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**The Evolution of Early Retirement:
Explaining Policy Blockage
and Policy Frustration**

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C O N T E N T S

INTRODUCTION..1

**THE EVOLUTION OF EARLY RETIREMENT:
A GAME-THEORETIC ANALYSIS** 5

POLICY DEVELOPMENTS IN FRANCE AND GERMANY 19
The Victory of French Socialists: The *Ordonnance* of March 1982....................22
A Corporatist Solution: The Negotiation of the *Early Retirement Act* of 1984..........25
The Emergence of a "Corporatist" Approach to Early Retirement in France.........28
The Return to Firm-Level Early Retirement in Germany.................................30

CONCLUSIONS 32

REFERENCES 35

INTRODUCTION

During the last two decades, early retirement—the creeping, silent and seemingly unstoppable withdrawal of elderly workers from the labor market prior to the statutory retirement age—has been a prominent policy issue in all advanced industrialized societies. Behind this continuous trend looms a significant discontinuity and change in the policy objectives pursued by most governments. In a first phase—lasting (roughly) from the end of the 1970s until the beginning of the 1990s—early retirement was accepted and encouraged as a measure of job-sharing that could alleviate some of the social difficulties associated with the growth in mass unemployment (OECD 1994: 171- 235; Clark and Anker 1990). At the beginning of the 1990s, the priorities of most governments changed (OECD 1995, OECD 1998). The failure of existing early retirement policies to generate new jobs for the cohorts of younger workers as well as growing public concerns about the long-term financial outlook of most old-age insurance systems led to an intensification of political efforts to abolish or reduce existing policies that encouraged the withdrawal of elderly workers from the labor market. Yet these policy efforts aimed at curtailing existing early retirement policies met only with a modest degree of success, largely because of the pervasive opposition of both unions and employers.

Existing research into the causes of early retirement policies has focused predominantly on the institutional characteristics of welfare states as the fundamental determinant of cross-national variation in the labor force participation rates at the end of working life (Esping-Andersen 1990, Esping-Andersen and Kolberg 1992, Kolberg 1992). In Esping-Andersen's influential *Three Worlds of Welfare Capitalism*, early retirement figures as a prominent example supporting the claim that different "welfare regimes" generate strong and enduring cross-national

differences in labor market outcomes: “the Nordic cluster is characterized by low exit, the continental European by very high exit; the Anglo-Saxon world, except for Britain, by moderate exit” (Esping-Andersen 1990: 151). Adding and complicating the institutional explanation for the development of early retirement policies, a new wave of research has begun to explore the joint interaction and complementarities between “welfare” and “production regimes” in structuring the incentives for early exit from the labor market (Naschold and de Vroom 1994, Mares 1996, Manow 1997, Manow & Ebbinghaus 1998).

These analyses focusing on the incentives generated by different welfare regimes have a number of significant limitations. Empirically, explanations deriving differences in early exit from the labor market from a number of characteristics of welfare regimes are unable to account for the change over time in the mix of policies directed towards workers at the end of their working lives. Yet empirically we observe a tremendous change and reorganization in the institutions of early retirement during the past two decades. Even more troubling for welfare regime theories is the fact that countries belonging to the same family of welfare regimes (such as Germany and the Netherlands) have experienced, during recent years, different degrees of success in closing off some of the existing pathways facilitating the early withdrawal from the labor market of elderly workers. The theoretical limitation of these explanations is the absence of a convincing micro-logic linking a hypothesized “institutional logic of a welfare regime” to the observed labor market outcomes. Why do universalistic welfare regimes (of the Scandinavian type) maximize the overall participation in the labor market, while conservative welfare regimes decrease labor force participation rates? The assumption of a “hidden institutional logic of a welfare regime” rests on an aggregation of a number of observed empirical effects from different subsystems of the welfare state (labor force participation rates of women, service sector

employment and early retirement), with no convincing explanation why these different labor market developments have to go together and reinforce each other.

This paper will present an actor-centered analysis of the development of policies towards early exit from the labor market that complements existing explanations focusing on the institutional incentives and constraints created by different welfare regimes. It will explore the strategic bargaining among unions, employers and the state centering on the institutional characteristics of early retirement policies. The goal of this analysis is to highlight the contested nature of policies of early exit from the labor market and the circumstances under which existing policies are renegotiated and redesigned. What are the political conditions that allow firms to retain exclusive control over the process of early exit from the labor market, allowing them to externalize the costs of rationalization to the welfare state? When is early retirement introduced as part of the wage bargaining arrangements—a solution which allows unions and employers to negotiate jointly over the number of elderly workers withdrawing from the labor market and over the number of new hires? When are governments able to defend the actuarial soundness of the welfare state and shift the costs of early retirement back to firms?

The use of a game-theoretic model allows me to characterize more rigorously the process of bargaining over the introduction or change in social policy and to specify more precisely the magnitude of the constraints posed by unions and employers on the efforts of governments to reform the welfare state. The model will characterize the conditions under which governments can overcome the opposition of unions and employers directed against the reform of existing institutions of early retirement and contrast these cases to situations in which governments remain unable to enact their preferred social policy outcome, settling instead for a compromise with the social partners on a lower-ranked policy alternative. Second, the analysis presents

important insights into the formation of cross-class coalitions among unions and employers over the introduction of a new social policy. During recent years, a number of studies have developed a number of “heuristic” arguments about the importance of cross-class coalitions among unions and employers during recent episodes of social policy reforms (Swenson 1991, Swenson 1997, Mares 1997a). However, we currently lack a well-developed theoretical analysis of the conditions that facilitate the formation of these cross-class alliances as well as of the impact of these alliances on different social policy outcomes. The model developed in this paper will generate a number of propositions pertaining to the significance of “strategic” alliances among unions and employers, i.e., alliances formed on the “second-best" preference of these actors.

The remaining part of this paper will be organized as follows. The first section will present a game-theoretic framework modeling the strategic interaction between unions, employers and governments in the formulation of early retirement policies. The following section will explore some of the theoretical implications of the formal analysis by contrasting successive attempts of the French and German government to reform the policy framework facilitating the early withdrawal of elderly workers from the labor market. Existing research on the development of early retirement groups France and Germany as most-similar cases of conservative welfare regimes and remain unable to explain the process of policy change within each country. The model developed in this paper sheds light on the political conditions under which reform of existing policies of early retirement is possible—and is able to explain the transition among different types of early retirement policies in both societies. A fourth section will conclude, by exploring the theoretical implications of the early retirement case for our analysis of the processes of social policy change during recent years.

THE EVOLUTION OF EARLY RETIREMENT: A GAME-THEORETIC ANALYSIS

Early retirement policies differ significantly in their institutional design. During recent years, a large body of descriptive research has explored and systematized the most salient cross-national differences in the organization and financing of early retirement policies (Kohli et. al. 1991; Naschold & de Vroom, 1994; Rein & Wadensjö, 1997). As these studies reveal, a highly contested difference among early retirement policies is the distribution of **control** over the initiation of early retirement—in other words who decides **when** and under what **circumstances** the employment relationship to elderly workers can be interrupted (Schön and Rein, 1994). In some cases, employers can retain a high discretionary authority over the introduction of early retirement, transforming these policies into an instrument of firm adjustment and reorganization. In other policies, control over the initiation of early retirement can be shared among unions and employers (allowing unions to protect elderly workers against unfair dismissal). Finally, the state can retain control over the introduction of early retirement and to deploy these policies selectively, as part of sectoral or regional aid to depressed industries, or as a response to worsening labor market circumstances.

