Common Market Law Review **42:** 67–89, 2005.
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CO-ORDINATION OF SOCIAL SECURITY ON THE BASIS OF THE STATE-OF-EMPLOYMENT PRINCIPLE: TIME FOR AN ALTERNATIVE?

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1. Introduction

On 29 April 2004, the Council of the European Union adopted a new Regulation that is to replace the present Regulation for co-ordination of social security, Regulation 1408/71. The new regulation, Regulation 883/2004,[1] will not come into force until an implementing regulation has been adopted, the preparations for which started after the adoption of "mother regulation" 883/2004. The adoption of the new Regulation does not mean that all issues concerning the modernization and simplification of co-ordination have been solved, since the result is based on many compromises. One important remaining issue is the extension of the material scope of the co-ordination rules: the present regulation is limited to statutory social security.[2]

In this contribution, however, I will discuss another issue which has been the subject of serious debate in the past years, but which has still not been satisfactorily solved. This is the question of the determination of the applicable social security legislation: should this be done on the basis of the State-of-employment or the State-of-residence principle? In the new Regulation, like in the old one, the State-of-employment principle is predominant. In this contribution I will discuss the dilemmas surrounding this issue and the opportunities for and effects of an alternative.

2. The objectives of the Co-ordination Regulation

From the very beginning of the European Community, it was clear that in order to realize free movement of workers, the social security position of mi-

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1. O.J. 2004, L 166.

2. See Pennings, "Inclusion and exclusion of persons and benefits in the new co-ordination Regulation", forthcoming in Dougan and Spaventa (Ed.), *Social Welfare and EU Law* (Hart, 2005).

grant workers has to be protected. In 1958 already, Regulation 3 was adopted for this purpose. In 1971 Regulation 1408/71 (henceforth: the Co-ordination Regulation) succeeded Regulation 3.[3]

The Co-ordination Regulation provides for aggregation rules, which enable persons falling within its scope to have periods of insurance or work completed in another Member State aggregated with those completed in the State where they apply for benefit: thus, they can use these periods in order to fulfil the entitlement conditions in the latter State. The Regulation also provides that if a person has acquired the right to, for instance, old age benefit in one Member State, this has to be paid also if the person resides in another Member State. A third main rule of the Regulation is the prohibition of discrimination on grounds of nationality.

A final main element, the major topic of this article, is that the Regulation determines the applicable social security system. Without such rules, it would often happen that the social security systems of two countries apply simultaneously, for instance if a person works in two States simultaneously or if he works in one State and resides in the other. This could lead to coverage by two schemes at the same time (and hence double contributions have to be paid) or no coverage at all. A co-ordination Regulation that gives binding rules is therefore essential for realizing free movement.

3. The State-of-employment principle

3.1. *Rationale*

The main rule of the Co-ordination Regulation is that a person is covered by the social insurance system of the country in which he works. This is the so-called State-of-employment, or *lex loci laboris,* principle. For instance, if a person works in the Czech Republic and resides in Germany, he is covered by the Czech social security system only.

The rule that a person is covered in the country of employment is at present more often disputed than it was in the past. One reason is that new types of benefits have been made, such as parental leave and long-term care benefits. Another reason is important developments in EU law itself, including the creation of EU citizenship. Also the characteristics of persons who make use of free movement have changed. All these developments, which

3. See, for an introduction on Regulation 1408/71, Pennings, *Introduction to European Social Security Law* (Antwerp, 2003).

will be discussed in more detail below, have led to criticism on the State-of-employment principle.

The choice for the *lex loci laboris* is – certainly seen from a historical perspective – straightforward. Many statutory social security schemes cover – following the German pioneers of statutory security schemes (Bismarck) – only or mainly employees. The entitlement conditions and the benefit rules of these schemes refer to the employment relation of the employee, including his wages, the duration of work and the weekly number of working hours.

A second reason is that the State-of-employment principle makes it often more attractive to make use of free movement, i.e. to cross the border in order to start working in another Member State, since the social security system of the country of employment is often more attractive than that of the country of origin. This is certainly the case when workers from the poor countries go to richer countries. Although for the 15 old Member States it can be said that (long term) migration from poorer to richer countries has almost become a historical phenomenon, this is not the case for the new Member States.

A third reason is that if an employee were to fall within the scope of the system of the country of residence (that not being the work State) or the system of the country of origin, he would be more expensive or cheaper for the employer than the employees who live in the country of employment (the "national workers"). More expensive workers would of course not be recruited; cheaper employees would be very welcome but would also be detrimental to the labour market of the host country. It would result in unemployment for the national employees and the country concerned would be likely to react by reducing the costs of its own social security system. The effect will be that the level of social security will become lower. Although free competition is one of the main objectives of the EU, this should not take place by making use of the differences between social security systems. Such a form of competition would finally infringe on another main objective of the Treaty, laid down in Article 2 EC, i.e. the promotion of a high level of employment and social protection, the improvement of the standards of living and the quality of the existence, and the economic and social cohesion and the solidarity of the Member States.

For these reasons the State-of-employment principle underlies the rules for determining the legislation applicable, also in the new co-ordination Regulation, Regulation 883/2004.

3.2. *The exclusive effect of the rules*

The rules for determining the legislation applicable determine the social security system to which a person is subject (the competent State). In the competent State he has to pay his social security contributions.

