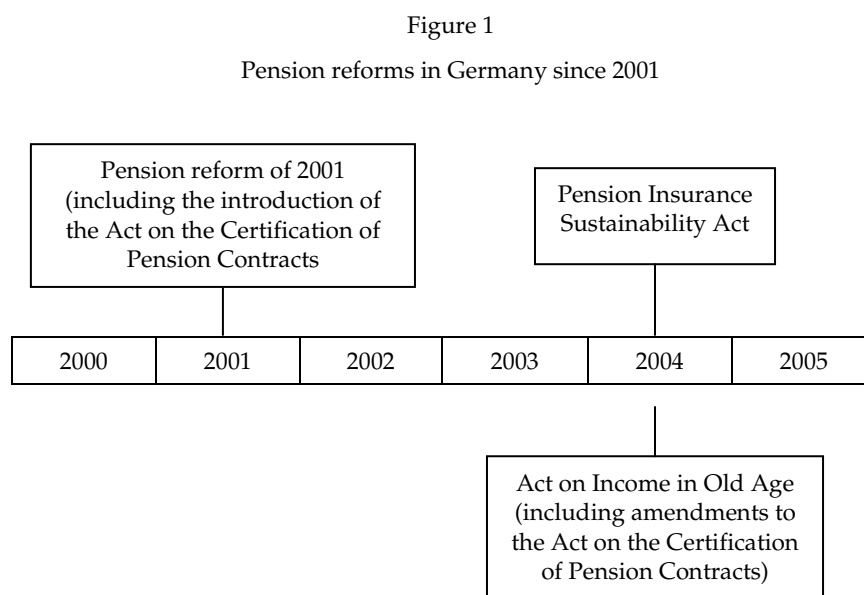
A stronger link between public and private pensions can be implemented by contracting-out arrangements. The basic idea of contracting out is that individuals are allowed to opt out of the public scheme if they are covered by a private scheme. Normally, the private schemes have to fulfil certain minimum standards, in order to provide an equivalent to the protection provided by the public scheme. The old-age security system in Great Britain is well-known for its contracting-out arrangements (Emmerson 2003; Blake 2004). In 1978, a public pay-as-you-go scheme was introduced (the State Earnings-Related Pension Scheme, SERPS). People covered by SERPS were allowed to opt out of the scheme and into an occupational private pension. They then had to pay lower contributions to the National Insurance System. Contracting out required that the private pension was a defined benefit scheme that guaranteed to pay at least as generous a pension as SERPS. Later, privatizing pension reforms in the 1980s and 1990s widened the range and lowered the minimum standards of contracting-out private schemes (Marschallek 2005). The British example shows that voluntary contracting out, encouraged by rebates or other incentives, can be used as a vehicle for privatization. In theory, the budget for public schemes can thus be kept small without cutting the replacement rate.

The closest connection between public and private schemes can be found where contributions to private pensions are made compulsory in order to formally replace public pay-as-you-go pensions. An interesting case of this type is the new Premiépension in Sweden, where a major pension reform with strong privatizing elements came into effect in 1998 (Palme 2003; Andersen 2005). Occupational and personal pensions already played a certain role before 1998, but these forms of pension provision have not been included in the reform. Instead, a funded component has been made part of the income related public scheme. Of the total 18.5 per cent contribution rate to the public scheme, 2.5 per cent are not used for the pay-as-you-go scheme, but redirected into individual investment funds. A public authority collects the contributions and manages the individual accounts. The investment funds themselves are administered and the investment of the capital managed by private companies. The private elements of the new premium pension are deeply embedded in a public framework, and there are clear rules about how the funded premium pension relates to the public pay-as-you-go scheme (Schwarze 2004). In the terminology of Kuptsch (2001), this type of privatization can therefore be called 'formal privatization'.

It can be resumed that national old-age security systems differ in respect to the established relation between public and private schemes. In most cases, 'privatizing' pension reforms do not mean a simple retreat of the state in the sense of a cutback in public provisions. Rather, the reforms change the relation between public and private schemes. This can even imply an increased involvement of the state in the form of regulatory pension policy (Leisering 2001 and 2006). As will be seen in more detail in the next section, the German pension reform of 2001 can certainly be called a kind of privatization, but it does not fit in one of the three categories of public/private-relations mentioned above. On the one hand, the reform intended to more than just decrease the benefit level of the statutory pension insurance: a whole number of measures has been taken to promote voluntary private pension provision. On the other hand, neither a contracting-out arrangement nor an explicit formal relation between the public and the private schemes have been introduced. The pension reform of 2001 is therefore more than just 'creeping privatization' or 'passive privatization', but it is less than 'formal privatization'. It has led to an unclear relation between public and private pensions.

3 The pension reform of 2001²

Germany has seen a number of major pension reforms since the coalition of the Socio-Democratic Party and the Green Party took over the government in 1998 (see figure 1).



The first of these was the pension reform of 2001. In the public debate, this reform is called the „Riester-Reform“, referring to the Federal Minister of Labour and Social Affairs in office at that time, Walter Riester. The principal aim of the reform was to control and to contain the rise of the contribution rate to the statutory pension

² The political conflicts about the reform package as a whole and about the changes concerning the statutory pension insurance have already been the object of several policy studies (Dünn and Fasshauer 2001; Nürnberger 2003; Hinrichs 2005).

