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Pension Systems in the EU:

Variable Patterns of Influence in Italy, the Netherlands and Belgium

Karen Anderson
Radboud University Nijmegen
k.anderson@fm.ru.nl

Michael Kaeding
kaeding@fsw.leidenuniv.nl
Leiden University

*****draft!*****

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ABSTRACT

The paper investigates how European welfare states respond to reform pressures arising from European integration. We examine the impact of two variables that mediate the impact of reform pressures caused by EU membership: the extent of public pension provision and the number of veto points in national political institutions. Our preliminary expectation is that, all else equal, member states with few veto points and a relatively small public pension sector are the most likely cases of policy change in response to Europeanization, whereas member states with a high number of veto points and extensive public pension commitments are the least likely candidates for policy change.

The impact of European integration on national models of governance is a rapidly evolving field of interest for scholars of European politics.[1] Scholars have shifted away from identifying the underlying dynamics of the European integration process to exploring the effects of EU membership on state-society relations, domestic policies and institutions. (Héritier et al, 2001; Cowles et al, 2001; Börzel, 2002; Featherstone and Radaelli, 2003). Much of this literature focuses on direct pressures for national adaptation (directives, regulations, EC law) and policy areas that are most subject to EU influence because of the high level of EU competence (i.e. environmental policy). This paper takes a different approach by analyzing both indirect and direct pressures for national adaptation in a policy area that is not very "Europeanized": social policy.

Our two cases of Europeanization are the impact of EC equality law on public pension arrangements and the impact of the EMU convergence criterion concerning budget deficits on public pension arrangements. The former is a case of strong, binding, direct pressure for adaptation, and the latter is a case of diffuse, indirect pressure for domestic adaptation. For both types of European pressure, we have chosen cases in which adpational pressure was significant, so that this variable is more or less held constant across cases. To explain variable patterns of adaptation across cases, we rely on two variables central to the literature on welfare state change: program structure and the number of veto points. We hypothesize that countries with low levels of public pension provision and few veto points are the most likely cases of substantial policy change in response to European pressures. Conversely, countries with many veto points and extensive public pension commitments are the least likely candidates for policy change, even when European pressures are strong.

The paper begins with a brief discussion of both the Europeanization and welfare state literatures. We then describe our explanatory model based on program structure and veto points. The next two sections test the model for Belgian and Dutch adaptation to the EC directive on equality in public pension schemes and Italian and Belgian adaptation to the Maastricht budget deficit target of 3% which involved significant pension reforms in both countries. We conclude with a discussion of the implications of our analysis for the Europeanization literature.

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[1] Note that, at the same time, the expanding field of comparative political economcy (Scharpf, 1997; Kitschelt et al, 1999; Schmidt, 2002) has examined the difficulties of European welfare states in the face of European economic integration and has generated the insight that different models of politico-economic governance respond differently to the common challenge of economic liberalization.

The Europeanization Literature

Europeanization is a 'highly contested concept' (Kassim et al. 2000: 235). Recent studies (Olsen, 2002; Featherstone and Radaelli, 2003; Buller and Gamble, 2004) identify a number of understandings: Europeanization as the development of institutions of governance at the European level (Cowles et al, 2001); Europeanization as the end goal of political unification in Europe; Europeanization as European form of organization and governance being exported outside Europe; Europeanization as a process in which domestic politics becomes increasingly subjected to European policy-making; and Europeanization as a 'smokescreen for domestic policy maneuvers' (Buller and Gamble, 2004). This study follows Cowles et al (2001) understanding of Europeanization as a 'process by which distinct structures of governance at the European level affect domestic structures and domestic politics'. Europeanization, here, highlights the role of European politics and institutions as an independent variable in domestic politics, and it refers to the processes by which domestic structures adapted to European integration.

Member states respond differently to European top-down pressures. [2] There is an ongoing discussion on the determinants of national adaptations to EU legislation and on the variation in national adjustment to and implementation of EU directives. Scholars have discussed the institutional 'fit', i.e. the compability of national and European policies and institutions, and found a strong causal relationship between the degree of match or mismatch and the domestic implementing performance (Börzel, 1999; 2002; Duina, 1997; Knill and Lenschow, 1998; 1999; Risse, Green and Cowles, 2001). Studies covering various policy areas have extensively tried to show that questions of fit of national institutions and policies could explain both the speed and quality of the domestic implementation of EU rules and the ways, means, problems and conflicts of national adjustment to European rules.

The goodness of fit hypothesis focuses on the degree of adaptational pressures on national structures and policies generated by the 'fit' between existing national and new European rules. A better fit exerts less pressure to change on domestic policies, structures or processes than a bad fit, which requires more changes to national legislation.. Thus, 'the extent and type of policy change which takes place in a

[2] Natali (2004) analyses the Italian pension reform process in Italy in the early 1990s and concludes that we need to apply a bottom-up perspective to access the Euorpeanization of Italian policy-making.

member state depends […] on the extent of legal adjustment that a country would have to achieve in order to close the gap between existing national policies and European integration' (Héritier, 1997: 539f.). The underlying assumption is that national resistance is often stimulated by poor policy fit between EU legislation and existing national structures: the greater the misfit between EU and national policies, the bigger the struggles will be to achieve correct and timely implementation. Conversely, when European rules demand only minor domestic policy modifications, thus not challenging traditional positions of institutional equilibria, it is unlikely that implementation will cause great problems.

