Let Social Policy Models Compete and Europe Will Win

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Introduction

The extensive and open-ended literature on Eurosclerosis seems to ignore the fact that many “rigid” features of the European institutional landscape are there because they play some useful function. Three are the main tasks assigned to labour and social policies: (i) reduce poverty and, more broadly, income inequalities, ii) protect against uninsurable labour market risk (and its interactions with longevity risk), and iii) increase the rewards from labour market participation.

These tasks are pursued at different degrees and varying efficiency on the two sides of the Atlantic. The US spends a bit less than half the amount devoted to redistributive policies by an average EU country. Unsurprisingly, the US displays larger inequalities and post-tax (relative) poverty rates than Europe. It is also less effective than many European countries in redistributing through its social policy budget and in providing protection to its workers against labour market risk. However, the US has significantly larger employment rates than most European countries, displaying better scores on the third criterion. This reflects both the almost unavoidable non-employment bias of social policy, but also avoidable institutional barriers to technology adoption, growth and job creation put in place by the redistributive institutions present in Europe.

The macroeconomic performance of Europe in the years to come, its ability to become “the most dynamic economy of the World” will very much depend also on its capacity to score better than the US also on the third criterion. Is this possible?

This paper argues that increasing competition among systems in Europe have the potential to result in better outcomes in Europe in terms of the third criterion and are not incompatible with a persistently better record of Europe in terms of criteria i) and, possibly, ii). If there is something Europe is not lacking at all is variety in social policy design and implementation. This may become a very important resource for Europe in the years to come in the “Transatlantic race”.

However, competition among systems take a long time to materialise. EU supra-national authorities may play some role in speeding up this process only if they resist the temptation to impose a particular social model over the others and rely instead on the mobility of the European workforce as a driving force of political integration and social policy convergence. The type of mobility to be pursued should also be one where intra-EU migrants can actually “vote with their feet” over the alternative social policy models currently characterising the European landscape. This means that rules of portability of social security rights across the EU should be based on a flow (pro rata) access to the provision of the country of destination, rather than endorsing the so-called “Origin Principle”.

The roadmap of the paper is as follows.

Part one characterises the main clusters of social policy institutions existing in Europe, their main crisis factors and achievements. Social welfare systems in the old continent differ widely in terms of both, composition of social spending and actual targeting of the various cash transfer schemes. This is documented by drawing on macro (Eurostat, ESSPROS) and micro data (European Community Household Panel). Then the focus is on performance, on the European success stories, the institutional clusters which prove capable of featuring both high employment rates and a low degree of wage and income inequality.

Part two speculates on whether the various Social Europe(s) are converging to a unique model and, given that this does not seem to be the case, how the best practises could be successfully exported to the countries displaying the poorest scores in terms of objectives i) through iii). Reference is made
to political opposition to reforms of social welfare systems in the largest EU economies and heterogeneity in preferences of EU citizens over redistributive policies.

The final section discusses the role that EU supra-national authorities are playing and should play in this process.

1. Social Europe(s): How many? How different one of another?

Europe is far from being a monolith in many policy areas. Social policy is certainly one of those. Economic integration has not levelled out differences in the size and composition of social spending. Cross-country heterogeneity in this respect is so marked that the term “Social Europe” is adventurous, to say the least. It may be used when speculating about the future, while it is certainly misleading when referred to the present structure of cash transfers across the EU. Differences among national social welfare systems are, after all, what makes Europe so interesting for researchers: there are just so many books and articles on the issue!

We will try to convince the reader in this paper that the heterogeneity is also promising for future developments. On the one hand, social policy is an area where there is much scope for experimentation; hence policy-making can learn a lot from the cross-country variation in the policy mix. On the other hand, competition across systems has the potential to arbitrage-away some of the inefficiencies in social spending. There are indications on mounting pressures for reform in the social policy area and there are “best practices” in various areas to draw upon.

1.1 The four models...

How many Social Europes, then? Any taxonomy having a lower dimension than 15 has forcefully to neglect some country-specific institutional feature. The one we prefer – and which draws on Ferrera (1998) and Bertola et al. (2001) defines at least four different social policy models in the old Continent, covering four different geographical areas. In order to characterise the models, we will proceed from the North-east to the South-West of Europe.