The rules have exclusive effect; this means that a person cannot be covered by the scheme of another Member State. For instance, if he works in a State other than his country of residence, he cannot be covered by the system of the latter State at the same time. If the national rules of the State of residence provide that he is insured, for instance in a residence or national insurance scheme, the regulation overrules theses rules. The effect is that the person concerned is deprived from the coverage of the system of his State of residence.

From this, it follows that co-ordination rules may have important effects. These effects are often the result of the large differences between the contribution rates of the competent State and the country of residence, and the differences between the benefit levels of the countries, as Member States are free to determine the conditions and contents of their social security system. As a result, a person may be entitled to benefit after an insurance period of three years in country *x*, whereas in country *y* the required insurance period may be six months or even nil.[4] Schemes may also differ in that one country does not have a statutory insurance scheme for a particular group, such as the self-employed, whereas that group is insured in other countries. An exhaustive enumeration of the differences between the schemes will not be easy to make.

Already in one of the first judgments of the Court of Justice, the *Nonnenmacher* judgment,[5] we can see that the exclusive effect can have tragic effects in an individual case. The case concerned the widow of an employee. The employee first worked in the Netherlands and then went to work in France as of September 1959, whereas he remained resident in the Netherlands. After one and a half months he died. It was beyond dispute that the employee was insured in France (as a result of the State-of-employment principle) and as a result his widow would not be entitled to any Dutch benefit. However, she was not entitled to a French benefit either, since the right to French widows' benefits was limited to incapacitated women. Shortly before

4. The co-ordination Regulation has, however, some provisions which may enable an employed or self-employed person to satisfy the conditions of his new State of employment, like the already mentioned aggregation rules.

5. Case 92/63, *Nonnenmacher*, [1964] ECR 583.

the man's decease, a General Widows' Benefits Law had come into force in the Netherlands, which was a national insurance scheme, which meant that all residents were covered, regardless of whether they work or not. Consequently, the widow would have been entitled to this benefit if the rules of the country of residence could have been applied.

The Court of Justice considered that the applicable provisions (the Regulation) were designed to establish the greatest possible freedom of movement of workers. This aim includes the elimination of legislative obstacles that could handicap migrant workers. From this it follows, that the co-ordination regulation (then Regulation 3) does not prohibit a Member State that is another one than the State of employment from applying its social security legislation to the persons living in its country.

This judgment was unique and is no longer applicable law, since Regulation 1408/71 provides explicitly that the rules for determining the legislation applicable have exclusive effect. This is also the case when this is disadvantageous for the employee.[6]

Consequently, an employee or self-employed person can feel the disadvantages of the application of the co-ordination rules. However, it must be stressed that these rules often have important advantages for employees and employers, since they have as effect that only one scheme is applicable at the same time, and therefore only contributions in one Member State have to be paid.

3.3. *Exceptions to exclusive effect*

The exceptions to exclusive effect will be mentioned here insofar as they show that the *lex loci laboris* is not sufficient in itself to prevent distortion of competition.

One exception applies if a person works as a self-employed person in one Member State and as an employed person in another. Article 14c provides as a main rule that in this case the social security system applies of the State where the person concerned works as an employed person. This means that the social security scheme of the latter State is applicable to the activities in both Member States. Contributions are therefore required according to the system of the State in which the person concerned works as an employed person on the income from both countries. Consequently, also the contributions on his remuneration as self-employed have to be calculated according to the rules of and to the funds of the latter State. Suppose that a person

6. See e.g. Case 302/84, *Ten Holder*, [1986] ECR 1821.

works as an employed person in a State that does not have self-employed schemes, whereas the State in which he works as self-employed person has high contributions for self-employed schemes, this person has lower costs than a self-employed person who works solely in the latter State. Here the rules of the Regulation allow distortion of competition.

The remarkable point now lies in the exception to this rule, also found in Article 14c. This provides that if Annex VII to the Regulation provides so, the legislation applies of the country where the person works as an employed person in respect of his activities as an employed person, and the legislation of the country where he works as a self-employed person applies on his activities as a self-employed person. As a result, the statutory systems of two countries can apply simultaneously, which is, of course, contrary to the basic principle of the regulation.

This exception to exclusive effect was found necessary since there are countries which have extensive schemes for the self-employed, with relatively high contribution rates, (e.g. Belgium), and countries which have hardly any self-employed schemes, or none at all (like Germany). As a result, there was the real danger that self-employed persons might escape the contributions required for the self-employed scheme by accepting, alongside their activities as a self-employed person, a small job as an employed person in a country that requires no or much lower contributions on income for activities as a self-employed person. The exception made possible for those countries that are listed in Annex VII envisages preventing this form of distortion of competition.[7]

4. Exceptions to the State-of-employment principle

The regulation has some exceptions to the State-of-employment principle.

4.1. *Posting*

The State-of-employment principle would work out unfavourably if it were applicable also to a person who goes, for his employer, to another country to work there for a short period only. If this person were subject to the social security scheme of the latter country already for this short period, he and his employer would have to pay contributions under this scheme, even though it

7. In the new co-ordination Regulation, simultaneous application of two schemes is no longer possible.

could not lead to any advantage for the employee. This would be an important impediment to free movement.

