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Abstract

In a path-breaking study, which marks a new phase in historical institutionalism, Streeck and Thelen (2005) show how a rigid dichotomy between path dependent, incremental adaptation and radical transformation fails to capture important transformative processes common to advanced political economies. While their research focuses on examples of gradual but radical transformation, the two authors leave open the interpretation of what constitutes abrupt, but only incremental change. This article integrates their framework, defines what they call 'survival and return' and, within this *genus*, indicates analytically distinct *species*. To shed light on the concept, Croatian and Hungarian pension reforms in the late 1990s are compared. Despite the two countries' efforts to introduce systemic changes in their retirement systems, flawed policy-making created enough institutional incoherence to steer the new arrangements away from their original designs, thereby making further hybridisation and marginalisation all the more possible. The paper analyses the two cases and individuates two distinct phenomena falling under the 'survival and return' category: *replication*, where the institution survives due to the redundancy of the new logic of action with respect to the old one; and *reaction*, where structural reforms generate demand for the old institutional logic, which is ultimately reintroduced.

Keywords: instability, institutional change, survival and return, multi-pillar pension system, pension reform

1. Introduction

In the struggle of historical institutionalism to explain the origin and change of institutions, the state-of-the-art is currently represented by Streeck and Thelen's (2005) study *Beyond continuity*. The book departs from the previous, bifurcated literature, which divides institutional evolution into long periods of stasis, characterised by incremental change and short, sudden bursts of institutional innovation. The authors, in fact, focus on change as a combination of process and result. In particular, they show how a rigid dichotomy between typically path dependent incremental adaptation (or simply continuity) and radical transformation does not capture important transformative processes common to advanced political economies. Most innovatively, their contribution focuses on examples of radical but at the same time gradual transformation.

In this essay, Streeck and Thelen's argument is integrated by investigating what the two authors call 'survival and return' types of institutional change. The paper first defines the concept and subsequently individuates two phenomena falling under this category. (i) Survival through *replication*, where the institutions that are the object of reform survive despite a structural overhaul. The breakdown of the old institution does not happen, because the new arrangements perform identical functions, as before, thereby failing to generate a concomitant shift in the logic of action. (ii) Return by *reaction*, where those institutions that undergo restructuring return despite structural reforms. In this case, the old logic of action returns as a consequence of rule-takers' demands for its reintroduction.

The study individuates in the agenda-setter's strategic behaviour the key explicans for the two phenomena. Under particular political-institutional conditions – that is, the operation of an unconstrained executive – unilateral or divisive policy-making that unevenly allocates gains and losses becomes more likely. The neglect of the distributive dimension of problem-solving implies that either the reformed institutional arrangements are disguised *replicas* that do not deviate from the old logic of action, if this provides material advantages to the agenda-setter; or they reallocate resources and create a new logic of action, but at the same time trigger the *reaction* of the reforms' losers, who demand the reintroduction of the old logic.

In order to substantiate such classification and explication of the two phenomena, the paper analyses the instability of paradigmatic pension reforms enacted in Croatia and Hungary in the late 1990s. Both countries' policy-makers unilaterally overhauled the respective retirement systems, but the partial, incoherent or fictive institutional replacement steered the new arrangements away from their original designs. The old, inherited and inefficient public pension systems either survived the abrupt process of change for politically instrumental reasons, or they returned as a result of popular dissatisfaction, thereby generating hybrids between old and new logics of action. The tangible possibility that the *reaction* against the new logic and the *replication* of the old schemes lead to further hybridisation or marginalisation requires yet another structural overhaul of the freshly implemented multi-pillar systems.

The paper's argument is structured as follows. The first section presents the evolution of historical institutionalists' understanding of change – from the early 1980s to Streeck and Thelen's theoretical framework – and defines their 'survival and return' concept. The second section lists the features of the new pension paradigm, compares it to socialist legacies and presents the two case studies. The following part shows how the implementation of pension reforms in Croatia and Hungary underwent the abovementioned processes, thereby leaving the new institutional arrangements in a haphazard state. In the final part, *reaction* and *replication* are conceptualised as two analytically distinct instances of 'survival and return'.

2. The evolution of institutional change

The three forms of the 'new institutionalism' – rational (Shepsle and Weingast 1981), historical (Evans, Rueschemeyer, and Skocpol 1985) and sociological (March and Olsen 1989) – appeared as reactions to those 'undersocialised conceptions of social action' advocated by both neoclassical economics and behavioural sociology. The rich research agenda engaged neo-institutionalist scholars in the attempt to, on the one hand, define the relationship between institutions and behaviour and, on the other hand, study the origin and change of the institutions themselves (cf. Hall and Taylor 1996). While the study of the effects of institutions (taken as exogenous) on human action has produced a very rich literature, research on how institutions (considered as endogenous) originate and change considerably lagged behind and was subordinated to the former (Shepsle 1989). The situation, 20 years later, is radically different: institutional change lies at the centre of a lively debate, in which historical institutionalists are probably the most advanced.

The evolution of the study of the effects of institutions is, in this context, of lesser importance than tracing the three phases delimiting the study of how institutions change. Nonetheless, a rigorous definition of how institutions affect actors' behaviour is necessary to explain why, once a relatively stable state is reached, an institution may eventually change.

2.1. Defining institutions

Far from being exogenous and fixed, institutions are the product of endogenous social choices (Riker 1980) and are central to political contestation (Thelen 2004). They regulate the relations between rule-makers and rule-takers by stipulating rules and relative enforcement procedures, so that different behaviour is constrained or encouraged. In the former case, behaviour responds to the lack of an alternative in individual conduct or to top-down imposition. In the latter case, behaviour is encouraged and rule-takers comply, depending on their individual pay-offs (the perceived 'gains from trade') and whether such behaviour becomes commonly accepted (the observance of the new rules by peers) (see Levi (1990) for a historical-institutionalist perspective and Moe (2005) for a rationalist viewpoint).