There are, first of all, the Nordic (Denmark, Finland and Sweden, plus The Netherlands which is a hybrid between the Scandinavian and the Continental models and has recently moved Northwards) featuring the highest levels of social protection expenditures, and universal welfare provision based on the citizenship principle. Extensive fiscal intervention in labour markets, based on a variety of “active” policy instruments, substantial tax wedges, and relatively extensive employment in the public sector also belongs to this model while unions' presence in the workplace and involvement in the setting and administration of unemployment benefits generates compressed wage structures.

Next, we have the Anglo-Saxon countries (Ireland and the UK), which are closer to the Beveridgian tradition and feature relatively large social assistance of the last resort schemes. Cash transfers are primarily oriented to people in working-age. Activation measures are important as well as schemes conditioning access to benefits to regular employment. On the labour market side, this model is characterized by a mixture of weak unions, comparatively wide and increasing wage dispersion and relatively high incidence of low-pay employment, half-a-way between Europe and the US.

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1 We refer, in particular, to the decision, made in the year 2000 in The Netherlands, to adopt a universal pension scheme and extend the sickness insurance scheme to the self-employed.
Continental European countries (Austria, Belgium, France, Germany, and Luxembourg), the third group, rely extensively on insurance-based, non-employment benefits and old-age pensions. Large invalidity benefit schemes are also present, which rely on contributions on employment income, along the Bismarckian tradition. While unions' membership rates have been falling quite dramatically in the last 20-25 years (Boeri, Brugiavini and Calmfors, 2001), a strong unions' influence has been to a large extent preserved by regulations artificially extending the coverage of collective bargaining much beyond unions' presence.

Finally, we have the Mediterranean countries (Greece, Italy, Spain and Portugal), concentrating their spending on old-age pensions and allowing for a high segmentation of entitlements and status. Their social welfare systems typically draw on employment protection and early retirement provisions to exempt segments of the working age population from participation in the labour market. Also in this case, strong unions' influence has been preserved by practices (e.g., jurisprudence) artificially extending the coverage of collective bargaining. As a result, wage structures are, at least in the formal sector, covered by collective bargaining and strongly compressed in these countries.

Chart 1 provides a simple characterisation of the four models, grouping the various social policy items into four main policy domains: pensions (encompassing old-age and survivors’ pensions), non-employment benefits (unemployment benefits, sickness benefits, invalidity pensions and early retirement, whenever listed separately from old-age pensions), family allowances (child-care benefits and family benefits) and social assistance (including means-tested housing benefits). Social expenditure is normalised by GDP, while information on the percentage distribution of social spending is provided next to each histogram. Data are drawn from the EC ESSPROS database which offers, to date, the best framework to assess the size and composition of social spending in the EU area.

\footnote{Note that these countries have implemented universal national health care systems in between the 1970s and the 1980s. However, we do not deal with health spending in this paper.}
As is apparent from Chart 1, differences in levels and composition are not of a second order of magnitude. They are broadly in line with the above characterisation of the four models, although not all institutional features can be measured. Universal non-employment benefits are what distinguishes the Nordic model (and makes it larger in scope than the others) from the Continental model, which is slightly less large in scope and focused more on pensions than on transfers to individuals in working age. The Anglo-Saxon world (mostly the UK as we are dealing with a GDP-weighted average) displays a smaller welfare state and one which devotes comparatively more resources to social assistance of the last resort. Finally Southern Europe displays the smallest welfare state, more than half of which goes to public pensions, whilst social assistance is negligible.

These country groupings should not conceal important differences in the policy mix which are present within each model. Yet, in three policy areas out of four, differences across models capture from 45 to 60 per cent of the total variation in the composition of social spending. This can be gauged by looking at Chart 2 which decomposes the total weighted (by GDP) sum of squared deviations of social expenditure shares (to social expenditure, rather than GDP in order to eliminate variation due to income levels) into a within-models and a cross-models mean variation. The only area where within models variation dominates is non-employment benefits, which is the most heterogeneous set of measures of the four and the one most affected by the underlying labour

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**Chart 1**
market conditions (notably the size of the unemployment pool which varies significantly from country to country).