For this reason the regulation makes exceptions to the State-of-employment principle, by means of Article 14(1)(a) of the Regulation, the so-called posting rule. This article provides that a person employed in the territory of a Member State by an undertaking to which he is normally attached, who is posted by that undertaking to the territory of another Member State to perform work there for that undertaking, shall be subject to the legislation of the first Member State, provided that the anticipated duration of work does not exceed 12 months (in Regulation 883/2004 this will be 24 months). For self-employed persons, a comparable rule applies, which may seem remarkable, as self-employed persons cannot be posted by an employer, since they do not have one. However, also self-employed persons have to be prevented from being subject to a foreign social security system in case of short-term activities in another Member State.

The posting rule makes it possible that persons remain temporarily subject to the system where they were insured before crossing the border, which is often, but not necessarily, the State of residence. As a result of the application of the posting rule an employed or self-employed person may continue to fall under a system with lower contributions than that of his new, temporary State of employment. The opposite may also be the case, but the first situation raises the largest problems, as the posting provision thus enables persons and their employers, or self-employed persons, to benefit from differences in social security contributions. A well-known example is that of Portuguese construction firms who posted workers to work in Germany after the fall of the Wall, when there were many projects in the latter country. The Portuguese firms could do the job much cheaper than the German firms since, among other reasons, they had to pay lower contributions.

In the case of posting employers, workers and self-employed persons can ask for a so-called posting certificate from the benefits administration of the sending State. This certificate proves that they are posted and that therefore no contributions are due in the receiving State. From research, it appears that posting certificates are often applied to a group of workers at the same time, in particular in the construction sector, tourist trade and agriculture. An obvious conclusion is that employers often use posting certificates to obtain cost advantages by posting workers from a country with low contributions to a country with higher contributions.[8]

8. Donders, Pieters and Schoukens, "Application of the provisions of Regulation (EEC) 1408/71 and the issue of posting: Facts, problems and comments", in Schoukens (Ed.), *Prospects of Social Security Co-ordination* (Acco, Leuven, 1997), pp. 80 and 81.

It will be no surprise that agencies for temporary work also make use of this construction. Relying on Article 14, they post workers to a State with higher contributions. The Court of Justice has accepted this use of the posting rules,[9] although special conditions were developed in the case law[10] and in a decision of the Administrative Commission.[11]

A deviation from the State-of-employment principle for a longer period than the 12 months which are allowed by the posting rules is possible on the basis of Article 17 of the Regulation: the competent institutions of two Member States can make an agreement which provides which legislation is applicable on an employed person or a group of employed persons. Although the general practice is that the agreement is made for a maximum period of five years, in some cases it is made for even 25 years.[12] This practice clearly undermines the State-of-employment principle.

4.2. *Normally working in two Member States*

The rule that the social security scheme of the State of employment applies does not give a solution in the situation that a person works simultaneously in two Member States, for instance 30 hours a week Belgium and ten hours a week in the Netherlands. In this situation the social security system of the State where the person concerned resides is applicable, provided he also performs activities in that country (Art. 14(2)(b)). Regulation 1408/71 does not make a comparison of the extent of the activities or the remuneration gained from them. Article 14(2)(b) enables the employed person or self-employed person to influence which system is applicable. If a Czech person starts to work, for instance, in Germany and he does not want to pay German contributions, he can take a small job in the Czech republic and thus remain covered by the latter system.

4.3. *Rules for special non-contributory benefits*

The Regulation provides that most types of benefit are paid also if a person does not reside in the State of employment. This "export" rule is relevant also to benefits based on a residence scheme. This rule, which was already

9. Case 35/70, *Manpower*, [1970] ECR 1251.
10. Case 202/97, *Fitzwilliam*, [2000] ECR I-883.
11. The Administrative Commission is established under the Regulation. It can, among other things, give recommendations for the application of the regulation. In Decision 181 it has given some conditions for posting by offices for temporary work.
12. Donders et al., op. cit. *supra* note 8, p. 81.

included in the first version of the Regulation, became problematic when benefit schemes were created which guarantee a minimum income for specific categories, for instance the old-aged or handicapped. These benefits are not funded by contributions but from general means (taxes). Initially, Member States argued that these schemes were beyond the material scope of the Regulation, on the ground that they are public assistance benefits which are excluded from the regulation (Art. 4(4)). In the *Frilli* judgment,[13] however, the Court of Justice decided that this category of benefits falls within the scope of the Regulation.

Member States remained opposed to the export of these types of benefits, as they wished the receipt of these benefits to be restricted to persons who stay in their territory. Therefore, a special regime was made for the so-called special non-contributory benefits, i.e. Article 4(2a). This provision makes it possible – in combination with Article 10a – for these benefits to be paid in the State of residence exclusively, on condition that they are listed in Annex IIa to the Regulation.

On the one hand, Article 10a restricts the export of this type of benefit, but on the other, it also means that for persons who *go* to a country with this type of benefit, it is easier to satisfy the conditions for this benefit. For example, a scheme for young disabled persons listed in Annex IIa can no longer exclude a person on the ground that he was already disabled in another Member State. This follows from Article 10a(4), which provides that where the granting of a disability invalidity benefit is subject to the condition that the disability or invalidity should be diagnosed for the first time in the territory of that Member State, this condition shall be deemed to be fulfilled where such diagnosis is made for the first time in the territory of another Member State.