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

However, in 2003 it became clear that the assumptions that had been made to calculate the projected target contribution rates for 2020 and 2030 had been too optimistic regarding the development of life expectancies and of the work force. New projections with updated assumptions predict a contribution rate of 21.5 per cent in 2020 (instead of 20 per cent) and of 24.2 per cent in 2030 (instead of 22 per cent). In order not to miss the target contribution rates for 2020 and 2030, another pension act, the so-called Pension Insurance Sustainability Act (*Rentenversicherungs-Nachhaltigkeitsgesetz*), was passed in 2004 with more measures to reduce the future standard pension level. The adjustment formula was changed once again by introducing the so-called sustainability factor (*Nachhaltigkeitsfaktor*). The sustainability factor is a parameter based on the ratio of the number of pensioners to the number of contributors. If the pensioner ratio rises (e.g. because of a rise in the average life expectancy or because of a shrinking work force), the benefit adjustment is smaller, and, as a consequence, the standard pension level is lowered. According to the projections, the introduction of the sustainability factor and other, minor, measures will bring about a decrease of the net standard pension level to 58.5 per cent in 2030 (see table 1).

Table 1

Recent German pension reforms and their effect on the replacement rate

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

Data for projected replacement rate: Hain et al. 2004

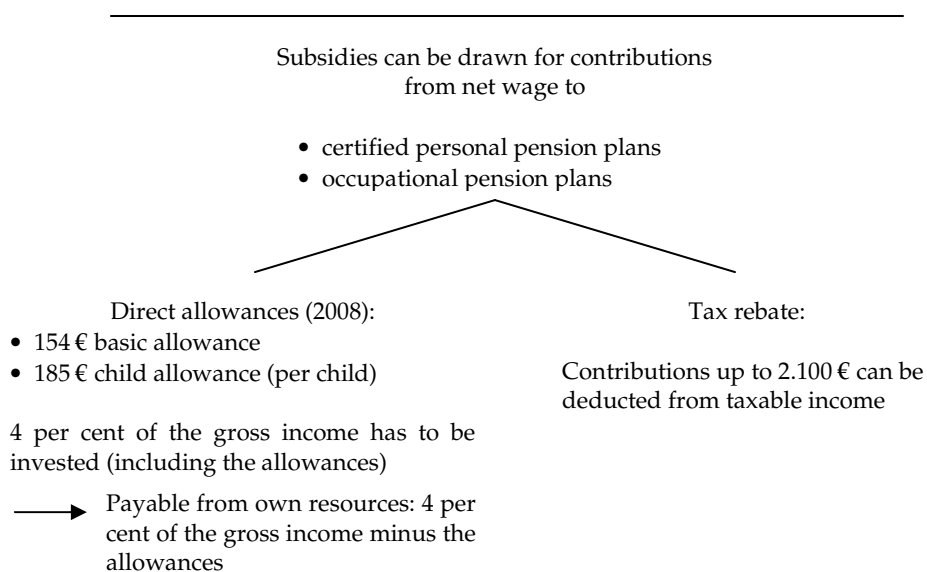
In order to gain acceptance for the reform, the government launched a programme to promote and to spread private pensions. The idea was that subsidized private pensions should compensate for the declining standard pension level of the statutory pension insurance (Bundesregierung 2001). The government decided to begin with the existing forms of private pensions (occupational as well as personal savings) as a starting point, instead of creating a completely new type of private pension. The government considered a high take-up rate more likely if people could just use the

³ It has since risen to 19.5 per cent.

well-known forms of occupational pensions and of personal savings.⁴ Private pensions were not made compulsory, but subsidies were introduced as an incentive. Basically, two types of subsidies were created, one for personal as well as occupational pensions, and one for occupational pensions only. In this paper I will only deal with the first type of subsidy: the so called 'Riester subsidy' (*Riester-Förderung*) (see figure 2).

Figure 2

The Riester Subsidy



The Riester subsidy can be claimed for contributions from *net wages* to

- either a funded occupational pension provision scheme⁵
- or a personal pension plan, if the plan is declared eligible for subsidies by the Federal Financial Supervisory Authority (see section 4).

The Riester subsidy consists of tax financed allowances and a tax rebate. If a saver pays contributions from his/her net wage to an eligible personal pension or to a funded occupational pension scheme, he/she will at least get the so-called basic allowance. For each child, the saver gets an extra child allowance. To get the full allowances, savers have to contribute an amount as high as 4 per cent of their gross wages per year (this is confusing: The savers are expected to contribute the amount of 4 per cent from their gross wages, but in order to draw the Riester subsidy they have to pay it from their taxed net wage). In fact, 4 per cent of the gross wage is the recommended contribution for 2008. The recommended contribution rate will rise in four steps. When the reform came into effect in 2002, it was recommended that from 2002 on, people spend 1 per cent of their gross wages from the preceding year. In 2004, this recommended rate rose to 2 per cent, in 2006 to 3 per cent and in 2008 it

⁴ As a high official from the Ministry of Health and Social Security said in a personal interview, there had neither been the time, nor the capacity, nor the willingness, nor the necessity to construct something new from scratch.

⁵ In fact, the Riester subsidy hardly applies to contributions paid into occupational pension plans (Kortmann and Haghiri 2005).

will reach the final level of 4 per cent. Individuals investing these proportions of their wages in eligible personal pensions are entitled to the full subsidies. If a saver invests less than the recommended rates, he/she will, on a pro-rata-basis, get lower subsidies. If he/she invests more, only the officially recommended amount will be subsidized.

The basic allowance and the child allowance are fixed annual lump-sums, financed from general tax revenue. The maximum amount of the allowances will rise in four steps from 2002 to 2008, parallel to the rise of recommended contributions. The basic allowance amounted to Euro 38 per year (in 2002), and rose to Euro 154 (in 2008), and the additional allowance for each child amounted to Euro 46 per year (in 2002), and rose to Euro 185 (in 2008) (see table 2).⁶ The allowances are already included in the percentage of the gross wage that people are supposed to contribute. This means that if a saver has several children, and if his/her gross wage is low, the allowances will make up for a great part of the total contribution. Therefore, parents and low earners only have to contribute a small amount of their own resources (see Viebrok et al. 2004: 131ff.). In fact, empirical data shows that parents and low earners (often people from the new Länder, and women) are overrepresented among those who draw the allowances (Stolz and Rieckhoff 2005).