The empirical results for the goodness of fit hypothesis, however, have been mixed (Mastenbroek and Kaeding, mimeo). By itself, the hypothesis does not adequately explain Europeanization results. In response, some scholars have proposed alternative explanations, such as institutional veto points (Haverland, 2000), or governments' party political preferences (Treib, 2003). Haverland's (2000) studies on the implementation of the Packaging Waste Directive indicates that it is national institutional veto points to European initiatives which determine the speed and quality of implementation irrespective of the policy fit between national and European legislation.

We agree with the central insight of this literature that European integration unleashes pressures for change that are mediated by domestic institutions and the domestic distribution of political resources. However, we want to go a step further by explicitly linking arguments about Europeanization to the broader literature in comparative politics and welfare state change. In our view, Europeanization is broadly similar to other pressures for change and can be analyzed as such (see Anderson 2002). In other words, national responses to adaptational pressure are likely to be the result of political bargaining among actors with unequal resources within defined institutional settings, just as most other domestic political issues are.

The Welfare State Literature

The mainstream institutional literature on comparative welfare state development emphasizes three variables for explaining policy change: the structure of political institutions; the balance of power among social groups; and the political effects of program structure. We will discuss each in turn.

<u>The structure of political institutions:</u> The central claim of arguments about the impact of institutions is that institutions provide the 'rules of the game' for political bargaining (Steinmo, Thelen, and Longstreth 1992; Hall 199x; Immergut 1992). Rather than classifying political systems as parliamentary or presidential, much current research attempts to view political systems in terms of 'veto points' (Immergut) or 'veto players' (Tsebelis). The key argument here is that national political institutions provide the context for political bargaining and policy-making. Political institutions do not determine outcomes; rather they shape the way the political game is played. This includes the manner of interest group access to the political process and how political actors define their interests. Policymaking requires that proposed legislation pass through several stages during which various political groups can try to block the proposed legislation or demand changes in content. The more veto points in the legislative process, the more likely legislation is to fail or be diluted because more political actors (interest groups; political parties; intra-party factions; the public in the case of referendum, etc.) have access to the decision-making process (Immergut 1992).

A central element of institutionalist analysis is <u>the distribution of political power.</u> Political institutions magnify and/or refract the strength of different political groupings. And political institutions provide different kinds of opportunities for influencing policy. As noted, institutions do not predict outcomes; rather, they channel political struggles in particular directions.

<u>Program Structure and Policy Feedback Effects</u>. The central insight of the 'new politics of the welfare state' literature is that the structure of existing welfare state programs influences the preferences and resources of political actors. Paul Pierson (1994) argues that the politics of retrenchment is very different from the dynamics of welfare state expansion. Whereas expansion policies are generally popular, retrenchment initiatives usually provoke public opposition. Thus retrenchment is politically difficult, largely because of the mobilizing potential of interest groups and policy advocates that previous policies helped to create. The central claim of Pierson's new politics thesis is that retrenchment is a "distinctive and difficult enterprise" that is likely to involve political dynamics fundamentally different from those associated with welfare state expansion. Thus retrenchment involves a politics of "blame avoidance" rather than the "credit claiming" that characterizes the extension of welfare state policies. The upshot of the argument is that retrenchment is

successful only when politicians are able to devise strategies that minimize popular opposition to proposed policy changes. Thus the new politics thesis portrays retrenchment as a politically risky process (Pierson, 1994, pp. 1-2).

How does this basic insight apply to pensions? As Myles and Pierson (2001) argue, pensions are a classic case of path dependent change. Because pensions usually entail long-term, costly benefit commitments to large groups of voters, the structure of existing policies seriously constrains the prospects for reform. Moreover, the groups with a large stake in existing policies have an important impact on reform, not least because of the enormous political risks involved in scaling back and/or re-organizing pension arrangements (Pierson 1994; Weaver and Pierson 1993).

What does all of this tell us about the domestic variables that mediate adaptational pressures emanating from Europeanization? First, we know that political systems characterized by multiple veto points, or to use Tsebelis' terminology, political systems that empower multiple veto players, tend to reinforce the policy status quo. In other words, the more veto points there are, the more stable policy is. Table one provides a ranking of West European political systems that roughly follows the arguments laid out by Immergut and Tsebelis. Here, potential veto points are political parties (if there are multiparty coalitions); interest groups; second chambers of parliament; and subnational government units. While not a perfect measure of veto points, Colomer's 'institutional pluralism' rankings roughly approximate what we are emphasizing: the number of blocking opportunities provided by the political system and interest group structure. We use Colomer's pluralism index as a rough equivalent of 'veto opportunities." The higher the value on this index, the higher the number of veto opportunities. This means Germany ranks highest in terms of veto points, and the UK and Greece rank lowest. German institutions thus favor the status quo, while British and Greek institutions provide more opportunities for changing the policy status quo.

Table 1: Institutional pluralism in the Union's member states

	Party system	*Bicameralism*	*President elected*	*Decentralization*	*Colomer index*	*One-party cabinets (%)*	*Veto players (Tsebelis) 1980s*	*Veto players (Tsebelis) 1990s*	
Germany	0	2	0	2	4	1.7	3	2	Germany
Spain	0	1	0	2	3	100.0	1	1	Spain
Finland	2	0	1	0	3	10.9	4	4	Finland
Austria	1	1	1	1	3	33.8	2	2	Austria
Belgium	2	1	0	0	3	8.3	4	4	Belgium
Denmark	2	0	0	0	2	42.9	1	2	Denmark
Italy	0	1	0	1	2	10.3	4-5	5	Italy
France	1	1	1	0	2	53.1	2	2	France
Netherlands	1	1	0	0	2	0.0	4	2-3	Netherlands
Portugal	1	0	1	0	1	43.0	2	1	Portugal
Sweden	1	0	0	0	1	70.4	1	1	Sweden
Ireland	0	1	1	0	1	53.9	1	2	Ireland
United Kingdom	0	1	0	0	1	100.0	1	1	United Kingdom
Greece	0	0	0	0	0	96.4			Greece

Source: Colomer (1996: 13); *party system*: measured by the effective number of parties; *bicameralism:* two points to symmetrical bicameralism; one point to semi-presidentialism; no points to parliamentarism; *president elected*: one point to semi-presidentialism; no points to parliamentarism; *decentralization*: measured by the proportion of public expenditure in the hand of regional governments (*R*): two points to *R*>20%; one point to 20%≥*R*≥10%; no points to *R*<10%. Lijpart (1999: 110) *one-party cabinets (%):* propotions of time during which one-party cabinets were in power. Tsebelis (UCLA website) veto players.

