

The Finnish National Pension in the Process of Europeanization – Co-ordination and Confusion in Pension Policy

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The Finnish National Pension has changed significantly since Finland became a member of the European Economic Area. Some of the changes have been made because of the European co-ordination of social security. These changes have had a major impact on pensions paid to other Member states.

The purpose of this article is to analyze to what extent the Finnish residence-based national pension `fits´ or `misfits´ the co-ordination of social security in European Union. The aim is to analyze the difficulties that the national pension faces when interacting with the co-ordination legislation. The method used in this article is the model family method. The chosen examples explain the changes in the individual level and elucidate the complications of the national pension in the co-ordination.

The findings of this article are that the national pension misfits with current co-ordination regulation 1408/71. The co-ordination regulation does not take into account the residence-based pension benefits that are income-tested and it creates inequalities between those who have used their right to free movement and those who have not. In particular, the decision to use theoretical earnings-related pension in the income-testing of the national pension is contradictory and it does not solve the problem of pension consolidation. The co-ordination of the national pension also creates a high administrative burden and it makes the pension system difficult to understand for the pensioner.

It should be re-considered whether the national pension could be placed as a special non-contributory benefit when the new co-ordination regulation 883/2004 comes into force. Now, when the Finnish government has decided to change the financing of the national pension by removing the employers' national pension payments and adding a new type of pension `the guaranteed pension´ to the Finnish pension system, there might be room for a new approach in this matter.

Key words: Intra-European social security, Co-ordination of social security, Regulation 1408/71, National pension, Europeanization

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Introduction

The Finnish national pension has changed significantly since Finland became a member of the European Economic Area in 1994. Some of the changes have been made because of the European co-ordination of social security. The purpose of this article is to analyze to what extent the Finnish residence-based national pension¹ 'fits' or 'misfits' with the European co-ordination of social security. First, the article describes how the national pension system changed after Finland joined the European Economic Area and later the European Union. Second, this article explains the administrative difficulties and the difficulties for individuals that the income-testing of the national pension creates when a pension applicant has several pensions from different Member states. The research focuses on the Finnish national pension and how the co-ordination of social security affects the calculation and income-testing of the national pension when a person has moved to another Member state. The income-testing of the national pension creates major problems in implementing the co-ordination regulation when a person has lived in several Member states.

The national pension has been one of the founding components of the Finnish social security system. Although earnings-related pension is today the main pension for most pensioners, the national pension has kept its position as an important part of social security. (Hagfors & Hellsten & Sakslin 2008.) The Nordic welfare model has traditionally been based on residence or citizenship (See Christiansen & Markkola 2006, 11-12). However, it has been argued that European co-ordination regulation 1408/71² favors the individualistic insurance principle and that it does not fully recognize residence-based social security systems (Martinsen 2004, 8-9). Therefore, the

¹ In this article the national pension means national old age pension and national invalidity pension. These pension forms can be granted when an applicant lives in another Member state.

² In the near future co-ordination regulation 1408/71 will be replaced by the renewed regulation 883/2004. However, the new regulation will not come into force until the implementing regulation has been adopted. The adoption of the new regulation does not mean that all the difficulties of co-ordination will be solved since the result involves several compromises. (Pennings 2005, 67.) Moreover, the general principles of co-ordination will remain the same as in the previous co-ordination regulation. (Pennings 2006, 215). In this article the regulation means the current regulation 1408/71 and the implementing regulation 574/72 if not mentioned otherwise.

membership of the European Economic Area changed the grounds of national pension when Finland adjusted its legislation to *acquis communautaire*.

The Nordic countries have a long tradition of having a common labour market and because of this history they had a different historical background when they entered the European Economic Area and European Union. Labour has moved freely in the Nordic countries since the 1950s; the first Nordic Agreement on the Free Movement of Labour is from 1954. In order to safeguard the social security of Nordic migrants, the first social security agreement between these five nations was signed in 1956. According to this agreement, workers that moved between these countries were able receive the social security in their new domicile without any waiting periods. (Hellsten 2004, 27-28.)

Before Finland joined the European Economic Area in 1994, social security agreements defined whether the national residence-based pensions were paid to a foreign country. The Nordic countries had agreed that the country of residence paid the entire national pension to a migrant. The Nordic countries had similar social security systems and consequently, it was straightforward to agree on this principle. All these countries had a residence-based national pension, which made this principle uncomplicated to implement without any economic compensations between the countries. (Hellsten 2004, 27-28.)

The Nordic Agreement on Social Security was significant for those who migrated: when they moved to another Nordic country they were able to directly enter its social security system. The system was simple to understand when the social security came only from the country of residence. This simple system changed significantly when Finland joined the European Economic Area and a whole new way of thinking had to be adapted in the area of social security. This was not an easy task and the process is still on-going.

An effective way to pinpoint the difficulties is to use the model family method, which has been widely used in studies on welfare policy. The idea of the model family method, which is also called fictitious micro simulation, is to create a model of the changes in social security that occur in reality (Hiilamo 1999, 502-503). The model family method explains how the social security system works at an individual level or what kind of security a system offers to a family. Large system explanations do not often provide

information that would explain how the system works at an individual level. The aim of this method is to answer this need. (Kuivalainen 2007, 1-2.) The model family method has proven to be influential and useful as it produces comparable information on an up-to-date basis (Kuivalainen 2004, 73).

The usage of the model family method requires complete knowledge of the social security system in question. The starting point of the study is always to standardize circumstantial factors such as age, income and other required factors. This creates the possibility to compare different situations or different social security systems. (Kuivalainen 2007, 1-6.) The method can also be used to explain the implications that the changes in the legislation have made to the incomes of individuals or families (Parpo 2006). It can also be used to illustrate extreme situations that individuals can face (Kuivalainen 2007, 8).

However, the method has some limitations. The results cannot be used at a macro level, for example, to analyze how a certain benefit reduces poverty in a population level. According to its critics, the results cannot be trusted if it cannot be shown how large the population is behind the examples. (Hiilamo 1999, 503.) The weakness of the method is that the individuals or families are always fictional and, consequently, they rarely represent the real situations of individuals or families (Kuivalainen 2007, 17).

Nevertheless, the model family method is useful and it was chosen for this article to explain the changes and the complexity of national pension calculation when there are several Member states involved. It is also used to explain the administrative difficulties and difficulties that individuals confront when the legislation of income-testing has changed several times.

The research questions may seem complex and to some extent technical. Because of the technical nature of the co-ordination regulation, academics have neglected this area (De Burga 2005, 5). Consequently, it is important that this detailed area of the social security co-ordination is explored. We must also return to basics and analyze why the national pension was originally created: the purpose of the national pension is to guarantee income to those who have small earnings-related pension. Although the pensions that are paid monthly to the pensioners in other Member states are rather small,

they may have an important role to some pensioners. At least 250 000 people migrated from Finland to Sweden between 1950 and 1980 (Korkiasaari 2001, 2) and the question is highly relevant when these migrants apply for pension.

This article has the following structure: first, social security co-ordination is defined and the theory of Europeanization and the sovereignty of welfare states analyzed. Second, the general principles of co-ordination regulation are explained and its impact on the Finnish national pension is discussed. Third, the changes made in income-testing of the national pension after Finland joined the European Economic Area are analyzed. Fourth, the theoretical earnings-related pension in income-testing of the national pension is analyzed and illustrated with examples. Fifth, adjustments and claim for recovery are explained and illustrated. Finally, the article ends with conclusions.

