When the welfare state meets the regulatory state:

EU occupational pension policy

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Abstract

The increasing relevance of occupational pensions for the income security of the elderly moves this policy area to the core of the tension between national redistributive welfare states and EU-wide single market regulations. Focusing on the European pension fund directive, the paper investigates whether European occupational pension policies are primarily shaped by the Commission's and international business' agenda of market liberalization or the governments' preferences for national autonomy in social policy. The study finds that the Directive liberalizes the pension market to some extent. Member states largely succeeded in securing the national prerogative in social policy. In explaining this outcome the paper argues that the nature of domestic pension arrangements does not only shape government preferences but also the preferences of the European Parliament and important business actors. Business was too fragmented internally to succeed in establishing a full blown liberal Europe in regard to occupational pensions, although their pressure was sufficient to secure liberal investment principles.

1 Introduction

Member states prerogative in social policy

Until recently, European integration of traditional welfare state areas such as pensions, health care and poverty alleviation has been very limited. The reasons for this are well understood. Providing and expanding a solidaristic system of social benefits has been an important source for the consolidation and legitimization of the nation state (Alber 1982; Ferrera 2003; de Swaan 1987). Welfare state policies also produce allegiance towards political parties. In particular for social democratic and Christian democratic parties ‘social policy remains the key to power mobilisation’ (van Kersbergen and Verbeek 1997, 31). In more recent periods, the importance of social policy for the nation state has been reinforced as ‘the welfare state remains one of the key realms of policy competence where national governments still appear to reign supreme’ (Leibfried and Pierson 2000, 270). Moreover, differences in benefit levels and the heterogeneity of path-dependent welfare state institutions complicate common European policies, even if governments would be willing to do so (Esping-Andersen 1990; Pierson 1994; Scharpf 1996). For these reasons, member states have been extremely reluctant in delegating social policy competencies to the European Union (EU) level. In addition, European Commission activism in this area is constrained as the welfare state is largely concerned with redistribution rather than regulation. Hence, while in areas of regulatory policy making the European Commission was influential as agenda setter, the EU’s lack of financial resources and member state autonomy with regard to taxes seriously limited the Commission’s power with regard to social security (Majone 1996).

Far reaching supra-national integration has been largely restricted to labor market related issues, in particular health and safety at work and gender equality in pay (Eichener 1995; Falkner 2000; Falkner *et al.* 2005; Leibfried and Pierson 2000; van der Vleuten 2001). The EU applies the voluntaristic and government-controlled open method of coordination for areas more central to the redistributive welfare state such as health, poverty, and old age pensions (Anderson 2002; Borrás and Jacobsson 2004; Zeitlin and Pochet 2005).

The rising importance of occupational pensions

While at first glance, the national prerogative on core areas of social security seems firmly established, there are very important long term developments in domestic pension arrangements which may seriously threaten the national autonomy in social policy by leading to supranational regulation touching upon traditional social security issues such as income maintenance and solidarity. Despite profound obstacles to the retrenchment of public pay-as-you-go (PAYG) pensions, almost all member states carried through significant cuts.[1] In the Netherlands, for instance, retrenchment measures resulted in a decrease of the basic public pension as a percentage of the average gross salary of 25 per cent between 1980 and 1998 (Delsen 2000, 151). And for Germany, Alber shows that the standard pension in 1998 is 22 per cent less than it would be if the pre-1977 legislation were still in effect (Alber 1998, 24). The 2001 pension reform reduced the standard pension further from 70 to 64 per cent (Haverland 2001). The decrease in the public PAYG pensions relative to wage earnings has been an important stimulus for occupational pensions based on funding, which generally increased in importance for the income security of the elderly. This holds in particular for those countries that have flat rate public pensions, providing higher income earners with an incentive for supplementary pensions (see also Bonoli 2003; Haverland 2001; Myles and Pierson 2001). A survey by the European Commission and the European Council revealed that currently about 40 per cent of pensioners' income in the Netherlands and the United Kingdom is made up of supplementary pensions. The relevant figures for Denmark and Ireland are 25 to 30 per cent, while in countries with generous and earnings-related first pillar pensions, it is still typically below 10 per cent, but is likely to rise significantly over the next decades (European Commission 2003, 72; see also Behrendt 2000, 12); The increasing importance of private pensions is also indicated in the rise of pension funds assets over the last decade (see Table 1).