Turning to our program structure variable, we know that two characteristics of pension schemes are important for understanding the dynamics of policy change. First, the maturity of pension schemes is crucial. Myles and Pierson (2001) argue that the maturity of a public pension system is a critical variable influencing reform outcomes; the longer a country has had a pay-as-you-go (PAYG) pension system in place, the more difficult it is to reduce or privatize public pension commitments. Large, PAYG public pension schemes that cover all or most of the workforce generate commitments over many decades that are similar to property rights. In order for cutbacks or privatization to be possible, current workers would have to pay twice: once for current pensioners in the public scheme and a second time for their own private pensions. Because the political costs of such a strategy are exceedingly high, major cutbacks or full-scale privatization of public PAYG pensions is nearly impossible.

For countries with mature, PAYG public pension schemes (Germany, Sweden, France, Italy, the Netherlands), past policies are highly constraining; policymakers and affected social interests make their policy choices in a context in which large scale cutbacks and/or privatization is nearly impossible. The main options available are "parametric" reforms that introduce changes within the existing public pension structure. For example, benefit formulae can be made less generous, contributions can be raised, partial privatization can be introduced to supplement public benefits etc.

A second group of countries did not legislate earnings-related, PAYG public pensions during the decades immediately following World War II. This cluster includes Denmark, the Netherlands, Switzerland and the Southern European welfare states. Here there is usually a basic form of public provision, and earnings-related benefits are organized collectively, usually as occupational pensions negotiated as part of collective wage agreements (Myles and Pierson 2001). Although earnings-related pensions are organized by the market and not the state, the role of the state is still crucial in terms of regulation. For example, the Dutch regulatory framework establishes rules for investment and capital coverage, and the Ministry of Social Affairs can extend mandatory pension provision to entire sectors and branches in the economy. The result is a coverage level of about 92% (SER 2001). However, the provisions of specific pension schemes (premiums; benefit formula, indexing etc) are

left to corporatist pension fund boards. In Switzerland, regulation appears even tougher; state regulation mandates a minimum rate of return, for example (Bonoli 2003).

The second aspect of program structure is closely related to the first: the size of the public pension schemes relative to private schemes, as well as their maturity. Basically, the argument here is that where mature public pension schemes dominate retirement provision, voters (both current workers and current pensioners) have a large stake in the status quo because public pensions are or will be the main source of their retirement income. This means that the stickiness of the status quo should be stronger in countries like Germany, Sweden, Italy, and Belgium, which all have comprehensive, mature, public pension schemes and relatively small or even insignificant private/occupational pension schemes. In contrast, countries like the Netherlands, Denmark and the UK have large private/occupational pension sectors (see table 2). These countries also have significant basic public pensions (less true for the UK), but about half to one third of retirement income comes from occupational pensions, so the status quo should less sticky because pensioners have other sources of income besides the public pensions.

Table 2: public/private mix in pensions

	share of public pensions in retirement income %* 1998
Italy	48.5**
Germany	81.9
Sweden	71.1
France	68.3
Belgium	data not available
Netherlands	63.3
United Kingdom	60.8

*source is Axel Börsch-Supan and Anette Reil-Held, Retirement Income: Level, Risk and Subsitution among Income Components. OECD Working Paper AWP 3.7. table 2.
**Amazingly enough, many Italians past retirement age still work; income from earnings accounts for 27.2% of income in retirement, and asset income is 24.3%. Few have private pensions.

Table 3 summarizes the basic argument: member states with few veto points and relatively small public pension sectors (defined in terms of maturity and size relative to private and occupational pensions) are expected to be the most likely cases of policy change in the face of adaptational pressures from Europe. Countries with a high number of veto points and large public pension sectors are expected to be the least likely candidates for policy change. Countries with either many veto points and a small public pension sector OR few veto points and a large public pension system are expected to fall between these two extremes.

Table 3: a crude model of factors influencing the likelihood of policy change

		Veto points	
		low	**high**
Extent of public provision	**low**	***substantial change*** Netherlands United Kingdom	Portugal ←Spain**
	high	Sweden	***little change*** Germany Belgium ←Italy*

*Italy is difficult to classify because veto points are not as numerous as in Germany and Belgium.
**Spain is also difficult to classify for the same reason; Spanish public pensions are not extensive in absolute terms, but relative to private and occupational pensions they are.

Adaptation to European Pressures for Change

A) Belgium, the Netherlands, and the implementation of EC Directive 79/7/EEC

In 1978, the Council adopted a directive requiring the member states to remove all provisions in statutory social security schemes that violated the principle of equal treatment between men and women. The directive prohibited member states from discriminating in terms of access, the calculation and payment of contributions, and the calculation of benefits. The directive created substantial adaptational pressure for member states with ‘breadwinner’ based social security schemes that excluded married women (because a breadwinner benefit was available only to the husband) or unmarried women (because the assumption was that they would get married at some later point and benefit from their husbands’ benefits). The deadline for transposition was December 19, 1985.