The model developed in this paper distinguishes among three broad early retirement outcomes. A situation in which employers retain control over the introduction of early retirement and are able to shift the costs of these policies to the broader community of taxpayers will be denoted in this paper as "firm." An example of this outcome remains the two French policies *garantie de ressources démission* (introduced in 1972) and *garantie de ressources licenciement* (introduced in 1977) which created a very permissive environment for firms to dismiss elderly workers, at costs financed by the unemployment insurance subsystem of the welfare state. A

second outcome, labeled “corporatist,” denotes a situation in which decisions about the introduction of early retirement is determined through the joint negotiation among unions and employers. This outcome can be exemplified by the German Early Retirement Act that was in effect between 1984 and 1988. Based on the *Vorruhestandsgesetz*, the number of early retirement cases in an industry was determined during negotiations among unions and employers and a number of institutional guarantees were established that employers would hire additional workers or trainees to replace the vacancy caused by early retirement. Finally, an outcome called “state” refers to a situation in which the government is able to enforce the statutory retirement age and to design an incentive structure that induces unions and employers to adjust their strategies and practices to conform to this policy goal.

The model assumes that different early retirement policies are chosen as the result of negotiation among the government, denoted by G, unions (U) and employers (E). The most important theoretical justification for restricting the analysis to these three players remains the fact that both unions and employers play an important role in the administration of social insurance and have the institutional capacity to frustrate policies introduced by the government that contradict their policy preferences. The three players—governments, unions and employers—have diverging preferences over the three policy outcomes. I will assume that employers prefer the outcome “firm” to “corporatist” to “state.” In contrast, unions prefer “corporatist” to “state” to “firm.” The government, in turn, ranks “state” highest, followed by “corporatist,” followed by “firm.”

The game has the following structure. In the first stage, unions and employers move simultaneously, by announcing their support for a particular early retirement policy. In a second stage, the government chooses a policy, after observing the moves of unions and employers. The

move of the government is not entirely unconstrained. If its choice contradicts the policy choice of one of the players, this actor is able to introduce a "penalty" on the government during the implementation of a social policy. Due to the fact that both unions and employers play an important role in the administration of social insurance, the "penalty" denotes the withdrawal of support in the implementation of a social policy (that may water down its actual impact). I will denote the "penalty" incurred by the state for choosing an early retirement policy that conflicts with the vote of unions and employers by $\boldsymbol{e}_U$ and $\boldsymbol{e}_E$, respectively, and will assume that $\boldsymbol{e}_E \geq \boldsymbol{e}_U$. If the government adopts an early retirement policy ER_i (with $i \in \{firm, corporatist, state\}$), for which none of the players has voted, it will incur both penalties simultaneously, so its payoff will be $U_G(ER_i) - \boldsymbol{e}_U - \boldsymbol{e}_E$. In contrast, if the government has the support of, say, unions, its payoff will be $U_G(ER_i) - \boldsymbol{e}_E$. Table 1 summarizes the payoffs of the government, given all possible moves of unions and employers. Given that $U_G(s) > U_G(c) > U_G(f)$, we can simplify the notation by further assuming $U_G(f) = 0$, in which case $U_G(s) > U_G(c) > U_G(f) = 0$.

Table 1

Moves of Employers/Unions	**Payoff of the Government if it chooses**		
	"State" (**s**)	"Corporatist" (**c**)	"Firm" (**f**)
(Firm, Firm)	$U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$U_G(c) - \boldsymbol{e}_E - \boldsymbol{e}_U$	0
(Firm, State)	$U_G(s) - \boldsymbol{e}_E$	$U_G(c) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$-\boldsymbol{e}_U$
(State, Firm)	$U_G(s) - \boldsymbol{e}_U$	$U_G(c) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$-\boldsymbol{e}_E$
(Firm, Corporatist)	$U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$U_G(c) - \boldsymbol{e}_E$	$-\boldsymbol{e}_U$
(Corporatist, Firm)	$U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$U_G(c) - \boldsymbol{e}_U$	$-\boldsymbol{e}_E$
(State, State)	$U_G(s)$	$U_G(c) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$-\boldsymbol{e}_E - \boldsymbol{e}_U$
(State, Corporatist)	$U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$U_G(c) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$-\boldsymbol{e}_E - \boldsymbol{e}_U$
(Corporatist, State)	$U_G(s) - \boldsymbol{e}_E$	$U_G(c) - \boldsymbol{e}_U$	$-\boldsymbol{e}_E - \boldsymbol{e}_U$
(Corporatist, Corporatist)	$U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$U_G(c)$	$-\boldsymbol{e}_E - \boldsymbol{e}_U$

With the use of this game-theoretic set-up, I will try to answer the following questions. What explains the enactment of a particular early-retirement policy? Under what conditions are governments able to end a situation in which employers externalize the costs of early retirement to the state? Under what circumstances is the state constrained to accept a less desirable social policy alternative? The second set of questions address the conditions leading to a strategic change in the preferences of the players and the implications of these strategic moves for the social policy outcome. Can the players afford to militate for their preferred social policy, or are they "constrained" to move strategically to avoid a worse outcome? Does this strategic behavior **always** matter, i.e., does it always succeed in influencing the social policy outcome of the game? When are unions and employers powerless despite their attempts to influence the governments by moving "strategically," i.e., by supporting their second-best policy choice?

In solving the game, we observe that there are two extreme cases in which the bargaining has a trivial outcome. These correspond to the situation in which unions and employers are able to impose only a very small "penalty" during the implementation of a social policy, on the one hand, and to a case in which $U_G(s)$ is very small when compared to the penalties of unions and employers, on the other hand. Let me first consider these two cases.

Lemma 1: If $U_G(s) \geq U_G(c) + \boldsymbol{e}_E + \boldsymbol{e}_U$, then the optimal move of the government is "state," irrespective of the moves of unions and employers.

The proof of this lemma is obvious: since $U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U > U_G(c) > U_G(f) = 0$, the advantages of the policy "state" outweigh the sum of the penalties which the government can incur during the implementation of this policy of early retirement. This situation is rather

uninteresting from a bargaining point of view and has also a very limited empirical applicability. Lemma 1 only describes an "extreme" situation in which the penalties are very small compared with $U_G(s)$, the utility derived by the government from introducing a "state-led" policy of early retirement. Similarly, if the relative importance of the penalties is reversed, it follows that

Lemma 2: If $U_G(s) < \boldsymbol{e}_E - \boldsymbol{e}_U$, then employers can impose the outcome "firm," which is their most favored policy.