Not dissimilarly, Streeck and Thelen (2005: 9) treat institutions as social regimes. These are characterised by a 'triadic' institutional nature, implying that rule-makers or institutional designers create a set of formalised, obligatory rules that stipulate expected behaviour and rule out undesirable behaviour on the part of rule-takers, which are enforced by a third party.[1]

Hence, institutions are not simply a collective endeavour to, for example, minimise transaction costs (see North 1990), but rather embody a relationship of power between those who devise institutions and those who have to abide by the rules. There are many ways in which this power imbalance can crystallise in an institutional setting, however; if institutions are the outcome of political bargaining by parties with competing interests, each party favours those institutional forms which bring it the greatest distributive share of the goods allocated by the institution (Kenneth and Schiemann 2001: 154). Consequently, rule-makers choose a favoured equilibrium by suppressing other alternatives.

How this is done, therefore, becomes crucial: once an institutional arrangement is set up, mutations are caused by the redistribution of the coercive and bargaining resources of power within the institution itself. Hence, if an institutional setting is being imposed without the consent of the majority of rule-takers, as in the case of unilateral policy-making, the reform outcomes inevitably become vulnerable to any preference change on the part of those in power. If, on the other hand, the new arrangement is the result of a concerted decision-making effort, the likelihood of such instability diminishes.

2.2. Chronology of change

Steinmo and Lewis (2007) show that neither behaviouralists (due, probably, to lack of interest) nor rational choice theorists (due to their emphasis on finding an equilibrium under any institutional setting that provides no incentives to change any of the individual choices) are able to explain institutional change, if not through exogenous shocks. In contrast, historical institutionalists push the agenda much farther and repeatedly endeavour to systematise change.

Three main, overlapping phases characterise their understanding of institutional change. First came the framing of the problem. This was followed by a reflective phase, in which concepts were consolidated but also basic tenets questioned. Finally, scholarship entered a more mature phase, which somewhat distances current ideas from earlier beliefs.

During the first period – early 1980s to early 1990s – the notion of institutional change intermeshed with the need to demonstrate that policy legacies and state structures constrain individual action (Weir and Skocpol 1985). Punctuated equilibrium – long periods of stasis interrupted by sudden bursts of activity, innovation and change – was seen as a convenient way of describing

1. This definition rules out informal mores and customs, voluntary social conventions and also organisations in which duties are dyadic.

institutional evolution.[2] However, not enough thought has gone into explaining why institutions are most of the time in a relatively steady state, or how change happens and why it happens when it does.[3]

Once agreement on the usefulness of the new institutionalism consolidated, a second period started, ranging, roughly, from the early 1990s until 2005. During this phase a wealth of research reinforced what Streeck and Thelen call the 'bifurcated literature'. Simultaneously, however, several scholars started to criticise its founding assumptions. The authors professing what I call a 'punctuated-equilibrium bias' either focused on instances of institutional continuity by developing the notion of path dependence or emphasised how fundamental change is possible only during critical junctures (cf. Pempel 1998).[4]

This bifurcated literature produced, on the one hand, almost utopian studies that extolled the virtues of voluntaristic, radical institutional change. The fall of socialism elicited great enthusiasm for social engineering, giving rise to such revolutionary metaphors as 'shock therapy' and 'clean slate'. These talked up the merits of a 'handful of heroes' (Harberger 1993: 343), 'vigorous political leadership' (Sachs 1994: 503) and the 'unconstrained executive model' (Haggard and Kaufman 1995: 7-11), which rendered institutional 'breakdown and replacement' possible and desirable.

On the other hand, it generated research that emphasised institutional continuity. In fact, many questioned the insufficiently developed definitions of what constitutes path dependence, which lies at the core of incremental processes of change and adaptation. The phenomenon was, as a result, conceptualised in a number of ways, which are neatly enumerated by Keune (2006: 28-33) and Page (2006). These range from very loose to very strict.

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2. The first person to borrow the term 'punctuated equilibrium' from evolutionary biology (coined in 1972 by Gould) and to employ it in an institutionalist setting was Krasner (1984). The nomenclature used by the author is, however, often inconsistent with what happens with institutions. Frequently, institutional change resembles relative stasis over a considerable period, followed by periodic, rapid, morphological change, not leading to lineage branching. This is in evolutionary biology called 'punctuated gradualism' (a term coined in 1983 by Malmgren, Berggren and Lohmann).

3. Steinmo and Lewis (2007) and, to some extent, Streeck and Thelen (2005: 19) even contend that institutions are never in equilibrium as they undergo constant reinterpretation.

4. Another, coeval branch of research tries to explain critical junctures by focusing on organisational behaviour. Baumgartner and Jones (1993) develop an encompassing punctuated equilibrium theory of agenda-setting. They stress that cognitive (the salience of an issue influencing its position on the agenda) and institutional frictions (obtaining a sufficient majority to deal with the issue) are key to explaining why policy-makers do not react proportionally to problems, but that their conduct follows a 'punctuated-equilibrium' pattern, with long intervals when nothing happens, interspersed by overreactions. Interestingly, even those authors researching the evolution of political sciences as a field of study attribute the existence of critical junctures to cognitive friction (a recent example is Blyth 2006).

Looser versions, such as Sewell's (1996) – 'what has happened at an earlier point in time will affect the possible outcomes of a sequence of events occurring at a later point in time' – have been criticised for stressing only that history matters and that the understanding of current events has to be traced back to temporally remote causes. Stricter versions are usually rooted in the more formalised work of new institutional economists (Arthur 1994) and often employ the same metaphors and examples (Pierson, 2000), as a result of which they underwrite a worldview in which continuity dominates. It is interesting that these definitions are sometimes rooted in a very narrow conceptualisation of path dependent change, which displays the 'punctuated-equilibrium bias' in full. In fact, Mahoney's (2000: 507-508) strict view of path dependence reads as follows:

> In this article, I argue that path dependence characterises specifically those historical sequences in which contingent events set into motion institutional patterns or event chains that have deterministic properties. The identification of path dependence therefore involves both tracing an outcome back to a particular set of historical events, and showing how these events are themselves contingent occurrences that cannot be explained on the basis of prior historical conditions.

The definition allows only for critical junctures – the contingent occurrences – that produce the conditions for institutional change and are then followed by continuity until a new juncture comes by. The deterministic features of such an approach clash with the centrality of institutions in political contestation.

