The political economy of regulating Social Services of General Interest: a case study of longevity insurance in the EU

Waltraud Schelkle*

Abstract: Under EU law, occupational and personal pensions are regulated in categorically different ways from public pensions: providing occupational and personal pensions is an economic activity while public pension schemes are non-economic. Welfare reforms have made the boundaries between economic and non-economic ever more blurry. The consultation and communication on SSGI were meant to clarify the distinctions between different types of services, so as to draw a line between member state and EU competences. But this 'federalizing' delineation of social and financial services has not settled the regulatory issue at stake, which is to find complementarities between social solidarity and market integration. In the case of insurance, this requires to contain competition and to allow for differentiated economic regulation. In practice, EU regulation actually allows for exactly that while the regulatory conceptualisation lags behind this practice.

1 Introduction: The challenge of longevity insurance for EU law

There is hardly a more pressing policy issue in advanced democracies than old-age security. Security here refers to the situation that individuals live longer than their available means can sustain them. Savings cannot fully provide this security as they may run out if somebody lives longer than individually anticipated or expected on average. Insurance for (the unanticipated part of) longevity is provided by financial mechanisms or products that are paid until the end of life. Three provisions are particularly relevant: first, public pay-as-you-go (PAYG) pensions that are paid out of taxes or contributions of the presently working population; second, funded (private or public) pensions for which the individual saves, ie pays contributions that should equal the present value of payments to be received by the representative individual; and third, life insurance products that are paid out after a specified period of time, for instance 30 years, after which this lump-sum is turned into an annuity, ie a regular payment until death.[1] Note that simply paying out the lump-sum without turning it into an annuity is not longevity insurance but simply saving for retirement.

European governments and their electorates are particularly concerned. Entitlements to old-age security are comparatively generous, populations become quickly older and retirement ages are strictly set while high employment of the working-age population is

* Waltraud Schelkle, European Institute, London School of Economics and Political Science (LSE), email: w.schelkle@lse.ac.uk. Research for this paper was done while I enjoyed the hospitable research environment at the Hanse-Wissenschaftskolleg in Delmenhorst which is gratefully acknowledged. I presented previous versions of the paper at the universities of Bremen, Osnabrück and Copenhagen and would like to thank seminar participants for most useful critique. Markus Krajewski made very helpful suggestions for improvement. The usual disclaimer applies.

1 The conversion rate depends on various risk factors such as the life expectancy of the policyholder, an issue to which we come back as a potential case of gender discrimination.

realised in hardly any member state. The EU urges member states through various channels, from fiscal surveillance to coordinated reform processes, to 'modernize' their pension systems which includes both public pensions but also the regulation of private provisions. My interest here is in the channel of the Single Market.

Under EU law, occupational and personal pensions are regulated in categorically different ways from public pensions: providing occupational and personal pensions is an economic activity while public pension schemes are Social Services of General Interest (SSGI) and therefore non-economic. In this chapter, I will argue that one can easily see why the EU chooses this legal distinction as it has competences with respect to (longevity and all other) insurance as a financial service but not regarding genuine social services. Yet, I will also show that this is at odds with the evolution of pension systems on the ground that the EU's very own modernisation agenda fosters. The point then is not to blame EU politics and law for this misleading distinction since it is common in mainstream comparative welfare state research. But it is politically damaging and economically inconsistent for the EU to base its regulation on this distinction.

Politically, the dichotomy of economic and non-economic, financial and social services, is a problem for the public perception of how the EU affects social policy in member states. It is shown below that EU law and regulation is quite differentiated and flexible in practice, accommodating a vast array of national pension arrangements. Yet the impression is rather to the contrary, namely that of a rigid rule-setter that constantly tests the boundaries of welfare states and puts social services on the defensive. A more sensible approach, both conceptually and politically, would be to follow the example of the *Albany* ruling (or rather the Opinion of the Advocate General Jacobs in this case)[2] which established the idea of differentiated regulation that acknowledges that social policy (or public interest) considerations can trump commercial freedoms *within* the realm of economic regulation. Economic regulation does not have to be pro-competitive even if it tries to achieve integration, for instance by establishing common regualotry principles.

From a political economy perspective, it is contradictory for the EU – Commission and Council alike – to push for welfare reforms and the 'modernization of the public sector' in member states that then get caught by EU's competition law pushing them into a direction that was not intended by legislators. Reforms of public schemes keep on tightening the link between contributions and entitlements of the representative member, a link that the European Court of Justice (ECJ) requested to be loose in order to be considered solidaristic. The reverse also holds: pension reforms not only make public pensions more similar to private schemes, some reforms also bestow elements of social insurance on private pension funds. For instance, many governments make it now mandatory for their citizens to pay into a private pension plan. In principle, the EU definition should then work the other way: if a financial service or a service of general economic interest assumes elements of a social service, the application of competition law should become ever more conditional and qualified. All this can be sensible and

[2] Case C-67/96 and the Opinion of the General Advocate Jacobs, delivered on 28 January 1999 (European Court reports 1999 p. I-05751).

improve old-age security. EU law even allows for that but it creates uncertainty among reformers whether it will be applied symmetrically.

The consultation over services of general interest culminating in Protocol 26 to the Lisbon Treaty tried to put an end to the uncertainty created by reforms that moved away from the three pillars of old-age security to multiple tiers and interwoven layers. All these hybrids will force the legal profession to develop more clever tests so as to determine on which side of a distinction a scheme falls. But to what extent is the dichotomous legal distinction of economic and on-economic services supported by economic and political reasoning? I am interested here in how and why legal concepts and distinctions have been construed in the way they were: What made them politically opportune and are they economically viable? What problems that the legislators perceived are thereby solved?

The paper proceeds as follows: The next section outlines briefly the significance of insurance for European political economy and the particular case study of pensions regulation. Then I explain the EU regulation of longevity insurance. The following section shows how EU insurance regulation based on a distinction between economic and non-economic services is challenged by major trends in national pension reforms in OECD countries. The final section discusses this distinction in light of the previous findings.