As occupational pensions are directly linked with the labor market and most schemes are capital funded rather than PAYG, the border between EU regulated labor and financial market issues and national welfare issues become blurred. There is a large variation in member state regulations concerning the way occupational pensions are set up, the security of accrued occupational pension rights and benefits, and the degree of inbuilt solidarity (see Table 1). This diversity has a number of negative effects on European integration. Companies employing workers in different member states have a high administrative burden as they have to subscribe to and administer as many pension schemes as countries they are operating in. Next, the free movement of workers is hampered, as in many cases these workers cannot transfer accrued entitlements to another country, or, as they lose tax subsidies to which they

[1] In a PAYG system pensions are paid from current contribution payments, predominantly out of domestic labor income. In the case of funded schemes employees pay part of their (labor) income into a fund of financial assets. Retirement pensions are paid out of current capital income, originating from investment revenues (interests) and by selling assets (Kuné, 2000, 16).

would be entitled to in the country of origin. The regulatory diversity is also an obstacle for the integration of capital markets due to quantitative restrictions on investments in some countries, most notably restrictions on foreign assets.

Towards a liberal European regime?

Given the market distorting effects of the national diversity in occupational pension regimes, the international political economy literature hypothesizes that internationally-oriented pension funds will strive for the freedom to invest and to provide services throughout the European Union. These funds are extremely powerful as they jointly control large capital assets, in some countries (almost) equaling the national GDP (see Table 1). The pension funds will be supported by multi-national companies who suffer from national diversity in regulations. Sponsoring a single pension fund for all employees in the EU countries reduces transaction costs and stimulates intra-firm labor mobility. Moreover, the removal of quantitative investment restrictions makes pension products cheaper. The lobbying group of the pension fund industry estimates that companies would save 3 billion EUR a year if it pooled their various schemes into one fund that is regulated according to a liberal approach (EFRP 2000, 21). In a period of economic and financial internationalization its voice in decision making is significantly strengthened by credibly threatening to exit, i.e. to locate production and service facilities elsewhere (Hirschman 1970; Milner and Keohane 1996, 19-20; Scharpf 1996). The position of international business is further strengthened by its capacity to lobby at all levels of the European multi-level polity (Smith 2001, 520) and by its close relationship to the European Commission which sees international business as its natural ally in its liberalization agenda (Van Apeldoorn 2000).

Structure of the paper

The theoretical discussion implies two rival hypotheses about the general shape of European occupational policies; from an international political economy perspective it can be hypothesized that European policies have strong liberal traits, whereas the welfare state literature posits that given its importance for national legitimacy and path-dependent heterogeneity European policies will be rather limited and symbolic granting national discretion. In order to arrive at more precise hypotheses about how these general expectations play out more specifically in occupational pension policies, the next section will sketch the issues at stake in this policy area and will also provide an overview of the national *status quo ante.* This treatment seems to be rather technical but it is important to note that these ‘technicalities’ may have important material consequences for contributors and beneficiaries, (multi-national) companies, pension funds and member states (Section 2). Then, the more refined hypotheses about the content of the European policy will be deduced (Section 3). Section 4 presents the case study on EU occupational pension policies. Using pattern matching of outcomes for rival explanations, the study evaluates to what extent the hypothesized patterns match the empirical observations (George and Bennett 2005, Yin 1994). The case study is largely based on interviews with key actors in the policy process, the analysis of legal texts, and information gathered from specialized professional journals and newsletters, such as *Investment & Pensions Europe* (I&PE). Section 5 reports the main results of the case study and discusses its implications for the two theoretical perspectives.

2 The diversity of national occupational pension regimes

There are a number of issues that can be potentially addressed by occupational pension regulations and the large diversity of national regulatory schemes reflect that these issues have been decided in a variety of ways on the domestic level (see Table 1; Davis 2001; European Commission 2000). The diversity in existing approaches is partly related to the relative magnitude of firm-provided or (sectorwide) collective occupational pensions (second pillar) in relation to public PAYG pensions (first pillar) and individual saving plans (third pillar). Here three ‘worlds of pension welfare’ can be distinguished. These worlds are roughly similar to Esping-Anderson’s ‘three worlds of welfare capitalism’ (1990).