At the same time, the bifurcated literature came under attack. Stark and Bruszt (1998: 82-83), as well as Stiglitz (1999), criticised the studies that focus on the path-breaking character of critical junctures (in particular, the fall of Communism). They forcefully questioned whether institutional replacement is possible, or even desirable. The former proposed the term 'institutional reconfiguration', the latter 'reform through recombination' to show that even during important contingent events, institutions may survive and have to be built upon, basically through managed 'gradual transformation'. Roland (2001: 31-39) supports a similar approach, conveniently called 'evolutionary institutionalist'.[5] Furthermore, the unmitigated reliance on crisis and external shocks as the motor behind radical change attracted widespread criticism with respect to the purpose, or even ontology, of critical junctures. Rodrik (1996: 27), for example, quipped: 'That reform should follow crisis is no more surprising than smoke following fire'.

Other authors started, instead, to argue that not only punctuated equilibrium is a possible description of how institutions change and hence that path dependence need not have deterministic properties or unavoidably generate continuity. In rational choice, Greif and Laitin (2004) demonstrated that en-

5. A formal linkage between evolutionary theory and institutional change has only recently come onto the research agenda (see e.g. Steinmo and Lewis 2007).

dogenous change of institutions (leading to their demise) in self-reinforcing equilibria is theoretically possible. More important for this article, historical institutionalists emphasised that different processes of change coexist. Thelen (2004) incorporated into the picture something akin to *phyletic gradualism*, that is, another concept borrowed from evolutionary biology by which new species arise by the gradual transformation of ancestral species (cf. Ridley, 2004), thereby implying that institutions may radically change through gradual transformative processes.

The notion that punctuated equilibrium and gradual transformation can coexist opened the door, in 2005, to the third phase in the evolution of institutionalists' understanding of the mechanisms underpinning change in their object of analysis. The innovative features of Streeck and Thelen's (2005) *Beyond continuity* lay in the breakdown of change into a combination of process and result. This distinction yields the matrix in Table 1.

Table 1 **Types of institutional change**

		Result of change	
		Continuity	Discontinuity
Process of change	Incremental	Reproduction by adaptation	Gradual transformation
	Abrupt	Survival and return	Breakdown and replacement

Source: Streeck and Thelen (2005: 9).

The approach consistently overcomes many of the inadequacies of the bifurcated literature and its 'punctuated-equilibrium bias' (Streeck and Thelen 2005: 8-9):

> In reality, however, there is often considerable continuity through and in spite of historical break points, as well as dramatic institutional reconfiguration beneath the surface of apparent stability or adaptive self-reproduction, as a result of an accumulation over longer periods of time of subtle incremental changes … The former, which we tentatively refer to as 'survival and return' … is of less interest to us in the present context than the latter, which we call gradual transformation and which stands for institutional discontinuity caused by incremental, 'creeping' change …

Consequently, throughout the book, the authors focus on examples of 'gradual transformation', thereby proposing conceptually distinct processes, such as layering, drift and displacement.

This poses two interrelated problems that this article tries to solve. First, a definition of institutional 'survival and return' is missing. Second, the category needs to be unpacked, as it combines analytically different modes of change. Institutions may in fact 'survive' an abrupt process of change, or 'return' after this has been carried through.

3. Survival and return?

As pointed out by Streeck and Thelen, 'survival and return' is the phenomenon by which, despite major shocks or abrupt processes of change, the core institutional structures survive (albeit, usually, in an updated form). A tentative definition of the concept can be given in both positive and negative terms. In fact, 'survival and return' entails an abrupt process of change, whose purpose is systemic change, but which yields significant continuity with the past logic of action. Therefore, it is complementary to institutional 'breakdown and replacement', since this process – the objective of the abrupt process of change – fails to materialise fully.

This broad definition can be broken down further. 'Survival and return' may entail: (i) the survival of the old logic of action, despite an abrupt process of change: a notable example is state-owned enterprises (SOEs) in post-socialist countries – for example, in the Czech Republic – which under certain types of privatisation never changed owner; (ii) the return of the old logic of action, after a structural overhaul takes place – as in the case of the return of a de facto single-party system in Croatia after the introduction of multi-party elections in 1990. In the first case, institutional breakdown is ineffective. The structural reform elements are inadequate to unseat the old logic of action. In the second case, institutional replacement is unsuccessful. Structural reform elements are indeed present, but they generate a backlash and hence the return of the old logic of action.[6]

From the definition given above, it transpires that 'survival and return' incorporates a multiplicity of abrupt processes of change that lead to continuous or only incremental outcomes. Logics of action, institutional structures and statuses may return at a later moment, may survive a process of abrupt change through marginal modifications or may undergo a mixture of both. Finally, it is entirely possible that, despite immediate continuity, a gradual transformative process sets in, thereby showing its effects only in the years to follow. Precisely this happened in both cases referred to above: most SOEs are now privatised in the Czech Republic and Croatia has had a moderate pluralist party system since 2000.

6. Both definitions differ substantially from the concepts developed by Roland, Stiglitz, Stark and Bruszt. They point out that forcing institutional breakdown and replacement may have much less beneficial consequences than building on existing institutional structures. They do not tackle institutional continuity directly, in spite of abrupt processes of change.

3.1. Research objectives

In order to analyse 'survival and return' and propose two conceptually distinct processes falling under this category, this essay focuses on paradigmatic reforms. These differ from their parametric counterparts in terms of the structural innovations that they introduce (Hall 1993). Paradigmatic reforms endeavour to change the logic of action of old institutional arrangements.

The focus on structural shifts has two purposes. On the one hand, it is a natural way of analysing 'survival and return'. When an abrupt process of change, aimed at institutional disruption, fails to induce the 'breakdown and replacement' of the old institution, then 'survival and return' is the complementary outcome. On the other hand, it can be shown that institutional 'survival and return' becomes more likely when structural reforms are a result of unilateral policy-making by unconstrained executives.