The co-ordination rules indeed are Janus-faced: they both determine who is *excluded from* and who is *included in* a national social security system. Therefore, Article 10(4) has advantages for the newcomers in a country with a scheme for the young disabled. Consequently, *if* all Member States had a good protection for young disabled persons, application of the residence principle would have advantages. Persons are entitled to benefits provided for by the system of the country of residence and that means that the level and conditions for that benefit will be better adjusted to the local circumstances than a foreign system. The reality in Europe, however, is different: a person in receipt of a disability benefit for the young who moves to another

13. Case 1/72, *Frilli*, [1972] ECR 457.

country has a substantial chance that the new State does not have such a system.

4.4. *Post-active persons*

For persons who are no longer engaged in work and who do not reside in the State where they were first employed, the latter State can provide that they are no longer insured. The Regulation provides that in that case the legislation of the State of residence is applicable (Art. 13(2)(f)). Also here we see a deviation from the State-of-employment principle.

5. Proposals for a different co-ordination principle

In the past years, several proposals have been made for alternative principles for co-ordinating social security, in particular, to take the differences in types of benefit into account. Danny Pieters, for instance, has argued that the State-of-employment principle fits best with work-related benefits, but he raised the question whether co-ordination on the basis of the country-of-employment principle is adequate for benefits that are not based on professional activities, but on residence. In answer to this question he proposed to distinguish between income replacement benefits and cost-compensating benefits. Income replacement benefits compensate the loss or absence of income partially or completely. Examples are sickness benefits, unemployment benefits, disability benefits and survivors' pensions. Also public assistance belongs to this type of benefit.[14] Cost compensating benefits are individual grants for special costs, such as family allowances, health care and orphans' benefits.

In Pieters' proposal, the income replacement benefits remain co-ordinated on the basis of the State-of-employment principle; the cost compensating benefits are co-ordinated on the basis of the State-of-residence principle (*lex loci domicilii)*.

The distinction made by Pieters does not correspond fully with the difference between work-related and non-work-related benefits. Benefits for persons disabled from birth, for instance, are based on residence schemes, but in his approach they are income replacing benefits and to be co-ordinated in accordance with the State-of-employment principle.

14. Pieters, "Towards a radical simplification of the Social Security Co-ordination", in Schoukens (Ed.), op. cit. *supra* note 8, p. 209.

Pieters' distinction between benefit types is not always easy to make. Sometimes it is not possible at all. A related problem of Pieters' proposal is that a migrant worker can be confronted with social security schemes of two different countries at the same time, depending on the type of benefit. For example, in country *x* employed persons can be entitled to family allowances and in country *y* all residents.

Thirdly, Member States must, as a consequence of his proposal, differentiate between types of benefit that are governed at present in one and the same scheme. For instance, usually one and the same law governs widows and orphans' benefits. Pieters distinguishes these benefits between income replacement and cost compensating benefits respectively. Such an operation does not make Pieters' proposal attractive.

Another proposal is by Anna Christensen and Matthias Malmstedt, two Swedish authors.[15] Before discussing this, I will first sketch the background of their criticism of the State-of-employment principle. The Nordic criticism of this principle must be seen in the light of a generation conflict between EU Member States: the Nordic countries belong to the fourth generation of countries that became members of the EC/EU. When doing so they were confronted with the EU law as it had been developed so far, "the *acquis*", and this meant, for the co-ordination of social security, the *lex loci laboris*. As we have already seen, this fits best with the Bismarckian schemes.

Nordic countries tend predominantly to have residence-based schemes, funded for the major part from taxes. Before entering the EU they had their own co-ordination system, based on the *lex loci domicilii* principle. If a resident of, for instance, Iceland moved to Sweden, he was fully incorporated in the Swedish social security system. Consequently, and we now give a simplified description, he was no longer entitled to benefit from Iceland, but to a full Swedish pension. This system required some preconditions to be fulfilled in order to be viable. For instance, strict immigration rules are necessary, in order to avoid social tourism from non-Nordic countries. The system also presupposes a large similarity of the schemes, as was indeed the case with the Nordic ones.[16]

15. Christensen and Malmstedt, "*Lex loci Laboris* versus *Lex loci Domicilii* – an inquiry into the normative foundations of European social security law", (2000) *European Journal of Social Security*, 70.

16. Sakslin, "Can the principles of the Nordic Conventions on Social protection contribute to the Modernization and Simplification of Regulation (EEC) No. 1408/71", in Swedish National Social Insurance Board and European Commission, *25 Years of Regulation (EEC) No. 1408/71 on Social Security for Migrant Workers A Conference Report* (Stockholm 1997), pp. 197.

The idea underlying the Nordic schemes and co-ordination method was that it was found unacceptable that people living in the territory of a State were excluded from its social security system, and received no benefit or a reduced benefit because they previously lived in another country.

The EU co-ordination rules have a different approach: persons who come from another country and start living in a country with a residence scheme acquire an old-age pension whose level is proportional to the period of insurance. In addition, they receive a partial benefit from the country in which they were previously insured, provided that they have acquired rights to a pension in this country. In other words, export of benefits is an essential characteristic of the EU co-ordination system. Another consequence of this system is that in case family members of a worker live in another Member State family allowances have to be exported to the latter State. Under the previous Nordic co-ordination system, each person falls within the scope of the benefits of the State of residence.