The pension systems of the ‘Scandinavian’ world, represented by Denmark, Sweden, and the Netherlands rely significantly on occupational funded pensions. These occupational schemes are based on collective agreements between employers and employees.[2] The schemes are financed by average premiums; hence disregarding individual characteristics. For these reasons they provide for solidarity among the contributors. Moreover, the benefits are paid as annuities. This implies that beneficiaries are protected against the longevity risk, the ‘risk’ that retirees – mostly applying to women - outlive their benefits. In most schemes also other so-called biometric risks are covered; hence members who become disabled may draw a pension that lie above the accrued pension entitlements and surviving dependents may

[2] Note, that under certain conditions Dutch companies are allowed to opt out of the sector-wide schemes and sponsor their own fund. About 80 per cent of the working population covered is member of a collective fund, however (Ebbinghaus, 2006).

have rights to parts of the accrued entitlements of their partner (Ebbinghaus 2006; European Commission 2000; Kuné 1996)

The ‘Anglo-Saxon’ world, represented by the United Kingdom and Ireland, also significantly rely on occupational pensions. However, these pensions are offered on a voluntary basis by individual employers. They often take the form of individual saving plans and are being paid out as a lump sum. The latter implies that the biometric risk of longevity is not covered; the retiree can outlive the benefits. Protection against other biometric risks, such as disability, and benefits for surviving dependants, is also often lacking (European Commission 2000).

The other member states of the European Union belong to the ‘Continental’ world with relatively generous earnings-related public PAYG schemes which provide for an extensive protection against biometric risks. Accordingly there is (still) only a small occupational pension sector and there is less need for covering biometric risks. Occupational pensions are offered on a voluntary basis by employers as fringe benefits. The protection against biometric risks varies significantly between schemes and member states (European Commission 2000).

Table 1: Occupational pensions: Increasing importance and regulatory diversity[3]

	1st pillar PAYG Flat-rate/ Earning. -related[1]	2nd pillar Occ-Pensions Set up[1]	2nd Pillar Cover Work-pop[1]	2nd Pillar Investment Regulation Approach[1,2]	Fund assets/ GDP 1992[3]	Fund assets/ GDP 2000[5]
				Anglo-Saxon world		
Ireland	FR	Voluntary	50	Prudent person	32,8	51,0
UK	FR&ER	Voluntary	46	Prudent person	52,2	80,6
				Scandinavian world		
Denmark	FR& ER	Collective	80	Quantitative Restrictions	14,7	23,9
Netherlands	FR	Collective	91	Prudent person	45,9	111,1
Sweden	ER	Collective	90	Quantitative Restrictions	16[4]	56,6
				Continental world		
Austria	ER	Voluntary	11	Quantitative Restrictions	-	12,0
Belgium	ER	Voluntary	31	QR/PP	0,2	5,9
Finland	ER	Voluntary	-	Prudent person	-	8,9
France	ER	Voluntary	<10	-	3,0	6,6
Germany	ER	Voluntary	50	QR/PP	4,8	16,3
Greece	ER	Voluntary	5	Prudent person	-	4,2
Italy	ER	Voluntary	5	QR/PP	0,9	2,6
Luxembourg	ER	Voluntary	30	Quantitative Restrictions	-	0,2
Portugal	ER	Voluntary	15	Quantitative Restrictions	2,4	11,5
Spain	ER	Voluntary	15	Quantitative restrictions	-	7,0

Sources: [1] European Commission 2000, [2]Davis 2001, [3] World Bank 1994, [4] CPB 1997, [5]EFRP 2002.

Besides the set up of occupational pension schemes and the degree of inbuilt solidarity, pension regulation also concerns the security of investment. Here different regulatory styles can be discerned that cut across the three worlds of pension welfare (Davis 2001; OECD 1998; Queisser 1998). The 'Anglo-Saxon' pension states United Kingdom and Ireland adhere to the relative flexible prudent person rule. That means that regulation is targeted towards the (prudential) quality of the person responsible for investments and that there are very few quantitative restrictions on investments, often dealing with the restriction of assets in the sponsoring firm. Most but not all 'Continental' welfare states, as well as Denmark and Sweden, impose more quantitative restrictions on the investment of pension funds: which financial instruments are authorized for investments, for instance shares, bonds, loans, is legally specified *ex ante;* minimum or maximum quotas are stipulated for the share of certain instruments in the overall portfolio; foreign assets are restricted; and matching between the

[3] Note that the Swedish first pillar pension has a funded component. Note also that France and Finland have compulsory occupational pensions. As these occupational pensions are mandatory by law and not predominantly funded, I included them under the 1st pillar.

currency of the liabilities and the currencies of assets is to a certain degree required (Davis 2001). Yet recent reforms in the ‘Continental’ pension states Italy (in 1993), and Germany (in 2001) are also based on the prudent person rule.