The two are used as the explicans that may generate a 'survival and return' process of change. Hence, they are not inherent characteristics. They represent sufficient but not necessary conditions for 'survival and return' to happen in the examples provided to illustrate the phenomenon. In fact, both legislation and the implementation of complex paradigmatic reforms (such as pension reforms) require very demanding modes of negotiation in order to succeed. Unilateral, exclusive decision-making, which arbitrarily assigns gains and losses, concentrates credit and does not diffuse blame, may be incompatible with changes in structure that necessitate a fundamental rewriting of the underlying social contract.

It is, in fact, likely that, under these circumstances, the said executives do not want to forgo the old logic of action (because, for example, it yields considerable economic or political advantages) and hence build into the reform insufficient structural elements for an institutional breakdown to be effective. Additionally, it is possible that, by resorting to unilateral or divisive policy-making, the structural changes trigger a reaction by rule-takers as soon as reforms are implemented and, in the case of a change in political power (or even in the preferences of the majority), the new arrangements may be overturned and the old logic of action reintroduced.

In order to provide tangible examples of 'survival and return', the paper proceeds with the analysis of systemic change in Central, Eastern and South-eastern European retirement systems. These pension reforms, when successful, are archetypical instances of institutional 'breakdown and replacement'. In practice, this does not always happen. The Croatian and Hungarian reform processes in the late 1990s are investigated, since they have, despite the abrupt and encompassing process of change, generated outcomes that were very different from initial expectations.

4. New pension orthodoxy as 'breakdown and replacement'

Two characteristics define traditional public pension systems: (i) the pay-as-you-go (PAYG) method of financing, which entails an intergenerational contract (an exchange of promises) between current and future workers, as opposed to advance funding; and (ii) the government as provider of the service, as opposed to private entities.[7]

After the Second World War, PAYG schemes, due to the ease with which they can be set up, appeared in the West and the East alike. In time, however, they proved to be vulnerable to increasingly adverse demographic conditions. As a result, the World Bank (1994: 15) wrote in its seminal publication *Averting the old-age crisis* that PAYG pensions should be overhauled, because they are 'beset by escalating costs that require high tax rates and deter private sector growth – while failing to protect the old'.

Hence, the Bank developed a new pension paradigm, which encompasses, according to Chłoń-Domińczak and Mora (2003: 132), two different systemic shifts: from collective to individual risk bearing, as with the substitution of defined-benefit with defined-contribution schemes; and from state to market provision, thereby entailing a partial privatisation of the public pillar. Both are consequences of the emphasis put on the virtues of prefunding. In its latest version, the Bank recommends a five-pillar structure: (i) a basic (zero) pillar to deal explicitly with the poverty objective; (ii) a mandated, unfunded and publicly managed defined-benefit (first) pillar; (iii) a mandated, funded and privately managed defined-contribution (second) pillar; (iv) voluntary retirement savings (the third pillar); and (v) a non-financial (fourth) pillar to include the broader context of social policy, such as family support, access to health care and housing (Holzmann and Hinz 2005).

Such systemic overhaul, which happens in the vast majority of cases after a process of abrupt change (the gradual proliferation of US 401k plans is an exception), may be labelled, in Streeck and Thelen's parlance, as 'breakdown and replacement' of old public PAYG pension schemes.

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7. A third characteristic may be added. Traditional PAYG schemes employ defined-benefit calculation formulae, based on the salary earned by the insured. The alternative – defined-contribution formulae – is to compute benefits on the basis of the accrued amount of contributions. The former method entails more redistribution than the latter.

The popularity of the new multi-pillar structure grew at a breathtaking pace, thereby taking on the contours of a genuinely global social policy (Orenstein 2005). According to the International Federation of Pension Funds Administrators (FIAP), by late 2008, 29 countries had introduced a mandatory fully-funded, privately-managed pension pillar, thereby implementing both paradigm shifts (FIAP 2008). Among these, 11 ex-socialist countries opted for a mandatory fully-funded private pillar (Guardiancich 2008b). Kosovo (2002) closed down its public scheme and replaced it with private arrangements, while Lithuania (2004) settled for parallel privatisation, where the funded pillar co-exists as an alternative to the public system. Bulgaria (2000), Croatia (2002), Estonia (2002), Hungary (1998), Latvia (2001), Macedonia (2006), Poland (1999), Romania (2008) and Slovakia (2005) opted for a mixed system, in which mandatory private arrangements complement the public pillar.

4.1. The socialist legacy, transition and reform

In order to understand why transition economies so eagerly overhauled their pension systems, some fundamental features of inherited retirement schemes must be spelled out. The erosion of socialist PAYG systems started long before the transformation of central planning into a market economy. These schemes were initially solid, but subsequent amendments rendered them obscure, financially unsound and illegitimate in the eyes of the public.

The retirement age was low and benefits rather undifferentiated. Notwithstanding the flat distribution of income, employees were granted earnings-related pensions, calculated according to best- or last-years formulae. Insurance was neither universal, as it depended on the existing employment relationship (only later was coverage extended to farmers and the self-employed), nor egalitarian, as privileges were granted to those in risky and unhealthy occupations (in Croatia, almost 20 per cent of all pensioners still enjoy privileged rights). In addition, these systems were used to cross-subsidise other budget expenditure items – for example, social assistance – and started to generate deficits.

If late socialism slowly wore down the schemes, the transformational recessions triggered their collapse. In the attempt to improvise a social safety net, older unemployed or redundant workers were forced to retire. Expenditure skyrocketed. At the same time, the tax authorities were unable to cope with the multiplication of contributors, the output decline, tax evasion and the informalisation of the economy. Revenues from contributions plummeted, thereby undermining the fiscal balance of public pension schemes.

During transition, the political exploitation of existing retirement schemes continued unabated. Marginal and disorganised losers were penalised to obtain fiscal savings, while better-organised interest groups were granted favours in exchange for electoral support. This led to the normative delegitimation of retirement schemes as performance expectations were betrayed and mutualism severed (Brooks 2006).

Of the three reform options (refinancing, retrenchment and restructuring), the former was soon taken off the agenda, due to high social contributions hindering international competitiveness. Subsequent retrenchment, especially irregular indexation of retirement benefits (Cashu 2003), was adamantly opposed and often declared unconstitutional. As a consequence, fundamental restructuring became the only available course of action.