### Chart 2

**Decomposition of the differences in the social policy mix**

![Chart 2](chart2.png)

1.2. ...*and their performance*

Social policies are deemed to play three main functions: (i) reduce poverty and, more broadly, income inequalities, ii) protect against labour-market-related uninsurable risk (including the interactions between unemployment and longevity risk) and iii) increase the rewards from labour market participation.

The first is perhaps the most important function attributed to social welfare cum tax systems. The extent of redistribution occurring via a combination of transfers and progressive taxation can be assessed by comparing Gini coefficients before and after taxes and transfers. This is done in Chart 3. Pre tax and transfer incomes are constructed making use of the European Community Household Panel, a longitudinal dataset providing income and labour market information on about 60,000 individuals across the entire EU. Pre tax and transfer income is calculated as total disposable income minus social transfers divided by a "net/gross ratio" factor provided by EUROSTAT in the ECHP. The top panel displays the changes in Gini allowed for by taxes and transfers when the focus is on the working age population and non-pension transfers only. The bottom panel repeats the same exercise having as reference the total population and total social expenditure (including pensions).

As revealed by Chart 3 the Southern and the Nordic groups come out as being respectively the least and the most successful in reducing inequalities. This holds also when pensioners are included,

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3 This conversion factor is only available for total household income.
which is important in light of the concentration of Southern social spending on pensions. The Anglo-Saxon model strongly reduces inequalities among the population of working age, while it is much less redistributive when pensions (and pensioners) are included.

Chart 3

Social Policy Models and the extent of redistribution

Encouragingly enough, Kenworthy (1998) and Foerster (2000) find a similar ranking of countries when analysing the redistributive properties of welfare states over LIS (Luxembourg Income Study) data. The latter also include the US which displays relatively high pretax poverty rates and the highest posttax incidence of poverty. This suggests that side effects of social policies (e.g., in terms of disincentives to work) are not as serious as to jeopardise the stated goal of these programmes to reduce inequalities. It also indicates that the US social policy model is much less redistributive than any of the European welfare states.

Differences in the scope of redistribution are broadly in line with differences in the size of the welfare state. The interesting question is, however, whether or not social policy achieves more in terms of reducing inequality than what would be implied by the relative size of redistributive programmes. Chart 5 provides rough indications as to the efficiency of social policies in the EU countries, by plotting differences between pre and post tax/transfers Ginis (vertical axis) against the social policy expenditure to GDP ratio. The Chart hints at a better targeting of social policies in the Nordics and in the Anglo-Saxon countries than in Southern Europe. The least efficient model is, however, the Continental welfare state, which achieves much less redistribution than implied on the basis of the size of its programmes.

More detailed information on the efficiency of the various social policy models can be gathered from micro data, notably (probit) regressions of the probability of receiving different types of cash transfers against family characteristics and income. As shown by Tables 1 and 2, social transfers appear to be poorly targeted by income in the Southern countries of the EU. If benefits were targeted by household income, then the coefficient of the household income variable would be negative; in fact, in Southern countries it is positive both when the focus is on the entire population (Table 1) or on persons in working age only (Table 2). Similarly, ownership of a house reduces everywhere the probability of receiving cash transfers, but the effect is significantly smaller in the
Mediterranean countries than elsewhere. This indicates that not only income, but also asset tests do not perform particularly well in the Southern welfare system. On both grounds – targeting on the basis of income and house ownership – the Nordic and Anglo-Saxon models would seem to offer a better performance than the Continental model.

Similar results can be obtained by looking at specific programme categories. For instance, in the case of unemployment benefits, the implicit allocation mechanism is mostly explained in Southern Europe, notably in Italy (Boeri and Perotti, 2001), by the industry of affiliation, as for instance agricultural workers display, ceteris paribus, a much higher likelihood of receiving unemployment benefits than other types of jobseekers. For family-related benefits, the "number of children" variable has the smallest coefficient among the four groups. And so on.