2 Insurance in European Political Economy

Insurance has an interestingly ambiguous relationship to both market integration and competition.[3] Economic integration tends to make individuals and firms more mobile. This inadvertently changes the established risk pools in member states, creating opportunities for more insurance of some risks while undermining opportunities for others. Labour migration is the most obvious mechanism by which individuals switch the communities with which they share risks of unemployment, ill health or longevity.[4] In the case of longevity insurance, countries of destination can typically rejuvenate their insurance pool although this is only of long-term advantage if national pension systems take adequate care of longevity risks, ie do not underestimate how long people live. Less obvious is how cross-border investment by financial firms affects insurance of national income and employment. Regulatory competition can lower standards everywhere but also make firms offer insurance products in areas that were underserved before. Holding claims in different jurisdictions can reduce risk if business cycles in different member states are not fully synchronised but it can also add risk if the exposure to volatility in one member state is contagious and cumulative. This is particularly critical for banks and insurers, hence the need for prudential supervision across borders.

3 Integration and competition are not the same, as Greer and Rauscher 2011 rightly stress, a point to which we return.

4 I concentrate here on insurance areas for (private and public) social insurance but these considerations could be extended to exclusively private insurance. In fact, the mobility that comes with tourism has made motor insurance a densely regulated area in the EU, mainly to allocate damages in case of accidents.

Insurance economics does not support the proposition that unfettered competition delivers the desirable amount of insurance across Europe. There are the well-known consequences of asymmetric information such as adverse selection, discrimination and moral hazard which would make competitive markets deliver less insurance than is desirable and feasible. There is also, well, uncertainty.[5] Because of uncertainty, the system of commercial insurance markets is incomplete. This is particularly severe for high damage-low probability events such as nuclear reactor accidents, but also for slowly accumulating risks such as climate change and the evolution of longevity. In all these cases, it is hard to translate uncertainty into calculable risk. This is why insurance against it has come to draw on the political authority of the welfare state, namely the political authority to tax and to include future generations into the risk pool, as in PAYG pensions. This does not necessarily lead to a complete takeover by the state, as our case study of longevity insurance illustrates and a study of health insurance could show as well; the main uncertainty here being the pace of medical progress.

The failings of insurance markets can explain why insurance was often made mandatory and became politically such a powerful force in creating 'imagined communities'[6]. Mutual insurance gave the working class a basis for identity formation well before social democratic parties in power were in a position to give them state backing – and this is important for the political legitimacy of occupational pensions until this very day. Liberal and even Conservative parties came to see social insurance as an opportunity to appease the 'deserving' workers and assemble constituencies among the worried middle-classes. Parties of all ideologies discovered social insurance schemes as a way of overcoming the divisions between rural and urban areas in nation-building.[7] As the great sociologist and historian of insurance, François Ewald, put it: 'what makes for its political success' is that '[i]nsurance provides for a form of association which combines a maximum of socialization with a maximum of individualization. It allows people to enjoy the advantages of association while still leaving them the freedom to exist as individuals.'[8] Without risk pooling, ie association on a sufficiently grand scale, it is difficult to leave the safety net of one's birthplace and become an individual that entertains intimate relationships for non-utilitarian reasons while relying on strangers for mutual support, that is modern insurance. European market integration has increased the pool of strangers with whom EU citizens can share their risks. But it also challenges established institutions of risk-sharing and may make them provide less insurance, for instance, in order to attract investors but not poor migrants.

To European political economy, it is therefore of keen interest to explore how EU regulation manages or tries to disentangle insurance as a financial and a social service.

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[5] A whole strand of modern economics, that explicitly takes uncertainty into account, has reinterpreted economic activities and contracts in terms of insurance (Stiglitz 1969, Varian 1980, Sinn 1995). This new welfare economics can be seen as an update of Adam Smith's doctrine that more division of labour creates economic value. The add-on is that this division is not only limited by economies of scale but also by the risk-bearing capacity of an economy.

[6] Anderson 1983

[7] Baldwin 1990

[8] Ewald 1991, 204

The EU's delineation exercise will be studied with respect to insurance for longevity, ie the risk of living longer than planned savings last. Those who pay into these schemes acquire an entitlement that is not purely based on residency and need as a pure social insurance tends to be.

The case study covers a standard theme of EU studies: that the Commission must disentangle social from financial services so that it can exercise its authority in internal market creation while it has to tread carefully with respect to social services because of the prerogative of member states in social policy (Articles 151 and 153 TFEU). There is also the more general theme of European integration as a modernizing force and reform lever. One interest I have here is how the delineation exercise of the EU interacts with trends in national pension reforms. It suggests that the conceptualization of SSGI was a way for member states to draw a line in the sand, fending off the Commission's relentless effort at integrating markets and promoting competition[9] -- I will argue below, however, that these two goals have to be viewed separately.

The distinction of social and financial services in terms of non-economic and economic reproduces a conventional idea of the welfare state that is regularly at odds with its reality. The idea is that the welfare state is 'the other' of capitalist markets, embedding and taming them. In the influential work of Gøsta Esping-Andersen[10], the generosity and maturity of welfare regimes can be measured in terms of how much social policies 'decommodify' labour, ie the extent to which they make the living standard of workers and their families independent of earnings through free services and cash transfers. Not only does this ignore the relevance of social policies for markets other than the labour market, notably financial markets. It also ignores that social policy is often intensely commodifying.[11] To take our case of longevity insurance: One of the universal trends of welfare state development over the last century was taking old age security to a considerable degree out of the care of families. State pensions allowed the elderly to retire and live on their own and to buy most of the services and commodities they need from markets. Moreover, public schemes become the basis on which private pensions can piggyback and typically cater to the better-off. In that sense, social policy makes markets for private provisions. It is this market-making role of social policy that the categorical classification as non-economic overlooks while domestic welfare reforms rely on this role in practice. Once we recognize this role, the regulation of longevity insurance in the EU is more social policy than the standard account would have it – yet it is also economic regulation.