Here we look at two cases in which adaptational pressure was high because public pensions were organized on the breadwinner principle (Netherlands) or because pension rules were different for men and women (Belgium). We assume that adaptational pressure is held constant, so the main difference between the two cases is that the Netherlands is a case of ‘likely change’ because of few veto points/small public pension sector and Belgium is expected to be a case of ‘limited change’ because of multiple veto points and an extensive public pension scheme.

Belgium[3]

The Belgian political systems is full of veto points because of federalism, a strong linguistic cleavage, and a multiparty system. Public pension provision dominates; the occupational pension system is relatively underdeveloped and only the affluent have access to private pensions. This means that organized interests with a stake in the status quo have strong preferences, and the political decision-making system offers many opportunities for blocking legislation.

Belgium was slow to implement the changes that Directive 79/7 EEC seemed to require. Even after the 1985 transposition deadline had passed, Belgium still had legislation in place that included different benefit formulae for men and women, and different retirement ages.[4] For example, there were different contribution bases (40 for women, 45 for men) for men and women, and different retirement ages. It was only a matter of time before the European Commission sued Belgium in the ECJ concerning these provisions.

Belgium failed to tranpose on time, and the ECJ found Belgium in violation of EC law in 1986. The Christian Democratic/Liberal government responded by trying to harmonize retirement ages for men and women as part of its "St. Anna Plan," a package of budget consolidation measures. Discussion focused on whether to increase womens' retirement age to 65 or lower men's to 60. Unions fiercely opposed a higher retirement age, and when the government consulted the social partners through the NAR (institutionalized bipartite council for negotiation which needs to be consulted on social reforms), the NAR (including the employers) unanimously rejected raising the retirement age. The NAR argued that because of the high benefit dependency among employees older than 50, the postponed retirement age (65 instead of 60) would lead to deficits in other social benefit schemes, which were more expensive than the pension scheme.

The socialist trade union FGTB/ABVV organized massive protest actions as soon as the S[t]. Anna plan became public (23 May 1986). The Christian trade union ACV/CSC called the plan 'unacceptable' and insisted that the government reconsider it and start negotiations with the social partners. When the government proposed minor adjustments to the S[t]. Anna plan in June, the unions were not satisfied. Another round of negotiation led to more adjustments (such as postponing the decision on

[3] This section draws extensively on Anderson et al. (2007)
[4] We still need information on whether Belgium did anything by 1985 to transpose the directive.

statutory retirement age) but there was still no consensus. The unions abandoned their strikes in the summer, and on 16 July 1986 the government enacted the S[t]. Anna Plan in a series of Royal Decrees (see *B.S.* July 30, 1986). The question of the equalization of retirement ages was not solved, however, and it would remain on the decision agenda for the next ten years.

The issue lay dormant until 1990, when the introduction of unisex rules for a flexible retirement age in 1990 was intended to head off another challenge by the European Court of Justice (ECJ) to Belgian pension law. In 1990, the government introduced flexible retirement age that meant that the retirement age for men and women was de facto equal. However, the benefit formula was still different for men and women (40 years of contributions for women and 45 years for men). This was considered discriminatory. Belgium wanted to keep the lower number of contribution years for women, but financial concerns meant that Belgium could not afford to apply this rule to men. The Minister of Pensions insisted publicly that the 1990 legislation solved the problem, but there was much speculation in the press that Belgian pension law still violated the directive. In July 1993 the European Court ruled that Belgian pension rules did not comply with the principle of equal treatment in social security and instructed Belgium to change its law and practice (*Le Soi*r, January 6, 1995).

The law of June 19, 1996 '*tot interpretatie van de wet van 20 juli 1990*" introduced a temporary solution to the equal treatment issue in anticipation of a more permanent reform. This issue was part of the discussion of pension reform at the Hertoginnedal-convention concerning the budget in 1997. The government agreed to gradually raise women's retirement age to 65 starting in 1997 so that by 2009 the retirement age is 65. Every three years it goes up by one year. In order to minimize negative effects, the rules for the minimum pension were relaxed somewhat.

To summarize, Belgian adaption to Directive 77/7/EEC was extremely slow, incorrect, and incomplete. Only after the ECJ found Belgium in violation of EC law twice, was the government able to introduce the necessary changes. It seems obvious that the multiple veto points in the Belgian political system provided opportunities for opponents to block policy change. And given the importance of the public pension in the retirement packages of most Belgian women, there was massive opposition. Unions promoted the cause of women and prevented two governments from making their planned changes.

Netherlands

Dutch political decision-making institutions are relatively centralized but the multiparty system produces multiparty cabinets. However, the Netherlands scores high on the Colomer scale, so we classify it as having few veto points. The Dutch public pension system only provides a flat-rate (but relatively generous) benefit, and mandated occupational pensions provide the rest of retirement income. The public pension (AOW) provides about half of retirement income and occupational pensions and private pensions provide the rest. The low number of veto points and the relatively small size of the public pension sector make the Netherlands a case of 'likely" policy change.

The structure of the Dutch public pension scheme, like the Belgian, conflicted with the provisions of Directive 79/7/EEC. Since its establishment in 1957, the AOW was based on the breadwinner principle. Married women did not receive their own, individual benefit; instead, the husband received a benefit intended for both spouses. Unmarried women (and men) over 65 did receive an individual benefit. Similarly, the structure of AOW financing was based on the single breadwinner principle; only the main breadwinner paid contributions, even if the spouse was employed. These provisions directly conflicted with European law concerning equal treatment, and the requirements of EU equality law have had a substantial impact on the AOW. Starting in 1979, all Dutch social security schemes were adjusted to the EC equal treatment directive. For the AOW system, this required the modification of existing rules excluding married women from eligibility.