Croatia and Hungary followed a similar course and embarked – in 1998 and 1997, respectively – on structural pension reforms. They both partially privatised their pension systems and while Hungary linearised (starting in 2013) its benefit formula, Croatia went a step further and introduced a points system, which strictly links benefits to contributions (see Table 2 for details).

Table 2 **Reformed pension systems in Croatia and Hungary**

	Croatia	Hungary
Zero pillar	GMI	Old age allowance
Eligibility	Entire population	Persons above 62
Benefit	% of state-defined subsistence allowance	Supplement to reach 80% of min. old-age pension
First pillar	PAYG-PS	PAYG-DB
Retirement age	60 women, 65 men	62 women, 62 men
Vesting period	15 years	15 years
TCR	20% employee	24% employer, 9.5% employee
Second pillar	January 2002	January 1998
Eligibility	Mandatory below 40 Voluntary 40–50	Mandatory for new entrants Voluntary for others
PCR	5% employee	8% employee
Third pillar	2002	1993
Retirement age	50	No
Vesting period	No	10 years
Tax treatment	EET	EEE
Fourth pillar (health care)	PHI	PHI
PCR active population	15% employer	4% employer, 11% employee
PCR retirees	No	No

Notes: EEE = Exempt, Exempt, Exempt. EET = Exempt Exempt Taxed. GMI = Guaranteed Minimum Income. PAYG-DB = Pay-As-You-Go Defined Benefit. PAYG-PS = Pay-AS-You-Go Points System. PHI = Public Health Insurance. PCR = Pillar-specific Contribution Rate. TCR = Total Contribution Rate.

Source: Holzmann and Guven (2008).

5. The origin of pension instability in Croatia and Hungary

Notwithstanding the new system's popularity and number of stakeholders, the 'breakdown and replacement' of a socialist PAYG scheme should have involved an open and inclusive renegotiation of the social contract. However, Eastern policy-makers failed to initiate a transparent debate on the prospects of reforms and overemphasised the advantages of funding. This created vain expectations that the funded pillar might outperform the PAYG system. Wide popular support for reforms was, therefore, based on rather hollow promises, thereby increasing the odds that backlashes or reversals would occur (Brooks 2006).

In Croatia and Hungary, policy-makers not only overstated the virtues of the new paradigm and used obfuscation tactics, but also resorted to unilateral policy-making to avoid dialogue and meaningful confrontation. Both countries enjoyed the benefit of an unconstrained executive. Standard veto actor theories suggest that such an executive is able to adapt policy more easily to changing socioeconomic needs, at the expense, however, of its (political) stability over time. In the words of Haggard and McCubbin (2001: 6) '[a] more decisive polity must necessarily be less resolute'. Recent theoretical advances suggest that even this may be an understatement (Scartascini, Stein, and Tommasi 2008). Once an intertemporal dimension is brought in – that is, the game between rule-makers and rule-takers is repeated – there is a positive correlation between policy adaptability and its stability (between decisiveness and resoluteness). Therefore, more concentrated authority not only is less resolute (politically stable) than one with extensive checks and balances, but it may also be less decisive (unable to adapt efficiently to changed socioeconomic circumstances).[8]

Using a counterfactual scenario (in which those parties excluded from policy-making are hypothetically included and can mobilise against reforms), it is possible to show that certain unacceptable lines of conduct would have been

8. Brooks and Weaver (2006: 374–375) propose a similar argument with respect to the conditions leading to the erosion of a defined-contribution public pillar. More specifically, they contend that political systems with sufficient veto points to require supermajorities are more immune to sudden policy reversals. Hence, broad multi-party agreements backed by public support and understanding is a conditio sine qua non for the political sustainability of reforms.

avoided, thereby rendering costly deviations from efficient practice and future backlashes less likely. The following paragraphs briefly trace legislation and reform outcomes in the two countries, starting with the mode of extrication from socialism, which is (as usual) a fundamental determinant of individual institutional settings.[9]

9. The accounts below rely on a number of recent studies on Croatian and Hungarian pension reforms and their implementation. See, in particular, Anušić, O'Keefe and Madžarević-Šujster (2003), Guardiancich (2008a, 2007), Puljiz (2007) and Simonovits (2008).

6. Reforms in Croatia

Croatia declared its independence from Yugoslavia on 25 June 1991. The pro- versus anti-communist cleavage between the successor Party of Democratic Change (SKH-SDP) and the conservative, nationalist Croatian Democratic Union (HDZ) was transformed into a pro- versus anti-Serbian national struggle. President Franjo Tuđman's HDZ prevailed in the founding elections, thereby replacing a communist single-party regime with an anti-communist single-party government. Croatia evolved towards a limited pluralist, clientistic, very presidential '*demokratura*' (Grubisa 2002), in which only the Constitutional Court had some countervailing influence.

A plenipotentiary for pension reform, headed by Prime Minister Zlatko Mateša's restricted cabinet, introduced a German-inspired points system for the public pillar in 1999 and a mandatory fully-funded second pillar in 2002. The Croatian pension reform of 1998 should not be considered an outright failure. The reform's design was, despite various postponements, rather good.

The problem lay much more in the imperative, clientistic and brutal policymaking, which was perfectly in line with President Tuđman's usual methods. Neither the corporatist arena nor the political opposition had the strength, expertise or will to oppose the plenipotentiary's decisions. Hence, none of these groups or the public provided any external legitimation. The government widely resorted to strategies of obfuscation and *divide et impera* against civil society interest groups, while favouring the state bureaucracy.

Costly deviations from efficient practice could have been avoided if policymaking had been more inclusive. Pensioners, in particular, very much resented the HDZ's disregard of a 1998 Constitutional Court ruling, which declared earlier retrenchment measures unconstitutional and restored retirees' entitlement to pension payments that had not been disbursed. Moreover, the Christian Democratic Union maintained unfair entitlement regulations, retained differential retirement ages and introduced higher-than-planned indexation just to appease its clienteles. At the same time, the plenipotentiary lowered the actual pension value (a fundamental component of a points system formula) to a level which would radically decrease future replacement rates.