### Table 1

The targeting of social policies

<table>
<thead>
<tr>
<th>Probability of receiving social transfers – all transfers, entire population</th>
<th>(1) Nordic countries</th>
<th>(2) Continental countries</th>
<th>(3) Anglo-Saxon countries</th>
<th>(4) Southern countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1=female</td>
<td>0.067**</td>
<td>-0.076**</td>
<td>0.289**</td>
<td>-0.072**</td>
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<td></td>
<td>(0.009)</td>
<td>(0.015)</td>
<td>(0.017)</td>
<td>(0.006)</td>
</tr>
<tr>
<td>Age</td>
<td>0.002**</td>
<td>0.013**</td>
<td>0.012**</td>
<td>0.013**</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.000)</td>
</tr>
<tr>
<td>1=married</td>
<td>-0.136**</td>
<td>-0.033</td>
<td>-0.036</td>
<td>-0.174**</td>
</tr>
<tr>
<td></td>
<td>(0.014)</td>
<td>(0.019)</td>
<td>(0.022)</td>
<td>(0.009)</td>
</tr>
<tr>
<td>1=primary education</td>
<td>-0.000</td>
<td>-0.062**</td>
<td>-0.049*</td>
<td>0.061**</td>
</tr>
<tr>
<td></td>
<td>(0.012)</td>
<td>(0.020)</td>
<td>(0.024)</td>
<td>(0.007)</td>
</tr>
<tr>
<td>1=tertiary education</td>
<td>0.032**</td>
<td>0.015</td>
<td>0.003</td>
<td>-0.058**</td>
</tr>
<tr>
<td></td>
<td>(0.012)</td>
<td>(0.017)</td>
<td>(0.023)</td>
<td>(0.010)</td>
</tr>
<tr>
<td>1=bad health</td>
<td>0.226**</td>
<td>0.041</td>
<td>0.181**</td>
<td>0.174**</td>
</tr>
<tr>
<td></td>
<td>(0.027)</td>
<td>(0.023)</td>
<td>(0.032)</td>
<td>(0.015)</td>
</tr>
<tr>
<td>Family size</td>
<td>0.044**</td>
<td>0.007</td>
<td>0.061**</td>
<td>-0.017**</td>
</tr>
<tr>
<td></td>
<td>(0.008)</td>
<td>(0.010)</td>
<td>(0.014)</td>
<td>(0.003)</td>
</tr>
<tr>
<td>number of kids (&lt;16)</td>
<td>0.003</td>
<td>0.168**</td>
<td>0.106**</td>
<td>0.59**</td>
</tr>
<tr>
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<td>(0.008)</td>
<td>(0.014)</td>
<td>(0.020)</td>
<td>(0.006)</td>
</tr>
<tr>
<td>HH non-transfer income</td>
<td>-0.188**</td>
<td>-0.130**</td>
<td>-0.171**</td>
<td>0.002*</td>
</tr>
<tr>
<td></td>
<td>(0.007)</td>
<td>(0.008)</td>
<td>(0.011)</td>
<td>(0.001)</td>
</tr>
<tr>
<td>1=own house</td>
<td>-0.024*</td>
<td>-0.042*</td>
<td>-0.084**</td>
<td>-0.017*</td>
</tr>
<tr>
<td></td>
<td>(0.011)</td>
<td>(0.016)</td>
<td>(0.026)</td>
<td>(0.008)</td>
</tr>
</tbody>
</table>

Observations | 22323 | 20902 | 13553 | 43939 |
Log-likelihood | -12353.95 | -10732.42 | -6494.20 | -18442.36 |

Robust standard errors in parentheses
* significant at 5%; ** significant at 1%
Nordic Countries: Finland, Denmark, Netherlands, Sweden.
Continental Countries: Austria, Belgium, France, Luxembourg, Germany
Anglo-Saxon Countries: United Kingdom, Ireland
Southern Countries: Greece, Italy, Portugal, Spain
ECHP, fourth wave (income data refer to 1996)
Table 2

Probability of receiving social transfers – all transfers without pensions, working age population only