Before the EU directive, there was little political pressure to modify the AOW system in order to provide married women with individual benefits. Because the AOW system provided married men a benefit that "included" a benefit for the wife, the system was not perceived by most to be unfair. However, when the EU issued its directive, Dutch policymakers changed the existing rules without protest, but the process took five years, and the government nearly missed the transposition deadline. Unlike other parts of the social insurance system that violated EU equality law (like unemployment insurance), modifications to the AOW system to conform to EU rules did not require additional AOW pension spending and did not result in *direct* benefit cuts. However, some pensioners experienced a decline in income because of the indirect effects of the changes. The basic solution that the Lubbers I government (Christian Democrats, CDA and Liberals, VVD) settled on was to simply divide the AOW benefit for two spouses in half and pay an individual benefit to both the

husband and the wife. For married couples over the age of 65, there was no financial change in the level of benefits, and the state was not required to spend additional money on pension benefits. However, the issue of how to treat couples in which one spouse received an AOW benefit and the other was younger than 65 raised several difficulties (see below).

The EC gave member states until December 17, 1984 to comply with the directive. In July 1981, the State Secretary for Social Affairs and Employment asked the Social Economic Council (SER) for an advisory opinion on how to legislate changes in the AOW to conform to European law. The cabinet had already expressed its preference for a new AOW benefit structure that gave single pensioners 70% of the current benefit for married pensioners and that divided the current benefit level in two for married pensioners. For married pensioners whose spouse was younger than 65, a supplement would be awarded. In its advice, the SER largely agreed with the cabinet and emphasized that legislative changes must not increase expenditures. The function of AOW as a universal basic pension providing a minimum income in old age should be retained (SER 1984).

The cabinet introduced its draft legislation in late 1984.[5] There was substantial agreement on the main provisions of the legislation (dividing the AOW benefit in two for couples, etc) but the issue of AOW pensioners with a spouse younger than 65 led to difficult negotiations in parliament. Under the old rules, an AOW pensioner received a full couple's pension even if the spouse was younger than 65. In order to prevent income losses for this group, the legislation included rules allowing a supplement for the spouse younger than 65. The difficult issue was how to treat spouses younger than 65 who also had earned income. If the younger spouse was not the breadwinner then she paid no AOW premiums and her husband received the full AOW couple's pension. The original bill provided a 50% supplement for AOW pensioners supporting a spouse younger than 65. This supplement was to be made dependent on the income of the younger spouse. After opposition, the income test was suspended for three years (Financieele Dagblad, 19 January 1985).

In particular, the VVD (one of the government parties) opposed income testing of the supplement. The VVD proposed instead to simply award the full AOW pension (equal to the amount for a couple) to those with younger spouses, regardless

[5] Legislation is Tweede Kamer 1984-85, 18515.

of the spouse's income. The VVD charged that the income test would lead to unwanted bureaucracy, and complained that income testing violated the insurance principle. The PvdA also had some reservations about the bill because it discouraged employment for the younger spouse. As a short term solution the PvdA proposed a longer transition period (five years) during which AOW pensioners with spouses under 65 would receive the full couple's benefit (Financieele Dagblad, 31 January 1985).

In February, the CDA and PvdA cooperated on an amendment to the bill to deal with these issues, mainly by increasing the amount of income (of the younger spouse) not subject to the income test (Financieele Dagblad, 1 February 1985). The VVD responded with an amendment to exempt AOW spouses younger than 57 from the income test, but this attempt failed because of lack of support). On March 1 the Second Chamber adopted the CDA-PvdA version of the bill (Financieele Dagblad, March 2, 1985).[6]

The First Chamber nearly derailed the compromise that emerged from the Second Chamber. By now, minorities in both the CDA and PvdA fractions in the First Chamber opposed the legislation because of the negative financial effects for AOW households with a spouse younger than 65 (*Financieele Dagblad*, 21 March 1985). The First Chamber finally approved the legislation. (check facts here).

To summarize, Dutch transposition of 79/7/EEC was slow, and the potential negative consequences for some households nearly prevented a compromise solution. Broadly speaking, the relatively low number of veto points in the Dutch system facilitated adaptation; interest groups did not take to the streets to protest potential losses for some households, as in Belgium. Consistent with our expectations about the effects of program structure, politicians appeared unwilling to risk punishment by voters; indeed, politicians tried to find a solution that would have few if any negative financial consequences for voters. However, this expectation applies to both pension systems dominated by public provision and systems (like the Dutch) in which public provision provides roughly half of retirement income. So it is not clear how much the 'program structure' variable explains here.

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[6] The final version awarded the full couple's AOW pension to the pensioner over 65 with a spouse under 65 without her own income. If the younger spouse had her own income, the supplement for the spouse was proportionally reduced.

B): Budget deficit (extent of EU constraint):

Our second case of European pressure for reform is EMU. In terms of fiscal discipline, the Maastricht convergence criteria create a powerful constraint on national policy choices (Moses 1996; Kurzer 1993) . Market actors use the convergence criteria as a critical information shortcut when they make their investment decisions because governments themselves use them to guide policy. And it is not only EU members that intended to participate in the first stage of EMU in 1999 which rely on the criteria; non-participating states also use the convergence criteria as a benchmark against which to make their own policies.[7] To the extent that pension schemes are perceived to contribute to unacceptable budget deficits, there may be pressures for pension reform in order to cut costs and restore budget balance.