3 The regulation of longevity insurance in the EU

In 2007, about 10.5 million Europeans lived in another member state which represents a bit more than two percent of the population.[12] Over one million people are frontier

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[9] Krajewski 2010, 86

[10] Esping Andersen 1990

[11] This is analysed more systematically in Schelkle 2011.

[12] MEMO/09/353.

workers, ie they cross an internal EU border for work on a daily basis. Migrant workers acquire entitlements to cash and in kind benefits for themselves and their families for which at least two states share responsibility. Every year about 250,000 new retirees take all or part of their pensions across borders because they worked in more than one other member state. In a classical immigration country like Germany, 1.1 million or 5.6 percent of all pensioners were foreigners in 1992, 3.8 percent or two thirds of which received their pension while living abroad; in 2008, 2.2 million or 9.0 percent of all pensioners were foreigners out of which 5.4 percent or 60 percent lived abroad.[13]

The variety and overlap of pension schemes pose real challenges for EU regulation. Within old age security, public PAYG pensions are the pure case of social services declared off limits for competition law. Private personal pensions or life assurances are financial services subject to competition law, which nevertheless rely heavily on regulation of risk bearing capacity that may require some exemption from competition law. Private, but collectively administered occupational pensions constitute an intermediate case since such pensions are both a social service for workers, covering various risks for which there may be no close market substitutes, but also a financial service for the individual employer and employee, namely part of the current remuneration package. The remuneration package may be ruled by national labour law which would tip the regulation towards a social service. So should these schemes be subject to competition law or exempt? All of them or differentiated according to whether they are voluntary or mandatory schemes? We start with the legal answers.

Three sets of rules carve up the regulatory space of insurance for longevity; a limited number of additional directives is also relevant but will be introduced only later.

1. There is first the *Coordination Regulation* 883/2004, namely 'on the coordination of social security systems' which replaces the famous Regulation 1408/71 since May 2010; it applies to statutory public pensions and also to some mandatory private schemes. They are social (read: non-economic) services of general interest.
2. The so-called *IORP Directive* 2003/41/EC, namely 'on the activities and supervision of Institutions for Occupational Retirement Provision' covers occupational pension funds that are the most important source of private pensions in most OECD countries (OECD 2009: 141). They are services of general economic interest.
3. The *Solvency II Directive* 2009/138/EC covers all life assurance, not only those for longevity risks, and replaces 13 insurance directives, including the Third Life Assurance Directive 2002/83/EC. They are regulated as financial services.

So the first impression is that EU regulation has established a fairly clear three-pillar structure on old-age security provision in which occupational and personal pensions are economic services. The main differences are summarized in table 1. The dimensions in the first column try to capture key characteristics of economic and social insurance regulation that classify them as a social or financial service, keeping in mind that a

[13] Deutsche Rentenversicherung 2009, 176

financial service can be socially regulated and social security can be to some extent economically regulated.

Universal service obligation
The notion of universal service obligation is not applicable to statutory social security as this term refers by definition to mandatory schemes – the stipulation that clients must be given access is thus trivially fulfilled. Whether occupational pension funds or IORPs[14] should have such an obligation, was one of the many political contests surrounding the IORP Directive, taking it ten years to get passed. This issue, concretely the coverage of biometric risks, was the subject of extensive negotiations on the IORP Directive, between Commission and Council and within the European Parliament.[15] The insurance of biometric risks on top of providing retirement income was perceived by the Council as an unwarranted social policy element while some in the industry feared stricter financial regulation if it had to provide such insurance activity. In the end, it was included as a recommendation, ie the contracting social partners are encouraged to ensure that pension schemes prevent poverty in old age and hence insure against the biometric risks of longevity by granting life-long payments rather than a one-off lump sum that can run out, occupational disability and destitution of survivors.[16]

The exact opposite is prescribed for life assurances, namely segmentation and actuarial pricing rather than solidaristic pooling of risks. The Solvency II Directive requires personal pension providers to segment risk pools, 'as a minimum by lines of business, when calculating technical provisions', ie the assets they have to hold in order to match their current obligations. Biometric risks thus would need to be dissected into health hazards of the representative individual, dangers of certain types of jobs and income risks for survivors. This segmentation has a financial supervisory rationale, making it easier to see what risks a firm has underwritten and whether it has taken precautions against foreseeable losses. But it does not necessarily make sense in terms of efficient insurance coverage as this separation of risks is likely to result in underinsurance.

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[14] An IORP in the sense of Directive 2003/41/EC is defined as 'an institution, irrespective of legal form, operating on a funded basis, established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity' (Article 6(a)). This excludes all pay-as-you-go schemes, firms' in-house pension plans including book-reserve schemes and general financial savings products, the latter being covered by the Solvency II Directive.

[15] Haverland (2007: 897-900; note 6).

[16] IORP Directive (Recital 30; Article 15).

Table 1: Overview of EU regulation in longevity insurance (as used in this paper)