Proof: If employers play "firm," then the payoffs of the government are shown in Table 2:

Table 2

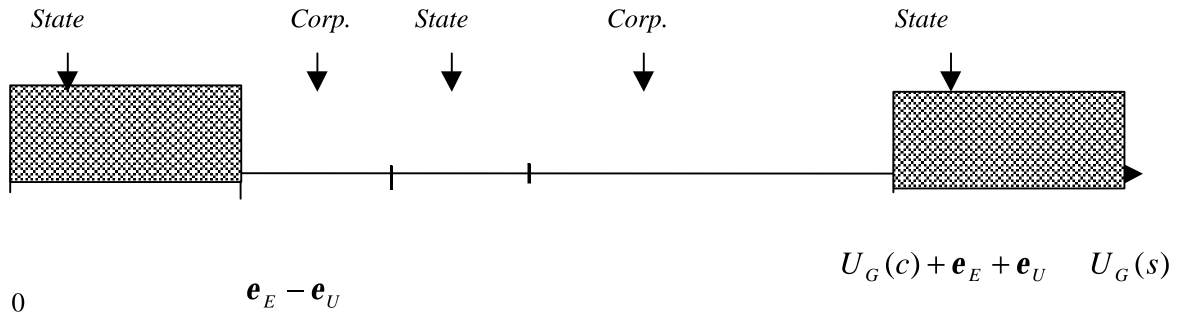
Moves of Unions	**Payoff of the Government if it chooses**		
	"State" (**s**)	**"**Corporatist" (**c**)	**"**Firm**"** (**f**)
(Firm)	$U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$U_G(c) - \boldsymbol{e}_E - \boldsymbol{e}_U$	0
(Corporatist)	$U_G(s) - \boldsymbol{e}_E$	$U_G(c) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$-\boldsymbol{e}_U$
(State)	$U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$U_G(c) - \boldsymbol{e}_E - \boldsymbol{e}_U$	$-\boldsymbol{e}_U$

It is easy to check that no matter what unions move, the best response of the state is "firm." For instance, if the unions move "state," then $U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U < -\boldsymbol{e}_U$ because $U_G(s) < \boldsymbol{e}_E - \boldsymbol{e}_U < \boldsymbol{e}_E$ and $U_G(c) - \boldsymbol{e}_E < -\boldsymbol{e}_U$ because $U_G(c) < U_G(s) < \boldsymbol{e}_E - \boldsymbol{e}_U$. Therefore, in this case employers' strategy determines the outcome of the game, while both unions and the government remain unable to constrain employers' choice of early retirement policy. These two "extreme" cases can be summarized graphically according to the magnitude of $U_G(s)$.

Figure 1

From now on we can restrict the analysis to the more interesting case when $\boldsymbol{e}_E - \boldsymbol{e}_U \leq U_G(s) < U_G(c) + \boldsymbol{e}_E + \boldsymbol{e}_U$ (**Condition ***), which corresponds to the unshaded interval above. As compared to the "extreme" situations described by Lemma 1 and 2, Condition * delineates a range of bargaining situations in which the balance of power among unions, employers and the government is more evenly distributed and none of the players has the power to determine the outcome of the game through its "unilateral" action. To anticipate the results of the game-theoretic analysis, we will be able to show that the bargaining yields two different equilibria. If unions and employers can "coordinate" during the bargaining process, then the structure of the game resembles an assurance game, in which these two players can ensure the outcome "corporatist." A second distinct equilibrium occurs if unions and employers are unable to coordinate and remain, instead, trapped in a prisoner's dilemma. This absence of coordination among the players creates a window of opportunity for social policy reform for the government, who will be able to introduce its preferred social policy, "state," despite the joint opposition of unions and employers.

Figure 2



To solve the game under the assumption of Condition *, let us compare the government's payoffs from playing "state," "firm" and "corporatist." A number of moves can be easily eliminated as dominated. For instance, if (*E, U*) = (*firm*, *state*), then Condition * implies that for the government $U_G(s) - e_E > -e_U$. Hence, "state" is a better move for the government than "firm." "State" is also a better move than "corporatist," since $U_G(s) > U_G(c)$ and $e_U > 0$ and so, $U_G(s) - e_E > U_G(c) - e_E - e_U$. Similarly, in response to (*E, U*)= (*corporatist, corporatist*), the government obtains a higher payoff by imposing "corporatist" (its second best option) rather than "state." Due to Condition *, $U_G(s) - e_E - e_U < U_G(c)$. By playing "firm," the government would obtain a payoff that is even lower, since $-e_E - e_U < 0 < U_G(c)$. This shows that in this case the optimal response of the state is the acceptance of a corporatist solution.

Assuming Condition * is satisfied, the results of Table 1—mapping the payoffs of the government—can now be reduced to the results shown in Table 3.

Table 3: Government's Moves if $e_E - e_U \leq U_G(s) < U_G(c) + e_E + e_U$.

Moves of Employers/Unions	Payoff of the Government if it chooses		
	"State" (**s**)	"Corporatist" (**c**)	"Firm" (**f**)
(Firm, Firm)	$U_G(s) - e_E - e_U$		0
(Firm, State)	$U_G(s) - e_E$		
(State, Firm)	$U_G(s) - e_U$		
(Firm, Corporatist)	$U_G(s) - e_E - e_U$	$U_G(c) - e_E$	$-e_U$
(Corporatist, Firm)	$U_G(s) - e_E - e_U$	$U_G(c) - e_U$	
(State, State)	$U_G(s)$		
(State, Corporatist)	$U_G(s) - e_E - e_U$		
(Corporatist, State)	$U_G(s) - e_E$	$U_G(c) - e_U$	
(Corporatist, Corporatist)		$U_G(c)$	

Note: Dominated moves are deleted.

Remark 1: The bottom row of Table 3 implies that if unions and employers ally on "corporatist," they are able to guarantee this policy outcome. Since we approach the game non-cooperatively, it is natural to ask whether (*E, U*) = (*corporatist, corporatist*) is a Nash equilibrium. It is clear that unions do not have an incentive to deviate, because "corporatist" is their preferred outcome. Employers, on the other hand, have no incentive to deviate to "state," since $U_E(s) < U_E(c)$. However, employers *may* have an incentive to deviate and play "firm," provided they can determine the government to choose "firm" instead of "corporatist." For the state, "firm" is the optimal policy response only if $-e_U > \max(U_G(s) - e_E - e_U, U_G(c) - e_E)$. This amounts to the simultaneous conditions

$U_G(s) < e_E$ and $U_G(c) < e_E - e_U$ (**Condition ****) .

If follows that

Result 1: If $\boldsymbol{e}_E - \boldsymbol{e}_U \leq U_G(s) < U_G(c) + \boldsymbol{e}_E + \boldsymbol{e}_U$ (**Condition ***) is true and either $U_G(s) > \boldsymbol{e}_E$ or $U_G(c) > \boldsymbol{e}_E - \boldsymbol{e}_U$ (in other words at least one of **Conditions **** is not fulfilled), then (E, U, G)= (corporatist, corporatist, corporatist) is a Nash equilibrium.

It is important to understand whether other Nash equilibria in addition to (*E, U, G*) = (*corporatist, corporatist, corporatist*) can exist under the conditions of Proposition 1. The first question to ask is whether "firm" can be an equilibrium outcome. In other words, can employers impose their preferred social policy (given that the equilibrium (*E, U, G*) = (*corporatist, corporatist, corporatist*) leads only to their second best option)? The answer to this question is no. To see this, note that according to Table 3, "firm" can be an outcome of the game only in response to (*E, U*)= (*firm, firm*) and (*E, U*) = (*firm, corporatist*). However, the discussion preceding Result 1 shows that under the assumptions of the result, "firm" is not an optimal response of the state to (*E, U*) = (*firm, corporatist*). Even if "firm" were an optimal response for the state in response to (*firm, firm*), unions could avoid this unfavorable outcome by playing "state" instead of "firm." (See row 2 of the table).