The goal of the Stability and Growth Pact adopted at the Amsterdam European Council in June 1997 is to prevent the occurrence of an excessive budgetary deficit in the euro area after the entry into force of the third stage of economic and monetary union. Implementation of the stability and growth pact rests primarily on two pillars: the principle of multilateral surveillance of budgetary positions and the excessive deficit procedure, defining a budgetary policy to be conducted after the changeover.

This type of European pressure for reform differs from the binding constraints of EC law. In the run-up to EMU, the member states had to meet the Maastricht convergence criteria in order to 'qualify' for participation in the Eurozone, and the 3% budget deficit limit was a key constraint. However, member states were free to take whatever measures they deemed necessary to achieve the target; they could choose any combination of spending cuts and tax increases, as long as the target was met. Our expectation here is that in the member states facing substantial pressure to cut deficits, pension reform should have been a natural target because pension spending is typically the most expensive program in public budgets.

We focus on two countries that faced substantial pressure to reduce their deficits in the run-up to EMU: Belgium, and Italy. Both countries had deficits between 5 and 10% of GDP so they had a long way to go before they met the 3% target. Both countries adopted ambitious plans to reduce public spending, and surprising, pension reform was a key goal in all three countries.

[7] Sweden is a good example here.

Italy[8]:

We classify the Italian political system as a case of moderately low veto points. Like the Netherlands, Italy has a score of 2 on the Colomer institutional pluralism index.

As we noted earlier, public pension provision dominates retirement income, although many over the age of 65 continue to work. An important feature of the pension system was that the weaknesses of the pension system were widely acknowledged, and there were many calls for reform in the 1980s, but the instability and short-term perspective of Italian politics made reform elusive. Of the three cases analysed here, Italy spends the highest proportion of GDP on pensions, and thus pensions have figured prominently in debates about how to restore pubic finances (Franco 2000). In 1960, pension spending was 5% of GDP, and grew to 14.9% of GDP in 1990. By 1999, Italy was spending 15.7% of GDP on pensions. (Franco 2000). This high level of spending, combined with low fertility and already high levels of public debt made for doomsday predictions about the future sustainability of the pension system. Pension reform was therefore the centrepiece of reforms to improve public finances. Pension costs endangered the capacity of Italy to meet the EMU public deficit requirement (table 4).

In the 1990s, pension reform reached the top of the political agenda, for several reasons. First, the weaknesses of the pension system were well-known and there was widespread doubt that the pension system could meet its future obligations without massive increases in contributions. Demographic trends were predicted to increase spending from 14 percent of GDP in the early 1990s to 23 percent of GDP in 2040 (Ferrera and Gualimini 2001: 205). Second, the collapse of the party system in the wake of political scandals created a window of opportunity for reform. Finally, the deadlines for achieving the EMU convergence criteria created considerable pressure on the Italian authorities to reduce the budget deficit, and this would require substantial cuts in public spending.

The years 1992-1997 were a period of major pension reform. Reforms had three broad aims: cost containment, removing perverse program aspects, and reducing fraud and inefficiency. In 1992, the Amato government adopted the first major

[8] This section draws heavily on Anderson 2002.

pension reform in decades[9]. The reform was aimed mostly at reducing pension expenditure. The reform increased the retirement age for men and women in the private sector by five years (to 60 for women and 65 for men), tightened rules for seniority pensions, increased the minimum contribution period from 15 to 20 years, introduced a more restrictive benefit formula (from five to ten years for the income reference period; for those with less than 15 years of contributions, the reference period was changed to lifetime earnings), introduced a shift from wage indexing to price indexing, and increased contributions. Most of these changes were phased in over several years. In addition, large temporary cuts were made by suspending the uprating of pensions and suspending new seniority pensions. The combined effect of all of these measures was the cancellation of at least one fourth of net pension liabilities. According to one estimate, accumulated pension liabilities decreased from 389% of GDP to 278% of GDP. The reform also included provisions for the gradual harmonisation of public and private sector pensions, but it did not solve the problem of seniority pensions. These reforms were explicitly motivated by the desire to reduce budget deficits in order to meet the EMU convergence criteria.

Union protests prevented the Berlusconi government from adopting more changes in 1995. After the Dini government replaced the Berlusconi government, another major package of reforms was adopted, which Ferrara and Gualmini (2000) call "revolutionary." The 1995 reform had more ambitious goals than mere cost containment. One goal was to stabilise pension spending as a proportion of GDP, remove labour market disincentives, and to reduce inequity. This included the switch from defined benefits to defined contributions (to take effect from 2013), the introduction of a flexible retirement age, standardization of public and private sector pension regulations, the gradual abolition of seniority pensions, and other changes aimed at controlling costs.

Most analyses argue that the 1992-1995 reforms were substantially influenced by the EMU process. Sbragia (2001) argues that "the misfit between Italian public finances and the Maastricht requirements was widely considered the most significant in the European Union." (80) Indeed, it was widely feared that Italy would not qualify for the first round of EMU. Because of the very high mass and elite support for Italian EMU participation, the adaptational pressures from EMU were "extraordinary."

[9] This section is based on Ferrera and Gualmini (2000) and Franco (2000).

(Sbragia 2001). Other analysts confirm this argument. As Ferrera and Gualmini (2000) put it, "The deadlines fixed at Maastricht in February 1992 forced Italy to make an immediate and radical effort to reform and correct its public finances in order to halt the growth of public debt." (204). It is worth noting that successful reform depended on compromise with the social partners, and reform-minded governments had to modify several aspects of their plans in order to gain the approval of the unions and employers. Moreover, the failure of the Berlusconi reforms demonstrate that the pressures generated by EMU were not in themselves sufficient to bring about reform.