	Old-age social security	**Occupational retirement provision**	**Life assurance**
Major rules	*Coordination Regulation* 883/2004	*IORP Directive* 2003/41/EC	*Solvency II Directive* 2009/138/EC
Scope	Public pensions and some mandatory occupational schemes	Occupational pension funds with own legal personality	Assurance contracts on survival to a stipulated age and annuities
Universal service obligation	n.a. [by definition, national prerogative]	Recommended, contracting social partners encouraged to insure against biometric risks and destitution of survivors (Recital 14, Articles 15(2) and 17(1)).	No, insurance obligations to be segmented into 'homogeneous risk groups' and technical provisions calculated for each separately (Article 80).
Risk classification and equality norms	*Equal Treatment Directive* 79/7 applies, stipulating 'progressive implementation' of gender equality in matters of social protection (Article 1).	*Recast Directive* 2006/54/EC, amending Directive 86/378 and 96/97/EC, on *Equal Treatment of Men and Women in Matters of Employment and Occupation*	*Gender Equality Directive* 2004/113/EC (Article 5(1)) applies. Solvency requirements provide some incentives for unisex tariffs (Article 105(3e)). C-236/09 *Test-Achats* asks for phasing-out of using gender as a discriminating factor.
Portability, calculation of benefits	Exportability or 'waiving of residence rules' (Art.7); 'aggregation of periods' (Art.6) and 'pro-rata calculation' (Art.52).	*Safeguard Directive 98/49/EC* ensures merely non-discrimination and freedom of capital for the payment of benefits from occupational pensions.	*Safeguard Directive 98/49/EC* ensures merely non-discrimination and freedom of capital for the payment of benefits from personal pensions/ life assurances.
Prudential principles	n.a. [national institutions of auditing, including parliaments; fiscal surveillance under the Stability and Growth Pact, not covered here]	'Prudent person rule' (Art.18) but quantitative restrictions on investments can be imposed by host state if justifiable (Art.18(5-6) and Recital 27). Technical provisions to be calculated using actuarial methods and following prudent principles (Article 15).	'Prudent person rule' (Article 132) with guarantee of 'freedom of investment' (Article 133, Recital 72), ie quantitative restrictions on investments must not be imposed by host state. Technical provisions to be calculated in a meticulously prescribed way (Articles 77-85); solvency requirements (Articles 94-96) analogous to Basel II rules for banks.

Source: own classification; if not otherwise mentioned, Articles refer to rules mentioned at the top of a column

Risk classification
The universal service obligation touches closely on the more general issue of risk classification. Risk classification is a crucial activity by which insurers compete and on which the 'politics of social solidarity'[17] thrives. For old age security, the most commonly used criterion of segmenting the risk pool is gender. It is a statistically robust and easy to construct predictor of life expectancy, even if it is not the cause. Such statistical discrimination makes it easy for a prudential supervisor to assess the commercial viability of firms, for instance by looking at the gender profile of their annuity portfolios. But as a consequence, women get considerably lower annuities for their savings than men because insurers expect to have to pay them for longer. This may aggravate other disadvantages, in this case lower life-time earnings of women. Critics can also point to the conventional character of risk classification and its regressive consequences: if gender is a good proxy for life style, such as drinking and eating habits, or the incidence of work-related stress, then this may change as women have careers and adopt less healthy life styles. Life expectancy may then be better predicted by education and disposable income, revealing that poorer women (assuming they are likely to have less healthy life styles and more stressful lives) have to pay the price for longer life expectancy of relatively well-off women – while men do not share this risk. One conclusion that social regulators have drawn from this is to outlaw risk classification on grounds of sex as gender discrimination. Or put in terms of a regulatory choice: gender discrimination is not compatible with insurance being regulated as a social service, while if regulated as a financial service, statistical discrimination on grounds of sex is likely to be allowed as a robust, hard to manipulate predictor of risks.

The Equal Treatment Directive 79/7 for social security requires governments to implement 'progressively' gender equality.[18] This meant that the retirement age for women and men did not have to be equalized immediately. By 2008, some governments still used different tables for the calculation of annuities in funded statutory pension schemes. Bulgaria, Lithuania and the UK did not use unisex conversion rates and thus reinforced the earnings inequalities of women just like voluntary commercial schemes would.[19]

Occupational pension schemes were covered originally by Directive 86/378 which required applying the principle of equal pay to men and women. But it excluded many items from the definition of 'pay', notably occupational pensions, and hence was compatible with charging different contributions or applying different pensionable age limits. But the Court's case law, in particular C-262/88 *Barber*, invalidated certain provisions of the Directive because the Court decided that the Treaty Article on the wider definition of 'pay' trumped the Directive. The *Barber* ruling said that an occupational scheme must not impose 'age conditions which differed according to sex [..] even if the difference [..] was based on the age laid down by the national statutory scheme.'[20] The

[17] Baldwin 1990

[18] Barnard 2006, ch.10.

[19] SPC 2008, 41.

[20] Barnard 2007, 522.

Court suggested limiting the retrospective effects of this ruling because the financial consequences (of compensating men) would have been enormous. The Maastricht Intergovernmental Conference decided then to apply the principle of equal treatment only to earnings-related benefits acquired after May 1990. Hence Directive 86/378 was replaced and case law taken into account in subsequent Directives, the latest of which is the Recast Directive 2006/54EC.[21] Occupational pension funds were still allowed to pay out different capital benefits in the case of defined contribution schemes and charge different contributions from employers in defined benefit schemes if this was justified on actuarial grounds when the scheme was implemented.[22]

Insurance companies covered by the Solvency II Directive were given some moderate incentives to use unisex tariffs and conversion rates for annuities. The incentive comes from Article 105(3e) which implies that they can save on capital requirements to cover the 'revision risk' that stems from 'changes in the legal environment'. The Article is not explicit about what these changes are but the political discussion surrounding the 'Gender Equality Directive'[23] suggests that they concern norms of equality and non-discrimination on grounds of sex, possibly age and race. The Gender Equality Directive prohibits, in principle, to use sex as a factor for calculating insurance premia (Article 5(1)). The draft for this Gender Directive, originally proposed to apply both to occupational and personal pensions, met with great resistance from the insurance industry and member states.[24]

Subsequently, its scope was narrowed down to personal pensions and an escape clause was introduced in Article 5(2): member states may allow their commercial insurance companies to charge different premia for women and men as long as they can prove this to be 'proportionate' to the difference in risk. Premia must reflect sex as 'a determining factor in the assessment of risk'[25] and be 'based on relevant and accurate actuarial and statistical data' which has to be published and regularly updated. This regulatory settlement has now been successfully challenged by a Belgian consumer protection organisation, *Test-Achats*. In its ruling[26], the ECJ said that using gender as a discriminating factor in insurance must be phased out by December 2012. So we have here a clear case of commercial financial services being subjected to social policy

[21] Barnard 2006, 515-517. Since the early 1990s, the Court's case law allowed levelling downwards, ie granting women the less favourable terms of men, even though in the famous *Defrenne (No.2)* Case C-43/75 [1976] ECR 455 the Court decided that compliance with 'the Treaty's aspirations' of improving working conditions could only be achieved by raising lowest salaries (Barnard 2006, 527). It was employers who triggered this change, using equal treatment to reduce occupational pension benefits for women.