The precarious fiscal situation gave Finance Minister Borislav Škegro the excuse he needed to thwart plans for a rapid expansion of the funded pillar as early as during the legislative phase. A major departure from the original draft was the lowering of the contribution rate to the funded pillar. The stepwise increase to 10 per cent was substituted by the formula ‘not lower than 5 per cent’, which failed to satisfy anyone other than Finance Minister Škegro. Of course, this approach could not count on cross-parliamentary consensus on reform. This severely hampered implementation, thereby generating two unexpected side effects: the de facto survival of the old logic of action through the *replication* of the public pillar within the private schemes and a *reaction* on the part of the electorate, which demanded the restoration of certain elements of the old PAYG system.

6.1. PAYG pillar

The instability generated by the unilateral distribution of benefits and losses erupted during and immediately after the two subsequent elections: relatively mildly in 1999–2000 and all but unmanageably in 2003–2004. A major factor strengthening the political budget cycle was the awakening and *reaction* of pensioners’ associations and of the Croatian Pensioners’ Party (HSU) from political lethargy, thereby blackmailing, first, Prime Minister Ivica Račan’s centre-left and then, Prime Minister Ivo Sanader’s centre-right coalitions.

Prime Minister Račan implemented contradictory measures that further deepened the cleavage between ‘old’ and ‘new’ pensioners – in other words, between those who retired before 1999 and those who retired after and whose relative income is falling sharply. On the one hand, Račan’s government restricted the eligibility criteria to pensioners retiring under the new formula and, on the other hand, moderately increased benefits to existing pensioners. In addition, special privileges were dealt with very clumsily. This stirred up even greater resentment.

The 2003 elections witnessed the return to power of the HDZ, which had to reach a suicidal electoral agreement with the HSU. The government partly met retirees’ demands, thereby rendering a rebalancing of the whole system necessary to eliminate discrimination against ‘new’ pensioners. Consequently, Prime Minister Sanader raised minimum pensions, lowered the monthly decrement for early retirement and granted ‘new’ pensioners a conspicuous ad hoc increase during 2007, which was, not coincidentally, another electoral year.

Croatian policy-makers, therefore, employed the same compensation tactics that the new pension system sought to eliminate. Parts of the old system were gradually restored to supplement the new multi-pillar scheme. This continuous fiddling not only severed the actuarial link between contributions and benefits, thereby weakening the new logic of action, but also worsened its future fiscal balance. In addition, spillover effects affected the funded pillar. Although the funded pillar functions relatively well and the system, as a whole, did not experience a rapid decline in popularity, continuous exploitation of the public pillar for electoral purposes worked against the originally planned expansion of private schemes.

6.2. Funded pillar

In a (tragi)comic article, Kotlikoff (2008) calls it 'a sham, a shell game, a deception, and a rip off' that funded pillars replicate PAYG ones. This basically consists in the interposition of a redundant institutional layer – made up of private pension funds investing in treasury bills – between the centralised, public collection of social security contributions and their disbursement to current pensioners.

The Croatian case substantiates Kotlikoff's allegations very clearly. The government set the investment limits for pension funds at a Draconian level, which implies strict quantitative portfolio limitations but is not abnormal for the first stages of privatisation (Vittas 1998: 22-32). However, it also required investment in state and Croatian National Bank (HNB) bonds equal to at least 50 per cent of the funds' assets.[10] This choice was directly linked to the interests of Finance Minister Škegro, who wanted privatisation to revive Croatia's lethargic capital market, but was not prepared to forgo the flow of 2.5 per cent social security contributions into the budget – that is, half of the contributions diverted to the second pillar.

The figures for December 2007, divulged by the Croatian Financial Services Supervisory Agency (HANFA), show that portfolio exposure to government bonds is still some 66.44 per cent, which means, objectively, that the non-PAYG size of the second, mandatory, fully-funded pillar amounts to 1.68 percentage points out of 20 per cent contributions on gross wages. This is inconsistent with the government's bombastic claim that there had been a paradigm shift from state to market.

Nonetheless, what differentiates Croatia from other countries is that there the limitations were intentional and deliberately imposed by policy-makers who wanted to have their bread buttered on both sides. In this way, they undermined one of the primary objectives of the reform, namely risk diversification, which requires putting eggs into more than one basket.

10. To the satisfaction of Croatian pension fund managers, the *acquis communautaire* on the free movement of capital does not permit most limitations. These will have to go when the country joins the EU.

7. Reforms in Hungary

The 1989 National Roundtable talks in Hungary were the first truly negotiated transition from single-party rule to multi-party politics. Politicians opted for institutions that would assure the creation of stable majorities in parliament – the dual-ballot mixed-member system, a compromise between the Hungarian Socialist Workers' Party (MSzMP) and the seven-party 'Opposition Roundtable' – and, after the founding elections in 1990, avoid a parliamentary dictatorship – the constructive vote of no confidence, a compromise between the incumbent Hungarian Democratic Forum (MDF) and the largest opposition party, the Alliance of Free Democrats (SzDSz) (Kenneth and Schiemann 2001; Bozóki 1992: 69-70). This institutional configuration allowed Hungary to have the least constrained executive among the democracies of Central and Eastern Europe (Stark and Bruszt 1998: 171-172). In these circumstances, the Hungarian Socialist Party (MSzP), led by Gyula Horn, gained 54 per cent of the seats in parliament at the May 1994 elections.[11] This dictatorship of the majority (or plurality) was mitigated only by a very active Constitutional Court.

During 1997, the MSzP–SzDSz coalition reformed the retirement system by linearising the degressive benefit formula and introducing a mandatory fully-funded pillar. In addition to several amateurish design flaws, the overall policy-making style was imperative.