Consequently, accession to the European Union meant an important change for the Nordic countries.[17]

Christensen and Malmstedt word their criticism of the State-of-employment principle with an emotional undertone, as they consider the normative content – their term – of co-ordination on the basis of the State-of-residence principle higher than that on the basis of the State-of-employment principle. It is not completely clear what they mean by the term "normative", but they suggest that the problem with co-ordination on the basis of the latter principle is mainly to promote free movement and therefore to realize economic objectives.

The authors acknowledge, however, insufficiently that normative values underlie the State-of-employment principle as well. These values have been mentioned above: maintenance of acquired rights, which is certainly relevant to persons who have come from poorer countries; equal treatment on the work floor; and prohibition of distortion of competition and social dumping.

Christensen and Malmsteldt make a distinction between work-related and solidarity benefits. They claim that from a "normative" point of view there are differences of principle between these types. Work-related benefits are based on work and contributions. Solidarity benefits are funded from the general means and are based on the solidarity within a national community. This is a normative base that differs from that of the work-related benefits. As an example of solidarity benefits they mention family allowances. In their view, solidarity benefits can be paid only to members of a community

17. See also Langer and Sakslin, *Co-ordinating Work-Based and Residence-Based Social Security* (Helsinki, 2004).

and therefore they cannot be exported outside the community, i.e. to another Member State. They criticize Regulation 1408/71 seriously for requiring such export.

The authors draw the following conclusions from their distinction. Work-related old-age pensions have to be exported, and also flat-rate old age pensions based on residence have to be exported. This conclusion is not fully consistent with their analysis, as the latter benefits have an important solidarity element. The authors argue, however, that the great majority of the residents have paid contributions for these pensions.[18] In their view benefits for members of the family that are part of work-related benefits have to be treated as work related-benefits. Consequently, widows and orphans' benefits remain exportable. The same is true for supplements to unemployment benefits for dependent persons. These are, of course, solidarity benefits but they have to be exported as the consequence of the fact that these are supplements to work-related benefit.[19] Minimum benefits for persons who did not acquire a full pension are solidarity benefits and can, in their view, not be exported. These benefits are closely connected with the economic and social circumstances of the country that adopted the benefit scheme.

This enumeration shows once more that a distinction between work-related and non work-related benefits is not easy to make, and, in any case, that it is not always possible to draw consistent consequences from this distinction. Moreover, the Christensen and Malmsteldt proposal is too much based on the knowledge of their own system only; the authors do not have a good overview of foreign systems. For instance, they seem to overlook that in some countries family allowances are related to employment and cannot be seen as solidarity benefits.

Although the proposals discussed in this section do not seem to give an adequate solution, their discussion is useful, as they show that co-ordination of social security is not merely a technical issue. Co-ordination raises questions of justice and solidarity. It shows the relevance of the characteristics of national schemes for the method of co-ordination.

6. Equal treatment and the concept of European citizenship

The State-of-employment principle has also come under pressure as a result of the developments in the area of equal treatment. Equal treatment on grounds of nationality is a cornerstone of European Community law.

18. Christensen and Malmstedt op. cit. *supra* note 15, p. 105.
19. Ibid. p. 106.

The non-discrimination provision of Regulation 1408/71 is Article 3. This reads that persons in the territory of one of the Member States to whom the Regulation applies shall be subject to the same obligations and enjoy the same benefits under the legislation of any Member State as the nationals of that State. As a result, this provision requires a comparison from the perspective of the legislation assigned by the regulation, and this means – if the main rule applies – equal treatment in comparison with employed or self-employed persons in the State of employment.

Consequently, equal treatment from the co-ordination perspective means that employed and self-employed persons are compared with their counterparts in the country of employment, even if they do not reside in the latter State. In other words, the group of reference is that of economically active persons in the State of employment. This approach is considered as being the most advantageous for promoting free movement (see also section 3.1). The equal treatment principle is limited to economically active persons (and their family members and survivors) and serves an economic purpose, i.e. prevention of distortion of competition.[20]

In the past decade, within EU law the equal treatment provision has been further developed, notably by the Maastricht Treaty, which introduced the concept of European citizenship (now Art. 18 EC) and a new equal treatment rule (now Art. 12 EC). The meaning of these provisions became clear, in particular, in the *Martínez Sala* judgment.[21] In this judgment, the Court acknowledged that citizenship of the EU is sufficient to require equal treatment on grounds of nationality in respect of those cases that fall within the material scope of the Treaty. Since social security benefits are governed by Regulation 1408/71 and Regulation 1612/68 they are also within the material scope of the Treaty.

The *Martínez Sala* case concerned a Spanish woman who wanted to be paid German child-raising benefits. She resided in Germany and had not been working for the past four years. The German benefit was refused on the grounds that she did not have German nationality. It was unclear whether she still belonged to the personal scope of Regulation 1408/71. In so far as the answer to this question – to be given by the national court – was in the negative, the person concerned could invoke Article 12 EC. As a result, equal treatment in social security was no longer related to free movement of work-

20. Malmstedt, "From employee to EU citizen – A development from equal treatment as a means to equal treatment as a goal?", in Numhauser-Henning (Ed.), *Legal Perspectives on Equal Treatment and Non-Discrimination* (The Hague, 2001), p. 95 et seq.

