

Paper presented at the  
European Network for Social Policy Analysis (ESPAnet) 8th Annual Conference: Social  
Policy and the Global Crisis: Consequences and Responses  
September 2-4 2010, Budapest, Hungary

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**Stream 10. Pension Policies**

**Draft 24<sup>th</sup> August 2010**

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**Effects Of The Current Economic Crisis On The Pension Schemes Of Coordinated And  
Liberal Welfare States In Europe**

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## **1. Introduction**

The global financial and economic crisis still keeps the economies busy. Neither the length nor the depth are predictable so far, but it is sure that the crisis will have effects on the social security systems. Nevertheless, the interaction of the weaknesses in the European labour markets and its huge impacts on the corresponding welfare states' pension schemes is often not considered. Therefore, this paper pursues the question which implications the present financial and economic crisis will have on the private old age security systems of the European countries - the so called second and third pillar pensions.

Carrying out a comparative analysis, the paper attempts to answer the following questions: Which countries are more successful in anticipating the arising negative consequences of the crisis on the private pension schemes and why? To which extent a pension scheme is affected in general certainly depends on the length and depth of the crisis, but particularly on the governments' path-dependent reaction to the crisis. Therefore, the objective of the paper is to analyze the institutional arrangements of the specific private pension schemes.

The comparative analysis instrument of coordinated and liberal market economies of the 'Varieties of Capitalism' (VoC) approach of Hall and Soskice (2001) serves as theoretical framework. The 'Varieties of Capitalism' approach focuses on the connection of economic performance and welfare-state arrangements. In addition to institutional frames, methods of production and country-specific labor relations on firm level are also considered. In this regard, Hall and Soskice also refer to the relevance of institutions, organizations and culture, which have a demonstrable influence on the problem solving strategies of firms. In order not to go beyond the scope of this paper, limits were set concerning the investigated political economies. So, the work discusses Germany as coordinated and Ireland as liberal market economy examples. Accordingly, the paper strives to develop the institutional reasons for dealing with the crisis differently in both types of political economies.

First, the paper describes the 'Varieties of Capitalism' approach as analytical concept in general. Then, its arguments are sharpened concerning private pension schemes proposing subsequently hypotheses concerning the impacts of the crisis on these systems. Second, the Irish and German old age security systems are presented to highlight actual effects of the crisis on second and third pillar pensions in both countries. Finally, the proposed hypotheses are verified or falsified allowing also some summarizing remarks.

## **2. Which effects can be expected according to the ‘Varieties of Capitalism’ approach of Hall and Soskice?**

### **a. The ‘Varieties of Capitalism’**

Hall und Soskice (2001) differentiate welfare-states between two types of political economies - coordinated (CMEs) and liberal market economies (LMEs). For instance Germany, Austria, the Netherlands and the Scandinavian countries can be classified as coordinated market economies. They can be characterized by multitude variations of non-market relationships as well as investments in specific assets. It is a type of market economy with a lower stock market capitalization and therefore long-term credit-financing of firms by a few main banks and firm control by a board of directors. Company performances are not left to pure market principles. Behavior and appearance of firms is mostly a result of strategic interaction with other players such as employee organizations and public institutions (Hall/Soskice 2001: 8-10). Firms do not take their own internal hierarchy as basis for their action but cooperate with external firms, players or institutions or build networks for achieving their objectives. In general, coordinated market economies tend to have a network of different institutions to coordinate financial and industrial relations (Hall/Soskice 2001: 19).

The second category of liberal market economies is more or less synonymous with the liberal welfare states category of Esping-Andersen (1990). Examples are UK, Ireland and the USA. First of all, liberal market economies rely on market mechanisms and invest therefore in transferable assets. This involves a huge stock market capitalization of firms and their control by the market and accordingly lower rights of co-determination. Market relations can be described by competition and formal contracts. The exchange of goods and services is based on market economic competition. So, firms follow internal hierarchies for reaching their goal – the profit maximization (Hall/Soskice 2001: 8f). Altogether, liberal market economies tend to act on the basis of market mechanisms to coordinate their endeavor in the industrial and financial sector (Hall/Soskice 2001: 19).

Hall and Soskice also spot on a third group of economies that are described here for completeness but are not further discussed in detail. This third group of countries is difficult to cluster and is therefore also named ‘ambiguous position’. These countries are France, Italy, Spain, Portugal, Greece and Turkey. They are sometimes also called Mediterranean group. Since they can be characterized by a large agrarian sector and recent histories of extensive state intervention, it makes them let look like liberal market economies concerning labor

relations and like coordinated economies concerning non-market coordination in the sphere of corporate finance (Hall/Soskice 2001: 20f.). Using the ‘Varieties of Capitalism’ approach, which conclusions can be drawn concerning the organization of private pension schemes?

**b. Integration of private pension schemes in the ‘Varieties of Capitalism’ approach and its reference to the financial and economic crisis**

In the following, the system of private pension schemes is integrated in the ‘Varieties of Capitalism’ approach of Hall and Soskice (2001) to analyze the effects of the financial and economic crisis on the schemes more precisely.

In context of the development of global financial market capitalism, the attention was especially on systems of corporate governance, i.e. structures, institutions and mechanisms of the corporate charta. In contrast to firms in LMEs, companies in CMEs are characterized by a strong stake of commercial and firm’s banks<sup>1</sup>. So, they have a lower stock market capitalization and a rather long-term credit-financing of firms by these firm’s banks and firm control by a board of directors.