Semi-sovereign welfare states and the theory of Europeanization

The construction of welfare states has historically been linked to the creation of the nation-state; social insurance was a breakthrough in the history of European states (Ferrera 2003, 620). Social rights and the citizenship played an important role in the process of nation- and state-building in Europe (Ferrera 2005, 11). Earlier, the state was able to define risks that the citizens are protected from within the territorial borders but the European co-ordination of social security has challenged this autonomy. (Martinsen 2004, 241-242).

The free movement of labour has been one of the founding ideas of the European Economic Community; it is expected to create flexible labour markets and a wealthier Europe. The co-ordination of social security is based on the assumption that in order to encourage intra-European migration, it is necessary to eliminate national barriers to movement. (Martinsen 2004b, 2-3.) Consequently, European integration has challenged the old form of territoriality and the right to decide on social policy matters has become less comprehensive than it was previously (Ferrera 2005, 11). Ensuring the free movement of workers requires active measures: workers cannot be expected to go abroad if it has negative effects on their social security position. Without any

intervention by co-ordination legislation these negative effects would be inevitable. (Pennings 2003, 3.)

The social rights of migrants had been negotiated between the European states already before the existence of European Coal and Steel Community. These bilateral agreements between the states favoured labour-importing countries. The Treaty of Paris was the first step taken at the European level to allow labour mobility within the Community. The Treaty of Rome went even further as the founding countries of European Economic Community agreed to grant the free movement of workers and obliged the s to remove those aspects of national law that were discriminative on the basis of nationality. (Martinsen 2005, 92-93.)

The predecessor of regulation 1408/71, namely regulation 3/58 was adopted the same year the Treaty of Rome came into force and it become the first social security regulation at the European level. Regulation 1408/71 was based on its predecessor, but it improved some of the regulatory gaps and unclear definitions. (Martinsen 2005, 92-93.) According to Ferrera, the adoption of regulation 1408/71 was the starting point of a process which accelerated integration after the Single European Act of 1987. As a result, the national boundaries of citizenship have weakened with specific implications for social rights. The right to residence is still part of national sovereignty, but the freedom to work anywhere in the European Union is strongly protected by the Treaties and supranational authorities. (Ferrera 2005b, 22.)

The co-ordination of social security has neither been defined in co-ordination regulation 1408/71 nor in the EC Treaty. The European Court of Justice has not given any definition of co-ordination in its rulings. (Pennings 2003, 7.) Pennings (2003, 6) has made this clear definition of co-ordination:

“Co-ordination rules are rules intended to adjust social security schemes in relation to each other (as well as to those of other international regulations), for the purpose of regulating transnational questions, with the objective of protecting the social security position of migrant workers, the members of their families and similar groups and persons.”

The definition of co-ordination is essential in order to separate it from the harmonisation of social security. Harmonisation involves changes to national social security legislation for all employees or residents, whereas co-ordination rules only replace those national rules that discriminate against migrants. (Pennings 2003, 7.) However, the co-ordination of social security may cause that the Member states to have to adapt their national social security systems to a more “European” system. According to Leibfried and Pierson, the European welfare states have become semi-sovereign in their development because of this phenomenon. The decisions made by the European Court of Justice have evidently led to the transference of power from the Member states to the European Court of Justice (Pakaslahti 2001, 74). Indeed, it is said that the European Court of Justice has become a market police in the field of social policy (Leibfried & Pierson 1995).

Leibfried and Pierson (1995, 45) divided the social security developments in the European Union into positive and negative aspects. The developments are positive when the European Commission and the Council of Ministers actively try to achieve something in the field of social policy, whereas the developments are negative when the changes in the social policy field take place because of internal market requirements. The free movement of workers and the free movement of services have especially (negatively) affected the social security system of the Member states. (Leibfried & Pierson 1995, 45.)

As a consequence of these negative reforms, Member states have witnessed an increasing erosion of their external borders and they seem to lack the capacity to control them. In the gradual expansion of EU regulation and the European Court of Justice’s rulings, Member states have gradually lost their control over beneficiaries. For example, Member states can neither limit the access to the benefits only to their own citizens nor to limit the consumption of benefits to their own territory. The benefits have become portable within the internal market and the insured can increasingly consume (health) services in other Member states. (Ferrera 2005, 120-121; Leibfried & Pierson 1995, 50.) The contrast between negative and positive integration has highlighted the effects that strike at the foundations of national social contracts. The main question in this discussion has been the increased power of markets in relation to these redistributive arrangements. (Ferrera 2005, 23.)

The discussion of the semi-sovereignty of European welfare states touches partly on the active discussion about Europeanization. The misfit theme has become one of the common points of reference in Europeanization research (Toskov 2005, 3). In the literature of Europeanization the concept of misfit, mismatch or goodness of fit plays an important role in explaining variation in the enforcement of EU requirements. In general, the goodness of fit theory is about how institutional change is formed and sustained. The theory answers the question of how and to what extent an external influence can change domestic institutions. (See Featherstone 2003.)

There are many definitions of what Europeanization is and where it can be utilized (Featherstone 2003). Europeanization can be seen as the pooling of power between national governments and the European Union. Some researchers see the process of Europeanization when domestic policy is influenced by the European Union. (Radaelli 2003, 29.) However, Europeanization should neither be confused with convergence nor with harmonisation. Convergence can only be a consequence of Europeanization while harmonisation is rarely a goal of Europeanization. (Radaelli 2003, 33.)

According to Börzel and Risse, (2003, 59-61) Europeanization should be understood as a process of institution-building on a European level. The idea is to investigate how the Member states have changed in this process. *“The lower the compatibility between European and domestic processes, policies and institutions, the higher the adaptation pressure.”* Europeanization changes domestic policy only if there is a clear misfit between European and domestic policies.

Researchers have acknowledged different types of misfit between the Member states and Europe. A very simple distinction has been drawn between misfit generating technical difficulties for implementing institutional change and misfit generating opposition to planned changes. This distinction is encapsulated clearly if the implementation is a matter of will or the matter of inability. (Toskov 2005, 8.)

Another distinction is made between legal, organizational, cultural and policy misfit. First, legal misfit concerns the compatibility of a new body of codified rules with the existing domestic legal system. This type of misfit is technical in nature. The second type of misfit concerns the organizational arrangements when the European Union

measures the existence of particular organizational units. Organisational misfit can be both technical and political. The similarities between the legal and the organizational types of misfit are that these conflicts deal with formal institutional change. The third type of misfit is cultural, namely shared understandings or norms which are not in coherence with the EU. Fourth, there may be specific logic that involves every aspect of an institution which is called policy misfit. (Toskov 2005, 8-9.)

However, the empirical evidence of “goodness of fit” theory has not been satisfactory. In order to construct more consistent hypotheses based on the intuitively appealing concept of “goodness of fit”, the research should examine the theoretical underpinnings of the idea and explain clearly what kind of fit/misfit is meant. (Toskov 2005, 1.) It must also be remembered that Member states are not merely passive receivers of European demands for domestic change: the Member states can proactively shape European policies, institutions, and processes. Furthermore, the need to adapt domestically to European pressures may have significant return effects at the European level where Member states seek to diminish the ‘misfit’ between European and national arrangements by shaping EU decisions. (Börzel 2003, 3.)

The general principles of the co-ordination and the Finnish national pension

To ensure that the application of the different national social security schemes do not negatively affect persons exercising their right to free movement, co-ordination regulation 1408/71 establishes certain common rules and principles. The objective of these principles is to ensure that people who use their right to move within the EU are not placed in a worse position than those who have always resided and worked in a single Member state. (Tuori & Kotkas 2008, 294; Martinsen 2004, 88.) According to Saari (2003, 98) the general principles are clear even though the co-ordination regulation itself is rather complicated. These general principles have strongly affected the Finnish national pension after Finland joined the EEA.