Table 2
The rise of the Riester allowances 2002 - 2008

Years	Recommended total contribution (per cent of gross wage)	Basic allowance	Child allowance (per child)	Payable from own resources (per cent of gross wage)
2002 - 2003	1 per cent	38 €	46 €	1 percent less allowances
2004 - 2005	2 per cent	76 €	92 €	2 percent less allowances
2006 - 2007	3 per cent	114 €	138 €	3 percent less allowances
from 2008 on	4 per cent	154 €	185 €	4 percent less allowances

Later, in their annual tax assessment the savers can deduct the contributions they have made to an eligible personal or occupational pension from their taxable income. They thus get a tax rebate for their contributions. Because of the progressive income tax, the tax rebate for persons with high incomes may be higher than the allowance they have received in the first place. If this is the case, the tax authority does not refund the whole tax rebate, but only the difference between the tax rebate and the allowance. This means, in fact, that the tax authorities take the allowance back from people with high earnings. At the end of the day, the allowances make no difference for high-earners whose tax rebate amounts to more than the allowances. Only those people whose tax rebate is smaller than the allowances profit from the redistributive effect of the allowances. For a high earner, whose tax rebate amounts to more than

⁶ The final maximum amount of 154 €/185 € from 2002 has not been awarded in order to save public money. In 2005, the great coalition of the Social-Democratic Party and the Christian-Democratic Party agreed to increase the child allowance to 300 € per child (Bundesministerium für Arbeit und Soziales und Bundesministerium der Finanzen 2006). This increase in the child allowance is planned to come into effect in 2008.

the allowance, the system is nothing more than an application of the principle of deferred taxation, since the benefits that result from subsidized private pensions are fully liable to taxation.⁷

In the reform process, the government made the impression that the Riester pensions were meant to replace and to substitute public pensions. In 2001, the government introduced the concept of a 'total provision level' (*Gesamtversorgungsniveau*) into the pension debate (Bundesministerium für Arbeit und Sozialordnung 2001). It claimed that despite the declining pension level of the public scheme, future pensioners could maintain their living standard if they combined benefits from the statutory pension insurance and from the Riester pensions. The sum of the standard pension from the statutory pension insurance scheme and a sort of standard pension from the Riester pension was called 'standard total provision' (*Gesamtversorgung*). The ratio between this 'standard total provision' and the average net earnings would in the future still amount to a 'total provision level' of around 70 per cent – in German pension policy, this is traditionally considered enough to maintain the living standard. The 'total provision level' thus replaced the 'standard pension level' (*Standardrentenniveau*) as the yardstick for the policy goal of maintaining the living standard, a replacement that appeared to be the logical consequence of the shift from a one-pillar to a multi-pillar approach.

The concept of a total provision level indicated that public responsibility for the provision of a high benefit level remained, even if the benefits stemmed from several provision schemes. However, by declaring itself responsible for specific results from subsidized private pensions, the government implied a readiness to heavily regulate private pensions, and thus to reduce the privateness of subsidized private pensions. This was obviously not what the government really intended: by 2002 the government had already renounced an implicit guarantee of a standard benefit level from the Riester pensions. The idea was silently dropped and the term 'Gesamtversorgungsniveau' disappeared from the pension debate. Today, it is striking to see how anxious the government and its representatives are to call the subsidized private pensions 'supplementary pension provision' (*zusätzliche Altersvorsorge*) (Bundesministerium für Gesundheit und Soziale Sicherung 2005; Deutscher Bundestag 2005).

From a legal perspective, the voluntary Riester pensions are supplementary, since the reduction in public pensions is inevitable, regardless of whether an individual takes up a subsidized private pension or not (Steinmeyer 2002).⁸ On the other hand, from

⁷ Some commentators do not consider deferred taxation a subsidy, but just a principle of taxation. Due to the progressive taxation rate, savers profit from it only to the extent which their general income is lower during the benefit phase than during the contribution phase. According to this interpretation, the Riester subsidy consists only of the allowances, not of the tax rebate. The combination of an element of tax financed redistribution (the allowances) and of the deferred taxation principle in the system of Riester-subsidy is a tricky means of directing the allowances to low-earners and to parents, without having to employ means-testing.

⁸ There is only a tiny formal link between the two schemes. When reforming the statutory pension insurance in 2001, the government changed the formula used to calculate how much the benefits rise every year (the formula for benefit adjustment – *Rentenanpassungsformel*). In principle, the formula

the social policy perspective, the subsidized private pensions *replace* a part of the public pensions. Rein and Schmähl argue that the subsidized private pensions are “designed to substitute for the decline in the public pension system” (Rein and Schmähl 2004: 6). Hinrichs takes the same point of view: “Although officially called *supplementary* provision for old age, this component of future retirement income is in fact meant to *compensate* for the declining target replacement ratio” (Hinrichs 2005: 59). The interpretations of the relation between the statutory pension insurance and the certified and subsidized Riester pensions are obviously diverging. In this respect, the scientific discussion mirrors the ambiguous relation between the public and the private schemes.

4 The Act on the Certification of Pension Contracts and its reform

The programme to promote voluntary private pension provision consists of two components. The subsidy itself is the first element. Its legal regulation (who is entitled, the details of the allowances and of the tax rebate, to how much the subsidy amounts, the administrative procedures for granting and transferring the subsidy) have been made a part of income tax law. The second element of the new policy on private pensions is the certification of pension contracts. The government did not want the Riester subsidy to apply to any form of pension provision or saving, but only to particular pension plans: the so called Riester pensions (*Riester-Rente*). Therefore, in order to define which pension contracts are eligible for the subsidy, a second regulatory complex has been introduced beside the regulation of the subsidy itself: the Act on the Certification of Pension Contracts. Contrary to the regulation of the Riester subsidy, which has been implemented into tax law, the Act on the Certification of Pension Contracts is a legal act of its own.