*Hypothesis 1: LME firms are stronger affected by the volatility of financial markets. So, the financial market crisis leads to a higher number of companies going bankrupt in LMEs compared to CMEs. Subsequently, these bankruptcies put pressure on the financing of private pension schemes.*

On the other hand, cooperative management strategies also play an important role taking into account the interests of different stakeholder groups. Especially the interests of the employees, also in case of retiring from a company, are considered strongly. In contrast to this, the stock market and shareholders have a privileged role in LMEs being expressed in particular by management concepts driven by stock prices.

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<sup>1</sup> In the case of a firm’s bank there is a long term relationship between the capital seeker and the bank. Furthermore, the capital seeker has certain exclusivity with regard to the handling of all its financing contracts. Therefore, the firm’s bank is a bank with a higher business volume transacted than with any other bank. Finally, it is also a long-lasting and trusting relationship that is characterized by mutual understanding (Gabler Wirtschaftslexikon 2010).

*Hypothesis 2: The extent of occupational pension plans is larger in CMEs compared to LMEs. In LMEs, second pillar (occupational) pensions do not play such a big role and especially the third pillar (private) pension schemes are the most relevant there. Since the third pillar is strongly affected via the equity market in times of crisis, this pillar is more affected than the occupational second pillar schemes.*

Furthermore, the relations with own employees are emphasized as an independent field of coordination. For a firm it is especially important to use the individual skills, knowledge and performance of its employees via specific incentives. Firms in CMEs focus on a comprehensive and specialized training and forms of cooperative participation. In LMEs, firms offer less specialized training. They offer a more general training and focus on monetary incentives and gratification.

*Hypothesis 3: Companies in CMEs have a high interest in benefiting from their employees skills and knowledge since they have firm-specific human resources. Therefore, the firms in CMEs tend to retain the staff even during the economic crisis. Since the ongoing employment status is secured it also allows the continuous payment for private pension schemes.*

The ‘Varieties of Capitalism’ approach also considers the interests developed by players within existing institutions. For this purpose, the expectations of players about the probable behavior of others are of great importance. Precondition for these expectations are certain common interpretations, often described as the common knowledge of players. Hall and Soskice (2001: 12–14) argue that these common perceptions, on which the strategic coordination is based on, have to be much more sustainable. When the prosperity or the survival of a company is at risk, managers want to secure that their expectations about the behavior of other players is founded. In some cases, institutions can hold this security. In other cases, the security about the expectations strongly depends on the preceding experience with the corresponding players and on the obtained common conception.

So, the history of an institution plays an important role due to the development of a path-dependency based on historical developments. The path-dependency is a result of a strategic coordination being dependent on a number of general conditions. So, a massive change in conditions because of exogenous shocks can result in a path breaking, on a national or international level. This can lead to the destabilization of existing arrangements and can finally result in an overall institutional change.

*Hypothesis 4: Despite of an exogenous shock in form of a financial and economic crisis, CMEs and LMEs react path-dependent within their market system.*

Hall and Soskice (2001: 17ff.) also assume that an institution is complementary to another institution if its existence and its functioning increases the output that can be obtained by the other institution. According to Boyer (2005), it can vary from institution to institution and economies respectively how these effects exert and which institutions are complementary to each other can. Furthermore, Hall and Soskice (2001) suggest that institutions facilitating the strategic coordination in one economic domain often provide also for a better strategic coordination in other domains by offering the necessary support for the formation of credible commitments working in more than one domain.

*Hypothesis 5: There are more comprehensive private pension schemes in LMEs and hence a minor importance of public pensions. So, the family has for instance a complementary function in LMEs as social net for old age security. Therefore, CME pension systems shield better against individual old age poverty, since the public social security still holds the most important, the first pillar.*

Before verifying these proposed hypotheses on the basis of existing data, the Irish and German old age security systems are described briefly.

### **3. Old age security in Ireland and Germany**

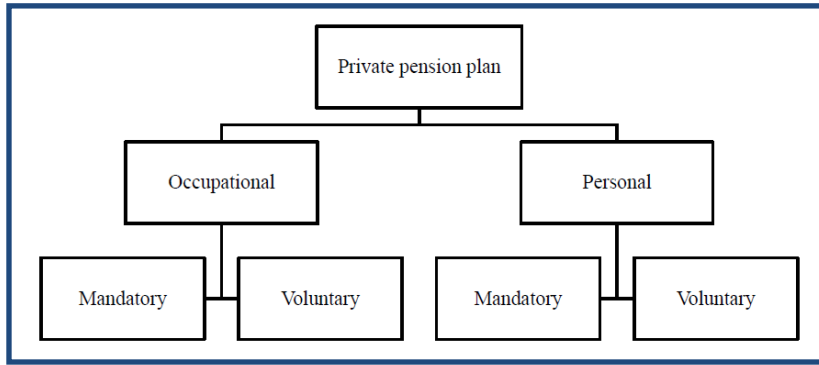
Primary goal of old age security systems is the coverage of the longevity risk of an individual which of course is no risk in the narrower sense but the associated loss of income due to retirement. Because of different ways to secure this coverage, a generic classification of pension systems of developed economies is difficult due to the diverse architecture of national retirement-income regimes and a various number of different programs. Nevertheless, both the World Bank and the OECD use taxonomy of a three pillar model (World Bank 1994, OECD 2005a, 2005b, 2007, 2009a, 2009b). According to Immergut and Anderson, the pillar describes the sector in which a pension program is located, i.e. whether it is a public, an occupational or private scheme. These sectors are split up in tiers to indicate the type of benefit (targeted, minimum, flat-rate, earnings-related or defined contribution in an individual account). Furthermore, it indicates whether benefits are mandatory or voluntary. A vertical

division of programs allows distinguishing special schemes for different (occupational) beneficiary groups (Immergut, Anderson 2006).