The MSzP-led government did everything it could to trigger a *reaction* to the clumsy reform on the part of the Alliance of Young Democrats (Fidesz), the liberal party. Neither the opposition, the social partners nor the public participated constructively in the debate, which ultimately lasted only a couple of weeks. Compensation was an internal affair between the MSzP and its leftist fringe, identifiable with the main post-communist trade union's (MSzOSz) leadership. The latter not only retained its privileged position on the extremely inefficient and wasteful self-managing social security boards – the Health and Pension Insurance Funds (OEP and ONyF, respectively) – but also ensured that their members need not be elected, as in 1993, but only appointed

11. Nevertheless, the party struck a pact with the Alliance of Free Democrats (SzDSz), thereby controlling 72 per cent of the seats, in order to assuage public concerns over the return of ex-communists and gained a two-thirds majority in parliament, which was sufficient to amend the constitution.

by the union's leadership. Even the coalition partner SzDSz voted against this excessive cronyism.

Furthermore, the financial lobby (one of the few already consolidated in Central and Eastern Europe) obtained important side-payments as it preserved or, better, *replicated* the voluntary pillar's mutualist structure in the mandatory funded schemes. Hence, distribution bargaining was limited and its nature clientistic.

The resulting policy outcomes were inefficient and extremely unstable. The system underwent severe policy reversals that intensified during each subsequent political budget cycle. Unfair competition from the PAYG pillar, as well as the dismal performance of private funds (imputable to their awkward governance), squandered the widespread public support that made reforms possible in the first place.

7.1. PAYG pillar

After the ascendancy to power of Fidesz in 1998, a *reaction* against the reforms came immediately. The party never hid its aversion to the new system. Prime Minister Viktor Orbán, who was slowly constructing an elective dictatorship in Hungary, enacted various distortionary measures to stop the fiscally demanding migration to the private pillar. He planned – but did not carry out – a thorough rollback of reforms and, for a short while, even rendered the mandatory pillar voluntary, thereby emasculating the institution's new logic. Simultaneously, labour was subjected to a wholesale frontal attack, which deprived it of many rights of association and of the management of the social security boards.

Notwithstanding their disruptive potential, these measures paled in comparison to the economic populism unleashed by the 2002 electoral round. The winning, but scandal-ridden MSzP coalition kept its innumerable promises, despite the leadership of premier Péter Medgyessy, former finance minister and putative father of the Hungarian pension reform. Ad hoc benefit hikes, the introduction of the thirteenth-month pension – aimed at neutralising the objectives of reform – and lower contribution rates both directly undermined the fiscal sustainability of the new system and siphoned off much of the initial support for the funded pillar. The MSzP's commitment to the original plan and a recovery in second pillar returns providentially restored some faith.

Clearly, the conduct of neither the conservatives nor the socialists was compatible with the delicate requirements of the new institutional environment. They preferred, instead, to once again exploit the old logic of action, irrespective of the disruptive effects on the fragile reform. In fact, those who joined the multi-pillar system were not in a position to predict that future legislation would discriminate against them with regard to non-switchers and older pensioners. Hasty emergency measures had to be cobbled together following harsh criticism from most international organisations, independent experts, the Hungarian National Bank (MNB) and, ultimately, the European Union. These patches, however, proved insufficient to cauterise a still exposed wound. The continuing weakness of Hungarian governments and the debate that opened up on discrimination against switchers, and how to solve it, cast serious doubts on the future of Hungarian old-age retirement.

7.2. Funded pillar

The Hungarian funded pillar *replicated* the corporate governance present in the voluntary pillar, which produced a hybrid institutional arrangement that diverges substantially from original intentions. The unique mutualist structure of Hungarian mandatory pension funds creates problems in two domains: (a) transparency and hence responsibility; and (b) competition among funds (cf. Impavido and Rocha 2006: 30-33).

Members own the pension fund and provide all the capital. This is simply the wrong institutional structure for anything other than a closed, employer-based fund. Consequently, administration of the fund is extremely opaque, since there are no formal investments or capital requirements. The sponsor (the effective manager) bears no legal responsibility for the institution, neither for downside risks nor for operational fraud. It enjoys upside risk benefits, without sharing any of the costs, apart from putting its reputational capital at stake. Furthermore, the law stipulates that these are non-profit organisations, while in reality they have a business plan, make a profit and cash it in. However, this is far from obvious in the books.

With respect to competition, mutualism violates it three times. First, competition based on asset management does not emerge. Tenders, which should exert downward pressure on asset management fees, are intransparent and invariably lead to the selection of the financial group's internal asset manager. Second, performance-based competition fails to materialise. Lack of comparability and weak disclosure requirements prevent members from 'voting with their feet' and migrating to funds applying lower fees. Third, the mutualist structure is also an effective barrier to entry, as a market for acquisitions simply cannot develop.

In a nutshell, as part of a complex side-payment to the financial lobby and regulatory agencies, the mandatory pension funds *replicate* their voluntary precursors, on a larger scale. Given that increased competition was a key justification for privatisation and that mutualism simply effaces it, the question arises of what the purpose is of having several expensive and identical funds instead of one public scheme.

8. Survival and return!

The implementation of pension reforms in Croatia and Hungary shows that institutional 'breakdown and replacement' is not an automatic outcome of abrupt processes of change. In both cases, the old logics of action survived, albeit in an updated form. These results coincide with the aforementioned definition of 'survival and return', which may entail the survival of the old logic of action, despite an abrupt process of change and the return of the old logic of action, after a structural overhaul. In both cases, 'breakdown and replacement' does not take place. Either the structural elements are insufficient to unseat the existing institutional arrangement and the old logic of action survives, or there are structural reform elements, but they do not prevent the return of the old logic after reforms are implemented.

What happened with the two countries' PAYG and funded pillars can be seen as distinct processes of institutional change that fall under the dual definition of 'survival and return', and which I call *replication* and *reaction*. In the following two sections, the two phenomena will be unpacked and linked to events in Croatia and Hungary. Table 3 summarises their conceptualisation.

8.1. Replication

The partial inclusion in the new institutional arrangements of the old logic of action, which had to be subjected to a structural overhaul, may trigger the phenomenon. *Replication* implies that the new institutional arrangements become, as a result, superfluous or redundant, since they ultimately perform similar tasks to the old ones. As an archetype of 'survival and return', *replication* has been known in a variety of forms and under many different institutional arrangements. New and radical institutional rules are here compounded with very gradual or non-existent adaptation of old to new logics of action, frequently generating hybrids. Lampedusa's adage in *Il gattopardo* – '*Occorre che cambi tutto, perché non cambi niente*' [Everything must change so that nothing changes] well describes this sort of institutional development.