According to the Act on the Certification of Pension Contracts, as it was passed in 2001, a personal pension is a Riester pension and qualifies for the Riester subsidy if the pension contract fulfils the following eleven requirements:

1. The saver has to commit himself/herself to continuously pay voluntary contributions.
2. Pension benefits must not be paid before benefits of the statutory pension insurance are paid or before the age of 60.
3. The provider has to guarantee that at least the total of the paid contributions (their nominal value) is available at the end of the contribution phase to be converted into an annuity.⁹
4. Benefit payments have to be paid monthly, continuously, and the monthly amount paid has to be constant or increasing until death. This can either take

indexes the benefits to the development of the gross wages. In the new formula, the amount that people are expected to contribute to private pensions (in 2006, 3 per cent and in 2008, 4 per cent of gross wages) is deducted from average gross wages. This has the effect that in 2006 the benefits are indexed to only 97 per cent of the average gross wages (and to 96 per cent in 2008). The government called this way of indexing the pension benefits the ‘modified adjustment to gross wages’ (*modifizierte Bruttolohnanpassung*).

⁹ This means that a minimum return of zero is guaranteed.

the form of a lifelong annuity or of a capital drawdown plan with a subsequent annuity for the remaining life time.¹⁰

5. In case of a capital drawdown plan, the drawdown payments have to be made monthly and continuously. Their amount has to be constant or increasing up to the age of 85. At the beginning of the benefit phase, a part of the accumulated capital has to be converted into an annuity that guarantees a monthly benefit payment from the age of 85 until death. The amount of the first benefit payment from the annuity has to be at least as high as the last payment from the drawdown plan.
6. The contract may include a supplementary survivor's pension.
7. Contributions can be paid into private pension insurance plans, bank accounts, or investment funds.
8. The acquisition and marketing costs have to be paid off over a period of at least ten years in equal amounts.¹¹
9. The providers have to meet certain transparency rules and provide a defined set of information.
10. The saver has the right to interrupt contribution payment. In addition, the contract can be cancelled and the accumulated capital be transferred to another Pension Contract with the same provider or with another provider.
11. Pension entitlements are protected against ceding and seizure.

In addition, the Act on the Certification of Pension Contracts determines the administrative procedure of the certification: It declares the Federal Financial Supervisory Authority responsible for checking if a contract is in line with the eleven criteria and, if it is, for granting the certificate. Finally, the act defines what documents the providers have to submit when applying for a certificate, and what fees they have to pay for the certification.

When the reform was passed in 2001, a great degree of enthusiasm spread among the potential providers of Riester pensions. They expected that up to three quarters of the 26.5 million individuals entitled to the subsidy would take up an eligible personal pension and draw the subsidies. This would have meant 18-20 million new contracts (Deutsche Bank Research 2001: 15). But in the first years after the reform came into effect, the take-up rates did by far not fulfil these high expectations. The Association of German Insurance Companies estimated that at the end of 2003 (i.e. almost two years after the new law came into force) the overall take-up rate was 10 per cent, instead of the expected 70-75 per cent (Gesamtverband der Deutschen Versicherungswirtschaft 2004). A survey of the Bertelsmann-Stiftung (Bertelsmann-Stiftung 2003) showed that at the beginning of 2003 16.6 per cent of those 30-50 years of age who were entitled to the subsidy had taken up a certified pension. In the long run, the Bertelsmann-Stiftung expected a take-up rate of 25 per cent. In addition, it

¹⁰ This requirement has been introduced to ensure a level playing field for all kinds of providers: banks, investment funds and insurance companies.

¹¹ This requirement prevents what is called 'zillmern': After a contract has been signed, all of the contributions for about the first two years are eaten up by the marketing and acquisition costs that have to be paid off. If the paying back of the fees and costs is stretched, a capital stock is accumulated right from the beginning (see section 5).

turned out that on average even those savers who had taken up a subsidized personal pension contributed less than the subsidized maximum amount per year. All in all, the total volume of contributions per year was only a small fraction of what the financial service industry had hoped to collect. As a consequence, a fierce debate evolved about the complexity and the density of the new regulations. The providers and the parliamentary opposition accused the government of making the Riester pensions unattractive by regulating them too much. The whole reform was disparaged as being a bureaucratic monstrosity and total flop (Sauga 2002; Fehr 2003). A reform of the regulatory framework, especially of the Act on the Certification of Pension Contracts, was called for. For example, a reform commission installed by the Christian Democratic Party (the so called Herzog Commission, since it was chaired by the former Federal President Roman Herzog) saw an urgent necessity to liberalize the certification criteria. In its report it proposed to reduce the number of requirements from eleven to three. Only the guaranteed minimum value of the total of the paid contributions (*Nominalwertgarantie*), the option to get a part of the capital paid out as a lump-sum (*eingeschränktes Kapitalwahlrecht*), and the requirement that benefit payments do not start before the age of 60 should be kept (Herzog 2003).¹²