First pillar (public)	Second pillar (occupational)	Third pillar (private)
Third tier:	Third tier: Voluntary occupational pension	Third tier: Voluntary private pension
Second tier: Earnings-related part of pensions	Second tier: Government-subsidized occupational pension	Second tier: Government-subsidized private pension
First tier: Basic pension  ----- Means-tested part	First tier: Mandatory occupational pension	First tier: Mandatory private pension
Social assistance		

**Figure 1: Classification of pension systems (according to Immergut/Anderson 2006: 22).**

Over the last two decades there was a large shift towards the second and third pillar, the sector of private pensions, in virtually all developed economies. Therefore, the OECD uses further detailed taxonomy to classify private pension plans. As illustrated below, from a functional point of view, private pension plans can be divided in occupational and personal pension plans which are further distinguished in mandatory and voluntary plans again. Private pension plans are either defined contribution (DC), defined benefit (DB) or mixed schemes (OECD 2005a). In DC plans, “the plan sponsor pays fixed contributions and has no legal or constructive obligation to pay further contributions to an ongoing plan in the event of unfavorable plan experience” (OECD 2005a: 14), whereas in traditional DB plans, “benefits are linked through a formula to the members’ wages or salaries, length of employment, or other factors” (OECD 2005a: 14). There also exists a second approach to classify private pension plans from an institutional perspective which is albeit not considered here in detail.



**Figure 2: A functional view on private pension plans (according to OECD 2009a: 32)**

**a. The pension system of Ireland**

As in most other countries, the Irish pension system follows the above mentioned three pillar model, consisting of public, occupational and private pension programs as the following figure indicates.

First pillar (public)	Second pillar (occupational)	Third pillar (private)
Third tier: None	Third tier: Voluntary occupational pension	Third tier: None
Second tier: None	Second tier: Subsidized and regulated voluntary occupational pensions	Second tier: Subsidized private pensions (PRSA)
First tier: Social Welfare Pensions (Contributory Old Age Pension and Retirement Pension) ----- Minimum old age pension	First tier: None	First tier: None
Non-Contributory Old age pension and social assistance		
Total population covered	43 % of employees covered	15 % of people covered

**Figure 3: The pension system of Ireland (according to Schulze/Moran 2006: 772)**

The public basic pension (first pillar), the so called Social Welfare Pensions consisting of the Old-Age Pension and the Retirement Pension, is a flat-rate pension and linked to employment. It is extremely low by international standards and targets the coverage at the poverty level,

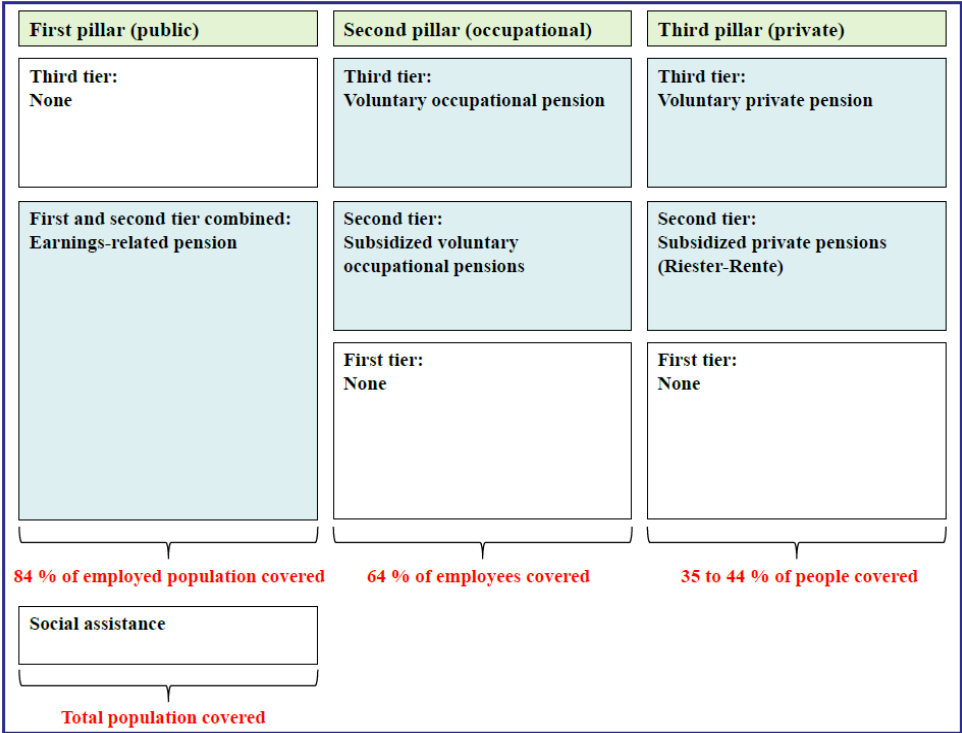
paying a current gross relative pension level (the level of pension in retirement relative to earnings when working) equivalent to approximately 32.5 percent (OECD 2009a) and 34.2 percent (OECD 2009b). So, the low replacement rates imply a moderate budget burden (Schulze/Moran 2006) of about 4.0 percent in 2007 compared to 10.1 percent as average of the 27 EU member states (OECD 2010). According to the Irish Pensions Framework, the government “will seek to maintain the rate at 35 percent of average weekly earnings” (Government of Ireland 2010: 14), so that the public pension continues to be the fundamental basis for the retirement income system. Furthermore, the Social Welfare Pensions are supplemented by a means-tested old-age pension under social assistance, paying slightly less than the above mentioned percentage of average income. All first pillar pensions are funded through social insurance contributions and tax revenue financed on the PAYG principle, meaning that current contributions pay for current benefits. Contributions are paid by employers, employees and self-employed. In 2005, 71.9 percent of recipients of a state pension got a contributory and 30.3 percent a non-contributory pension. The at-risk-of-poverty rate (the share of persons with income below the at-risk-of-poverty threshold) for retired was 26 percent in 2006, which is substantially lower than in previous years due to an increase in old age pension rates (Government of Ireland 2007a).