The first principle forbids unequal treatment on the grounds of nationality. This means that every European citizen that belongs to the social security system of any Member

state enjoys the same rights and obligations regardless of nationality.³ (See, for example, Pennings 2006, 217.) The European Court of Justice has expanded the concept of who has the right to enjoy equal treatment. This generous interpretation means that the Member states cannot favour their own citizens when granting social security benefits. (Martinsen 2004, 88.) One of the basic functions of the co-ordination regulation is to break the solidarity circles of national social security schemes. In regard to national social security schemes, it excludes nationality as a criterion of belonging. (Numhauser-Henning 2002, 186.) The principle prohibits all unequal treatment on the basis of nationality and applies it without exception (Martinsen 2004, 88).

Before Finland joined the European Economic Area in 1994 the national pension was only granted to Finnish citizens who resided in Finland.⁴ The national pension system was based on residence so that every citizen over 16 years old was insured according to the National Pension Act against old age, invalidity and unemployment. Finnish citizens were entitled to the national pension if they permanently lived in Finland. In order to receive a pension, foreign nationals had to reside five years in Finland directly before the pension application. The co-ordination regulation overruled this paragraph in the National Pension Act and the national pension also had to be paid to people who had already left the country and to European citizens who domiciled in Finland. (Arajärvi 2008, 66.)

The second principle prevents conflicts of law and involves rules on one applicable legislation. The aim of this principle is to ensure that all citizens who are active in the labor market and the members of their family are always integrated into the social security system of one Member state. The one applicable legislation principle applies both to social security payments and benefits. The idea is that a person who gets social

³ The question of nationality was widely discussed at the European level before the co-ordination regulation was changed in 2004 with regulation 859/2003. Subsequently, also third country nationals when they had worked in more than one Member state (besides Denmark) were included in the personal scope of the regulation. However, it must be remembered that third country nationals do not enjoy the right to movement inside the EU. This makes the change in personal scope rather symbolic. (Ferrera 2005, 143; Martinsen 2004, 324.)

⁴ Social security agreements made exceptions to this principle. In addition to the Nordic countries Finland had bilateral social security agreements with many European countries including Germany, Great Britain, Switzerland, Austria and Spain. The social security agreement was also made with the United States and Canada. These agreements made it possible to grant the national pension to a non-Finnish national who lived in a country covered by the agreement. (Niemelä & Ruhanen 2008, 174-175.)

security benefits from one Member state also pays the social security payments to the same Member state even though he/she would reside in another Member state. The country of employment is always responsible for the social security of a worker and his/her family members. (Tuori & Kotkas 2008, 296.)

The one applicable legislation principle is also called the state of employment or *lex loci laboris* principle. In recent years, there has been heavy criticism of this principle. Some authors have suggested that it should be replaced with the state of residence, that is to say the *lex loci domicile* principle. It has been argued that the founding countries of the European Community laid down the principles of co-ordination according to their traditions of social security. The social security systems of the six original Member states were largely based on Bismarckian heritage. The critics argue that the employment principle of co-ordination undermines the countries with residence-based social security systems. It has been claimed that the co-ordination regulation promotes an individualistic insurance principle and does not sufficiently take into account residence-based social security systems. This is said to jeopardise the existence of residence-based social security. This discussion has been active in the Nordic countries, in particular, in Denmark and Sweden. (Martinsen 2004, 9; Pennings 2004 and 2005, 76-79; Christensen & Malmstedt 2000.)

The state of employment principle has also been chosen in the new co-ordination regulation 883/2004 to determine the applicable legislation. According to Pennings (2005, 69) the choice of this principle is straightforward: most of the statutory benefits in central European countries only cover employees. Another reason for this choice was that labour usually migrated to wealthier nations; the social security of the new Member state is more attractive to the migrant than the social security of country of origin. The third reason for the choice of *lex loci laboris* is that if the employee falls under the legislation of the country of residence, he would be either cheaper or more expensive to the employer. The competition of social security systems is not a way to promote the free movement of workers. (Pennings 2005, 69.)

The *lex loci laboris* principle did not directly change the Finnish national pension. However, this state of employment principle has been problematic to the Nordic Member states because these countries have residence-based benefits that are often

funded by taxes. (Pennings 2005, 77.) These benefits are neither social aid nor are they considered to be social insurance. According to Saari, (2003, 311) Finland has tried to avoid the situation where it would pay a benefit to a Member state that does not have similar kind of benefit. This has been the basis of Finnish policy since the European Economic Area negotiations.

The third general principle of co-ordination regulation 1408/71 is the aggregation of periods. This means that the periods of insurance, employment or residence completed under the legislation of one Member state are counted, where necessary, for entitlement to benefits under the legislation of another Member state. (Martinsen 2004, 88.) Many social security benefits include waiting periods. For example, the Finnish national pension requires a three year residence period; two of these three years can be replaced by an insurance period from another Member state. (Tuori & Kotkas 2008, 297.)

Fourth, the principle of exportability means that benefits can be paid to persons residing in another Member state. The acquired rights are exportable within the geographical scope of the co-ordination regulation. However, this principle is not as absolute as the principle of non-discrimination. There is a certain group of benefits that can still be territorially demarcated. (Martinsen 2004, 89.) These special non-contributory benefits have to be mentioned in Annex II a of regulation 1408/71. In conflict situations with national legislation, this principle overrules all the restrictions that prevent paying the benefits to another Member state. (Tuori & Kotkas 2008, 298.) Earlier, the export of Finnish national pension was limited: the national pension was paid to other countries for only one year and only certain exceptions were made to this principle (Arajärvi 2008, 66). Since Finland joined the European Economic Area in 1994 the national pension has been paid without exception to other Member states.

Fifth, there is the principle of *pro rata temporis*. The regulation grants right of pro rata share to a benefit if a beneficiary has not been insured long enough to gain the full benefit. This principle is applicable to long-term benefits such as pensions. When counting a pension in one Member state, also the other Member states` insurance periods must also be taken into consideration. First, the theoretical amount of pension is

calculated⁵. Thereafter, the real pension is calculated so that the insurance period in one Member state is in proportion to all periods. (Tuori & Kotkas 2008, 298.) The coordination regulation treats long-term benefits differently than short term benefits.⁶ The long-term benefits have more serious financial consequences and, therefore, the partial pension method or pro rata pension method is used. As a result of this method the total pension consists of a number of pensions that are based on the periods of insurance completed in the Member states where the person has been employed or has resided. The Member states where the person has been insured must pay the pension related to the periods completed under their legislation. (Pennings 2003, 179.)

Due to the *pro rata temporis* principle, the Finnish national pension became proportional to the time of residence. The full basic part of the national pension could be received if a person had lived in Finland 40 years between the ages of 16 to 65. Denmark, Norway and Sweden have made the similar decision with their national pension. (Arajärvi 2008, 67.)

When Finland joined the European Economic Area in 1994, the general principles of the regulation were discussed in parliament. However, according to Arajärvi (2008, 65) the question of how the European Union has challenged the Finnish social security system has been in the hands of the civil servants and there has not been enough open political discussion (Arajärvi 2008, 65). The Finnish social security system is mostly based on residence. Employment is not a precondition in order to obtain social security benefits. The idea is to grant social security benefits to those who inhabit inside the territorial borders. (Saari & Kari 2006, 143.) The Social Affairs and Health Committee of the parliament stated in their discussion that the changes were inevitable and could not be rejected. However, it emphasised that Finland should not be forced to pay social

⁵ The theoretical amount is the amount that the applicant would receive if he or she had been insured in the country in question for all the time when he or she has been insured anywhere in the European Union or European Economic Area countries and/or Switzerland. In Finland, the theoretical employment pension is the amount that the pension applicant would receive if he or she had spent all of his or her EU employment pension periods in Finland. The theoretical amount of a national pension is the amount that an applicant would receive if he or she had resided all of his or her EU pension insurance periods in Finland.