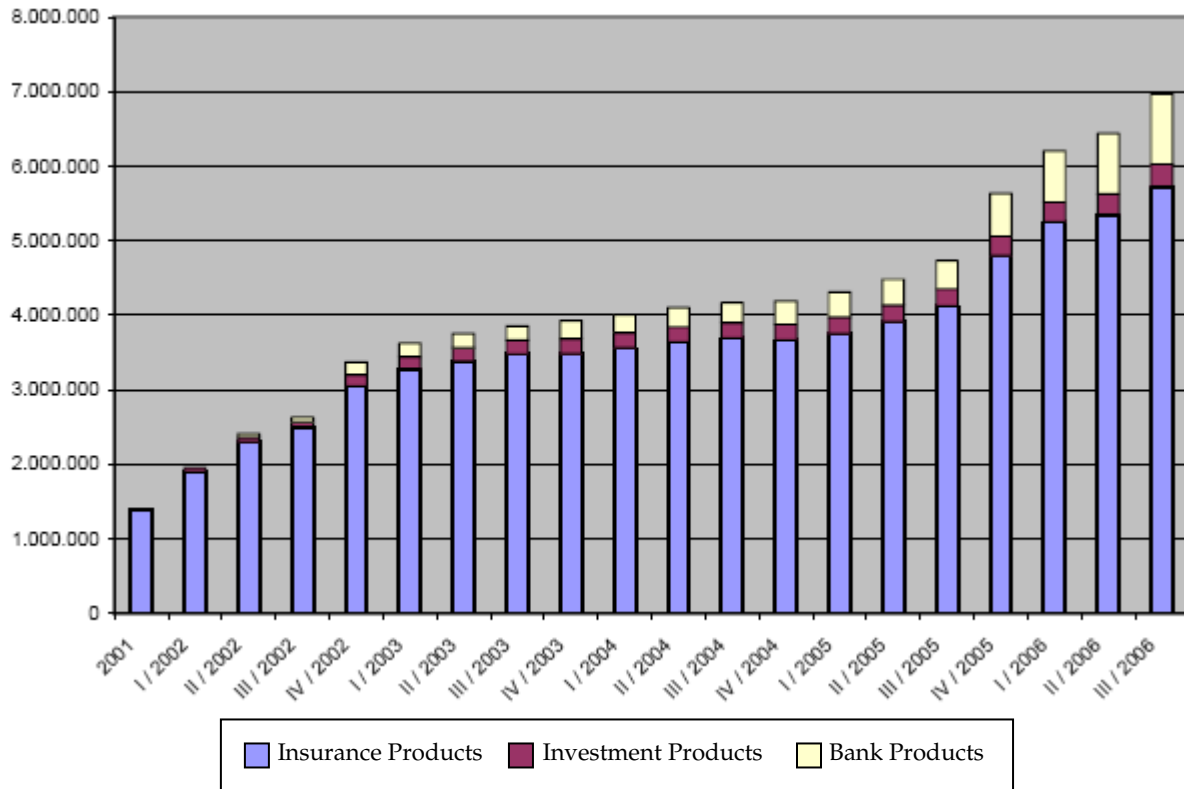
In 2004 the Act on Income in Old Age was passed (see figure 1). The main purpose of this act was to harmonize the taxation of the various pension schemes in Germany, but it also included some liberalizing amendments to the Act on the Certification of Pension Contracts. The draft of the act explicitly stated that the amendments were made in order to broaden the selection of certified pension plans (on the side of the providers) as well as to stimulate the demand for the Riester pension and for the subsidy (on the side of the entitled savers) (Deutscher Bundesrat 2004: 47 and 87). After the reform was passed, the government claimed that the Riester pension had been made much more attractive. And indeed, after the amendments came into effect in 2005, the take-up of Riester pensions increased significantly (Gesamtverband der Deutschen Versicherungswirtschaft 2006; Bundesverband Investment und Asset Management e.V. 2006) (see figure 3).¹³

¹² At the same time, a commission installed by the government and chaired by Bert Rürup pointed out the importance of increasing the take-up rate. To increase the take-up rate, the commission suggested modifying some of the regulations in order to make the system of subsidies more transparent. The commission admitted that this would mean more paper work for providers as well as for the supervisory authority, but it considered transparency indispensable if take-up rates were to increase (Bundesministerium für Gesundheit und Soziale Sicherung 2003).

¹³ It is difficult to assess whether the increasing take up is a consequence of the reform of the Act on the Certification of Pension Contracts, or if the take-up rates would have gone up anyway, just because people are becoming accustomed to the Riester pensions.

Figure 3

Take-up of Riester pensions 2001-2006



Source: Bundesministerium für Arbeit und Soziales und Bundesministerium der Finanzen 2006

5 Controversial issues in the reform of the Act on the Certification of Pension Contracts

The general aim of the reform of the Act on the Certification of Pension Contracts in 2004 was to liberalize and to simplify the certification. The number of certification requirements has been reduced from 11 to 5. Yet, a closer look reveals that the certification has not been liberalized to a great extent. Some of the criteria have been dropped because other regulations with the same function already existed. The original criterion number 7, for example, was redundant, because another passage of the Act on the Certification of Pension Contracts already defined which providers were allowed to offer Pension Contracts. The supervisory law for these providers restricts the range of products in the same way that criterion number 7 did. Criterion number 11 could also be dropped as the ceding and the seizure of Pension Contracts had already been prohibited by other regulations. Other modifications of the act were editorial changes: The criteria 4 and 5, for example, were simply combined into one requirement. Some commentators therefore called the reform a bluff package.

Apart from such symbolic policy making (Sarcinelli 1987) in the name of liberalization, three substantial changes have been discussed in the parliamentary process leading to the amendments of the Act on the Certification of Pension Contracts. Two of them – the compulsion to transfer the accumulated capital stock into an annuity, and the compulsion to apply gender-neutral annuity calculation –

have been discussed with an explicit reference to the statutory pension insurance. A third feature – the liberalization of the rules on the distribution of the marketing and acquisition costs – was not discussed in relation to the statutory pension insurance, but presumably had an impact on the take-up rate.