In addition to this general approach to investment regulation, there is typically also regulation in place that seeks to ensure that pension funds have enough assets to finance their commitments, the so-called technical provisions. Regulation can stipulate for instance that liabilities are fully funded: either on average over a certain time period, or at all times. (OECD 1998; Queisser 1998). Again there is large diversity between member states in regard to the stringency of these solvency standards cutting across the typology of pension states.

This regulatory diversity combined with the increasing importance of occupational pensions for income maintenance after retirement and for achieving social policies goals such as solidarity across gender, and within and across generation, implies that EU policies area that seek to cope with adverse effects on the European labor, capital and service market potentially interfere with national social policies: national welfare states meet the EU regulatory state.

For instance, the possibility of transborder membership in pension schemes would undermine the solidaristic compulsory arrangements in most Scandinavian countries and in the Netherlands due to adverse selection. As the compulsory schemes have average premiums and have to accept all potential members, a sponsoring firm with a relative good ‘risk’ structure, for instance young and healthy employees, has an incentive to exit the collective system and to sponsor a scheme abroad, which in turn would undermine the solidarity of the domestic scheme.

Another example is the potential danger of forum shopping with the effect of a race to the bottom with regard to regulations and enforcement. Companies have an incentive to sponsor schemes in countries where the legislation is less stringent or less strongly supervised and enforced as pension funds in those countries can provide cheaper products. Member states would have to allow their citizens to sponsor schemes abroad, hence beyond their control, but the citizens would fall back on domestic social security and assistance in cases of pension fund insolvency or unexpected drawbacks.

In short: the ability of member states to achieve social policy goals with funded occupational pensions - in many countries supported with generous tax subsidies - may be undermined by a relatively unrestricted single market for pensions.

3 Hypotheses

Based on the overview of potential issues that could be regulated on the EU level, it is now possible to derive more precise observable implications of the two rival theories. According to the welfare state literature, European integration is unlikely in the pension area, as member states are jealously guarding their competencies in this electorally sensitive area (van Kersbergen and Verbeek 1997). Moreover, differences in welfare levels and the institutional heterogeneity of path-dependent national welfare regimes, for instance concerning the relative importance of the occupational pension pillar, make European harmonization difficult, even if governments would prefer to do so (see Introduction). In this view, member states are generally opposed to any directive in this area, and as by implication governments being the most powerful actors in the European Union, there will be no European directive or a rather a symbolic one. The directive will be narrow in scope, and full of exemptions safeguarding national autonomy. The existing diversity in worlds of pension welfare will remain unaffected by the directive. Note that this outcome pattern should not depend on the specific decision-making procedure in the Council (unanimity/qualified majority voting), given the expected homogeneity of member state preferences.

From the perspective of those theories in international political economy that emphasize the power of international business – partly transmitted via the European Commission (Milner and Keohane 1996, Van Apeldoorn 2000), it can be hypothesized, that those European policies will be adopted that have strong liberal traits favoring choice rather than benefit security and solidarity: granting pension funds a maximum freedom to invest, and lacking strict solvency requirements and protection against biometric risks. These policies will require that national tax, labor- and social legislation that distort the European market will have to be abolished.

Table 2 Rival theories and their observable implications

Theory	**Hypothesized Outcome Pattern**
Welfare state theory	*Least Common Denominator*
- governments seeking autonomy	- minimum harmonization
- path-dependency	- exemptions safeguarding national laws and practices
International political economy	*European Liberal Regime*
- power of international business	- maximum freedom for (transborder) investments and services
- partnership with Commission	- lenient solvency standards
	- no mandatory protection against biometric risks
	- dismantling of interfering national labor and tax laws

4 The Institutions for Occupational Retirement Provision (IORP) Directive

This section traces the decision-making process of the IORP Directive and evaluates the rival theoretical arguments against the empirical material.