⁶ There are some exceptions to the partial pension methods: there are two main types of schemes for disability and survivors' benefits. (Penning 2003, 179-180.) These exceptions are not relevant to this article and are thus not discussed.

security benefits to foreign countries especially to those who had not financed these benefits. (StVM 10/1993.)

Finland has several benefits that are universal, the purpose of which is to eliminate poverty. Social assistance is, however, not included in the material scope of the co-ordination regulation. The benefits that were difficult to adapt to the co-ordination system were child benefit, the national pension and the labour market subsidy for persons who do not qualify for unemployment allowance. Child benefit and the national pension were included in the material scope co-ordination. (Saari & Kari 2006, 148.)

The changes that were made to the national pension were necessary when Finland had to obtain *acquis communautaire*. Consequently, the Finnish national pension was formally adapted to the co-ordination of social security. The difficulties that arose later in the co-ordination of residence-based national pension are discussed in the following section.

Income-testing of the national pension – confusion and changes

Means-testing has been a principle in many social security systems, especially in social aid. In general, the term means-testing has been used to define all the benefits that are income controlled. Usually means-testing is used to define the applicant's income. Another term, namely needs-testing, is used to define not only the applicants' income but also their needs. (Julkunen 2001, 228-229.) Means-testing can be divided into two different categories: first, benefits that the authorities can decide if the benefit is granted for a person in need and second, the benefits that are only technically income-tested. Means-testing is often supported by the idea that the benefits are meant for those who need them the most. However, many studies have shown that for poverty reduction the universal benefits are more effective. (Arajärvi 2002, 255.) The needs-, means-tested, non-contributory and tax funded forms of social security increased in all EU countries throughout the 1980s and 1990s. According to Eurostat calculations 10% of European social security benefits are means-tested. (Ferrera 2005b, 25.)

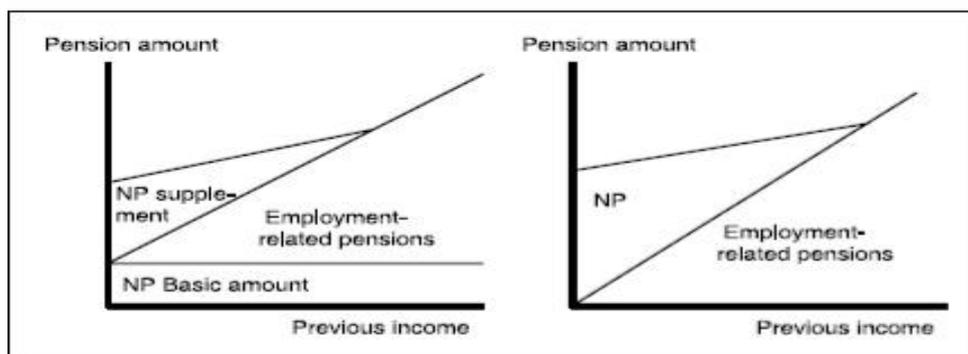
The national pension became an entirely income-tested benefit in 1996 when the government decided to make the basic amount of national pension subject to income-testing⁷ (Kangas, Hinrichs 2003, 582). However, the means-testing of national pension is income-testing and more precisely pension income-testing; only other pension incomes reduce the national pension. (National Pension Act § 22.) The income-testing of the national pension is a rather technical procedure. In Finland, the authorities of The Social Insurance Institution of Finland receive all other pension benefits automatically from different pension insurance companies.

Previously, only the supplemental amount of the national pension was income-tested and the basic amount of this pension was granted to all Finnish citizens. According to Kangas, changes in 1996 transformed the idea of residence-based pension from citizens' right to poor relief (Kangas 2001, 91). It has been discussed whether these changes in national pension were made because of the membership of the European Union. However, it seems that other reasons were behind this decision. First, the Finnish earnings-related pension system developed so that now people receive increasingly full earnings-related pensions. Second, the economic crises that hit the Finnish economy in the 1990s may have caused the change. (Arajärvi 2008). According to Hinrichs and Kangas, (2003, 582-583) the Finnish pension regime shifted from citizenship-based model towards an employment-based pension model. It can be said that the reform changed the Finnish pension system towards the European pension model (Julkunen 2001, 218).

⁷ Until the year 2000 the basic part of the national pension was also removed from all the pension receivers whose other pension incomes were above the income test limit.

Figure 1. (Hinrichs & Kangas 2003, 583)

Coordination of national pensions (NP) and other legislated pensions in Finland in 1990 and 2000



The income-testing of the national pension has been changed several times after Finland joined the European Economic Area in 1994. Most of these changes have been minor changes in the National Pension Act and the changes have affected only those who have pensions from several Member states. However, the minor reforms show that the income-testing of the national pension in European co-ordination has not been an easy task for the Finnish authorities. According to Hinrichs and Kangas, (2003) small changes can amount to system shifting, when their cumulative effect is counted.

The International Labour Organisation has categorised social security into three different categories. The pension system can be categorised accordingly. First, there are pensions that are paid according to legislation. Second, there are occupational pensions, which are often compulsory but not enacted in law. Third, there are voluntary pension insurances. However, the Finnish pension system has certain special characteristics and both the national residence-based pensions and the earnings-related pensions are regarded to be first pillar pensions. The co-ordination regulation includes only the benefits that are enacted in law. This means that neither occupational pensions nor voluntary pension insurances are included in the co-ordination of social security. (Kari & Pakaslahti 2003, 29; Kari & Laitinen-Kuikka & Markwort 2001.)

Table 1: The International Labour Organisations categorisation of pensions and the Finnish pension system

	First pillar	Second pillar	Third pillar
In General	Pensions paid according to legislation	Occupational pension	Voluntary insurance
The Finnish pension system	The earnings-related pension and the residence-based national pension	Occupational group pension insurances	Voluntary pension insurances

Article 46 A of the co-ordination regulation defines which benefits are regarded to be parallel.⁸ This definition is important because in pro-rata calculation of pensions similar benefits cannot reduce one another. The European Court of Justice has on several occasions defined this article. In cases *van Gestel*⁹ and *Valentini*¹⁰ the European Court of Justice clarified that the benefits are regarded to be similar, regardless of the characteristics of the national law, when the purpose and aim, grounds of calculation and grounds of granting the benefit are comparable. (Sakslin & Rentola & Klemola 1998, 217.) In practice this means that first pillar pensions that are granted from several Member states cannot reduce one another. For example, Swedish earnings-related pension cannot reduce Finnish earnings-related pension or vice versa. This principle also concerns residence-based pension benefits: Swedish earnings-related based pension or Swedish residence-based guaranteed- pension cannot reduce the Finnish national pension. This principle has been problematic because according to the National Pension

⁸ The co-ordination regulation includes in its material scope all the branches of social security mentioned in Article 4 of the regulation. The list of benefits includes sickness and maternity benefits, invalidity benefits, old-age benefits, survivor's benefits, accident of work and occupational diseases benefits, death grants, unemployment benefits and family benefits. Although it seems that the list is unproblematic, it is not always easy to determine which category a specific benefit belongs to. Social assistance is excluded from the material scope of the regulation. (Pennings 2003, 55.) For pension benefits this means that all first pillar pensions are included in the material scope of the regulation. This fact is important when regarding the income testing of national pensions after Finland joined the EEA.