21. Case C-85/96, *Martínez Sala*, [1998] ECR I-2691.

ers; Ms Martínez Sala was to be treated in the same way as the other persons living in her State of residence, Germany.

Consequently, the reference group is – if Article 12 EC is involved – constituted by the persons living in the same country as the person concerned.

This may cause tension with the equal treatment approach of the co-ordination regulation, since the latter requires equal treatment with the employed or self-employed persons of the country of employment. At first sight this problem can be overcome, as Article 12 EC prohibits discrimination "within the application of this Treaty, and without prejudice to any special provisions contained therein". Therefore priority is to be given to Regulation 1408/71. Consequently, if this Regulation applies, the reference group is that of employed or self-employed persons in the State of employment. If it does not apply (and Regulation 1612/68 does not apply either), Article 12 EC may be applicable and then the reference group consists of the residents of the country where the person concerned lives. A problem that can arise is, however, that it is unclear whether a person is (still) an employed or self-employed person. Such uncertainty existed indeed in the case of Ms Martínez Sala. In her case different answers to this question do not lead to different outcomes, as her State of residence is also her last State of employment. If the State of employment and the Sate of residence do not overlap, there are, however, different outcomes. In that case the fundamental question arises of whether the priority of the State of employment is still justified. Take, for instance, the case of members of the family or survivors of employed persons. Members of the family and survivors can invoke all provisions of Regulation 1408/71, except those that apply exclusively to employed persons.[22] This means that members of the family and survivors have to be treated in the same way as their counterparts in the country where the worker works or last worked, even if these family members live in another country. For instance, the widow of a self-employed person who (i.e. the husband) has always worked in Germany and lived in the Netherlands has to rely on German social security. Since the German system does not provide for such benefit for survivors of self-employed persons she would like to claim Dutch benefit, to which she would be entitled under national law, as it is a residence scheme. However, she will fail to be successful, due to the rules for determining the applicable legislation of the regulation. Equal treatment on the basis of Article 12 EC would give a different result.

The question of whether this result is justified is the more pressing, now the personal scope of the Regulation 883/2004 includes all nationals of the

22. Case 308/93, *Cabanis*, [1996] ECR I-2097.

EU, and is thus no longer restricted to the economically active population. For non-active persons (not in the capacity of members of the family or survivors) the equal treatment provision of the new Regulation will mean a comparison with persons in the country of residence. As a result, the reference groups for the application of the various EU non-discrimination rules will vary more and more. Legal experts will still be able to determine the relevant group of reference, but it will become much harder to explain the differences in outcome to the persons concerned.

7. Recent developments on the labour market and their relation to the State-of-employment principle

7.1. *New categories of employed persons*

Recently, authors have argued that there are important developments on the labour market as result of which the State-of-employment principle has lost much of its meaning. One of these is that alongside the traditional migrant workers, various new categories of workers are now making use of free movement.[23] The traditional migrant worker – sometimes called guest worker – is the blue collar worker, who moved from a poor to a richer country hoping to be able to earn more; he worked and lived for a long period in his new country. After retirement, he often returned to the country of origin. His pension rights were mainly or exclusively acquired in the State of employment and he was dependent on this pension after his return.

This traditional migrant worker is becoming more and more a phenomenon of the past, in any case insofar as the old 15 Member States as sending countries are concerned. No longer do workers come from Spain or Italy to work in the heavy industry and mines in the richer countries. The accession of the States in Central and Middle Europe may mean, however, that this phenomenon has not disappeared completely yet, as there will still be workers who come to do unattractive work in the old States. But even these workers will hardly ever spend their entire working life in another country. One reason is the changed labour market, which creates more temporary and flexible jobs than long-term low-skilled jobs. Another reason is the increased transparency of the labour markets, which means that the workers will

23. Numhauser-Henning, "Freedom of movement and transfer of social security rights", in VII European Regional Congress, *Labour Law Congress 2002. Reports* (Stockholm, 2002), p. 200.

sooner be "job hoppers". And also the changed family circumstances – often their spouses work as well – mean that long-term migration is becoming rarer.

One new category of workers which make use of free movement is that of the flexible worker. The flexible worker frequently changes jobs and has much more variation in his work and legal position than the traditional migrant worker. He may have a marginal job, but he may also be a highly qualified worker, who alternates periods of work as an employed person, periods of work as a self-employed person and periods of study. This person may be posted to various countries. He may also go to work in another country on his own initiative.[24] For these situations the term "migration" is not entirely adequate, as the person concerned does not move from one country to another. *Mobility* is a better term to denote his situation. Mobility has become important in the last decade as a result of increased internationalization and improved transport facilities.

In the case of a mobile worker co-ordination on the basis of the State-of-employment principle without exceptions would not be adequate. Otherwise one social security scheme after another would be applicable, like a traffic light. However, as we have seen, there are exceptions to the State-of-employment principle, in the form of the posting rules and the rules concerning persons normally working in the territory of two or more Member States. These bring some stability and imply that the traffic light will stick to the same colour for a considerable period, often the social security scheme of the State of residence.