4.1 Amplifying liberalization: the European Commission's proposal

In October 2000, the European Commission adopted a proposal for a directive for Institutions for Occupational Retirement Provisions (IORP, COM (2000) 507 final). The directive is based upon single market Treaty provisions and therefore subject to the co-decision procedure, hence requiring a qualitative majority in the Council and an absolute majority in the European Parliament to pass it.

As the choice for single market treaty provisions indicates, the European Commission framed the directive as a liberalization measure. The proposal is part of the EU Financial Service Plan (European Commission 1999). Pension funds should enjoy similar single market freedoms as other financial institutions that have been object to single market regulation before, that is banks, (life) insurance companies, and investment funds. Pension funds in one member state are enabled to manage company schemes in other member states. The conditions of operation are largely determined by the home country of the pension fund. Hence, member states have to mutually recognize their regulatory regimes.[4]

With regard to the issue of contribution and benefit security, the proposal is generally informed by the prudent person rule. Hence member states are not allowed to require prior approval of investment decisions, the investment in particular category of assets, or ban investments in risk capital markets. Member states may adopt some quantitative restrictions, but they have to allow their pension funds to hold up to 70 per cent of their assets in shares and corporate bonds, and to hold at least 30 per cent in non-matching currencies.[5] A further restriction to full liberalization is stipulated by the provision that member states can require more stringent investment rules in individual cases. With regard to technical provisions, that is sufficient assets to meet liabilities, the proposal makes a distinction between domestic schemes and cross-border schemes. In principle both types of schemes have to fully fund their liabilities at all times. But domestic schemes are allowed derogation for a – unspecified – 'short period'.

Importantly, the proposal lacks any provisions with regard to solidarity. The directive applies to all institutions providing services based on an employment contract between employees and employers; collective schemes and individual saving plans. Hence collective schemes – that are more likely to have solidaristic elements –are not privileged. Also, the proposal does not entail any obligations with regard to the coverage of longevity, disability or other biometric risks.

The European Commission clearly aims at liberalizing the pension market. Taking prudence in investments as basic concept, the Commission very much followed the ideas furthered by the international financial service industry that heavily lobbied the Commission already at the pre-proposal stage (EFRP 2002, Tamminga 2000). To make it more palatable for the member states, member states were allowed to adopt some quantitative restrictions. Also, the Commission does not go so far as questioning domestic social and labor laws. In the case of transborder activities, pension funds have to respect the relevant laws of the host country. This provision is likely to establish significant obstacles for transborder activities. In order not to overburden the agenda, the European Commission has left the problem of tax discrimination and other issues regarding the free movement of workers outside the scope of

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[4] For an analysis of the effect of mutual recognition in the insurance sector, see Schmidt 2002

[5] Holding assets in the same currency as liabilities (currency matching) prevents the risk of changes in the relative values of currencies. It also implies that capital remains in the same currency area, which is welcomed by some governments as it helps to generate 'domestic' economic growth.

the directive. Tax discrimination is arguably the greatest obstacle to a single market for pensions. Harmonizing tax treatment has been dropped, as the European Commission anticipated large member state opposition, which would be difficult to break in particular as the tax issue would require unanimity in the Council (I&PE 9 March 2001). In this sense the proposal is quite narrow, but overall it matches most closely the perspective pointing to a European liberal regime.

4.2 Amplifying liberalization strongly while strengthening the social dimension: the pro-integration position of the EP

The European Parliament is known for its strive for pro-integrationist outcomes in EU decision-making processes (Hix 1999, 79). The case study reveals that occupational pensions are no exception to this: a broad majority of the EP preferred more far reaching integration in occupational policies than the European Commission aimed for in its proposal. However, the European parliament was deeply divided about the issue whether the more integrationist solution should have a liberal or a social outlook.

The European People Party Group (EPP-DE, Christian-democrats and Conservatives) and the liberal party group (ELDRP) supported the European Commissions approach to clearly frame the directive as a single market directive. These parties wanted to increase the liberal outlook of the directive in a number of ways. Most importantly, they proposed to phase out the possibility to erect quantitative investment restrictions. After a transitional period of a maximum of five years full investment freedom should be secured. Moreover, they proposed more lenient solvency requirements. In particular, they proposed for cross-border activities the application of home country rule rather than ‘fully funding at all time’. This implies that rather than imposing a uniform EU standard, they wish to leave this issue to the mechanisms of mutual recognition: member states with high solvency standards would have to accept the operation of pension funds originating from member states with low standards on their territory.