Compulsory annuitization

The Act on the Certification of Pension Contracts, as it was introduced in 2001, required that, in order to be certified, personal pensions have to provide for a disbursement either in the form of a lifelong annuity or a drawdown pension until the beneficiary reaches 85 years of age and a subsequent lifelong annuity. After the reform of 2001 came into effect, the Financial Services Supervisory Authority interpreted the Act on the Certification of Pension Contracts in a liberal way that allowed paying out 40 per cent of the capital stock in a lump sum, i.e. without annuitizing it (Bundesanstalt für Finanzdienstleistungsaufsicht 2004). Nonetheless, in the parliamentary debate preceding the reform of the Act on Income in Old Age, the financial services industry and market-liberal policy makers argued that compulsory annuitization even of 60 per cent of the capital amount had a deterrent effect on young people for whom retirement is still far away. Young people were said not to like the idea of saving money for many years and then, after the contribution phase, not having the capital at their free disposal. The associations of the financial service companies claimed that compulsory annuitization especially drove young people away from the Riester pensions and pleaded to completely drop the annuitization requirement (Zentraler Kreditausschuss 2004). The Liberal Party suggested making the annuitization compulsory for 50 per cent of the accumulated capital, and to let the other half be paid out as a lump sum (Deutscher Bundestag 2004).

On the other hand, two arguments in favour of compulsory annuitization of the total capital amount have usually been put forward in the debate. The first one is the comparison with the statutory pension insurance: subsidies should only be granted for financial products that lead to full fledged pensions and not only to a capital stock (Rürup 2005). Only then will the subsidies fulfil their purpose, since they have been introduced to promote private provision in order to compensate for the decline in the benefit level of the statutory pension insurance – and the statutory pension insurance only pays annuities. A second, related argument is that beneficiaries have to be prevented from using up the capital stock before the end of their lives or from frittering it away in a light-hearted manner and then becoming dependent on social assistance (Riester 2004). Many policy makers consider compulsory annuitization an important instrument for securing a constant pension income until the end of life, and ultimately for preventing poverty in old age. Both arguments were shared by a large part of the policy community. At the end, the reform of 2004 strengthened the principle of annuitization: From 2005 on, 70 per cent of the capital stock has had to be transformed into an annuity; the other 30 per cent can be paid out as a lump-sum. This means that in 2004 the annuitization regulation become even stricter.

Gender-neutral annuity calculation

Although the general purpose of the reform of the Act on the Certification of Pension Contracts was to reduce the number of requirements, one requirement was introduced additionally: the unisex requirement. In the German insurance sector, it is common practice to calculate annuities on the basis of the different average life expectancies for men and women. As a consequence, the transformation of the same capital stock into an annuity results in a lower monthly benefit payment for a woman than for a man, simply because women have a higher average life expectancy than men. Or, to put it the other way round: Women have to pay higher contributions and accumulate more capital for the same monthly pension benefit.

The different treatment of men and women in actuarial theory was already a controversial issue in the policy process leading to the reform of 2001. In 2000, at the beginning of the policy process, the government proposed that a unisex requirement should be considered (Deutscher Bundestag 2000: 63). The associations of the financial services industry (of the insurance, the banking and the investment sector), lobbyists from influential insurance companies, and market-oriented liberal policy makers (from the ministry of finance as well as from the liberal and the green party) tried to prevent such a requirement. They pointed to the statistical fact that men and women differ in their average life expectancies and constitute, in the logic of actuarial theory, two distinct risk groups. Pooling the two groups would mean the introduction of an element of redistribution from men to women, making the unisex pensions unattractive to men. In a process of adverse selection, men (the good risks because of their lower average life expectancy) would refrain from taking up such plans. The contracts for the remaining women would then become more expensive. At the end of the day, unisex Riester pensions would be unattractive to men as well as women. In the reform of 2001, the anti-unisex coalition was successful: the Act on the Certification of Pension Contracts, as it was passed in 2001, did not include such a certification requirement (see above, section 4).

But after the reform of 2001 had come into effect, the advocates of a gender-neutral annuity calculation continued to campaign. A large coalition was formed by feminist movements, the women-sections of the different political parties and of the trade unions, and left-wing politicians from different parties (see www.tagderabrechnung.de). Their most powerful argument was that the Riester pensions were meant to *replace* a part of the benefits from the statutory pension insurance. The Riester pensions should therefore be made as similar to the statutory pension insurance as possible.¹⁴ And since the benefit calculation formula of the statutory pension insurance scheme does not distinguish between men and women, the Riester pensions should not distinguish between men and women either (Kopischke 2006). Between 2002 and 2004, in the course of the policy process leading

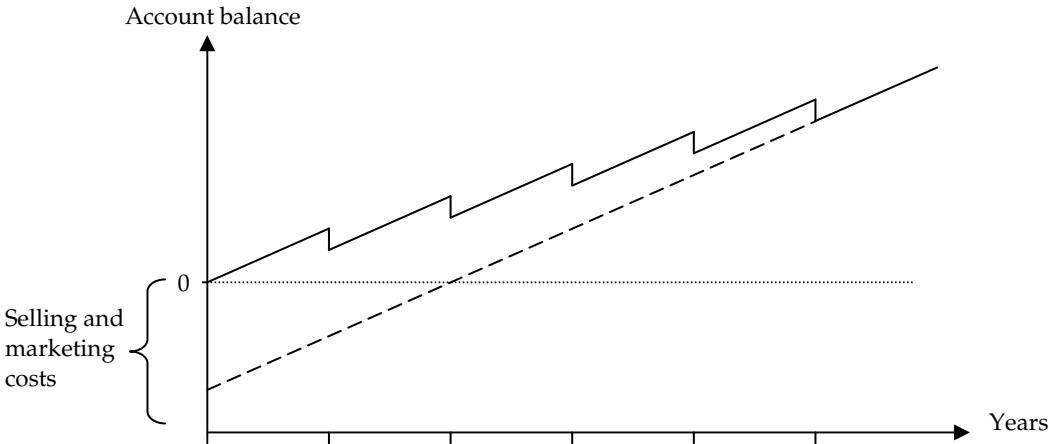
¹⁴ In 2004, the coalition campaigning for the gender-neutral annuity calculation had an additional advantage: at that time, the European Commission planned to prohibit discrimination between men and women in the whole insurance sector (Kopischke 2006). The proponents of unisex Riester pensions could thus claim that a differentiating annuity calculation would sooner or later be prohibited anyway.