Table 4: Italy: Public Deficit (as %GDP)

year	public deficit as %GDP
1993	-9.4
1994	-9.1
1995	-7.6
1996	-7.1
1997	-2.7
1998	-2.8
1999	-1.8
2000	-0.3

source: OECD Economic Outlook.

How did domestic actors and institutions influence these particular responses to EU pressures for financially sustainable pensions? The Italian reforms are substantial, even radical, attempts to cut costs, increase work incentives, and remove inequitable features of the pension system. Italy is the clearest case of EMU pressure on pension policy, but pension reform was not a foregone conclusion. Italian politicians faced the daunting task of legislating reform in a parliamentary setting known for its instability and incapacity to deliver major reform.

The success of reform hinged on two political factors. First, EMU pressure helped change interests, both among the governing elite and for the social partners. The unions in particular were crucial players in the reform process, because their consent was essential for success. The desirability and potential benefits of Italian EMU participation (among other things) persuaded union leaders to accept reform, and internal union procedures helped persuade rank and file to accept reform (Baccaro 2000). Second, the collapse of party system created an opening for reform-minded politicians to overcome traditional parliamentary obstacles. Italian governments

negotiated directly with the social partners and convinced the unions of the costs of non-adjustment. A growing debt burden would threaten not only EMU entry but also divert more and more resources from social insurance spending. Politicians convinced unions of the long-term advantages of sound finances, and the unions accepted pension cuts in order to reduce debt payments by the state. In sum, persuasion, supported by EMU, helped transform unions' narrow interests into encompassing interests. In addition, a more or less open and negotiated policy making style facilitated compromise and enabled political actors to overcome the electoral risks of pension reform.

Belgium

The link between pension reform in Belgium and the goal of qualifying for EMU is less well-known than the Italian case, but the Belgian case is strikingly similar to the Italian one. In both cases, qualifying for EMU was defined as a national project requiring extraordinary policymaking. To borrow from Kingdon (2003), EMU created a huge window for reform.

Qualifying for EMU dominated Belgian politics in the mid-1990s. The Dehaene I government (Christian Democrats and Socialists) scheduled early elections on May 21, 1995 “in the hope of strengthening political resolve for austere economic and monetary policies” (Downs 1996: 169). It was the first election after the constitutional reform. New laws such as those on the reduced assembly size of parliament, three new regional parliaments, and separate competences between federal and subnational levels of government had come into force in the past period.

When the Dehaene II cabinet took office it promised to announce the main features of a social security reform by the end of 1995 and to make these plans more concrete in the first half of 1996. In addition, the cabinet wanted to pass a new law on competitiveness based on the advice of the social partners. Unrest in the public sector, especially a strike at the railways, slowed the plan down (article in *Res Publica*). By now, Prime Minister Dehaene conceded that the pension system for employees was evolving into a system that could only deliver a basic benefit in the future. In order to fill the pension gap, employees and employers needed to improve supplementary pensions. The run-up to EMU would provide the government with the political capital necessary to secure approval for some but not all of its reform goals.

The pension reform discussion in 1995/1996 introduced important changes into the pension system. The framework law (*kaderwet/ loi de cadre*) of July 1996

(see below) gave the government significant powers to enact a reform, after several years of failed reform attempts. The main objective of the reform was to reduce long term pension expenditure. Civil servant pensions were considered to be one of the problems. In the 1970s the civil service was expanded to fight unemployment, creating a large group of future public pensioners. Due to the rapid growth of public sector pension benefits (wage indexed, last five years income) substantial costs were forecast for the future. An attempted reform by the government in 1994 was defeated by the municipality lobby (*Le Soir*, January 5, 1995).

The background to the pension reform was plans to boost employment and reduce the government deficit so that Belgium could qualify for the first stage of EMU. In addition, employers were pleading for reforms that would improve the competitive position of Belgian industry while the unions were pushing for negotiations about how to boost employment. In early 1996, the Prime Minister once again delayed social security reform by linking it to improving public finances, the budget for 1997, and discussions with the social partners about creating jobs.

In late April, 1996 the four majority parties in the cabinet decided to ask for ‘special powers’ to be granted for "three large dossiers." (government finances; modernization of social security; and the Future Plan for Employment). The government wanted to use program/framework laws in order to avoid direct opposition and facilitate decision-making. The framework laws contained the broad outlines of policy, and the details would be specified in royal decrees. In concrete terms the government wanted to pass a framework law that gave them permission to take all necessary measures needed in order to reduce the deficit to 3% and to guarantee the financial balance of the social security system, including pensions.

The framework laws would allow the government to pass legislation on the 1997 budget, employment policy and social security reform, with only "post-factum" parliamentary control. The opposition criticized the government's strategy, to no avail, and discussion of the three laws in the lower chamber began on June 12. By the end of July the lower chamber had approved all three framework laws.

First, the "EMU Law" (*De wet van 26 juli 1996 "strekkende tot realisatie van de budgettaire voorwaarden tot deelname van Belgie aan de Europese Economische en Monetaire Unie;" B.S.* August 1, 1996) gave the government until August 31, 1997 the authority to take a wide range of measures necessary to enable Belgium to join EMU. This included both taxing and spending measures. The main limitation was

that the lowest incomes should be protected and the measures should not conflict with the framework law on the modernization of social security.