The second and third pillar pensions (occupational and private pension schemes) are voluntary but comparatively important, wide spread and well developed. Although the overall rate of coverage has gone up, the inequalities in occupational and private pension are still large. In 2008, about 54 percent to 55 percent of all persons in employment were enrolled in these voluntary funded second and third pillar pension plans (Antolin 2008; Pensions Board 2008; OECD 2009a), whereof around 43 percent of employees have an occupational pension plan (OECD 2009b). According to the Irish Pensions Framework, the government seeks to increase the supplementary pension coverage and contributions to improve the adequacy of incomes in retirement (Government of Ireland 2010). Other sources amount the ratio of occupational to personal voluntary private pensions to 40.1 to 14.9 percent (OECD 2009a), whereas the probability of coverage depends on factors such as the economic sector of the employer, age, income, gender, marital status, company size, work contract and regional location of the workplace. So, the highest coverage rates have male employees in the banking sector with full-time employment contracts and a workplace in Dublin. In 2008, employers offered 91,695 occupational pension schemes and insured 852,119 members. For years, the number of insured people has been steadily growing whereas the number of schemes decreased. The ratio of defined benefit to defined contribution scheme member in 2008 was

about 68 vs. 33 percent with an increasing proportion of defined contribution schemes. All second and third pillar pensions are monitored by the Pensions Board, a special pension authority which was established by the Pensions Act 1990. Its members are appointed by the Minister for Social and Family Affairs (Pensions Board 2008).

**b. The pension system of Germany**

Just like Ireland, Germany also follows the three pillar model of public, occupational and private pension schemes as the following figure indicates.



**Figure 4: The pension system of Germany (according to Schulze/Jochem 2006: 674)**

In comparison to Ireland and many other countries, the retirement income system is more complex due to the influence of different interest groups when designing the schemes, leading to a vertical division of many programs for different groups such as employees, civil servants, farmers and the self-employed. So, the first pillar pension, which is financed on the PAYG principle, includes compulsory statutory pension schemes for employees (white and blue-collar), for the agricultural sector, civil servants and judges and several other professional schemes, being compulsory for all private sector employees. It covers about 84 percent of the employed population. So the budget burden of public pension spending is rather high (10.4

percent of GDP in 2007) and is even growing due to serious future demographic developments. There are no compulsory schemes for all types of self-employed, but they can join the public pension system voluntarily. Liberal professions are mostly organized in occupational chambers and its members are compulsory covered. The first pillar statutory pension system targets the principle of contribution equivalence securing the maintenance of the individually achieved standard of living, since high contributions “transfer into pension claims of similar distribution” (European Communities 2009: 102). Since there is no minimum pension, the system is supplemented by a means-tested old age pension under social assistance covering the total population. The at-risk-of-poverty rate for retired in Germany was 13 percent in 2006 (European Communities 2009).

The importance of second and third pillar pensions is to date only moderate since the first pillar rather maintains the individuals’ standard of living and participation in occupational and private pension schemes is voluntary as well. Although about 64 percent of employees are enrolled in occupational schemes (OECD 2009b), this source of income only amounts to 10 percent of the total retirement income. With a pension reform in 2001, the government made allowances for the change in socio-economic conditions in Germany. For a long-term sustainability of the first-pillar, the benefit level was slightly reduced to secure that future contributors are not financially exhausted. The reduction in benefit levels provided by the first pillar has been amended by the increase of the retirement age from 65 to 67 and the expansion of private pension schemes, supplemented by public subsidies. The contribution rate of this ‘Riester pension’ is 4 percent and the coverage rate is about 35 percent.

#### **4. What kind of reaction exists?**

The global financial and economic crisis, beginning in 2008, has profound impact on the national social security systems and until now, neither the length nor the depth of the crisis is predictable so far. In matters of old age security systems the crisis has already affected the incomes during retirement, since “private pensions play a large and growing role in providing incomes” (OECD 2009b: 29) and are involved in the crisis in particular. Nevertheless, the impact of the crisis strongly depends on the chosen pension mix of a country. Even public pension schemes are hit by the crisis via a reduction in contributions due to unemployment or reduced working hours. This pillar is albeit not discussed here in detail. In the following paragraph, the hypotheses concerning the anticipated effects of the financial and economic

crisis on private pension schemes in LMEs and CMEs are verified. As example for an observation of the crisis on LME serves Ireland and as CME serves Germany.

**a. Effects via the capital market**

The beginning of the crisis was in the banking sector and therefore hit the global financial market first. According to the ‘Varieties of Capitalism’ approach of Hall and Soskice (2001), especially LME firms react on a volatile financial market more sensitive due to a higher stock market capitalization compared to CMEs. So, it can be expected that the financial crisis affects firms in LMEs such as Ireland stronger than in CMEs such as Germany.