to the reform of the Act on the Certification of Pension Contracts, the pro-unisex coalition managed to get the financial committee of the parliament and the red-green government to support the unisex requirement – although the requirement was heavily disputed in the financial committee (Deutscher Bundestag 2004). Eventually, the campaign for a unisex requirement was successful: With the reform of 2004 the unisex requirement was inserted in the Act on the Certification of Pension Contracts. The regulation has become stricter: From 2006 on, only such personal pensions are certified and are then eligible for subsidies if they provide gender-neutral annuities.

The distribution of acquisition and marketing costs

In the German insurance sector it is a common practice to cover the acquisition and marketing costs with the contributions paid at the beginning of the contribution phase. This means in fact that when a new contract is signed, the new individual saving account is debited with these costs. The contributions of approximately the first two years (depending on the amount of the costs and of the size of the contributions) are used to pay off this initial debt. The accumulation of a capital stock starts only after the saving account is balanced (the dashed line in figure 4). Expenses for marketing, for the advisory service preceding the signing of the contract, and for setting up the contract are hence recovered in a hidden manner. From the perspective of consumer protection this practice is more than dubious in two respects. First, the insurance companies and their selling agents are reluctant to make this way of covering their expenses transparent, for obvious reasons. Many clients do not understand the mechanism and think there are no fees. Second, if a saver cancels the contract in the first few years, he/she will get nothing or very little in return. This is not only a theoretical but a real life problem of some relevance, since the cancellation rate in the first few years is quite high.

Figure 4
The distribution of selling and marketing costs over five years



In order to reduce the financial loss in case of an early cancellation of the contract, the government determined in 2001 by means of a certification requirement that only

personal pension contracts are eligible to the Riester subsidies whose selling costs are paid off over a period of at least ten years in equal annual amounts (see above, section 4). This meant that in each year the individual savings account could be debited with only a tenth of the selling costs. The legally enforced spreading of the repayment of the costs is consumer friendly: If the saver cancels the contract after, for example, three years, he/she has paid off only a part of the acquisition costs and will get paid back more accumulated capital. Consumer protection associations even suggested obliging the insurance companies to spread the repayment of the selling costs to the whole term of the contract, which could be up to 25 years or more.

Before and after the reform of 2001, the insurance industry strongly opposed this certification requirement. Again, their representatives argued that it kept the take up of the subsidized Riester pensions low, because it had the effect of a disincentive for the selling agents to actively offer Riester contracts. The longer the repayment of the acquisition costs has to be spread, the later the selling agents and the insurance companies get their expenses covered, and the higher their risk of not getting them covered at all, in the case that a saver cancels the contract before all costs are paid off. According to the insurance industry, this regulation made the selling of certified pension contracts unprofitable and unattractive for the selling agents. In this case, the original regulation from 2001 was made less strict in 2004: from 2005 on, the repayment of the acquisition costs has had to be spread over five years instead of ten (the zigzag line in figure 4). From the perspective of the selling agents and the insurance industry, this liberalization is an improvement to the regulation from 2001.

6 Two approaches to subsidized private pensions

I have argued that the pension reform of 2001 has not established a clear relation between the statutory pension insurance and the new certified and subsidized Riester pensions. The unclear status of the Riester pensions has left room for contradicting interpretations of how they relate to the statutory pension insurance. Between 2002 (when the Act on Certification of Pension Contracts came into effect) and 2004 (when it was amended), the debate about the reform of the Act on the Certification of Pension Contracts was framed by the polarity between substitution and supplement. The preceding section has shown that the political debates about gender-neutral annuity calculation and compulsory annuitization have been characterized by divergent interpretations of how the Riester pensions relate to the statutory pension insurance. From the great range of particular positions in this debate on how to interpret the Riester pensions, two ideal types can be distilled: the 'assimilation approach' and the 'distinctiveness approach' (see table 3).¹⁵

¹⁵ Both approaches are ideal types in the Weberian sense (Weber 1982): They do not describe the empirical world as we can observe it. They are images, constructed by the social scientist in order to simplify the empirical diversity.

Table 3
Two ideal types of regulatory approaches

Ideal types	Perception of the subsidized private pensions	Expectations towards the public policy on private pensions
Assimilation approach	replacing statutory pension insurance	transfer features of the statutory pension insurance to the subsidized private pensions
Distinctiveness approach	essentially distinct from statutory pension insurance, with particular principles and mechanisms, supplementing public pensions	nurture and stimulate market mechanisms, leave decisions to market participants

The proponents of the *'assimilation approach'* emphasize that benefits resulting from Riester pensions replace what pensioners are losing from the statutory pension insurance. Actors holding this view tend to argue that the Riester pensions should reproduce features of the statutory pension insurance – like gender-neutral annuity calculation and annuitization. In general, they favour a policy on private pensions that transfers principles and features of the statutory pension insurance to the subsidized private pensions. They do not reject private pensions per se, but are reluctant to depart from the one-pillar approach in pension policy because they expect that expanded private pensions will result in more inequality and poverty in old age. The assimilation approach is shared by policy makers and experts who are hooked on traditional social policy goals, in general, and on traditional goals of pension policy, in particular. They expect to solve what is perceived as a social problem by means of coercive state intervention. Some of the trade unions (the IG-Metall and Ver.di) and the Deutsche Rentenversicherung (the organisation administrating the statutory pension insurance) would prefer making the Riester pension a second statutory pension insurance. Members of the Ministry of Labour and Social Affairs also sympathize with a stricter state regulation of private pensions – although Walter Riester has a rather liberal view (see below).