The second question is whether, under the conditions of Result 1, any equilibrium strategy can lead to the policy outcome "state." It turns out that this may be possible under the assumptions of Result 1, if additional conditions hold true. These conditions will not be discussed in this context. Since both unions and employers rank the "corporatist" outcome higher than "state," they can opt instead for the Pareto superior equilibrium (*E, U*) = (*corporatist,*

corporatist). As a consequence, this case corresponds to an assurance game in which unions and employers can ensure a Pareto-superior outcome.

It remains to analyze the case in which all the conditions in * and ** are satisfied. These conditions can be combined into:

$$U_G(c) < \boldsymbol{e}_E - \boldsymbol{e}_U < U_G(s) < \boldsymbol{e}_E$$ **Condition *****

As explained above, the strategy pair (*corporatist, corporatist*) is not a Nash equilibrium under this assumption. If unions play "corporatist," the optimal response of employers is "firm," since this move would lead to their preferred outcome, "firm." Assuming Condition ***, we can now eliminate more strategy pairs for (*E, U*) which are not part of a Nash equilibrium. For instance, (*E, U*) = (*firm, firm*) and (*E, U*) = (*firm, corporatist*) (with outcome "firm") are not optimal moves for unions. If employers play "firm," unions' best strategy is "state," leading to their preferred policy, "state." Similarly, the strategy pairs (*E,U*) = (*state, firm*), leading to the outcome "state" and (*E, U*) = (*corporatist, firm*), leading to the outcome "corporatist" are sub-optimal for employers. By playing "firm" instead of "state" or "corporatist," employers can guarantee their favored policy, "firm." Finally, the strategy pair (*E, U) =* (*state, corporatist*) is not optimal for employers, since it leads to the outcome "state." "Corporatist," a superior outcome for employers can be obtained as a result of (*E, U*) = (*corporatist, corporatist*). Summing up, Table 3 reduces further to Table 4:

Table 4

Moves of Employers/Unions	Payoff of the Government if it chooses		
	“State” (s)	**“Corporatist” (c)**	**“Firm” (f)**
(Firm, Firm)			0
(Firm, State)	$U_G(s) - \boldsymbol{e}_E$		
(State, Firm)	$U_G(s) - \boldsymbol{e}_U$		
(Firm, Corporatist)			$-\boldsymbol{e}_U$
(Corporatist, Firm)		$U_G(c) - \boldsymbol{e}_U$	
(State, State)	$U_G(s)$		
(State, Corporatist)	$U_G(s) - \boldsymbol{e}_E - \boldsymbol{e}_U$		
(Corporatist, State)	$U_G(s) - \boldsymbol{e}_E$	$U_G(c) - \boldsymbol{e}_U$	
(Corporatist, Corporatist)		$U_G(c)$	

Note: Dominated moves are deleted.

The possible Nash equilibria at this stage are (*E, U) = (firm, state), (E, U) = (state, state) and (E, U) = (corporatist, state).* To analyze these remaining cases, it is necessary to specify the outcome of the game following the strategy pair (*corporatist, state*). This outcome depends on the relative magnitude of the government’s payoffs $U_G(s) - \boldsymbol{e}_E$ and $U_G(c) - \boldsymbol{e}_U$. In response to (*E, U*) = (*corporatist, state*), the government will move “state” if $U_G(s) - \boldsymbol{e}_E \geq U_G(c) - \boldsymbol{e}_U$ and “corporatist,” if the sign of the previous inequality is reversed.

Result 2: Assuming $U_G(c) < \boldsymbol{e}_E - \boldsymbol{e}_U < U_G(s) < \boldsymbol{e}_E$ (**Condition *****), the Nash equilibria of the game are as follows:

- if $U_G(s) - \boldsymbol{e}_E \geq U_G(c) - \boldsymbol{e}_U$, then (E, U, G) = (*firm, state, state*) and (E, U, G) = (*state, state, state*)
- if $U_G(s) - \boldsymbol{e}_E < U_G(c) - \boldsymbol{e}_U$, then (E, U, G) = (*corporatist, state, state*). Due to the inability of unions and employers to coordinate on a social policy ranked

higher than "state," in both cases the government can impose its preferred social policy.

To interpret Result 2, recall a previous observation. Assuming Condition *, if both unions and employers play "corporatist," the policy outcome is "corporatist." However, Result 2 shows that this strategy pair is not an equilibrium under the requirements of Condition ***. Here unions and employers are stuck in a prisoners' dilemma: the outcome is "state," even though both unions and employers could ensure, by cooperating, a Pareto-superior outcome preferred by both players. Thus, Result 2 specifies the conditions under which the state is able to impose its favorite policy outcome, despite the opposition of both unions and employers.

Summarizing this analysis, we can graphically map the resulting social policy outcomes, based on the magnitude of four different parameters: $\boldsymbol{e}_U$ and $\boldsymbol{e}_E$—the magnitude of the constraints imposed by unions and employers during the implementation of a social policy and $U_G(c)$ and $U_G(s)$, respectively, in other words the utility of the government towards "state" and "corporatist."

By holding the utilities of the government constant, Figure 3 maps the resulting social policy outcomes as a function of changes in the magnitude of the penalties $\boldsymbol{e}_U$ and $\boldsymbol{e}_E$. Note that the government is able to implement its preferred social policy outcome, "*state*" under two broad set of conditions: if both $\boldsymbol{e}_U$ and $\boldsymbol{e}_E$ are very small (corresponding to Lemma 1) and, despite the high magnitude of $\boldsymbol{e}_U$ and $\boldsymbol{e}_E$, if unions and employers are unable to coordinate during the process of bargaining (corresponding to Result 2). In Figure 4, I hold the two penalties $\boldsymbol{e}_U$ and $\boldsymbol{e}_E$ constant and vary the two utilities of the government, $U_G(c)$ and $U_G(s)$. We observe again

that , despite the increase in the magnitude of the two penalties, the government remains able to overcome the opposition of unions and employers and introduce its preferred social policy "*state*" in the interval [$\boldsymbol{e}_E - \boldsymbol{e}_U , \boldsymbol{e}_E$].

Figure 3: Policy Outcomes as Functions of the Magnitude of "Penalties" $\boldsymbol{e}_E , \boldsymbol{e}_U$
(assuming constant utilities $U_G(s), U_G(c)$)