At least two processes can be identified: the *deliberate* and *inertial* versions of *replication*. In both cases, redundancy is the mechanism which prevents the abrupt process of change from generating a successful institutional 'breakdown and replacement'. Instead, the new institutional layer is redundant and replicates the old logic of action under a new guise.

In its *deliberate* version, *replication* can again be related to unilateral decision-making. Such a mode of interaction allows rule-makers to insert into the new institutional arrangements some of the old logics of action, which should have been subjected to a structural overhaul. In this vein, the agenda-setter tries to exploit the credit-claiming potential of the new institutional arrangement without forgoing the advantages of the old logic of action. By definition, this way of proceeding represents the negation of paradigmatic reforms, since the paradigm is here exploited as a rhetorical device: the agenda-setter pretends that structural change is under way, while in practice its outcomes are marginal. This is exactly what happened with Croatian pension funds with the introduction of minimum investment requirements with regard to government bonds. The schemes intentionally replicate a PAYG system, thereby adding an expensive additional institutional layer to the public schemes.

Inertial replication is a similar phenomenon, although it is only indirectly related to the actions of the decision-maker. Here, the original institutional design is overhauled by a group of rule-takers, who have no interest in forgoing the benefits of the old institutional arrangements. Failed implementation, bureaucratic deadlocks and rent-seeking behaviour may all lead to the creation of redundant institutional layers, which perform exactly the same tasks as the previous arrangements.

As in the case of the corporate governance structure of Hungarian pension funds, the insertion of potentially disruptive elements can still be traced back to the agenda-setter's preferences, for example, in the form of side-payments to special interest groups. The replication of existing institutional structures results again in the introduction of a redundant institutional layer.

8.2. Reaction

As its name implies, there is a *reaction* by rule-takers against the new institutional arrangements. They demand the reintroduction of the old logic to counteract their effects. This generates an underlying institutional incoherence, and hence the coexistence of the two prevents successful institutional replacement.

At least two modes of *reaction* can be distinguished. The reintroduction of the old institutional logic either siphons off support for the new arrangement or even sidelines the new institution altogether. The former happened in Hungary: the reintroduction of generous public pillar benefits instituted unfair competition with the private pillar, which lost its initial support. The latter took place in Croatia: the return of costly parts of the PAYG pillar prevents the initially envisaged growth of the funded pillar.

Both phenomena may have originated in the adoption of reform outcomes which are subject to policy reversals and cyclical instability. Unilateral decision-making, resulting in the uneven distribution of gains and losses, is a good example of how to achieve politically unsustainable systemic reforms.

The government tries to appropriate all the credit, maximising its immediate payoff. By doing so, however, it simultaneously precludes a wider spread of the blame and ultimately fails to create sufficient incentives for all parties to stick to the original design.

As a result, a *reaction* against the new institutional arrangement occurs. Rule-takers demand the return of the old logic of action and, following the formation of new political preferences, the agenda-setter (a new government, for example) may well give in. In this case, the old logic of action is reintroduced and is exploited as it was before the unsuccessful institutional replacement, thereby nullifying the objectives of the abrupt process of change.

Table 3 **Replication and reaction**

	Definition	Mechanism	Elaboration
Replication	New institutional arrangements perform similar functions to the existing ones, thereby annulling the underlying shift in the logic of action	Redundancy	The old logic of action is deliberately inserted in the new institution (Un)intentional neglect allows for the inertial conversion of the new institutional arrangements to the old logic of action
Reaction	Rule-takers demand the continuing employment of the old logic of action, thereby clashing with the coherence of the new institutional logic	Reintroduction	The old logic of action is reintroduced and siphons off support for the new one Continuing employment of the old logic of action sidelines the new institutional arrangements

9. Conclusions

Historical institutionalists' understanding of change has come a long way since the rediscovery of the importance of institutions in the early 1980s. This article traces this evolution up to Streeck and Thelen's seminal study, which, for the first time, convincingly overcomes the ever-present 'punctuated-equilibrium bias' in the literature. However, the article also points out their framework's main lacuna: the missing definition and categorisation of institutional 'survival and return', that is, of instances of abrupt but incremental change.

The article argues that 'survival and return' can be defined in both positive and negative terms, as it is complementary to institutional 'breakdown and replacement'. Two different modes of imperfect 'breakdown and replacement' are hypothesised, *replication* and *reaction*. The introduction of a new, but clearly redundant institutional layer typifies the former; while the re-introduction of the old logic of action within the new institutional arrangements characterises the latter. Hence, *replication* depicts a situation in which institutional replacement does not take place, as the new institution is devoid of significant structural elements of reform and retains old logics of action. *Reaction* captures instead those states of affairs in which structural transformation occurs, but where, as a result of the demands of rule-takers, the old institutional logic contaminates the new arrangements.

Strategic behaviour on the part of the agenda-setter, in this essay, represents the key explicans for the two phenomena. It is argued, in fact, that single-handedness and, especially, the neglect of the distributive dimension of negotiations is an opportunistic strategy, which very rarely pays off. Unilateral policy-making neither spreads the blame evenly among actors nor generates sufficient incentives to observe the commitments made during the legislative phase. Not only are ensuing reforms challenged and reversed, but also the new institutional arrangements risk deviating from the initial designs to end up as hybrids or become marginalised.

To empirically substantiate the theoretical arguments, the essay investigated the Croatian and Hungarian structural pension reforms of the late 1990s. The newly implemented multi-pillar pension arrangements were broadly based on the World Bank's recommendations. They were initially aimed at breaking down and replacing the existing PAYG public schemes, but their implementation soon underwent unexpected involution. The imperative decision-making style played a crucial role in ruining the initial plans, thereby eliciting, in both cases, the *reaction* of rule-takers and subsequent reintroduction of the old logic of action in the new multi-pillar arrangements and the *replication* in their funded pillars of old and redundant institutional logics. The old logics of action survived the abrupt process of change and returned, thereby rendering necessary a renewed overhaul of the freshly implemented institutional arrangements.

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