[22] Barnard 2006, 530-531, refers to Directive 96/97/EC, Article 6(1h-i), now replaced by the Framework Equal Treatment Directive 2006/54/EC, Article 9(h, j).

[23] Council Directive 2004/113/EC of 13 December 2004, implementing the principle of equal treatment between men and women in the access to and supply of goods and services.

[24] Mabbett 2011

[25] This wording allows both for a causal and a probabilistic reading, thus getting around the fierce debate of whether discrimination on either is more justified.

[26] Case C-236/09, Association Belge des Consommateurs Test-Achats ASBL and Others v. Conseil des ministres, Judgment of 1 March 2011. See Mabbett 2011 for a full discussion.

obligations. Mabbett argues that the Court has overridden an industry-friendly escape clause because it concerned a fundamental right of equal treatment.[27]

Portability

This norm safeguards entitlements from insurance contracts and thus allows for mobility. Personal pension schemes invariably grant portability while the 'politics of solidarity' that underpinned the creation of communities of risk has not always been favourable to individual mobility and therefore does not normally grant portability of accrued entitlements. For instance, the Advocate General acknowledged in his Opinion on *Albany* that, ceteris paribus, more recently established occupational pension funds can always offer lower premia and thus outcompete an existing one simply because their pools of the insured is younger. Allowing everybody to leave who would be accepted by the new competitor would make the previously existing unviable and jeopardize the old-age security of those not accepted or already retired.

Accordingly, the Coordination Regulation 883/2004 is preoccupied with portability, namely how to ensure equality of treatment between permanent resident nationals, temporary residents, and frontier workers. Case law has continuously expanded the personal scope of the Regulation even though the Treaty Article still refers only to 'workers'. The notion of 'insured persons' now covers the employed and the self-employed, the retired, students, stateless persons and refugees residing in a member state, as well as the family members or survivors of each.[28] The normally valid *lex loci laboris*, ie the country of employment is in principle also the 'competent' member state, had therefore to be complemented in parts by a residence principle (*lex loci domicilii*) for all those who are 'not to be professionally active'.[29] In kind benefits such as free public transport or low-cost access to museums for senior citizens must be provided at the expense of the place of residence[30], an instance of intergenerational solidarity in the EU becoming de-territorialized.[31]

The principles on which the coordination of social security regimes is based generally[32] have been developed not least in order to deal with pension entitlements of so-called guest workers. Exportability in this context means that pension benefits must be paid regardless of where the pensioner resides. An exception is 'special non-contributory cash benefits' which member states sought to make non-exportable.[33] Another principle, aggregation of periods, asks authorities to take the periods of insurance in other member states into account when assessing whether a claimant of old age benefits satisfies the minimum qualifying periods of contribution, employment or residence for the domestic

[27] Mabbett 2011, 5.

[28] Coordination Regulation 883/2004 (Art. 2)

[29] Schoukens 2010, 36

[30] Coordination Regulation 883/2004 (Art.23)

[31] See Martinsen 2005 for health care.

[32] Barnard 2006, 212-217

[33] The listing of all these benefits in the Annex of the new Coordination Regulation 883/2004 is the main reason why it could not be implemented before May 2010 (Pennings 2005, 251-253).

scheme. In case law[34], the Court clarified that the aggregation principle must be applied independent of residence but if the beneficiary resides outside the Union, in this case the United States, it is for the competent member state to decide whether it will pay the benefit thus calculated. A last principle, pro-rata calculation, asks member states to share the costs of pensions in proportion to the time that a person has spent in each. 'Overlap', ie more than one state paying for the same period of compulsory insurance, should be avoided. However, the pension benefits acquired in the competent state for a period may be lower than if that period would have been spent in the more generous state; case law has decided that the difference must be paid by the more generous state. In turn, when calculating the earnings-related contributions to social security in the member state of residence, the authorities are allowed to take into account any income earned in another member state.[35] These principles prescribing aggregation of periods and pro-raterization thus try to prevent that mobility is driven or deterred by social security considerations. If in doubt, however, the benefits awarded to the migrant must be the 'most favourable'.[36] We can thus see that social security coordination is used to combine the integration of labour markets in Europe with safeguards against 'welfare shopping' and, at the margin, redistribution from richer or more generous countries to poorer or less generous ones.

By contrast, the Safeguard Directive 98/49/EC, applying to private pensions, does not guarantee portability. This can lead to non-trivial disadvantages for leavers of an occupational scheme, in particular. The Directive merely stipulates, first, that there must be freedom of capital for the payment of benefits from pensions and, second, there must be no discrimination between those who leave a scheme for another member state and leavers who remain in the country. This does not prevent supplementary occupational schemes from disadvantaging leavers. Such schemes tend to stipulate long vesting periods (minimum time for acquiring an entitlement), low transfer values (if the employee wants to take out the entitlement and invest in another scheme) and no full protection of reserved rights (the entitlement if the leaver does not want to take it out and waits for payment until retirement) so as to keep employees attached to the firm.[37]

These means of privileging loyalty over mobility – that the Safeguard Directive respects -- have obviously been a target of the Internal Market and Competition Directorates in the Commission. However, a Commission initiative in 2005 to make occupational pensions fully portable failed. A broad coalition of national social partners, the European employers and pension fund associations as well as influential member state governments, in particular from the Netherlands, rejected the draft of a Portability Directive for occupational pensions.[38] These opponents resented the attempt to treat all pensions as financial savings and insurance vehicles for individuals, rather than as an employment-related benefit, ie corporate welfare at the discretion of employers or social

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[34] In Case C-331/06 *Chuck* (para 28), the Court states that the objective of the Regulation is to promote 'the greatest possible freedom of movement for migrant workers within the Community', not merely the coordination of social security systems as the Dutch and some other governments maintained.