⁹ Case 37/86 Johanna Van Gestel, née Coenen v Office national des pensions pour travailleurs salariés and Caisse nationale des pension de retraite et de survie [1987] 3589

¹⁰ Case 171/82 Biagio Valentini v ASSEDIC, Lyon [1983] 2157

Act Finnish earnings-related pension reduces the national pension. Consequently, the consolidation rules of the regulation put pensioners that resided in another Member state in a better position than those who had insurance periods only from Finland. (Solmu 3, 2003, 46.)

Before 1994, all foreign earnings-related pensions reduced the supplemental amount of national pension. When Finland joined the European Economic Area, the national pension legislation was changed so that foreign pensions *did not* reduce the supplemental amount of national pension. (Arajärvi 2008, 67.) It is likely that this decision was made because the pension pillar model was not sufficiently understood. According to the Government Proposal (HE 227/1992) the national pension was reduced enough when it came in proportion to the residence period. However, the Government's Proposal did not take into account anything other than the statutory first pillar pension, that is to say occupational pensions could have reduced the supplemental amount of national pension.

According to Arajärvi and Skinnari (1993, 105) the decision to change income-testing was trouble-free because it was possible for only a small group of posted workers and frontier workers to earn national pension and foreign earnings-related pension at the same time (Arajärvi & Skinnari 1993, 105). However, this argument did not take into account the fact that the national pension and the foreign earnings-related pension do not need to be earned at the same time. The rules of co-ordination also applied to those who had already moved to other Member states before the membership of the European Economic Area.

Income-testing of the national pension was changed in 1995, when accident and traffic accident pensions were included in the income-testing of national pension. (HE 206/1994.) Again in 1997, Finland changed the income-testing of the national pension so that all foreign pensions were accounted for in income-testing if the international agreements do not prevent the income-testing of these benefits. (HE 189/1996). In practice, at a European level this meant that all foreign *second pillar occupational pensions* were accounted for in the income-testing of the national pension. This decision did not remove the problem of consolidation of similar *first pillar* pensions: For

example, the Swedish statutory earnings-related pension did not reduce the Finnish national pension.

Income-testing legislation was changed several times in a short period of time in the 1990s. This demonstrates that the national pension was not easily adapted to the European co-ordination of social security. Other problems also arose and they are discussed in the following section.

Theoretical earnings-related pension in income-testing of the national pension

Some years after Finland joined the European Economic Area it was observed that a considerable number of national pensions were being paid to other Member states. The pensions paid to other Member states increased from 14.4 million euros in 1993 to 128.3 million euros in 1997. Sweden, that had more Nordic migrants than the other Nordic countries, did apply for *ex officio* re-calculation of national pensions. This meant that when the national pension was paid before it was from one and only country, after the re-calculation, the pension was paid from several Member states. (Niemelä & Ruhanen 2008, 177.) Consequently, the pension of over 30 000 Finnish citizens was re-calculated¹¹.

Because of the administrative burden and the complicated cases that Finland confronted because of this re-calculation, it took several years before all the pensions were granted. In 1997 and 1998 many pension decisions were made and those decisions included payments from several years. This is why statistics show that the pension payments to other Member states grew enormously. (Niemelä & Ruhanen 2008, 177.)

However, it was also observed that the national pension was often proportionally bigger for those who had lived in other Member states than for those who had lived in Finland the entire residence period. The first problem was that the insurance period of national pension started to run from the age of 16 whereas the Finnish earnings-related based

¹¹ Kela, Office for International Affairs, Director Maini Kihlman

pension started to run from the age of 23. Pension applicants often have a seven year residence period in Finland, which the earnings-related (first pillar) pension cannot reduce. (Solmu 3, 2004, 47.) Another problem is that, if the period of residence in another Member state is only 20% of the entire period (9 years), it does not reduce the national pension. For example, if a person lived in Sweden from the age of 16 until the age of 25 and then in Finland until he/she turned 65, the full national old age pension is granted. (Solmu 3, 2004, 46.) This observation led to new changes in the National Pension Act and also to a new interpretation of income-testing in the national pension.

At the beginning of 1997, the Social Insurance Institution of Finland decided to change the income-testing of the national pension and the interpretation of the article 46 of the regulation 1408/71. This change is not well documented and it was never submitted to a political discussion. Before 1997, the exact amount of Finnish earnings-related (first pillar) pension was accounted for in the income-testing of the national pension in pro rata pensions. In 1997, the Social Security institution of Finland decided to use the *theoretical amount* of Finnish earnings-related pension in the income-testing of pro rata national pensions. The Finnish theoretical earnings-related pension is counted as if a person would have worked in Finland all the periods he/she worked in all Member states. (Sakslin & Rentola & Klemola, 1998, 215.) The pension is only a theoretical amount and the pensioner has never received the amount. This means that the national pension is reduced by income that is not based on reality.

This change was justified with the fact that the national pensions paid to pensioners who lived in other Member states were proportionally bigger than pensions that were paid to those who had worked the entire period in Finland. As it was explained earlier the coordination regulation 1408/71 forbids the income-testing of first pillar pensions from other Member states. However, the Finnish earnings-related pension has always reduced the national pension. (See Solmu 3, 2003, 46 and Arajärvi & Skinnari 1990, 266.)

The following example illustrates this change of interpretation. In these cases the circumstantial factors are almost identical: the persons were born on the same day, have resided ten years in Finland before moving to Sweden and they apply for national old age pension when they turn 65 years old. The cases are fictional, but the migration history is common. In 1965 over 20 000 Finns moved to Sweden when the Swedish

industry needed a larger workforce. (Korkiasaari 2001.) The only difference in circumstantial factors is that the person number one worked in Finland *6 months* after he turned 23 years old.

Table 2. The effects on earnings-related theoretical pension in national pension income-testing

	Person number 1	Person number 2
Date of Birth	12 March 1939	12 March 1939
Turned 16 years old	12 March 1955	12 March 1955
Domiciled in Finland	12 March 1955 - 12 March 1965	12 March 1955 - 12 March 1965
Domiciled in Sweden	13 March 1965 - 11 March 2004	13 March 1965 - 11 March 2004
Worked in Finland	1 January 1963 - 30 June 1963	non
Worked in Sweden	13 March 1965 - 11 March 2004	13 March 1965 - 11 March 2004
Applies national old age pension	1 April 2004	1 April 2004
Earnings- related pension from Finland	12,5 €month	non
National pension	0 €	118,90 €month

The six months working period in Finland reduces the national pension to zero not because the factual earnings-related pension, but because the *theoretical amount* is accounted for in income-testing. (See the entire calculation in Annex 1.) However, the person that did not receive any national pension paid taxes and national pension payments during the period he worked in Finland.¹²

¹² It must be noticed that all pension incomes from all Member states are not known in these cases. The applicant does not have to inform the first pillar pensions from other Member states when the regulation 1408/71 prevents the income testing of these pensions.

It is logical that Finland wanted to reduce the national pension payments to other Member states. Article 46 of regulation 1408/71 prevents the income-testing of first pillar pensions from other Member states and the Finnish earnings related pension always reduces the national pension when an applicant has domiciled only in Finland. This fact made it easier for the applicants in other Member states to receive a pension than it was for those who had never used their right to free movement. However, this decision to use a theoretical pension in income-testing creates new inequalities: now between those who have used their right to free movement. The cases demonstrate that payment of national pension to other Member states is almost random.

One of the problems that arose from the decision to change the national pension's income-testing without changing the legislation lies in the adjustment of the national pension. If there is a reason to adjust a pension, the change in income-testing legislation always causes changes to pensions. The new rules apply after the adjustment. However, for those who received a pension between 1994 and 1996, the theoretical earnings-related pension was not accounted for in income-testing even after adjustments. That places those who applied for a national pension before 1997 in a better position than those who applied for a pension after 1997. This decision was also made without a proper documentation.