Second, the "Social Framework Law" (De wet van 26 juli "*tot modernisering van de sociale zekerheid en tot vrijwaring van de leefbaarheid van de wettelijke pensioenstelsels*;" B.S. August 1, 1996) was based explicitly on the coalition agreement. This law's aims were to: maintain the system of social security that combines social insurance with solidarity; ensure a durable financial balance in the social insurance system; confirm the importance of alternative means of financing in order to reduce labor costs; modernize the administration of social insurance; increase control and reduce fraud; and to maintain or improve living standards of those with minimum benefits. The law also said that equality between men and women in the social security system was a central goal. The right to the minimum pension was also expanded. Under the provisions of the framework law, the cabinet was empowered to take any and all decisions it deemed necessary to reach these goals.

In concrete terms, the law provided for extra revenues for the social insurance system from VAT income; at least BEF 104,490 from the VAT revenues would go to social insurance. In addition, the federal subsidies to employee and self-employed pension schemes would be improved. These measures were designed to reduce reliance on payroll taxes.

The role of EMU membership was a crucial factor allowing the government to gain passage of social insurance and pension reform. As the Governor of the Central Bank, Fons Verplaetse, put it: "if Belgium misses the train for the European common currency, the unity of the country is endangered." (*Res Publica*, need page number)

Budget deficit: reference value: -3.0% of GDP

	1980	1986	1990	1992	1993	1994	1995	1999	2000	2001	2004*
Belgium								-0.5	0.1	0.4 (0.2)	0.4
Spain	-2.6	-6.5	-3.5	-3.2	-7.1	-5.9	-6.6	-1.2	-0.8 (-0.9)	-0.1	0.1
Italy	-8.5	-11.6	-10.9	-9.5	-9.6	-9.0	-7.5	-1.7	-0.6 (-1.8)	-2.6	-2.8
EU15								-0.7	0.9 (-0.3)	-0.9	-2.6
Euro area								-1.3	0.1 (-1.0)	-1.6	-2.7

*Figures based on economic forecasting by the Commission, autumn 2003. The exceptional revenue from UMTS licences had a significant impact on some Member States' budget deficits in 2000-2002. In these cases, the figure between brackets indicates the deficit without this additional revenue.

Discussion

Obviously our four case studies are not a complete test of the model, so our results are only suggestive. The case studies show that our model of domestic adaptation to European pressures for change is only moderately successful in explaining outcomes. The two cases of domestic adaptation to the requirements of Directice 79/7/EEC broadly confirm our expectations. The multiple veto points of the Belgian political system and the entrenched and influential interests attached to the public pension system made policy change difficult and slow. Only after Belgium was hauled into European court on two occasions were the necessary changes made. This suggests that even when European adaptational pressures are very strong, domestic institutional variables may still impede and/or slow down policy change. Our expectation for the Dutch case is broadly confirmed; domestic adaptation was correct and punctual, but the processes of negotiating adaptation was fraught with difficulties, largely because of potential negative financial consequences for some households. The low number of veto points and the more limited extent of public provision in the Netherlands should have facilitated adaptation because the preferences of organized interests should not have been as intense as in Belgium and

the political system offers fewer veto opportunities. We find that this explanation only explains part of the Dutch story.

We argued that our model should be capable of explaining domestic adaptation to both strong/direct pressures for change as well as indirect/diffuse pressures for change such as those created by the Maastricht budget deficit limit of 3%. Our two cases of domestic adaptation to the deficit target demonstrate the limits of our model. In the Belgian case, our model predicts less adaptation than actually occurred because the Belgian political system is full of veto points, and the maturity and scope of the public pension system mean that organized interests have intense preferences about preserving the status quo. In other words, we should not have seen as much pension reform in Belgium. The Italian case also causes problems for our model. Although not as veto-prone as Belgium, the scope and maturity of the public pension system should have made reform more difficult for vote-seeking politicians afraid of electoral risks.

How do we reconcile these findings with our model? The obvious answer is that the run-up to EMU was an extraordinary episode in the history of European integration, and basically the only period in which the EMU constraint is likely to substantially influence domestic fiscal policies. Indeed, the recent weakening of the Stability and Growth Pact at the behest of Germany and France confirm this line of argument. This suggests that the reform pressures emanating from EMU in the years immediately prior to 1998 are unlikely to be repeated. To be sure, EMU is still a constraint, but it is a shadow of its former self.

Conclusion

What do our findings suggest for the study of domestic adaptation to Europe? First, we want to emphasize the value of using carefully constructed theoretical arguments drawn from the literatures on comparative politicis and public policy to explain domestic adaptation to Europe. If our goal is to understand how national governments adapt policies and practices to European requirements, however these are defined, it makes sense to start by asking what the existing literatures in specific policy fields or areas have to say about change. For social policy this means looking at the welfare state literature; for environmental policy this means drawing on insights from existing studies of national environmental policymaking. It is not clear from the existing Europeanization literature that there is any added value in constructing ad hoc

explanations for domestic adaptation. And if national adjustment is basically a domestic political game, it makes sense to use our existing models of institutional change to explain adaptation to Europe.

We think that our analysis demonstrates the utility of drawing on existing explanations of policy change, even if our results were not always in line with expectations. We have shown that our model broadly explains the dynamics of change in the Belgian and Dutch implementation of Directive 79/7/EEC and is partially successful in explaining the Italian and Belgian pension reforms in the run-up to EMU.

Finally, we want to stress the importance of comparing national adaptations to different kinds of European pressures. If our models of domestic adaptation are any good, they should be able to explain not just the transposition of directives, but also the ways in which member states adapt to the requirements of the Stability and Growth Pact, the completion of the internal market, and other types of pressure.

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