[35] Paskalia 2009, 1207-1209.

[36] Schoukens 2010, 58-59; Paskalia 2009, 1213-1215.

[37] Mabbett 2009, 780

[38] Mabbett 2009

partners. Thus, national employment laws trumped the EU imperatives of integration and competition.

Prudential principles

Prudential supervision tries to ensure that providers of longevity insurance stay solvent and honour long-term contracts on which the livelihood of their clients in old age depends. In publically provided old-age security, this is ultimately a question of fiscal capacity: present and future pension obligations must be met by social security contributions and taxes over the same time horizon. Public pensions are typically defined-benefit, ie the risk of longevity is borne by the insurer, ultimately the community of present and future taxpayers, that guarantees a certain replacement of previous income. Yet, state authorities also have the possibility, typically subject to approval of parliament, to change certain parameters of the insurance compact, such as the contribution rate, indexation rules and the taxation of pension benefits. This is politically one of the most important reasons for why the SSGI for old age security is a prerogative of member states still.

In commercial insurance, the terms of a contract can normally not be changed ex post. Benefits are typically defined contribution, possibly with certain guarantee elements.[39] Solvency II requires insurance companies to hold capital ('own funds') which is the difference between their (uncertain) liabilities under the insurance contracts they sell and the assets they acquire with the premiums they collect. The capital base must absorb, with a certain probability, the unexpected losses from the various risks that insurers incur.[40] The security is ultimately dependent on market valuations, which the crisis of 2007-09 has shown to break down if asset markets freeze or collapse.

No such risk-based solvency requirements and technical provisions are imposed on IORPs, even though they may provide defined benefits and thus run high risks. They have to hold mandated funds that match their (uncertain) contractual commitments in line with stipulations originally laid down in the Solvency I Directive. IORPs engaging in cross-border activities must hold fully funded assets to meet their obligations 'at all times'[41] – a stipulation which does not strictly apply to domestically operating institutions. In a public consultation on higher solvency standards for IORPs, to be harmonized with the requirements for insurers under the Solvency II Directive, the pension funds, and especially the Dutch authorities, put forward a whole list of arguments for why and how they should be treated differently.[42] Occupational pension providers can ask for additional contributions from members, and benefits are often flexible or

[39] For instance, in Germany, it is not allowed to offer pure defined contribution pensions, at least the nominal value of contributions must be guaranteed (ie a minimum defined benefit), notably in all schemes qualifying for subsidies as a Riester Rente.

[40] More precisely, Solvency II asks insurers to have capital or own funds that avoid ruin with a probability of 99.5% over the next year; financial economists speak of the 'Value-at-Risk' of a firm 'subject to a confidence level of 99,5 % over a one-year period'.

[41] IORP Directive (Recital 28; Article 16(3)).

[42] EC 2009, 10; Consultation available at URL (accessed 30 April 2010): http://ec.europa.eu/internal_market/consultations/2008/occupational_retirement_provision_en.htm

conditional. Similarly, the covenants of sponsoring employers and the existence of an employer's insolvency protection fund can be treated like reinsurance – more generally, there is an additional buffer due to the fact that it is part of an employment relationship. And uniform risk capital requirements ignore that there is often an implicit or explicit government guarantee for occupational pension funds.

The funds and supporting governments insisted that IORPs are part of national welfare arrangements, based on mutuality rather than exchange, and not simply participants in specialised financial markets that the EU would like to integrate. In particular, prudence is based on organisational guarantees, such as mutuality, and not on market valuations of assets.

Summary
The EU has developed differentiated legislative and regulatory instruments for the regulation of social and private insurance of longevity. They are the outcome of political contestations, over market integration, competition and national specificities, but also economic pressures, such as the fiscal and commercial viability of pension schemes. These instruments divide up the regulatory space into the provision of old-age security through PAYG schemes, occupational pension funds and annuities. Social security comes on the side of social services and life assurances on that of financial services.
The case of occupational pension funds indicates that the dichotomous understanding of economic and noon-economic services, as construed by the SSGI and SGEI distinction, is fragile. The norms selected above, from universal service obligation and portability norms to prudential standards, apply less stringently to occupational pensions than to personal pension providers and to statutory social security. From the point of view of EU law, they appear as concessions in both directions – neither fish nor foul. Public pensions, by contrast, are meant to facilitate the integration of labour markets, in particular through the detailed regulation of portability that tends also to redistribute from better-off to less well-off members of the Community. The regulatory thrust stresses individual entitlements and can come into conflict with governments' attempts at protecting social partnership at home, even though governments have not been consistently kind to this institution otherwise.[43]

4 Trends in national reforms of old-age security

The consultation and communication on SSGI was motivated officially by the need for clarification that the modernization of social security systems had created. While this related to wider issues such as the outsourcing of social services to private providers, in the area of old age security three trends in pension reforms are of interest.[44] First, there was a trend towards multi-tier systems, ie the dominant public system was supplemented by private sources. Second, there was an increase in the pre-funded elements overall, both in public and occupational schemes. And, finally, closer links between contributions and

[43] See the contributions in a special issue of the *European Journal of Industrial Relations* on the role of trade unions in the recasting of welfare states, in particular Ebbinghaus 2011 on pensions.

[44] EC 2010, 107, 111-115; OECD 2009, 28.

entitlements have been established in public PAYG systems which, together with the trend towards defined contributions schemes in occupational pensions, have reduced the insurance of longevity provided to individuals. These trends were realized in rather technical reforms, for example by changing parameters in indexation rules, introducing rules that trigger adjustments of benefits conditional on demographic projections, and granting or abolishing credits for care time or education.