In practice mobile workers do not seem to care much about the co-ordination Regulation, which may also be true for the readers of this journal, who presumably also frequently visit other EU Member States for their work. They do not apply for a posting certificate, but assume that they are covered anyway by the system of their State of residence. Since their situation can often be called "posting", their assumption frequently fits with the rules of the Regulation. However, negligence of the official rules is not unproblematic. A mobile worker may happen to work longer in a foreign country than the 12 months allowed for posting, and as a result he does not satisfy the posting rules, without being aware of this. It may also be the case that at a certain moment a self-employed person does no longer have the infrastructure in the sending State (as required for posting of self-employed persons).[25] In such situations, workers may be confronted with large bills for the contributions

24. Numhauser-Henning, op. cit. *supra* note 23, p. 200.
25. Case 202/97, *Fitzwilliam*, [2000] ECR I-883.

in the State of employment and/or insufficient coverage in case a risk materializes.

Even if there are no problems with determining which system is applicable, mobile workers may be inadequately protected. Let us take as an example a music teacher who gives lessons in the Netherlands as a self-employed person to individual pupils and earns a low income. At a certain point, she finds it more attractive to teach in Germany. As she is not posted (the activities are not anticipated to last less than 12 months), she falls under the German system. This means that she is no longer covered by the Dutch residence schemes for old age and long-term health care, whereas there are no comparable schemes in Germany. The Dutch schemes gave her cheap and automatic protection. In Germany she has to take initiatives to buy adequate insurance. Crossing the border is easier than being aware of your change in legal position.

If she resumes work in the Netherlands her situation changes again; she falls again under the Dutch schemes and has to terminate the German private ones. It is obvious that this is an awkward situation, which causes an administrative and financial burden for the teacher.

If our music teacher works simultaneously in both Netherlands and Germany, she is subject to the system of the country of residence. By doing so she influences her social security position. This is allowed from the view of the Regulation, but room for manipulation is in principle alien to the idea of statutory social security.[26] There may also be unclear circumstances, such as in the case of a person working in Belgium who says he works during the week-ends at home, in the Netherlands, in order to do the administration of his work and thus claims to fall under the Dutch system. Is this working at home sufficient to achieve the effect that he falls under the social security system of the State of residence?

7.2. *Mobile self-employed persons*

Co-ordination on the basis of the employment principle causes also problems in the case of mobile *self-employed* persons. Self-employed persons who make use of free movement mostly do so for a short period only. They alternatively or simultaneously work in more than one Member State for a short period. Application of the State-of-employment principle is therefore often

26. See Pennings, "Regulation 1408/71 and the room for manipulation of the facts", in Numhauser-Henning (Ed.), *Normativa perspektiv, Festskrift till Anna Christensen* (Lund, 2000), p. 321.

inadequate. Pieters, in discussing this problem, proposed making a new co-ordination rule for self-employed persons, which is related to their specific characteristics, such as their membership of a Chamber of Commerce or their (main) office in a particular country. In line with this, he proposes taking the infrastructure or the place of establishment of the self-employed person in order to determine which social security system is applicable.[27] This new co-ordination rule makes posting rules unnecessary and undesirable. The advantage of this approach is that it is no longer necessary for the benefit administration to check continually where the self-employed person performs his activities.

Pieters' analysis can be followed: mobility of the self-employed is indeed growing in importance. His proposal is more problematic: his proposal allows distortion of competition and social dumping. Moreover, as Pieters admits, his proposal has the problem that it introduces a double set of co-ordination rules: for employed persons the State of employment, and for self-employed persons the State of establishment.

8. Preliminary conclusions

The State-of-employment principle is in itself adequate to co-ordinate many situations of free movement, as it allows for exceptions, including the posting and working-in-two-States rule. Moreover, the traditional arguments in favour of the State-of-employment principle are still relevant. It promotes movement of workers and prevents undesirable competitive advantages from differences between social security systems.

Good reasons exist, however, to reflect on alternatives to this principle, as it does not give good results in the situation of a person who alternately works short periods in different Member States. The Regulation has some exceptions to the State-of-employment principle but now these are applied more and more, the State-of-employment principle comes under pressure. It becomes increasingly difficult to check in practice whether the conditions of the regulation are satisfied. Meanwhile, several co-ordination rules assign the State of residence, such as in respect of the special non-contributory benefits and post-active workers. The present set of applicable rules thus differ-

27. Pieters, "An overview of alternative solutions for overcoming the problematic issue of co-ordination", in Ministry of Labour and Social Security and European Commission, *The Free Movement of the Self-Employed within the European Union and the Co-ordination of National Social Security Systems* (Athens, 2000), p. 147.

entiates between persons and benefits, not just causing practical problems, but also raising the question whether these differences are always justified.

The proposals discussed so far increase the number of situations in which different co-ordination principles apply simultaneously. This causes problems both from a dogmatic and a practical point of view, such as in the case of a person who works simultaneously as self-employed and employed person. If new co-ordination rules are required it is highly preferable that the principle that only one system applies simultaneously is reinforced.

Below I will discuss the question whether co-ordination on the basis of the State-of-residence is a good alternative. It is useful to consider this, even though the realization of this proposal would take a very long time. In any case, it will give a good overview of the problems involved and can therefore address the question whether the State-of-employment co-ordination method has become outdated.

9. The residence principle

9.1. *Prerequirements*

A main argument for the State-of-employment principle was that it should prevent unfair competition. This argument has not become outdated, quite the contrary. With the present communication and transport facilities it has become even easier to make use of differences between the social security systems. Before co-ordination on the basis of the residence principle can become possible this problem must first be solved. It requires the total amount of social security contributions for employers, employed and self-employed persons and other groups (residents) to be the same for all Member States for each group respectively. The exact rate cannot and does not have to be fixed within the framework of this article, although we realize this is a major topic.