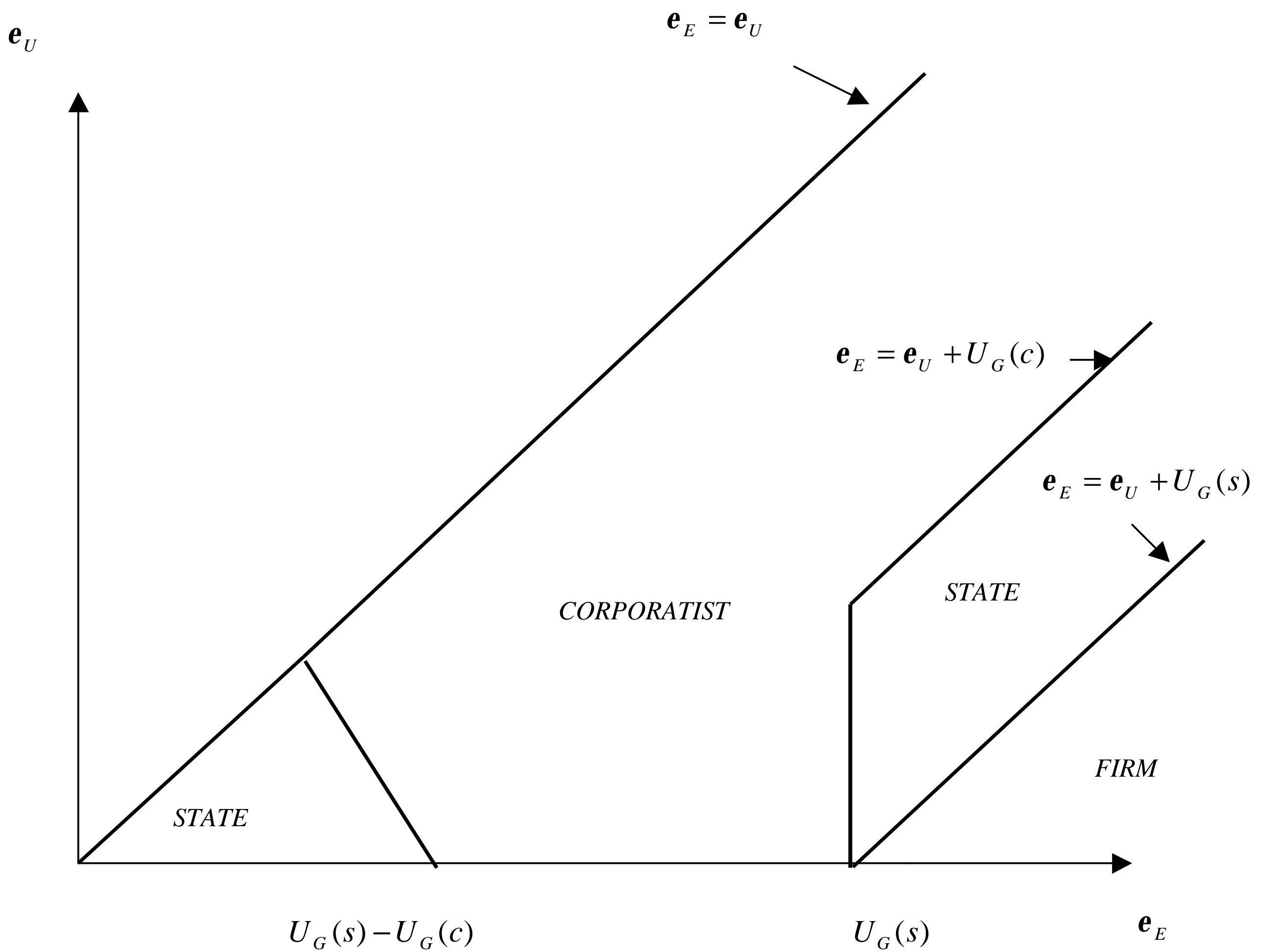
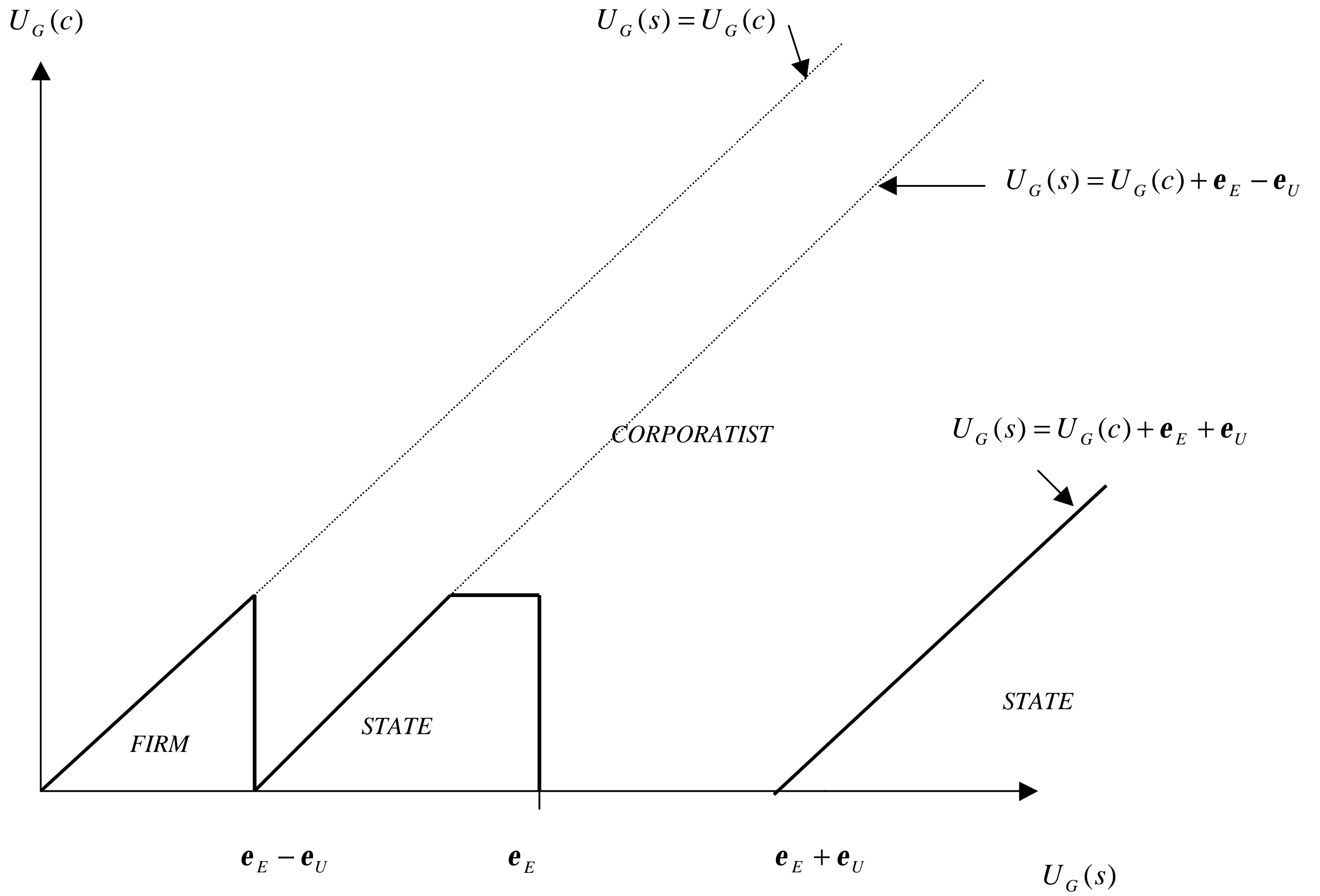


Figure 4: Policy Outcomes as Functions of the Government's Utilities $U_G(s), U_G(c)$
(assuming constant penalties $\boldsymbol{e}_E, \boldsymbol{e}_U$)



POLICY DEVELOPMENTS IN FRANCE AND GERMANY

The model developed above sheds important insights for the analysis of the development of early retirement policies and allows us to understand the political dynamics that have prevented governments from introducing their preferred social policy. In the following section, we will explore the dynamics of policy change in France and Germany, two countries that, despite their similarities, are characterized by significant differences in the evolution of early retirement policies.