The trend towards multi-tier systems is the most relevant in our context. Supplementing and partly replacing public pensions by private sources can, at first sight, mean that the share of financial services in old age security increases relative to social services. The extent to which this shift happens can vary considerably, however. It is more extensive where public schemes are quite redistributive, for instance towards low-income workers and carers with interrupted contribution histories. But public pensions do not necessarily redistribute much. There is a robust relationship between generosity and redistribution: 'Programs for the poor are poor programs' or, the other way round, 'contributory (Bismarckian) systems are rich programs and rich programs are good for the poor' as the latest study shows for pensions.[45] The link between contribution-base (in contrast to tax), generosity and redistribution can be explained by a simple electoral logic: providing middle-class earners with earnings-related benefits increases their support for generous programmes that include the poor.

What replaces (parts of) the public tier is also relevant. If replacement is by voluntary and/ or personal pensions, coverage tends to be patchy and to have regressive effects that match closely the purchasing power of the insured.[46] To mitigate these effects, the new member states in Central and Eastern Europe have made personal pensions mandatory while Germany subsidises them heavily.[47] 'Pioneering member states' in the Netherlands, Sweden, Denmark and the UK have, by contrast, made occupational schemes quasi-mandatory so as to reduce the fragmentation and unfair distribution of coverage.[48] Making schemes mandatory is the standard way of dealing with adverse selection and also addresses the adverse redistributive effects of voluntary schemes. However, the mandatory character of occupational and personal schemes can get governments into conflict with EU competition rules, as the *Albany* case and its many predecessors showed.

Declaring supplementary private schemes mandatory adds an element of social insurance to private schemes. The second and third trends, introducing funded elements into public PAYG systems and reducing the redistributive ('solidaristic') elements, blurs the distinction of pillars as well. The most sophisticated way of doing both is to make them 'notional defined contributions' schemes. The Swedish pension reform is the prime example for this kind of reform. It ended the promise of defined benefits in a universal PAYG system, replacing it by a system of notional accounts that is still pay-as-you-go but emulates a funded pension scheme with fixed ('defined') contributions. The pension

[45] Lefèbvre 2007, 7; cf. Korpi and Palme 1998
[46] SPC 2008, 23
[47] EC 2010, 111
[48] EC 2010, 111; see also SPC 2008, 21-22

benefit out of every individual's notional account depends on the growth rate of the average pensionable income of all insured. Adjustments will be automatic, based on a formula that kicks in when imbalances between contributions and projected benefits occur.[49] So the cohort of the insured will bear the risk of unanticipated real growth and life expectancy, not future generations.

The second noticeable innovation is that a number of implicit redistributive elements have been separated out or made more transparent, for instance disability and widows pensions, and a point system shows clearly how care work or time spent in higher education is valued. Every person with pension rights receives an annual statement on the funds accrued. Italy and Poland have also introduced notional defined contribution schemes. Others (eg DE, ES, FR, PT) have tightened the correspondence between contributions and entitlements in a more conventional way but it amounts to the same thing: 'a number of statutory, public PAYG systems [..] now emulate the individual accounts and actuarial connections hitherto only found with private, fully funded schemes.'[50]

Automatic adjustment mechanisms, built into notional accounts, have been introduced in other forms by a number of member states. 'These [adjustment mechanisms] are designed to stabilise pension systems through automatic adjustments (e.g. SE, FI, PL, DE) or periodically required reviews and adjustments (e.g. AT, IT, FR). They intend to reflect changes in one or more factors such as longevity (e.g. in SE, FI, IT, PT), the support ratio (e.g. in DE), reserve fund performance (e.g. SE) or general economic performance (e.g. in FI, SE). The effects vary from increases in contribution rates (e.g. DE), lower (or even negative) indexation of benefits (e.g. FI, SE) and lower accrual rates (e.g. PT), to increases in pensionable ages (e.g. in DK).'[51] Automatic adjustment makes insurance rely more on the current risk pool and less on the intergenerational spreading of risks, which pay-as-you-go as part of public debt management does on a grand scale. The political beauty of automaticity is not difficult to see: The bargaining modus of politics is replaced by rules that safeguard individual entitlements, including the terms of any (downward) revision that no longer require parliamentary approval. This depoliticised mode of governance by public authorities can easily be seen as addressing the problem of credible commitment despite having to keep promises flexible when dealing with the vagaries of demographic and economic developments.

These trends amount in practice to a significant deviation from the 'pillar' model of pension systems of which every major supranational organisation (World Bank, ILO, OECD) promoted its own version. The Commission took it up in a slightly modified form in the late 1990s which we have seen in the last section left its traces in the regulation of longevity insurance.[52] The World Bank version makes clear why this was politically not attractive to governments. Each pillar was supposed to fulfil one of the three functions of

[49] Anderson and Immergut 2007, 384-385; Palme 2005, 45

[50] EC 2010, 111

[51] EC 2010, 114

[52] Mabbett 2009, 777-778

a pension system: redistribution was the state pillar's task, insurance (including basic savings) was for the occupational pillar, and (higher) savings was the personal pillar's role. Concentrating the redistributive function in the much reduced state pillar would have heightened the political salience of public pensions, mobilising opposition to change without making them more popular with broad sections of the working middle classes that do not benefit from redistribution.

The international policy community subsequently turned against the very terminology and normative thrust behind the pillarisation concept.[53] Instead, the terminology switched to the notion of a multi-tier system. The goal is apparently still to provide 'security through diversity'.[54] But rather than 'diversity', the reform trends arguably lead to convergence, each tier providing for (more) insurance, (more) savings and (some) redistribution[55]. Beforehand, the political-economic rationale of this overall thrust looks surprisingly functional, in that reforms arguably aim both at hardening the inherently soft budget constraints of public schemes and at reducing the endemic failures of competitive insurance markets for private schemes. Yet, in this very endeavour, the pillars became hybrid. That triggered the delineation exercise of EU regulation in non-economic (social) and economic services (of general and particular interest).