	2005	2006	2007	2008	2009	Changes 2007/2008	Changes 2008/2009
<b>Germany</b>	36850	34040	29150	29580	34300	+ 1.4 percent	+ 16.0 percent
<b>Ireland</b>	327	304	363	773	1400	+112.9 percent	+ 81.1 percent

**Figure 5: Company bankruptcies**

**Source: Creditreform 2010: 2; own calculation**

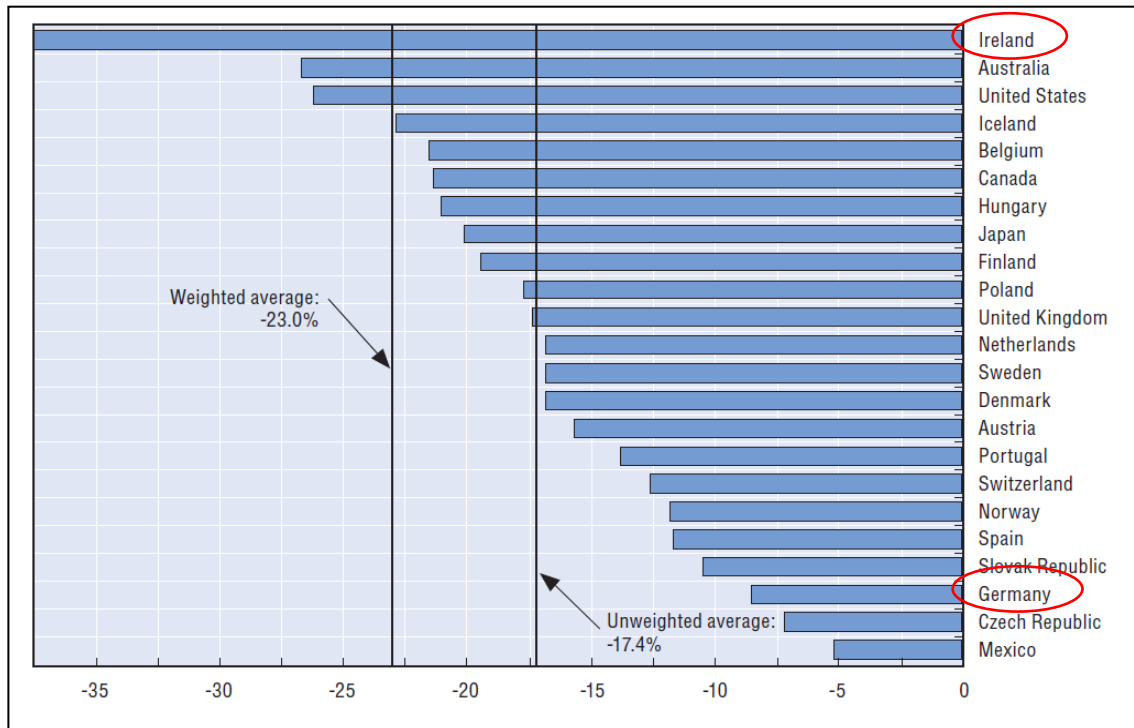
The above presented figure shows that the number of company bankruptcies in Ireland increased dramatically since 2008, while the number of company bankruptcies in Germany was on a constant level since 2005 and increased only by 16 percent in 2009. In Ireland, the dramatic increase in bankruptcies by 112.9 percent in 2008 can be traced back to the burst of the real estate bubble and the following collapse of the construction sector in particular. Similar to the developments in the USA, Irish banks had started dealing with cheap credits promoted through a low interest rates policy of the European central bank and the arising credit bubble at the financial markets. Most common were credits for construction projects and credits for the purchase of building plots and real estate. Since this worked so well for the Irish banks, they also started lending in the UK and the USA, increasing the housing bubble steadily.

When the bubble finally burst in 2008, the crisis in Ireland, the UK and the USA hit the Irish banks very hard. At the end of 2008, the Irish government gave a guaranty up to 400 billion Euros for all assets until 2010. This amount of money fits two times the GDP of the country. But reasons for the company bankruptcies in the year 2009 are founded in a smaller amount

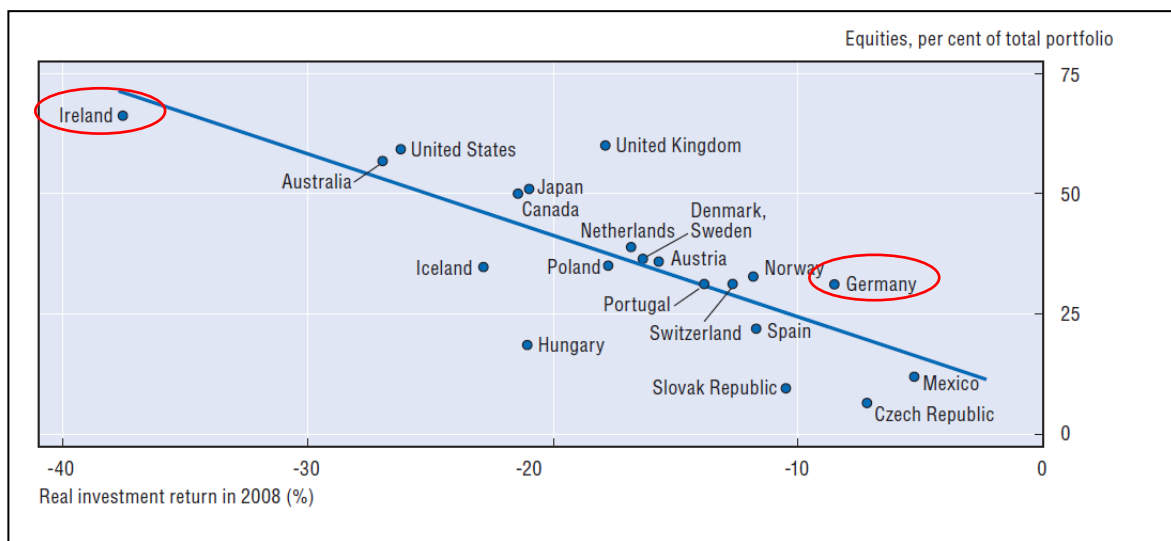
of exports. The United States are one of the most important trade partners of Ireland, one fifth of the Irish exports go to the USA. So, the downsizing of the American economy influenced the Irish export rates consequentially. Therefore, the crisis hit the real Irish economy as well. In 2009, the number of business insolvencies increased by 81.1 percent.