The Socialist Party Group (PES) was not a cohesive countervailing force against this plan for strong liberalization. On the contrary, it was deeply divided about the directive along national lines, largely reflecting the respective national status quo. Socialist MEP’s from the Southern countries including France, and Belgium, were highly skeptical about the very idea of pension funds and a directive dealing with it. They are generally in favor of a large solidaristic first pillar based on PAYG systems. With this view they were close to most green and radical left MEP's. The MEP's from the Netherlands, but also those from Germany, were in favor of a European directive in this area as long as it would only apply to collective systems protecting against biometric risks, reflecting the Dutch situation. Other funds should either not benefit from the single market or should be subjected to other financial service directives. This preference met opposition with the British MEP's who did not want such a restriction in scope, implying that most British pension funds would fall outside the regulation. But together with the Dutch MEP's, the British were in favor to Europeanize their national prudent person approach and relatively to adopt relatively lenient solvency requirements, while most other MEP's, in particular German ones, wanted quantitative restrictions and strict solvency requirements. To compromise the different views, the official line of the party group was to support a directive, if its application would be restricted to those funds covering biometric risks (Interviews; EFRP 2002, 4).

As votes from both large parties, the EPP-DE and the PES, were needed to get the necessary absolute majority, the rapporteur, an Austrian EPP member, formulated a 'fragile' compromise (Interview) between the EPP-DE and the PES view on biometric risks. It was stated that pension funds have to offer the option to cover biometric risks.[6] During the plenary session a related amendment was added stating that pension funds have to offer the option of a minimum return guarantee of the contributions paid in. Moreover it was stipulated that benefits usually take the form of life time benefits rather than lump sums (Van t'Zet 2002). The compromise of the rapporteur turned out to be successful. The EP passed an amended version of the directive with a broad majority in July 2001. Apart from the slight (and rather symbolic) strengthening of the solidarity dimension, the EP agreed on a number of amendments strengthened the liberal outlook of the directive, most crucially the temporal limitation of quantitative investment restrictions, but also relatively lenient standards for technical provisions and regulatory own funds. Hence, the EP advanced a liberal rather than a social policy position.

The debate within and between party groups had evolved against the background of heavy lobbying by pension funds, most notably its European federation (EFRP) and the British and Dutch national associations, and other suppliers of financial services, in particular insurance companies. They tried to convince the MEPs of the merits of the prudent person principles and lenient solvency standards and most of them also warned against the restriction

[6] An absolute majority of all MEP's, not just those voting, is necessary to pass legislation. As Hix points out, due to the fact that the average turnout at voting is 75 per cent, a proposal need on average 65 per cent of those voting to be passed (Hix 1999: 81)

of the directive to those funds covering biometric risks (EFRP 2002).[7] This may help to explain why the amendments of the EP pointed to more investment freedoms and why the social elements remained limited. This evidence matches with the European Liberal Regime perspective.

4.3 Liberalization light while maintaining national autonomy: the Council's Common Position

The debate in the Council was characterized by a conflict between some 'Continental' welfare states, in particular France, Spain and Portugal who were against the prudent person principle and did not want the directive or at least Europeanize their quantitative approach, and the 'Scandinavian' (including the Netherlands) and 'Anglo-Saxon' member states that were in favor of the directive and the prudent person principle (Interviews; I&PE 6 June 2002; EFRP 2002: 9; European Voice 4-10 April 2002). The latter group was joined by Italy and Germany, two continental welfare states (I&PE 7 May 2002). The preference of these countries reflected the changing status quo in their countries. As stated earlier, already in the mid 1990s, Italy has introduced reforms that strengthened the occupational funded pillar and the investments are regulated according to the prudent person principle (Ferrera and Gualmini 2000; European Commission 2000). In Germany, the government had enacted a major pension reform in 2001, and during the implementation process of the reform it was decided that pension funds will be governed by prudent person principle (dpn July/Augustus 2002).
Hence, the debate followed very much the logic of 'regulatory competition': member states seek to upload their own regulatory practices in order to reduce adaptation costs, once the directive is in place (Heritier *et al.* 1996). Note, however, that the conflict in the Council revolved around investment regulation and solvency standards. None of the member states wanted to turn the directive into a social policy directive or include incentives for social policy elements indirectly, by restricting its application to those pension funds covering biometric risks.