The aim of the national pension is to reduce poverty and raise income for those who do not have sufficient employment history. For the national pension receivers, who live in other Member states, it is impossible to say whether this requirement is fulfilled. Because the first pillar pensions from other Member states are not accounted for in income-testing, there might be many who *do not* actually need the Finnish national pension. However, there might also be those who have short employment history from Finland who would in fact need the national pension. Basically, if they have an employment history from Finland, the national pension is very small or they do not receive it at all. It is also contradictory that those who have paid taxes and earlier also national pension payments do not receive this benefit and those who never contributed to the system receive it.

According to the statistics of the Social Security Institution of Finland, in 2007 altogether 39 406 people living in other Member states received a national pension

proportional to their period of residence. Furthermore, the pro-rata calculated national pensions were altogether 55 068. Thus, 15 662 pro rata pensions were paid to those who had lived abroad but who now resided in Finland.¹³ (KELA Statistical yearbook 2007.) In 2006, pensioners in other Members States were ten times more than when Finland joined the European Economic Area (Niemi & Ruhanen 2008, 187).

According to the Finnish Centre for Pensions in 2007 there were 17 745 pensioners who lived in another Member state and received only Finnish statutory earnings-related pension. All of these pensioners had also applied national pension, but the pension had not been granted because of the income-testing. Many of these pensioners would have received national pension if their factual Finnish earnings-related pension would have been accounted for in income-testing, not the theoretical earnings-related pension.

This question of pension income-testing in European co-ordination is very complicated and the cases clearly show that the Finnish residence-based national pension misfits the current co-ordination regulation. The co-ordination regulation does not take into account that there are also pension benefits that are income-tested.

The decision to change the income-testing of the Finnish earnings-related pension has never been submitted to the European Court of Justice, even though it was a change in interpretation of regulation 1408/71. Furthermore, it puts the applicants in unequal position in regards to whether they worked in Finland before they moved to other Member states. The highest court in insurance affairs in Finland is the Insurance Court. This Court has not submitted this issue to the European Court of Justice for preliminary ruling even though many applicants have asked for the decision. As the change was made as an administrative procedure and not as a change in legislation, it was never submitted to larger political discussion.

¹³ In regulation 1408/71 there are specific rules when the Member states grants pensions according to its legislation only and when according to pro rata calculation. If a person's history does not fulfil the requirements on national law, the right for the pension comes only from the regulation. For example, if a person has resided in Finland only one year, but he or she has two years of insurance period from another Member state, the pension is granted according to the regulation. Furthermore, if a person has fulfilled both the requirements of national law and the regulation 1408/71, the pension is calculated in two different ways: According to national law and according to the regulation. The larger is always granted. (Sakslin & Rentola & Klemola 1998, 210-211.) In practice, if a person resides in another Member state, the national pension is always granted as a pro rata pension.

The adjustment of national pension and claim for recovery

According to the National Pension Act, the national pension must be adjusted if there are changes in other pension incomes or if there are changes in the pensioners' family circumstances. (22 § and 56 § National Pension Act). The adjustments are uncomplicated when it comes to pensioners who live in Finland: the correct information can be directly received from other authorities. For example, the Population Register Centre directly sends the information to the Social Insurance Institution of Finland if there are changes in family circumstances and the pension insurance companies send notification if there are changes in other pension payments. However, the situation becomes more complicated when a pensioner lives in another Member state. In this section these complications are explained and made concrete with an example.

One of the biggest problems arises with foreign occupational pensions. Occupational pensions are not included in co-ordination regulation 1408/71.¹⁴ In many Member states private occupational arrangements are increasingly popular way to support the retired. These arrangements can be either voluntary or statutory to all employees. (Kari & Pakaslahti 2003, 30; Haverland, 2007) Despite the fact that occupational pensions are safeguarded to the pensioner when they move to another country, there are still problems that arise when the occupational pension interact with statutory pensions, that is to say residence-based pensions.

As was discussed above, the Finnish national pension is pension income-tested: since 1997 all second pillar occupational pensions have reduced the national pension. In Finland, occupational pension arrangements have not become popular due to the generous first pillar earnings-related pension system. For example, the Swedish statutory earnings-related pension system has a ceiling and over 90% of the employees are covered by the statutory second pillar occupational pension system (Vidlund & Bach-Othman 2008, 136). In cross-border situations, the occupational pensions are often involved in pension income-testing. There are several difficulties when these

¹⁴ However, occupational pension rights are safeguarded with the directive 98/29/EC. The aim of this directive is to remove the obstacles of free movement and guarantee the supplementary pension rights to those who reside in several Member states during their career.

pensions are not co-ordinated within the same system. Most of these problems are purely practical, but they can make the pension system difficult to understand for the pensioners.

First, there is a problem of gathering information. The Social Insurance Institution of Finland has made connections to many occupational pension insurance companies in other Member states in order to receive information about applicants' pension benefits. However, because these occupational pension insurance companies have strict rules of privacy, the applicant must give his/her acceptance before this information is given to the Finnish authorities. If an applicant does not give permission to the authorities to sort out his/her pension benefits and does not give the right information him/herself, it is impossible for the authorities to receive correct information. If the information is given later, the pensioner faces claim for recovery.

The second problem lies in the adjusting of the national pension. According to the National Pension Act the national pension has to be adjusted if the income has changed or the family circumstances have changed. This means that all the changes in other pension benefits oblige the authorities to make adjustments. This can lead to absurd situations. For example, in 2005, the Swedish occupational pension insurance company AMF announced that because of a good year of investments, they raised the level of pensions.¹⁵ This led to a situation where almost 12 000 national pensions had to be adjusted. In some situations the pensioners' total incomes were smaller after the adjustment. In 2008 again 6000 pensioner with Finnish national pension received a raise to their AMF pension and again the national pension had to be adjusted.¹⁶ This has led to a situation where a small upgrade in one pension can lead to big reduction in national pension.

Problems can also arise when other Member states change the statutory first pillar pension system. For example, at the beginning of 2003, the Swedish pension system was renewed. Widowers' pensions were improved but become taxable. In reality, the pensioners' income did not change to a great extent. Nevertheless, the income-testing of

¹⁵ <http://hd.se/inrikes/2005/04/19/guldregn-oever-amf-pensionaerer/> Visited October 15, 2009

¹⁶ Kela, Office for International Affairs, Director Maini Kihlman

the national pension is made from gross-incomes. Consequently, almost six thousand national pensions were adjusted because of this change.¹⁷

These situations clearly show that the income-testing of national pensions can lead to high administrative burden. The changes can arrive suddenly and they are very difficult to predict. Furthermore, several changes in the income-testing of the Finnish national pension and the complexity of regulation 1408/71 have put the national pension receivers in other Member states in an unbearable situation where claim for recovery has become a general situation for pensioners.

Claim for recovery can be a very difficult procedure, because there is no direct way to receive payments if the pensioner does not have any social security benefits from Finland. Claim for recovery can be seen only as an administrative problem, but it also has an other side: a pensioner, with possible low income and a debt to the Finnish authorities. The amount of claim for recovery has also risen: In 2009 almost 2500 claim for recovery decisions were made with 680 000 euros of debt.¹⁸ This means that around 6 % of the national pension receivers in other Member states confronted a claim for recovery.

This example is chosen to explain the sometimes absurd situations that pensioners in other Member states face when the legislation has changed and when second pillar occupational pensions are not co-ordinated in the same European co-ordination system. (See entire calculation in Annex 2.)

¹⁷ Kela, Office for International Affairs, Director Maini Kihlman

¹⁸ Kela, Office for International Affairs, Director Maini Kihlman

Table 3. Example of possible claim for recovery when a pensioner lives in another Member state.