What was gained by this dichotomy, given that it does not reflect the degree to which the EU regulation of longevity insurance differentiates between schemes? In section 3 and 4, I mentioned repeatedly conflicts over the regulation of pensions. These conflicts are conveniently framed as one between the market-maker EU and welfare-state preserving governments, even though the latter are busy reformers. The distinction is part of this framing exercise by pretending that there are issues that are subject to competition law and Internal Market regulation and issues that are matters for sovereign national welfare reform. Yet, in practice the distinction collapsed. Financial services are subject to social regulation, especially gender equality norms, and statutory social services are subject to economic norms, such as portability. The last section argues that legal concepts could take account of this hybridisation by differentiating between integration and competition as two different goals of the Internal Market Programme. In practice, differentiated EU regulation already does this.

5 The misleading distinction between economic and social services

This contribution has put the regulation of SSGI in the wider context of the reregulation of social and financial services. Based on a case study of longevity insurance I argued, first, that the differentiated regulation of public, occupational and personal pensions did not put markets against states. It can be better understood as trying to foster (labour) market integration through social security but also private welfare provision through market integration. Competition as a norm of the EU's insurance regulation came to be

53 OECD 2006, 28-30; SPC 2008, 7

54 OECD 2009, 49-50

55 Unisex tariffs are a way of forcing private providers to redistribute (Lefèbvre 2007, 8-9).

heavily qualified, for instance by restricting the use of risk classification as a means of competing for clients. Another piece of evidence for this is a Block Exemption Regulation for the insurance industry since 1992, renewed in 2010.[56] It allows insurers to cooperate, in particular by sharing data on mortality tables, and come to agreements concerning the calculation of risk premia. These agreements must be passed on as non-binding recommendations. Data must be made available to insurance companies in other member states that have not yet entered a national market. The Commission justifies this measure as being pro-competition but since it allows the collusion of firms, the block exemption is de facto an integration measure.

This pro-integration, contained-competition thrust of EU insurance regulation finds support in the new economics of welfare that has become a well-established part of mainstream economic theory.[57] It makes sense for the EU to push for integration, yet competition is not always an appropriate maxim for social services regulation as it may give rise to market failure. This body of literature would confirm that there are unexploited opportunities for risk pooling in the Internal Market with its home bias for asset-holdings etc. Portability stipulations for social security or equality norms for private insurers can be justified on the grounds that they lead to more risk pooling and potentially more insurance.

Why is this apparent win-win situation then not always fully exploited? Integration can be achieved through market competition or through common standards of regulation (possibly in segmented markets). The former is politically and economically at odds with strong institutions of corporate welfare. Several regulatory norms, such as universal service obligation, portability and equality, have to be qualified with respect to these SGEI. This is to take account of the different way in which risk bearing capacity of occupational pension schemes is achieved, namely through organisational features rather than diversification through markets. The recent experience of the crisis has actually bolstered the claims of occupational pension funds in corporatist countries. Their organisational guarantees of prudence may be a viable alternative to the market-based guarantees provided by capital requirements. This is for the very reason that organisational guarantees are more akin to statutory social security. The political conflict that emerges from this is whether welfare provisions by the state and by undertakings should safeguard primarily individual entitlements, or whether the institutional viability of these provisions can trump individual choices. If competition is the norm, individual choice should prevail. But if integration is the maxim, then the constituent parts that are to be integrated need safeguards as they ensure the diversity of choices, here: among pension instruments, in the long term.

Second, national pension reforms in the EU are not forced to follow the irresistible path of privatisation of old age security. We saw that elements of social insurance are also introduced in private schemes, notably by making them mandatory. The two-way process undermined the pillar model of pension provision. Reform-minded governments were

[56] BER /267/2010.

[57] Barr 1992

aware that redirecting the public pillar towards redistribution would be politically suicidal for robust public provisions. The EU Commission and the various regulatory committees concerned with ‘age-related spending’ did not resist this hybridisation of pillars too much. After all, these reforms are compatible with several EU agendas, such as improving the financing of old age security, steady adjustment of benefits to demographic developments and preventing poverty in old age.

The economic and non-economic distinction of services supposedly takes account of this undermining of the three pillar model. But the new distinction misses the point and sends all the wrong signals of what the EU means for welfare states. Through the lens of this distinction, EU interventions are bound to be seen as infringements of sovereignty on the part of member states while maintaining national or corporate communities of risk are bound to be seen as protectionist tendencies by EU bodies. When unresolved regulatory issues then pop up in court cases, it appears as if the ‘non-economic’ services were put on the defensive.

The economic versus non-economic distinction suggests that European markets are ‘the other’ of national welfare states. In practice, regulation already acknowledges that welfare states make and shape these markets. The implicit criterion for differentiated economic regulation and integration is arguably whether a reform or a service can provide more insurance for existing beneficiaries or additional insurance for those so far excluded *if* markets become more integrated -- or not. An example for more insurance is the rejuvenation of insurance pools for longevity through migration. This can justify the strong portability requirements for social security; although one would also have to consider whether facilitating migration in this way means less insurance for the country of origin. Another example for additional insurance is to extend benefits for the elderly to all residents, irrespective of contributions, which gives reality to the universal service obligation.

All this would follow in the footsteps of the *Albany* ruling which called for differentiated economic regulation. Note also that financial viability can be one reason for containing competition, because adverse selection in competitive markets would jeopardize solidaristic insurance to workers.[58] A number of characteristics qualify a scheme as solidaristic, for instance the same flat contribution and benefit rates for all members, or no close correspondence between contribution and entitlement. The exemption from competition law is subject to a weak proportionality test of appropriateness. The underlying regulatory idea is to acknowledge a tradeoff between solidarity and competition but to see solidarity and integration not as alternatives. Like efficiency and equity in the new economics of welfare, they can be complements, at least along a range of policy options. Acknowledging that requires little more than making legal distinctions catching up with practice.

[58] Sauter and Schepel 2009, 84-90

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