In order to achieve a common position it was crucial to achieve a compromise on financial regulation issues while it was clear that no social issues would be included. The Spanish government that took over the presidency from the Belgians proposed a number of

[7] As the Dutch pension funds cover the longevity, disability risks and as a default also survivor benefits, one may expect these funds to argue for the Europeanization of their approach. However, these funds are managed by the social partners who want to keep their domestic autonomy to negotiate these issues as the domestic level and are therefore against the transfer of competencies to the EU (Interview).

compromises revolving around the notion of *prudent person plus* and also proving more discretionary authority with regard to quantitative restrictions (see below, see also European Voice 4-10 April 2002; I&PE 6 June 2002). Given these concessions, France, the last large opposing member state, gave up its opposition. This was crucial for passing the directive as together with the other remaining fierce opponents, Belgium and Portugal, France had a blocking minority. At the end only Belgium did not support the common position in the Council (I&PE 21 June 2002). Interviewees have suggested that the final support of the French government was informed by the strategy to use Brussels to liberalize the domestic pension market against strong opposition within France (Interviews). While it would cause too much domestic problems if the French government had pushed for liberalization from the beginning, the domestic opposition was expected to be weaker if the government could present some bargaining success and point to the large majority favoring the directive.

As a result of the wheeling and dealing in the council, the Common Position, adopted in November 2002, had a less liberal and integrationist outlook than the document resulting from the EP's first reading and even less so than the European Commission's proposal and any reference to solidaristic elements was lacking. More in particular, though the Council endorsed the prudent person principle, it did not accept any of the Parliament's amendments that would make the directive's approach to investment rules more liberal and the solvency standards more lenient. With regard to the investment rules, the Council rejected the EP's amendment that quantitative investment restrictions (within limits) are only possible for a time period of a maximum of five years. The Council even moved beyond the European Commission's proposal by increasing member states' autonomy in regulating pension funds on their territory. It was decided that host member states were allowed to demand from foreign pension funds stricter investment rules than in their home country, if these rules are also applied to funds established in the host country and if a certain minimum investment freedom is guaranteed. This provision does in fact undermine the principle of mutual recognition. Is also implies that pension funds may have to hold separate assets for the liabilities abroad, which may be quite complicated and hamper transborder membership in pension funds.

With regard to solvency standards, the Council reaffirmed the European Commission's proposal that, as far as domestic funds are concerned, fully funding at all times needs to be the general principle with only tightly circumscribed exceptions and that with regard to cross-border schemes, liabilities always need to be fully funded. Hence the Council opposed the EP's amendment to introduce home country rule and mutual recognition regarding this issue.

With regard to solidarity, the Council did not accept any EP amendment which would point towards the inclusion of biometric risks. Hence with regard to the type of benefit it followed the European Commission's approach to allow for lump sum payment besides life long payment and temporary payment, and it rejected the requirement that pension funds have to offer the option of protecting against biometric risks and a return guarantee of the contributions paid.

Yet, the Council, in particular pressed by the Dutch government, clarified that in the case of transborder activities pension funds have to respect national social and labor law by adding '*including compulsory membership and the outcomes of collective bargaining*' (Article 20.1) and added further provisions to ensure that the respect for national social and labor law will be effectively monitored and enforcement. Though autonomy with regard to national and social labor law was already part of the European Commission's proposal, the Dutch government feared that it might not be sufficient to shelter the Dutch system when it would be challenged in the European Court of Justice (Interviews). Generally speaking, the Council's Common Position largely fits the least common denominator pattern derived from the welfare state perspective. 'Largely', because some smaller countries have to slightly change their status quo, e.g. Austria, Finland and Portugal have to reduce their investment restrictions with regard to shares and real estate (OECD 2001).

4.4 Avoiding Conciliation: the Short Cut to the Directive

The preceding analysis reveals that the EP on the one hand, and the European Commission and the Council on the other hand, were divided about the directive. Neither the European Commission nor the Council were ready to accept the more integrationist stance of the EP with regard to both investment freedoms and the social dimension. In order to avoid the Conciliation procedure, an informal trialogue started between the European Commission, the Greek presidency and the EP's Rapporteur: an institutional short cut that has become quite common since the 1990s (see also Farrell and Héritier 2003). The goal of the trialogue was that in its second reading the EP should only adopt amendments that would be acceptable to the European Commission and the Council. The deal worked out. All 18 amendments made by the EP in its second reading (March 2003), were accepted by the European Commission and the Council (Interviews).