In both countries, a first phase of policy development has been characterized by the creation of a decentralized regime of early retirement that allowed large firms to retain significant discretionary control over the introduction of these policies and to externalize the costs of adjustment to the welfare state. A number of policies that intended to defend elderly workers against the poverty during unemployment were responsible for the creation of this decentralized early retirement regime and for the increase in the discretionary ability in the initiation of early retirement retained by firms ($\boldsymbol{e}_E$).

The institutions that formed the core of French early retirement policies emerged in the spring of 1972 as a result of political negotiations between the French political authorities and the social partners (Guillemard 1983, Guillemard 1986: 250 ff.). This policy development was triggered by the strong mobilization of two trade union federations—the *Confédération Générale du Travail* (CGT) and the *Confédération Française Démocratique du Travail* (CFDT)—in defense of the pension benefits of elderly workers. In response to these demands of trade unions, the state introduced a policy that raised the unemployment benefits of elderly workers in case of dismissal (a policy called *garantie de ressources licenciement*). Based on the *garantie de*

ressources, workers aged sixty, who had been dismissed became eligible for benefits financed by unemployment insurance that could be as high as 70 percent of their previous wages (Kerschen and Remniac 1981, Kerschen 1983, Gaullier and Gognalons-Nicolet 1983). Yet the relative generosity in the level of unemployment benefits in fact made firms' practices of labor shedding easier, allowing firms to respond to economic downturns by dismissing elderly workers. Although the state did not grant an unconditional green light to employers to dismiss elderly workers, the policy outcome remained, in fact, very close to employers' ideal policy point. An Anne-Marie Guillemard pointed out about the introduction of this policy: "The compromise of the accord of March 1972 that was institutionalized in the law of July 5th, 1972 represents a victory of employers, who succeed in imposing their definition of the problem, and in bringing the negotiation of issues of early retirement on their own terrain, that of the regulation of employment" (Guillemard 1983: 15). The *garantie de ressources* established no monitoring mechanism over the ways in which employers made use of the now available dismissal option. Employers were not required to compensate unemployment insurance—which financed the costs of this policy—nor the pension subsystem (due to the resulting contraction of its the contributory basis) and could thus literally externalize the costs of enterprise adjustment onto the broader subsystems of the welfare state.

During the 1970s, similar to France, Germany introduced early retirement policies that established important and forceful incentives for large firms to dismiss elderly workers and failed to create mechanisms by which either the state or trade unions could "control" the deployment of these policies. A first set of measures, introduced during the severe recession of the mid-1970s, opened up the possibility of retirement several years prior to the official retirement age without a reduction in the level of pension benefits (Jacobs, Kohli and Rein, 1991;

Manow and Seils, 1999). This legal provision (Paragraph 128 of the Employment Promotion Act) allowed large firms to lay off workers at age fifty-nine, supplement their unemployment compensation for one year until the former employee became eligible for early pension benefits at age sixty. For large firms, this policy instrument became a mechanism for the stabilization of their demand for training and an adjustment resource during economic downturns. Based on the estimates of the Federal Social Ministry, during the decade between 1970 and 1980, every second large firm made use of Paragraph 128 of the Employment Promotion Act (Kühlewind 1986).

A number of influential decisions of the Federal Social Court created the institutional precondition for the use of disability pensions as a second pathway into early retirement. In 1969, the court ruled that the occupational disability pensions (*Erwerbsunfähigkeitsrenten*) could be granted to partially disabled workers unable to find a part-time job in their profession (Bundessozialgericht 1970). These ruling thus "blurred" the criteria separating "disability" from "unemployment" insurance and transformed disability pension into a "disability unemployment compensation" (Jacobs and Schmähl 1988, Frankfurter Rundschau 1981). This decision of the court, which attempted to defend elderly workers against the risk of unemployment was, nevertheless, less successful in defending the financial stability of Germany's public pension.

The consequence of these policies that created an extremely permissive framework for firm-level early retirement was either a deficit of various branches of social insurance or an increase in social insurance contributions. In France, the costs of *garantie de ressources* (which in 1977 was extended even to cases of dismissals) amounted to half of the expenditures of unemployment insurance (Commissariat Général du Plan 1991). In Germany, according to an estimate of the Federal Social Ministry, the "hidden" costs of early retirement in terms of unpaid

insurance contributions to pension insurance contributions amounted to 1.7 billion DM per year (Süddeutsche Zeitung 1984). In response to these developments, the governments of both countries launched attempts to reform early retirement and to restore the control of the state over the broad terms and conditions regulating the withdrawal of elderly workers from the labor market.

The Victory of French Socialists: The *Ordonnance* of March 1982

To reestablish control over the development of early retirement, the French government of Pierre Mauroy proposed to introduce a policy that unilaterally lowered the retirement age from sixty-five to sixty (Le Monde 1981a, 1982b). For the newly-elected socialist government, this solution brought immediate electoral and political advantages, since it fulfilled an important electoral promise of presidential candidate François Mitterrand. By unilaterally lowering the retirement age, the French government hoped to defend elderly workers against the potential risk of unemployment and simultaneously restore old-age insurance as the subsystem of the French welfare state regulating the exit from the labor market.

Due to the institutional design of the French pension system, the state needed the political support of unions and employers in implementing its goal of a general decrease in the retirement age. The French old-age insurance is organized as a two-tiered system, consisting of a basic insurance—the *régime général*—administered by the state and a second tier of occupational risk pools—*régimes de retraite complémentaires*—administered by the social partners (Lyon-Caen 1995: 159- 170; Dupeyroux, 1995, Dalloz 1994). Pension benefits are financed through a combination of these two different sources, with the basic pension of the *régime général* offering a replacement rate of 50 percent that is supplemented by additional benefits (totaling around 20

percent of the average wage) financed by the *régimes complémentaires*. Given these two separate sources of funding of old-age benefits, the state could not guarantee a replacement rate of 70 percent, after the decrease of the retirement age without cooperation from the social actors in the implementation of the social policy.

Employers' initial opposition to the plans announced by the socialist government was very high. The main federation representing employers, the *Conseil National du Patronat Français,* denounced the law as "improvised, costly and difficult to implement" (Le Monde 1982, La Croix 1982, Le Figaro 1982). Based on employers' calculations, the law increased the number of beneficiaries to old-age insurance by about 25 percent, requiring a 28 percent increase in the contributions to old-age insurance to finance this deficit (Union des Industries Métallurgiques et Minières 1981: 133). Refusing any additional increase in social insurance contributions, employers proposed the continuation of the existing regime of early retirement based on the *garantie de ressources*. In contrast to a uniform retirement age—determined by administrative decree—this policy instrument that was more attuned to the swings of the business cycles, giving firms desirable and needed "flexibility" to adjust their workforce during periods of economic downturns.

While supportive of a decrease of the retirement age, unions opposed any plans that suggested financing the lowering of the retirement age through a decrease in the pension replacement rates. Since *garantie de ressources*, the early retirement policy, already assured a replacement rate of 70 percent, unions considered any policy proposal to offer lower pension benefits than the current benefits as a "social involution." On numerous occasions, unions threatened to use their participation in the administration of the second-tier of the French pension

system to block any proposals contemplated by the state to make the lowering of the retirement age more affordable by lowering pension benefits.