Date of Birth: 12 March 1931			
Date of retirement: 1 April 1996			
Domiciled in Finland: 12 March 1947- 12 March 1956= 108 months			
Domiciled in Sweden: 13 March 1956- 1 April 1995 = 468 months			
Worked in Finland: -			
Worked in Sweden: 460 months			
Earnings- related statutory pension from Sweden: not relevant			
Earnings-related occupational pension from Sweden: AMF pension. Not accounted for in income-testing in 1 April 1996			
In 1 August 2006 a pensioner becomes a widow.			
Date of granting / adjustment the pension	1 April 1996	1 April 2005	1 August 2006
The maximum National pension in II community group	Supplemental amount 1681 FIM Basic Amount 446 € Family status married	420,70 €+ 7 € of National pension elevation in March 1, 2005 family status married	489,85 € Family status, single
The marginal return	243,33 FIM	46,75€	47,25€
Accounted pensions in the income-testing	none	Occupational pension from AMF Sweden	Occupational pension from AMF Sweden and widower's pension
Reason for adjustment	-	AMF pension has raised the occupational pensions because of good investment result.	Changes in family relations
Finnish national pension in Euros after the adjustment	Basic amount 100,35 FIM + Supplemental Amount 378,23 FIM 478 FIM= 80,40 €	67,75 €	42,40 €
Claim for recovery	-	430,40 €	

The national pension was granted at a time when the occupational pensions from other Member states were not accounted for in income-testing. However, the applicant should have given notification that there was a change in his AMF pension in 1 April 2005 even though it was not accounted for before in the income-testing. Since he/she had not been informed this and the information was given later, the pensioner faced claim for recovery. The critical question is how the applicant can know in these kinds of situations that he should inform the authorities of incomes that were never accounted for in the first place. Consequently, the changes in the income-testing legislation can make the pension policy unpredictable in individual cases.

Conclusions

The aim of this article has been to analyze how the Finnish residence-based national pension system fits /misfits with the European co-ordination of social security. The conclusion is that European social security co-ordination does not take into consideration the special characteristics of the Finnish national pension system and the Finnish national pension misfits with the co-ordination legislation. Income-testing of the national pension is especially problematic since the co-ordination legislation prevents the income-testing of pension benefits from other Member states. This creates serious inequalities between pensioners who have domiciled in Finland and those who have moved to other Member states.

However, the decision that Finland made in 1997 to account for theoretical earnings-related pension in income-testing of pro rata national pensions is contradictory. First, it creates new inequalities, for those who have moved to other Member states depending on whether they have worked in Finland before they left the country. In fact, those who have *not* contributed to the Finnish system with taxes and social security payments receive a bigger national pension. Second, the decision was made as an administrative procedure and without open political discussion. It also lack open documentation of the administrative decision. This is problematic because the control of administrative power requires that decisions are well documented and openly discussed.

Furthermore, income-testing of the national pension creates many administrative problems and makes the pension system as a whole difficult to understand for pensioners. The national pension was renewed in 1956 at a time when labour moved freely only in the Nordic countries. At the time it fed well with the Nordic Social Security Agreement. However, with the more complex world of the European Economic Area, income-testing created major problems for pensioners and also for the administration. Claim for recovery, which should be an exceptional case, has become a systematic procedure in pensions paid to other Member states. The small pensions paid to other Member states also create high administrative costs.

When we analyse the issue through the theory of Europeanization, we can recognize that the misfit between the Finnish national pension and the European co-ordination regulation can be seen both as a legal and cultural misfit. On the one hand, the problem is rather technical, but the solving of this problem is rather difficult without changing the basis of the entire system. On the other hand, the problem is cultural: Finland did not want to adapt to the restrictions of co-ordination legislation and it has tried to solve the problem by changing the income-testing of earnings-related pension on its own. When the Finnish Insurance Court has not asked for an interpretation from the European Court of Justice, it is not possible to say whether the European Court would accept this current practice. Even if the rules of co-ordination were followed by the book, there is always one group that is in a worse position than others. Equality between pensioners is impossible to achieve because of this misfit.

Regulation 1408/71 will be renewed with regulation 883/2004. It seems that the new regulation will come into force in 2010 when the implementation regulation also comes into force. In the negotiations, Finland achieved its goal and the income-testing of the national pension will change again: now, the first pillar earnings-related pensions from other Member states will be accounted for in the income-testing of the national pension¹⁹. The problem of theoretical pension in income-testing has partly been solved. However, this raises new questions: what happens to the pensions that have already been falsely accounted with theoretical earnings-related pension in income-testing? Is

¹⁹ Sosiaali- ja terveysministeriö E-jatkokirjelmä STM 2006-00044 April 7, 2006
<http://217.71.145.20/TRIPviewer/show.asp?tunniste=U+9/1999+7.+STM+07.04.2006&base=euykirj&palvelin=www.eduskunta.fi&f=WORD> Visited January 4, 2010.

Finland going to re-calculate all the pensions that were rejected because of the theoretical earnings-related pension with the factual earning-related pensions from other Member states and adjust all the pensions that are currently paid with only partial incomes accounted for in the income-testing? This may mean the re-opening of close to 17 000 rejected applications and the adjustment of almost 40 000 pensions. Nevertheless, the renewed regulation with the new income-testing of the national pension shows that the theory of semi-sovereign welfare states (Leibfried & Pierson 1995) is not entirely accurate. It seems that the European Union has to take into account the special characteristics of Member states.

However, on the other hand, the theory seems to be right. At the beginning of 2009 the Finnish government submitted a proposal of new type of pension – guaranteed pension. This pension would not replace national pension but it would add to those who receive only national pension or national pension and a small earnings-related pension. The guaranteed pension would guarantee an income of 685 euros / month for those who receive a smaller pension than this.²⁰

The background to this pension proposal is clear. The national pension is not able to guarantee a minimum income to pensioners even though it is supposed to be a minimum pension. In the proposal, the new pension is aimed at those who live in Finland. The idea seems also to be to replace the special assistance for immigrants, which was created in 2003 to those immigrants who do not have right to full national pension and are because of this dependent on social assistance. One may deduce from this that the guaranteed pension will not be proportional to time of residence. Furthermore, only the other pension incomes would be accounted for in income-testing.²¹

It seems that the government wants to reduce the amount of pension receivers who live in other Member states. The national pension elevation would also lead to bigger

²⁰ Valtioneuvoston viestintäyksikkö. Takueläke käyttöön vuonna 2011. Tiedote 32/2009. January 30, 2009

<http://www.valtioneuvosto.fi/ajankohtaista/tiedotteet/tiedote/fi.jsp?oid=252591> Visited April 17, 2009

²¹ Sosiaaliturvan uudistamiskomitea (SATA) esitys sosiaaliturvan kokonaisuudistuksen keskeisistä linjauksista. P. 37.

<http://www.stm.fi/Resource.phx/vastt/sostu/sosiaaliturvauudistus/sataesitys.htx.i1119.pdf> Visited April 17, 2009

pensions in other Member states. By making the guaranteed pension a separate form of pension, payments to other Member states may be avoided. However, this approach may not be possible when the social security is coordinated at the European level.

If the government would not like the guaranteed pension to be co-coordinated, it basically has two different options. The guaranteed pension could be regarded as a social assistance, but it would then have to be strictly means-tested, more like social assistance to elderly people. Another option is to try to get the guaranteed pension into annex IIa of the regulation and claim that it is a special non-contributory benefit. However, it is not only up to the Member state if the benefit is regarded as being non-contributory. The Member state can distinguish the benefits and declare the benefit to annex IIa of the regulation, but the European Court of Justice can see the issue differently. The rules of co-ordination, especially the exportability rule, are rather strict.