Most critically, the EP did not re-introduce a temporal limitation to quantitative restrictions and it endorsed that host member states, under certain conditions, can dictate that pension funds active in their territory have to obey to stricter standards than in their home country. With regard to biometric risks, the EP amendments are rather symbolic. It is said that pension benefits should be generally paid out in the form of life time payments but it can also be paid as lump sum or for a temporary period. Also, rather than obliging member states to demand from their pension funds to offer the option to cover biometric risks and the guarantee of repayment of contributions, the EP proposed that member states may demand so, if employers and employees agree. However, there is no need for such a provision, as member states are allowed to do so anyway, in other words, the provision does not add any substance to the directive.

5 Discussion and Conclusion

The European pension fund directive will neither lead to a full liberalization of pension markets, nor does it establish a European social policy regime at the EU level. Despite liberalization pressures from international business, member states that have quantitative restrictions and/or (quasi) compulsory schemes, largely succeeded in defending their domestic status quo and made sure that they maintained their prerogative when it comes to the social dimension of occupational pensions. This finding lends support for the welfare state theory and more generally to EU theories that see member states as prime movers of the EU integration process (e.g. Moravcsik 1993). That there has been a directive at all can be explained by the changing status quo in Italy and Germany which resulted into the isolation of France among the larger EU member states. It has been suggested by interviewees that French government finally agreed on the directive because it wanted to use the directive to increase the role of funded pensions at home. That the member states have been relatively successful in defending the (changing) status quo can be explained by a number of factors.

First of all pressure from business was weaker than is often assumed in the International Political Economy literature. To be sure their pressure was sufficient to guarantee the basic liberal outlook of the directive from the Commission’s proposal stage onwards. Also, business had successfully lobbied the EP to opt for home country rule for solvency requirements and the phase out of investment restrictions. Yet, both amendments have not been accepted by the Council and the EP did not try to fight it through. Business did not act as a cohesive actor. Multinational companies that would be the consumers of the new services became less interested in the directive as it became clear that the directive would not address tax harmonization and other issues related to the free movement of workers. They left the lobbying to the providers of financial services. However, the financial service industry was fragmented. Life insurers pursued partly diverging interests from pension funds and even among insurers and among pension funds disagreement on a crucial issues prevailed. For instance, the insurance industry could not agree a united position on the issue of the obligatory coverage of biometric risks (Interviews). And those pension funds enjoying a national sectoral quasi- monopoly, such as the Dutch pension funds, did not side with those pension funds such as the British, who argued against these monopolies. To be sure, cleavages in business interests, for instance between internationally-oriented business and import-competing firms, are sometimes acknowledged in the literature (Keohane and Milner 1996, Van Apeldoorn 2000). This analysis cast even more doubt on the still prevailing general image of uni-directional business power, at least in cases where the regulatory state meets the welfare state.

The case study also showed that the European Parliament was divided, with a majority favoring a liberal rather than a social approach to the issue. Interestingly, the socialist fraction group did not uniformly favor a directive with strong social elements. Its preferences were shaped by the national status quo rather than general party ideology. Given this fragmentation it was relatively easy for the Council to impose its will on the EP.

The directive is close to the least common denominator in the Council, although some smaller countries, like Austria and Finland need to change their status quo. But it should be kept in mind that yet again another area of public policy that traditionally had been solely regulated by the member states, has been made subject to European integration. Moreover, rather than the new voluntaristic and intergovernmental open method of coordination a directive has been chosen. Hence supra-national rules have established European minimum standards with regard to the operation and supervision of pension funds, technical provisions and investment freedoms which will also apply to new countries joining the European Union. Member states are locked into this system. Any member state that wants to unilaterally change its policies has to do so within the boundaries set by the directive. As the history of European integration has shown, once a directive is in place ambiguities and vague language, in this case for example with regard to the meaning of the 'prudentially justified', may unleash monitoring and enforcement activities by the Commission and the Court that may increase the grip on the member states.

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