In contrast to the German situation that will be discussed below, French unions and employers were trapped in a prisoner's dilemma, being unable to coordinate their policy efforts and militate for a "corporatist" solution to early retirement. On the one hand, French employers militantly stuck to their defense of the status quo situation. Unions, on the other hand, demanded only hesitantly a policy solution that entrusted unions with a higher role during the negotiation of early retirement, and, due to the low chance of achieving this outcome, ended up in endorsing the proposal of the government. In 1982, the French state was able to use the lack of coordination among unions and employers to implement its preferred social policy outcome—the lowering of the retirement age. To make this measure more palatable to the social actors—and to respond both to employers' fear of an increase in social insurance contributions and unions' worries of a decrease of the pension replacement rates—the French state agreed to subsidize, for a limited period of time the second tier of the French pension system. The state agreed to establish a "transitional fund" subsidizing the two major occupational pension funds (AGIRC and ARRCO) for a period of seven years and counteracting in part the financial disequilibrium the resulted from the increase in the number of retirees.

A Corporatist Solution: The Negotiation of the *Early Retirement Act* of 1984

In contrast to France, the German government enacted a reform that introduced a corporatist solution to early retirement. The *Vorruhestandsgesetz* of 1984 established the institutional preconditions for an industry-wide negotiation of early exit from the labor market and attempted make firm-level early retirement based on Paragraph 128 of the Employment

Promotion Act costly and, thus, unattractive to employers. Unions' support for a corporatist outcome and the endorsement by the state of the use of early retirement as an active labor market policy were the political preconditions for this policy development.

In Germany, the issue of early retirement was brought to the forefront of political debates by trade unions. While the more radical IG Metall placed the objective of a reduction of the working week at the center of its political efforts, more moderate unions—such as the chemical union (IG Chemie), the construction union (IG Bau) and the food processing workers' union (NGG)—militated for the introduction of policies of reduction in the working life as labor market instruments that could counteract the growing levels of unemployment (Mayr and Jannsen 1984; Markovits 1986: 434-435; Swenson 1989: 222-223). The most elaborate early retirement proposals, formulated by Günter Döding, the president of the food processing union, suggested the negotiation of early retirement on an industry-wide basis, not only at the firm level. According to these plans, the negotiation of early retirement at the collective level could bring advantages to all the parties involved: employers could be compensated for an increase in their non-wage labor costs, through a collective wage restraint on the part of unions, trade-unions could achieve a redistributive objective of work-sharing, while the state could be compensated for the costs of early retirement if the proper institutional guarantees that employers filled the vacancy created through early retirement by rehiring an unemployed worker or a trainee were established (Döding 1984a, Döding 1984b).

The Christian Democratic coalition government remained equally interested in a reform of existing early retirement policies that—in the words of labor minister Norbert Blüm—could "defend the actuarial basis of the pension system threatened by so many alien claims" (Süddeutsche Zeitung 1984; Frankfurter Allgemeine Zeitung 1983). The reform legislation put

forward by the Ministry of Social Affairs in the fall of 1983 rested on a complicated plan of "institutional substitution" of existing firm-level early retirement through a corporatist policy. A first policy—the "Law of the Adaptation of the Employment Promotion Act and of Pension Insurance to the introduction of early retirement benefits"—attempted to stop the financial drainage of the pension system caused by the early retirement practices of large firms by requiring employers to pay pension insurance contributions for early retirees three years after the termination of the employment relationship. This measure was expected to raise the early retirement costs for firms from about 30,000 to 70,000 DM per worker. A second element of the reform package—the Early Retirement Act (*Vorruhestandsgesetz*)—encouraged industry-wide negotiation of early retirement and provided subsidies to firms that decided not to rationalize away the vacancy created by early retirement.

These proposals towards reform were a strong political attack against the interests of large firms. On numerous previous occasions, Labor Minister Norbert Blüm had denounced existing practices of early retirement as "conspiracies between works-councils and management" that misused the resources of old-age insurance (Blüm 1983a, Blüm 1983b). In objecting to this policy change and defending the status quo, employers expressed worries about the resulting increases in the non-wage labor costs of firms that acted as further brakes on the growth in employment. Both large firms and representatives of *Handwerk* opposed the loss in the voluntary character of early retirement—and demanded the freedom to opt out of early retirement settlements that were negotiated at the industry level. Due to the high costs of early retirement, employers viewed the subsidies to firms rehiring workers as insufficient and demanded their increase (Zentralverband des Deutschen Handwerks 1984a, 1984b).

During the parliamentary deliberations surrounding these new policy proposals, a number of veto groups within the Christian Democratic coalition were successful in obtaining further concessions that diluted the legislative intentions of the lawmaker (Mares 1997b). The association representing the interests of small firms (*Mittelstandsfraktion*) called for the introduction of protective mechanisms for small firms and succeeded in obtaining an exemption for small firms from the industry-wide agreements (Zentralverband des Deutschen Handwerks 1984c, 1984d). The Social Committees (*Sozialausschüsse*), representing labor's interests within the Christian Democratic coalition, obtained a further lowering of the retirement age—as a measure designed to protect elderly workers against the risks of unemployment (Frankfurter Allgemeine 1983b, Frankfurter Allgemeine 1984). These political concessions—necessary to overcome the political opposition of the representatives of employers—significantly weakened the ability of this new law to counteract the unfavorable financial pressures faced by the German old-age insurance.

The Emergence of a "Corporatist" Approach to Early Retirement in France

The lowering of the retirement age was a measure by which the French government attempted—and for a brief period of time succeeded—to regain control over the process of early retirement. A number of additional policies—introduced or re-deployed during this period—attempted to reinforce this outcome and to limit the process of firm-level early retirement (Kerschen and Nenot 1993). To undermine the importance of the *garantie de ressources*, the government increased the financial attractiveness of a "substitute" pathway into early retirement that was administered by the Ministry of Labor. This policy, known in France under the acronym ASFNE (*Allocation Spéciale du Fonds National de l'Emploi*) was a form of "exceptional aid"

granted by the government to regions or professions "threatened by a severe disequilibrium in employment"(Code du Travail Article L322-4; cf. Husson 1994). The number of beneficiaries of this special aid (who could "exit" from the labor market prior to the official retirement age) increased from 1682 (in 1980) to 99,286 (in 1984) and 188,561 (in 1989) (Commissariat Général du Plan 1991; Gaullier and Goldberg 1993). As Kerschen and Nenot point out, in deploying this policy "the French state attempted to maintain its discretionary power, to intervene in a selective manner […] and to affirm its primacy and exclusivity on the issue of early retirement" (Kerschen and Nenot 1993: 471).

Despite these policy changes, the French government remained unable to maintain control over the process of early exit from the labor market. Due to the poor employment performance of the French economy during the second half of the 1980s, the labor market chances of elderly workers deteriorated further. Unemployment rates of elderly workers rose dramatically after 1986, when the state removed an important constraint on the ability of firms to lay off workers (the administrative authorization for dismissals) (Guillemard 1990: 69). This newly gained labor market flexibility increased the ability of employers to push the status-quo outcome back to a situation of "firm-based" early retirement, characterized by a limited ability of the state or trade-unions to influence or defend the labor market situation of elderly workers.