However, in Germany proportionally less construction firms were among the total number of companies that went bankrupt. Here, the rate was 18.6 percent in 2008 and declined to 16.7 percent in 2009. Within the German economy, the economic sectors are affected differently (IW-Köln 2009). While the construction sector and the industry for consumer goods recorded slight growth, there was on the other hand a sharp drop in the sectors of intermediate and capital goods (IW-Köln 2009). In particular the engineering sector was affected since the total order quantity of machines declined in May of 2009 over the same month last year by 48 percent. In contrast to Ireland, the financial and economic crisis hits the Germany economy by the side of the market for goods rather than from the side of the capital market.

In 2008, world stock markets fell by about 50 percent and especially property markets decreased accounting for nearly all of pension funds' investments along with corporate bonds and deposits (OECD 2009b). So, the real investment return of private pension funds was lowest in countries with a large proportion of the portfolio in equity investment in 2008. As the following figures 5 and 6 indicate, Ireland was the OECD country with the largest loss in relative terms (-38 percent) having the highest proportion invested in equities. In countries with lower losses, private pension funds preferred investment especially in government bonds. In Germany, losses were less than 10 percent. These investment losses have affected DC pensions directly, but also DB pension plans.



**Figure 6: Real investment returns of pension funds in 2008 in percent (according to OECD 2009b: 33)**



**Figure 7: Real investment returns in 2008 and equity exposure in 2007 in percent (OECD 2009b: 34)**

Many DB plans are in deficit since their future as well as current pension liabilities are larger than their assets. Finally, the overall impact of the economic crisis on the individual retirement income depends on the national automatic stabilizers and safety nets securing at least coverage at the poverty level.

## **b. Effects via the labor market**

The economic crisis also affects the private pension schemes via the labor market, since the labor market is a central transmission mechanism between the financial crisis and social security. The influence of the financial and economic crisis on the social security depends on the duration of the crisis and its influence on the labor market.

In Germany, employment has not fallen in parallel with a significant decline in GDP. The unemployment rate declined from 10.7 percent (2005) to 7.3 percent (2008) and remained at a constant level in 2009. The change in GDP from quarter 1, 2008 to quarter 3, 2009 was – 5.6 percent. So, the financial and economic crisis does not hit the entire German labor market (cf. figure 8). It is expected that the unemployment rate will fall even to 6.9 percent in 2010 and 6.5 percent in 2011 (ifo 2010). First, it is due to the positive labor market conditions at the beginning of the crisis. The labor market in Germany benefited from the recent boom, after which the long-term unemployment fell to 3.4 percent in 2009. In addition to this starting position, the employment instrument of short-time work (Kurzarbeit) also protects German workers against collective redundancies. In 2009, the number of total hours worked in Germany decreased by 3.2 percent – this is the largest fall at the German labor market ever recorded (IW-Köln 2010).

The great response to this employment instrument for companies is mainly due to the fact that professionals were missing during the recent booms. Therefore, the goal is to hold the core workforce for the anticipated boom phases. However, it should be noted, that short-time work leads to a decline in working hours and gross earnings per month. This leads to a loss of revenue of the private pensions. Consequently, and despite of a positive labor market situation, the private pension schemes are so - without delay - under pressure. In the manufacturing sector for example, the paid hours worked per week decreased due to the high use of short-time working in the first quarter of 2009 (compared to same quarter last year) by 4.2 percent and resulted in a decrease in the average gross monthly earnings by 2.3 percent (Statistisches Bundesamt 2009).

Unemployment has risen extremely in Ireland. In 2009, the unemployment rate was 11.9 percent whereas a year earlier the rate was 6.3 percent. The dramatic development is particularly clear in comparison with 2007, as Ireland was the country with the lowest unemployment in the euro area (4.6 percent in 2007). The largest decline in employment was recorded in the construction sector (-28.2 percent), were the Irish employment growth used to take place before the collapse with a 59 % increase in employment between 2000 and 2008

(Forás 2008). According to Kirby (2010), the construction sector employed about one-eighth of the national labor force in 2006. This labor-intensive sector collapsed during the crisis and unemployment has nearly doubled. It is expected, that the volume of the construction sector will remain below the pre-crisis level in medium term, due to the immense size of the burst bubble. Such a structural change makes it hard for the released workers of the construction industry to find a new job (ifo 2010). It is expected that the unemployment rate will rise even to 13.7 percent in 2010 and 14.0 percent in 2011 (ifo 2010). In contrast to Germany, the employment in Ireland has fallen parallel with a decline in GDP. The change in GDP from quarter 1, 2008 to quarter 3, 2009 was -9.3 percent. The long-term unemployment in Ireland has risen sharply as well (cf figure 9).

The impact of the financial and economic crisis on the Irish labor market is different in two respects from Germany. Ireland was like the USA, UK and Spain affected earlier than Germany by the bursting of the housing bubble and the chaos it caused. There, the crisis has been reflected with particular force and this captures the real economy and the labor market. Secondly, Ireland, like the USA, UK and Denmark has more flexible labor markets, which means that core workers are hired and fired more quickly than in Germany. These institutional conditions in Germany can inhibit structural change and mobility in the labor market, but they contribute to the stabilization of employment with internal flexibility, in particular working time adjustment (Eichhorst/Marx/Thode 2009).