The second ideal type is the *'distinctiveness approach'*. Actors sharing this view of the world emphasize the fundamental differences between the public and private pension schemes. From their point of view private pensions are essentially distinct from and not comparable to the statutory pension insurance, and can therefore never replace public pensions. Because of the essential differences between the statutory pension insurance and private pensions, transferring features of the statutory pension insurance to private pensions reduces the effectiveness of private pensions. Public policy on private pensions should rather enhance market principles and the freedom of choice. The distinctiveness approach is typically represented by market-liberal policy makers, by members of the Ministry of Finance, and by experts involved in the policy networks dealing with occupational and personal pensions.

Interestingly, politicians supporting the distinctiveness approach can also be found in the SPD and in the Green Party. In a personal interview, a high-ranking member of the Green Party insisted that the subsidized personal pensions are not substituting but supplementing public pensions. The Green Party supports and promotes the 'Altersvorsorgekonto', a market-liberal concept developed by the federal association of investment and asset management companies (Scheel 2004). Walter Riester, the former Minister of Labour and Social Affairs and a member of the social-democratic party, emphasized the supplementary character of the subsidized pensions. Although he intended to make private provision compulsory at the beginning of the reform process, he is now in favour of the voluntary solution. Furthermore, he considers the unisex requirement to be counter-productive (Riester 2004). Even protagonists of consumer protection are not in favour of too much state intervention. They criticize unfair conditions on markets, but in principle they are convinced that markets can solve many problems if they are not overly regulated.

One of the most powerful players in the policy field of private pensions is the Ministry of Finance. This is due to the fact that taxation is an important means for regulating the structure of private pensions and stimulating the demand for provision products. Although Walter Riester was generally in charge of the pension reform in 2001, the Ministry of Finance has developed much of the details concerning the subsidized private provision. The subsidies, for example, are completely regulated by tax law. The Financial Supervisory Authority that is responsible for the certification of pension plans is subordinate to the Ministry of Finance. Both authorities, the Ministry of Finance and the Financial Supervisory Authority, have close contacts to the providers of private pensions, and the members of both tend to share the ideas forming the distinctiveness approach.

7 Conclusion

A first conclusion that can be drawn is that from a bird's eye view, and compared to other Western-European welfare states, the pension reform of 2001 in Germany has only half-heartedly incorporated private pensions into the sphere of the social state. It is true that the pension reform of 2001 brought about a paradigmatic change in the overall policy of old-age security. But the links between public and private pensions are much stronger in other countries. No new private pension scheme has been introduced (such as the Premiépension in Sweden), but existing forms of occupational and personal pension provision have been modified and fitted with new subsidies. This fits a well-known pattern of welfare reform in Germany: Even revolutions take place on a small scale. The German tradition of welfare reform remains unchanged: "old institutions are reformed from within: they change substantially but retain basic characteristics and continue to be viewed as the same institutions" (Leisering 2001: 178). The public/private-mix in the average income in old age will certainly change in the long run, but the institutional change induced by the pension reform of 2001 is not really radical.

In this paper I have shown that the comparison of the Riester pension and the statutory pension insurance played an important role in the political debate preceding the reform of the Act on the Certification of Pension Contracts in 2004. Political actors considering the Riester pension a substitute for the declining pension level of the public pensions called for the unisex requirement and for stricter regulation of the annuitization. Adherents of market-liberal ideas, in contrast, argued that the Riester pensions are a supplement to declining public pensions, and are most efficient if state intervention is reduced to a minimum. The initial assumption has been confirmed that the policy of private pensions depends on how private pensions are conceived in relation to the public scheme. The stronger the link between public and private schemes, the more the regulatory policy on private pensions pursues social policy goals, and the stricter are private pensions regulated. The reform of the Act on the Certification of Pension Contracts included elements of liberalization as well as elements of stricter regulation. The regulation of the annuitization, and the obligation to use gender-neutral annuity calculation have been regulated in a stricter way. These were issues where references to the statutory pension insurance could be made. The regulation of how fees and marketing costs can be recovered has been liberalized; but, interestingly, this liberalizing element has been carried through with the aim of increasing the take-up rate of Riester pensions and thus ultimately enhancing financial security in old age.

However, the reform of 2004 has still left the relation between the statutory pension insurance and the new subsidized private pensions undefined. The German public policy on private pensions is at a crossroads, and it is still not clear, in which directions future developments will go. In this respect, an important decision will have to be made in 2007: the decision to either leave private provision for old age voluntary or to make it compulsory. The coalition of Christian Democrats and Social Democrats has announced that they will decide on this issue in 2007. Compulsion would have far reaching consequences for the design of the whole system, probably involving considerably more regulatory measures and strengthening the welfare orientation of regulatory pension policy.

The rise of the regulatory welfare state implies a blurring of the distinction between public and private. I suggest understanding the ambiguous status of the Riester pensions between substituting and supplementing public pensions as an expression of their hybrid character: Riester pensions are neither clearly public pensions nor clearly private pensions, but combine elements of both. Policy makers interpreting the Riester pensions as substituting public pensions emphasize their public side and plead for more regulation. Others who view the Riester pensions as supplementing public pensions see them more as private, and disapprove of state intervention. The dispute whether the Riester pensions are supplementing or substituting public pensions reflects deep-rooted convictions on how much state intervention into private pensions is legitimate, and how private pensions should be. By inventing the Riester pension, the government has created a new segment of private pensions with a stronger public side than, say, conventional non-earmarked personal saving. The pension reform of 2001 has thus rocked the traditional relation between public and private in old-age security.

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