In 1987, French policymakers launched an initiative to negotiate with the social partners the details of a new early retirement policy. Unions' participation in these negotiations was motivated by their desire to the increase their ability to defend the employment status of elderly workers. Employers, on the other hand, were profoundly worried about the growing deficit of unemployment insurance (caused by the long-term unemployment of elderly workers) and hoped to persuade the state to finance some of these costs—via special subsidies to unemployment

insurance. The result of these negotiations was the law for the prevention of long-term unemployment of July 10, 1987. Two provisions of this law are testimony of this new "corporatist" consensus to the question of early retirement. In attempting to stop firm-level early retirement, the law made it more expensive for firms to dismiss elderly workers (by increasing the contributions to unemployment insurance of these firms).[1] In attempting to defend elderly workers against the risks of unemployment—and to respond to unions' concerns about the employment chances of elderly workers—the law simultaneously introduced financial incentives for employers to "reassign" (*reclasser*) elderly workers to a different job within the same firm. A number of bipartite agreements among the French social partners signed during the following years complemented these legal developments (*Protocole d'accord à la convention d'assurance chômage* of December 13, 1991 and of July 18, 1992; Kerschen and Nenot 1993: 477). To counteract the financial deficit of unemployment insurance, unions and employers agreed to shorten the period during which elderly workers were entitled to unemployment benefits.

At the end of the 1980s, as compared to 1982, both unions and employers faced stronger incentives to coordinate around a corporatist solution to early retirement. Unions' incentives to "deviate" strategically and support a state-led early retirement were rather low—due to the low attractiveness of the special allocation of the National Employment Fund, the policy that was, at the time, preferred by the French Ministry of Labor. Employers, on the other hand, had to balance the gains brought by firm-level early retirement (which brought to the firm a younger and, perhaps, more productive workforce) against higher social costs (caused by the increase in the number of beneficiaries and decrease in the contributors to unemployment insurance). The

[1] This provision is also known as "Contribution Delalande." See Code du Travail, Article L. 321- 13. On this legal change, see Kerschen, N. and A.-V. Nenot (1993) "La fin des pré-retraites ou l'éternel recommencement?" *Droit Social* 5, 474.

corporatist solution appeared attractive to firms, partly because it entailed only a modest increase in the state's supervision over a firm's employment practices.

The Return to Firm-Level Early Retirement in Germany

The German *Vorruhestandsgesetz* of 1984 was limited to a duration of four years. In 1988, the debates about the economic and labor market impact of a policy facilitating the withdrawal of elderly workers from the labor market resurfaced again on the German political scene. As compared to 1984, political voices opposing the reliance on the shortening of working-life as a labor market instrument had now gained in visibility (Die Welt 1987; Frankfurter Rundschau 1988). Critics of the Early Retirement Act pointed out that the employment effects of this policy had been modest, since many firms chose not to hire new workers. Despite this small re-employment rate, the costs of early retirement had been very large, contributing to a deficit of the Federal Employment Office. Additional financial worries about the long-term financial sustainability of the public pillar of Germany's old-age insurance led to calls to raise the retirement age.

Some of the harshest criticisms of the Early Retirement Act were voiced by German employers. Large firms joined representatives of the *Handwerk* in denouncing the increase in the non-wage labor costs that resulted from the negotiation of early retirement at the industry-level (Zentralverband des Deutschen Handwerks 1987; 1988). Employers used the opportunity for reform to militate for a reintroduction of a policy facilitating firm-level early retirement that was similar to Paragraph 128 of the Employment Promotion Act (Ebert 1988).

Trade unions remained the strongest defenders of the status quo policy. According to the estimates of the German Trade Union Federation (DGB), the elimination of early retirement

could lead to further increases in the level of unemployment of about 100,000 per year (Süddeutsche Zeitung 1988). The social wing of the Christian Democratic coalition and the Social Democrats joined the protest of trade unions and denounced a solution that carried the risk to transform the unemployed into the victims (*Manoeuvriermasse*) of the pension policy of the government. A Social Democratic proposal to extend the Early Retirement Act failed to find the necessary support and was defeated during the deliberations of the *Bundestag* (Bundestags-Drucksache 1988).

In attempting to steer a compromise between the demands of trade unions (and of the Social Committees) and the opposition of employers, the Christian Democratic coalition initiated an ambiguous process of reform. It decided to replace the Early Retirement Act by a policy facilitating gradual withdrawal from the labor market—the Partial Early Retirement (*Alters-Teilzeitrente*). This policy opened up the possibility for firms to employ elderly workers only part-time—and guaranteed a subsidy to compensate for the loss of income of the employee. Employers were however burdened with the financial obligation to continue to pay pension insurance contributions for these workers (Schmähl and George 1996). Thus, although employers' costs of early retirement were raised, the new policy granted control over the introduction of early retirement back to firms.

The Law of Partial Early Retirement reflects German policymakers' realization of the pervasive difficulties associated with any political attempt to undo the complex interlocking practices linking firms to the welfare state. Anticipating the ability of firms to continue to rely on early retirement as an instrument of adjustment and restructuration—or by using the concepts of the first part of the paper, given high values of the parameter $\boldsymbol{e}_E$—the German state deferred to the demands of firms and granted them control over early retirement. Subsequent policy

developments testify to this low willingness of the German state to curtail the privilege "to externalize the adjustment costs unto the welfare state" enjoyed by German firms (Manow and Seils 1999). The pension reform of 1989—heralded by observers as a landmark event—left important pathways into early retirement "untouched" and failed to unsettle the hidden consensus about the acceptability of firm-level early retirement in Germany.

CONCLUSIONS

Existing comparative research on the development of early retirement policies groups France and Germany together as examples of "continental welfare regimes" that encourage a massive premature exit of elderly workers from the labor market. These analyses pay, however, insufficient attention to the discontinuity and change in existing early retirement policies and to the political conflict among unions, employers and the government over the institutional design of early retirement policies. So far, the causes for the variation in existing early retirement institutions **within** the same country and within the same "family of welfare states" have remained insufficiently understood. This paper has developed an actor-centered analysis of the development of early retirement policies. I have argued that **control** over the broad terms and conditions under which elderly workers become entitled to early retirement benefits has been a highly contested political issue and I have explored the political conflict among unions, employers and the state over this contested issue. Using a game-theoretic model, I have attempted to specify the political conditions under which the bargaining culminates with the introduction of the social policy outcome that is preferred by one of the players and the policy impact of strategic moves of different players. The formal analysis has generated two

propositions. If employers and unions play an assurance game, governments will be unable to obtain their preferred early retirement policy and will settle instead on a corporatist solution—a policy in which early retirement is determined through joint negotiation among unions and employers. In contrast to this situation, governments will be able to introduce their preferred policy only if unions and employers are trapped in a prisoner's dilemma and remain unable to coordinate their strategies.

Using the insights generated by the model, I have explored the dynamics of policy change of early retirement policies in France and Germany. Despite a strong preoccupation with the adverse implications of early retirement on the financial stability of old-age insurance, both the French and the German government have been unable to stop and undo the trend towards early exit from the labor market of elderly workers. The causes are not to be found in the political myopia of these governments, or, as Paul Pierson has argued, in the "blame-avoiding strategies" of politicians, but in the strong political constraints posed by unions and employers. Yet these strategic constraints remain still poorly understood by welfare state scholars.

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