	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>Deutschland</b>	10.7	9.8	8.4	7.3	7.5
<b>Irland</b>	4.4	4.5	4.6	6.3	11.9

**Figure 8: Unemployment rate**

**Source: Eurostat**

	2005	2006	2007	2008	2009
<b>Deutschland</b>	5.7	5.5	4.7	3.8	3.4
<b>Irland</b>	1.5	1.4	1.4	1.7	3.4

**Figure 9: Long-term unemployment in percent of the labor force**

**Source: Eurostat**

### **c. Long-term effects**

“The financial part of the crisis has not directly affected ... public pension schemes in CME and LME countries (OECD 2009b) and as mentioned above, the financial and economic crisis has not hit private pension schemes in CMEs that much, since on the one hand, the third pillar is of less importance and on the other hand, the occupational schemes are more stable because of long-term labor relations. The private old age income security in LMEs and especially the third pillar are much more affected by the crisis since there is almost no market regulation. Which conclusions can be drawn concerning the long-term effects of the financial and economic crisis on private pension schemes in LMEs and CMEs using the ‘Varieties of Capitalism’ approach of Hall and Soskice?”

At first, it has to be noticed that the crisis affects both types of economies and according to the theory of path-dependence it can be assumed that both types maintain their path in the first instance. It was also shown above that the short-term effects of the crisis are felt first in private pension schemes in LMEs. However, it still applies that a long-term crisis leads to large externalities in both types of capitalism potentially causing a breakup with the former path. The first pillar (public pension) is hit if the labor market is affected when entering a recession. So, the economic crises that started with financial-market turbulence will significantly affect public pension systems if the number of unemployed increases (OECD 2009b) leading to lower social insurance contributions and tax revenue. Even in spite of a successful employment policy instrument such as short time work, a long crisis would result in higher unemployment affecting the contributions for the first pillar of CMEs.

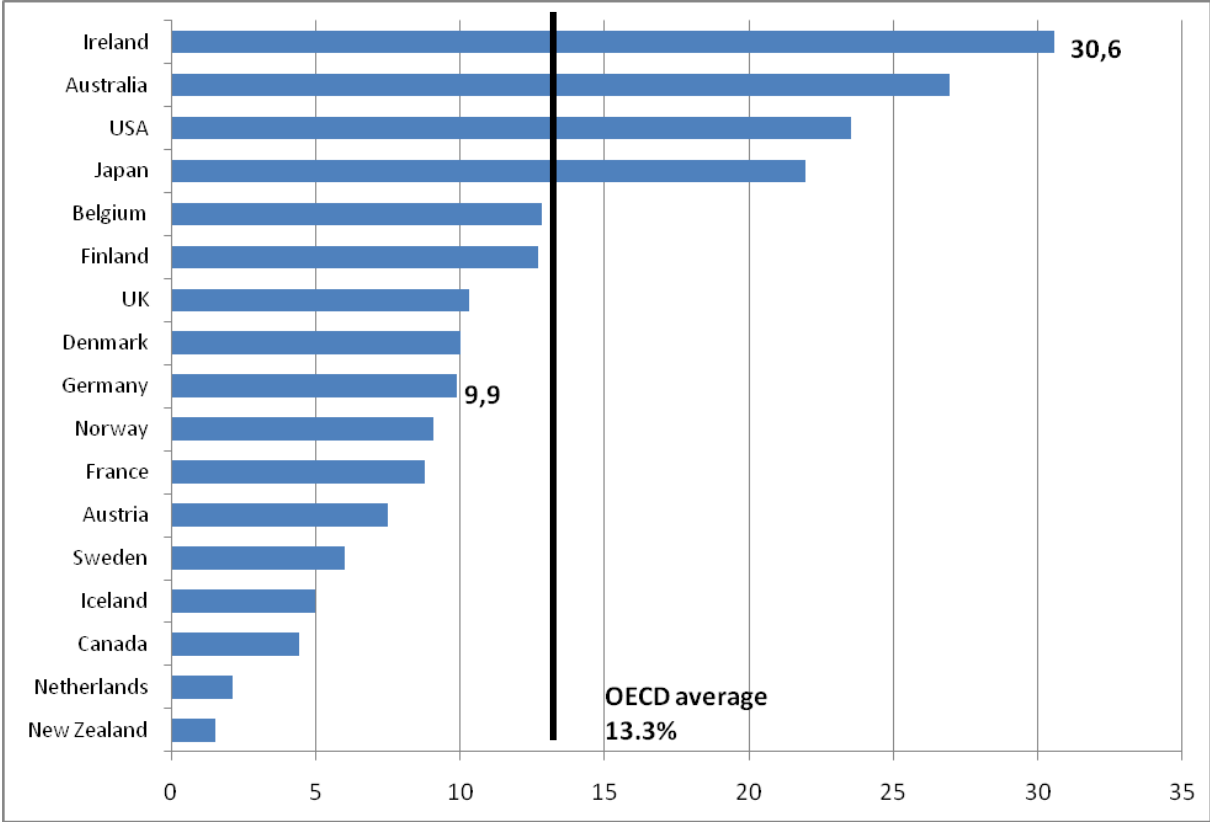
Therefore, the effects of the crisis on the public pension in Germany are described in detail. In Germany, the contribution rate to the public pension scheme, the German Pension Fund (GRV) is 19.9 percent. The reserves of the German Pension Fund (sustainability reserve) amount to € 16.1 billion, representing the expenditures for one month. The general federal grant and the additional federal grant (for the accreditation of child-raising) amount to about €

80 billion. These grants are the largest expenditures of the federal government budget. Last, there was a pension increase of 2.41 percent for West and 3.38 percent for East Germany as of July 2009 being the largest percentage increase in pensions for several years after numerous small pension adjustments or even no adjustments.