This proposal does not require full harmonization of the benefit schemes. Benefits conditions and rates can still vary, and to that extent they may require extra funds. Member States can fund part of the system from taxes, as long as they do not discriminate between foreign and national workers.

If the precondition is met, co-ordination on the basis of the residence principle is possible. Employers and employees and self-employed persons pay contributions in the State-of-residence of the person concerned.

Although harmonization would indeed solve some of the State-of-employment problems as well, the choice for the State-of-residence principle has the additional advantage of bringing more continuity in the applicable system than under the present rules, as persons change their home much less fre-

quently than their work place. A person working temporarily in another Member State will stay there for some time. In accordance with the present approach under the Regulation, this does not mean that he immediately starts to reside in the new Member State. His place of residence is the place where the centre of his activities is (for this it is relevant where his house or family is, where he is registered, the duration of his residence before departure, the duration and purpose of his absence, the nature of the activities in the other Member State and the intention of the person concerned as appearing from all the circumstances).[28] It may, for the benefit administration, be necessary to define these criteria more strictly if residence becomes the main co-ordination criterion.

Of course, it could be possible for persons to move to a country with a better social security system. However, for workers, movement to a country with the sole view of acquiring better benefits is not very practical, as they will still have to travel to their work place in the previous State. The costs involved in moving to another State will not outweigh the possible higher benefits in the future. For non-active persons, the situation will not change much, as they are not entitled to workers benefits.

A further advantage of this system is that it brings more uniformity and that no distinctions between, for instance, income replacing and cost compensating benefits are necessary.

It does cause, however, new problems. In the first place, it is obvious that it has consequences for the income tax system, as a discrepancy between the applicable social security and tax rules may be disadvantageous for the migrant worker. Levying taxes in the State of employment is not obvious, since taxes are used to fund provisions in the State of residence (schools, roads, army). Levying tax according to the State-of-residence principle is therefore not a fundamental, but a technical problem, as new bilateral treaties will have to be made. A more important problem exists in respect of labour law, since the provisions of statutory social security are often related to the work relationship. However, also under the present system sometimes the relation between the applicable labour law and social security law is broken, such as in the case of posting. Another issue concerns supplementary social security, which supplements the statutory social security provisions, and which is not within the scope of the Regulation. Co-ordination on the basis of the residence principle will make it even more difficult to bring supplementary social security within the scope of the Regulation, as it would mean that

28. Case 76/76, *Di Paolo*, [1977] ECR 315.

employers have to paid to social funds in. the country of residence of the employee. This problem seems to be surmountable, as also at present the gap in co-ordination, though regrettable, does not cause problems that cannot be solved.

9.2. *Legal issues*

It will be obvious that this proposal will not be realized in the near future. Apart from the fact that the problems mentioned in the previous section have to be solved, there are legal problems. The proposal requires changes to the Treaty, since Article 39 EC requires equal treatment with the employed persons in the State of employment. This is possible, but requires unanimity of the Member States. The same is true for a change of the Regulation.

10. Recommendations

The conclusion of the previous section is that, although the *lex loci domicilli* has several attractive aspects, in the near future we will still have to live with the *lex loci laboris*.

The practical problems with the *lex loci laboris* principle can be distinguished into two main categories. The first is that some persons so frequently cross borders that the State-of-employment principle is inadequate to determine the legislation applicable. The other is that by means of the posting rules it is possible to make active use of differences between social security rates.

In order to solve these problems some short-term solutions are necessary. Co-ordination will be improved if the rules are clarified in such a way that they do not lead too quickly to a change of the applicable system. An example concerns the rules discussed in Section 4.2: when does a person "normally work in two States"? Does this have to be considered per year or for each calendar week separately? Most probably, the best solution is to consider this per month, while work done in compulsory or usual rest periods (holidays and weekends) has to be disregarded. In Regulation 883/2004 the rule concerning working in two countries assigns the legislation of the State of residence only if the person pursues "a substantial part" of his activity in that Member State (Art. 13). It is recommended to define this rule further, in order to avoid interpretation problems, for instance in terms of hours per week or in terms of income.

In order to realize more stability it is recommended to introduce thresholds before the posting rules are applicable. A possible rule is that posting is

possible only after the person has worked at least six months for the same employer. If it is necessary to deviate from this rule, Article 17 agreements can still provide for adequate solutions.

11. Conclusions

A very important reason for the choice of the State-of-employment principle is to prevent distortion of competition. In addition, it promotes, given the current differences between the social security schemes of the Member States, free movement of workers. These arguments are still relevant, as there are still large differences between the social security schemes of the Member States. The State-of-employment principle has certainly not become outdated.

New types of benefits have been created, however, and there are new forms of movement, which have put the State-of-employment principle under pressure. As a result the State-of-residence principle has already acquired more relevance. There are also developments in EU law, in particular that of European citizenship, which mean that the focus on the active working population is becoming less adequate and is even becoming problematic.

The State-of-residence principle seems to be a very interesting alternative, but also causes the problem of distortion of competition. Solving this problem will require a harmonization of contribution rates. This is very complicated and this will mean that a change of co-ordination principle will not take place in the near future.