At the time, when the Finnish government made a proposal to change the pension system with a new guaranteed pension it appears that the theory of Leibfried and Pierson (1995) becomes apparent and the Finnish welfare state has become semi-sovereign in its development. It seems that the guaranteed pension has been created so that benefits could be excluded from the co-ordination legislation. European co-ordination legislation does not directly harmonize the social security systems but it forces Member states to create systems that would better fit to the co-ordination. This phenomenon limits the options of the welfare states to create their own type of welfare systems.

If the guaranteed pension is created as a separate benefit because of this phenomenon, other options should also be considered. In 2009 the Finnish government decided to change the financing of the national pension: the national pension payments are to be removed from the employers and the national pension will be financed directly through taxes.²² According to the Final report of the working group on residence-based social security (Solmu 3, 2003, 47) the financing of the national pension has thus far made it impossible to place the national pension as a special non-contributory benefit. When the national pension becomes separate from the pension payments, the government should

²² Tiedote 397/2009. Sosiaali- ja terveystieteiden ministeriö 19 November 2009. <http://www.stm.fi/tiedotteet/tiedote/view/1439702> Visited January 6, 2010.

re-consider if the national pension could be placed as a special non-contributory benefit. Then, the new guaranteed pension could fuse together with the national pension and the equality problems would be resolved. Moreover, the need of the national pension for those who reside in other nations and all the administrative costs that are involved in the income-testing of the national pension should be closely analyzed. Open political discussion about the consequences of this decision would be needed.

In the end, one may say that when Finland joined the European Economic Area it had to entirely change the basis of the national pension. This has been a long process and it seems that the process of Europeanization is still on-going.

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Annex 1

The calculation of earnings-related pension, earnings-related theoretical pension and the national pension.

Case 1

Date of Birth: 12 March 1939

Turned 16 years old: 12 March 1955

Domiciled in Finland: 12 March 1955 - 12 March 1965

Worked in Finland: 1 January 1963 - 30 June 1963, which is 6 months

Domiciled in Sweden: 13 March 1965 - 11 March 2004, which is 468 months

Applies for old age pension: in 1 April 2004

Marital Status: single

Pension salary: 1600 €

Vested pension: 6 months / 800 x 1600€ = 12€/month

Calculation of earnings-related theoretical pension:

(The entire period of insurance / the Finnish period of insurance) x vested pension + accelerated accrual

$$= (474/6) \times 12 \text{ €} + 1\% \times 1600\text{€} \times 63\text{months} / 12 \times 100$$

$$= 948\text{€} + 84\text{€} = 1032\text{€}$$

The theoretical pension can only be 60% of the pension salary. The 60% of 1600€ is **960€/ month**

Earnings-related pro-rata pension is:

Finnish period of insurance / entire period of insurance x theoretical pension =

$$6 / 474 \times 960\text{€} = \mathbf{12,15 \text{ €}}$$

The pro rata pension is compared with the pension calculated after the national legislation and the bigger is paid to the pension recipient.

The national pension of case 1

The proportion coefficient according to the National Pension Act:

Finnish period of residence / Entire period

$$10 \text{ years} / 40 \text{ years} = 0,25$$

Pro rata coefficient:

Finnish period of residence / Entire period of insurance in EC countries =
 $10 / (10+39) = 10/49$

Because the entire period is over 40 years only 40years is accounted for

$$10 / 40 = 0,25$$

Pro rata calculation of the national pension:

The proportion coefficient x maximum national pension – Pro rata coefficient x
0,5 (other pensions- marginal return)

$$= 0,25 \times 475,73 - 0,25 \times 0,5 \times (960\text{€} - 46,58)$$
$$= 118,93\text{€} - 114,1775 = \mathbf{4,75 \text{€month}}$$

The lowest amount of pension paid in 2004 was 11,26 €

Case 2

Pro rata calculation of the national pension:

The proportion coefficient x maximum national pension – Pro rata coefficient x
0,5 (other pensions - marginal return)

$$= 0,25 \times 475,73 - 0,25 \times 0,5 (0-46,58)$$
$$= 118,93 - 0 = \mathbf{118,93\text{€month}}$$

Annex 2

Date of Birth: 12 March 1931

Date of retirement: 1 April 1996

Domiciled in Finland: 12 March 1947 - 12 March 1956= 108 months

Domiciled in Sweden: 13 March 1956 -1 April 1995 = 468 months

Worked in Finland: -

Worked in Sweden: 460 months

Earnings- related statutory pension from Sweden: not relevant

Earnings-related occupational pension from Sweden: AMF pension

In 1 August 2006 a pensioner becomes a widow. Because of the occupational pension form AMF the adjustment will also be made from 1 April 2005. This will lead to a larger claim for recovery.

Date of granting / adjustment the pension	1 April 1996	1 April 2005	1 April 2006
The maximum National pension in II community group	Supplemental amount 1681 FIM basic amount 446 FIM Family status: married	420,70€+ 7€ of National pension elevation in March 1,2005 Family status: married	489,85€ Family status: single
The marginal return	243,33 FIM	46,75€	47,25€
Accounted pensions in the income-testing	none	Occupational pension from AMF Sweden	Occupational pension from AMF Sweden and widower's pension
Reason for adjustment	-	AMF pension raised the occupational pensions because of good investment result.	Changes in family relations
Finnish national pension in Euros after the adjustment	100,350 +378,23 = 478 FIM = 80,40€	67,75€	42,40€
Claim for recovery	-	430,40€	

The proportion coefficient according to the National Pension Act:

Finnish period of residence / Entire period

$$9/40 = 0,225$$

Pro rata coefficient

$$9 / (9+39) = 9/48$$

Because the entire period is over 40 years only 40years is accounted for

$$9 / 40 = 0,225$$

Supplemental amount 1 April 1996

The proportion coefficient x maximum national pension supplemental²³ – Pro rata coefficient x 0,5 (other pensions- marginal return)

$$0,225 \times 1681 \text{ €} - 0,225 \times 0,5 (0 - 243,33 \text{ €}) = 378,225 \text{ FIM}$$

The basic amount of national pension 1 April 1996

The proportion coefficient x Maximum basic amount of national pension

$$0,225 \times 446 \text{ FIM} = 100,350$$

The entire national pension is: 100 FIM + 378 FIM = 478 FIM= 80,4 €

²³ Maximum national pension supplement in the II community group and with the family status married is 1681 FIM

Adjustment of the national pension in 1 April 2005 because of the changes in AMF pension:

Pro rata calculation the national pension:

The proportion coefficient x maximum national pension + 7€elevation – Pro rata coefficient x 0,5 x (other pensions - marginal return)

$$0,225 \times (420,70 \text{ €} + 7 \text{ €}) - 0,225 \times 0,5 (300\text{€} - 46,75) = 96,2325 - 28,49 = 67,75 \text{ €}$$

The national pension 1 August, 2006

The proportion coefficient x maximum national pension + 7€elevation – Pro-rata coefficient x 0,5 x (other pensions - marginal return)

$$0,225 \times 489,85 \text{ €} - 0,225 \times 0,5 (650 \text{ €} - 47,25) = 110,21625 - 67,8 = 42,40\text{€month}$$

Claim for recovery:

Pension paid to the pensioner from 1 April 2005

$$0,225 \times 420,70 = 94,6575 \text{ €}$$

The pension with the changed incomes should have been 67,75€

The pension was paid incorrectly for 16 months

$$16 \times (94,65 \text{ €} - 67,75\text{€}) = 16 \times 26,90 = \mathbf{430,40 \text{ €}}$$
 Claim for recovery