So far, there is also no significant decrease in social insurance contributions and because of employment policy instruments such as short time work and a reduction of overtime hours there was also almost no change in unemployment. Social security contributions are also paid for employees working short time. Therefore, the German Pension Fund is only confronted with a problematic situation when recipients of unemployment benefit I (ALG I) have to change to unemployment benefit II (ALG II) due to a long lasting financial and economic crisis leading to a considerable shortfall for the individual. For a recipient of unemployment benefit II (ALG II) there was only a compulsory contribution to the first pillar of about €40 in 2009. According to calculations of the German Pension Fund, this leads to a pension entitlement of about €2 per month being a recipient of unemployment benefit II for about a year. A massive increase in unemployment caused by the crisis and especially an increase of recipients of unemployment benefit II can result in a massive decline in social security contributions. Dependent on the length and depth of the crisis and the successful reintegration into employment and the labor market, the extent of old age poverty could also increase having a relatively high external effect on the public pension systems' long-term stability (Sesselmeier/Haupt/Somaggio/Yollu-Tok 2009).

The first pillar of the Irish pension system follows the path of a flat-rate pension that is linked to employment and supplemented by a means-tested old-age pension under social assistance. Therefore, the system is based on personal responsibility and “a pay-related welfare state in which minimal levels of universal entitlement to income and services are supplemented by market-based resources” (O’Connell/Rottman 1992: 206). Furthermore, the second and third pillar already exist much longer in Ireland than in Germany but individuals without personal plans and private insurances are rather facing old age poverty. Even before the crisis, Ireland had a high old-age poverty rate (cf. figure 10). As discussed above, the structural changes induced by the financial and economic crisis lead to a higher long-term unemployment rate. So even in spite of a self-responsible behavior, the funding of private pension coverage is more difficult. Thus, the external effects in the form of financial and economic crisis can be so dramatic causing even a breakup with the former path of the Irish pension system. Thus, it

can be summarized that CME pension schemes at least better protect against old age poverty, since the state still holds the most important pillar.



**Figure 10: Old-age income poverty rates, mod-2000s (percentage of over 65s with incomes of less than half median equivalised population incomes)**

Source: OECD 2009b: 64.

Following the ‘Varieties of Capitalism’ (VoC) approach of Hall and Soskice (2001) there are nevertheless complementary institutions. An institution is complementary to another institution if its existence and its functioning increase the output that can be obtained by the other institution. Thus, it has to be questioned whether elderly care (private nursing home care) is supported by the state. In Ireland, grants are available towards the cost of private nursing home care but they are means tested and far below the minimum required, since elderly care is expensive for individuals. This has caused a dilemma for older people, their families, and the government which have to spend on this subsidy scheme. Thus, there is almost no complementary in the case of elderly care in Ireland.

On the other hand it has to be questioned whether family structures are complementary to private old age schemes. Thus, the design of the pension system in Ireland increases the

returns produced in the family. In 1996, nearly 26 per cent of older people lived alone. In other European countries the percentage is nearly 40 per cent (Fahey 1995). In 2002, 29 percent of older people lived alone. The number of elderly living alone continues to increase (Government of Ireland 2007b).

In the mid-2000s, the poverty rate was 65 percent for older people living alone in Ireland compared to 15 percent in Germany, while just 9 percent of the elderly couples in Ireland and 5 percent in Germany are affected (Zaidi 2009). So, there is a complementary via the elderly partnership.

## **5. Conclusion**

As discussed above, using Germany as coordinated and Ireland as liberal market economy examples, it can be shown that LMEs are more affected by the volatility of financial markets. So, the financial market crisis leads to a higher number of companies going bankrupt in Ireland compared to Germany. Subsequently, these bankruptcies put pressure on the financing of private pension schemes. So, hypothesis 1 can be verified.

The effects of the current financial and economic crisis via the capital market illustrate that the extent of occupational pension plans is larger in Germany compared to Ireland. In LMEs, second pillar (occupational) pensions do not play such a big role and especially the third pillar (private) pension schemes are the most relevant there. Since the third pillar is strongly affected via the equity market in times of crisis, this pillar is more affected than the occupational second pillar schemes. So, hypothesis 2 can be verified.

Furthermore, a detailed labor market analysis points out that companies in Germany have a high interest in benefiting from their employees skills and knowledge since they have firm-specific human resources. Therefore, the firms in CMEs tend to retain the staff even during the economic crisis. Since the ongoing employment status is secured it also allows the continuous payment for private pension schemes Hypothesis 3 can be verified as well.

As discussed in paragraph 4.c, CMEs and LMEs react path-dependent within their market system, despite of an exogenous shock in form of a financial and economic crisis. Nevertheless, it has to be questioned whether the first pillar system in Germany and the second and third pillar system in Ireland can maintain its path in case of a long lasting crisis and a looming increase in old age poverty.

Finally, hypothesis 5 can be verified: There are more comprehensive private pension schemes in LMEs and hence a minor importance of public pensions. So, the family, especially the family status has a complementary function in Ireland as social net for old age security. Therefore, Germany's pension system shields better against individual old age poverty, since the public social security still holds the most important, the first pillar.

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