<table>
<thead>
<tr>
<th></th>
<th>Nordic countries</th>
<th>Continental countries</th>
<th>Anglo-Saxon countries</th>
<th>Southern countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1=female</td>
<td>0.082**</td>
<td>-0.060**</td>
<td>0.291**</td>
<td>-0.043**</td>
</tr>
<tr>
<td></td>
<td>(0.009)</td>
<td>(0.014)</td>
<td>(0.016)</td>
<td>(0.005)</td>
</tr>
<tr>
<td>Age</td>
<td>-0.005**</td>
<td>-0.001</td>
<td>-0.003**</td>
<td>0.000</td>
</tr>
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<td>(0.000)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.000)</td>
</tr>
<tr>
<td>1=married</td>
<td>-0.083**</td>
<td>0.097**</td>
<td>0.088**</td>
<td>0.008</td>
</tr>
<tr>
<td></td>
<td>(0.013)</td>
<td>(0.018)</td>
<td>(0.022)</td>
<td>(0.007)</td>
</tr>
<tr>
<td>1=primary education</td>
<td>-0.021</td>
<td>-0.102**</td>
<td>-0.068**</td>
<td>0.046**</td>
</tr>
<tr>
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<td>(0.012)</td>
<td>(0.017)</td>
<td>(0.023)</td>
<td>(0.005)</td>
</tr>
<tr>
<td>1=tertiary education</td>
<td>0.042**</td>
<td>0.015</td>
<td>-0.035</td>
<td>-0.032**</td>
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<tr>
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<td>(0.011)</td>
<td>(0.017)</td>
<td>(0.022)</td>
<td>(0.007)</td>
</tr>
<tr>
<td>1=bad health</td>
<td>0.251**</td>
<td>0.049*</td>
<td>0.277**</td>
<td>0.215**</td>
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<td>(0.030)</td>
<td>(0.023)</td>
<td>(0.036)</td>
<td>(0.017)</td>
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<tr>
<td>Family size</td>
<td>0.046**</td>
<td>0.001</td>
<td>0.056**</td>
<td>-0.007**</td>
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<td></td>
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<td>(0.010)</td>
<td>(0.013)</td>
<td>(0.002)</td>
</tr>
<tr>
<td>Number of kids (&lt;16)</td>
<td>0.007</td>
<td>0.141**</td>
<td>0.103**</td>
<td>0.032**</td>
</tr>
<tr>
<td></td>
<td>(0.008)</td>
<td>(0.013)</td>
<td>(0.018)</td>
<td>(0.004)</td>
</tr>
<tr>
<td>HH non-transfer income</td>
<td>-0.158**</td>
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<td>-0.112**</td>
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<td>(0.001)</td>
</tr>
<tr>
<td>1=own house</td>
<td>-0.053**</td>
<td>-0.047**</td>
<td>-0.138**</td>
<td>-0.024**</td>
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<td>-10411.10</td>
<td>-5825.75</td>
<td>-13123.20</td>
</tr>
</tbody>
</table>

Robust standard errors in parentheses
* significant at 5%; ** significant at 1%
Nordic Countries: Finland, Denmark, Netherlands, Sweden.
Continental Countries: Austria, Belgium, France, Luxembourg, Germany
Anglo-Saxon Countries: United Kingdom, Ireland
Southern Countries: Greece, Italy, Portugal, Spain
ECHP, fourth wave (income data refer to 1996)

Moving to the second criterion, protection against uninsurable labour market risk is typically provided in two ways: (i) by imposing legal restrictions against firing – the so called employment protection legislation (EPL); (ii) by providing unemployment benefits in addition to those established by collective bargaining (UB). The differences between these two systems are clear: EPL protect those who already have a job, and do not impose any tax burden; UB can also be targeted to specific groups, but generally provide insurance to the population at large and are typically financed by a tax on those who work. Thus insiders, those with a stable and regular job, typically prefer EPL to UB. EU countries employ both tools, though to varying degrees.

Chart 5 provides indications as to the coverage and generosity of these two protection schemes. In particular, the index of EPL draws on a measure of employment protection for regular workers provided by the OECD (OECD, 1999) while the horizontal axis displays the percentage of unemployed receiving unemployment benefits. Since UB and EPL are two instruments designed to achieve a similar purpose, there is a clear trade-off between them. Having a generous unemployment insurance system reduces the need for firing restrictions, and vice versa. This trade-off is indeed well visible over the cross-section of European countries. It is clear that the EU member states have chosen very different points in the trade-off between the two main instruments to protect individuals against unemployment risk.
Indeed, the four Social Europe(s) come out very clearly in this respect. Southern Europe is characterised by very strict employment protection regulations and a rather low coverage of unemployment benefits. Such a low coverage is partly a by-product of the fact that unemployment hits disproportionately the youngsters, who are without previous work experience, and hence do not qualify for unemployment insurance. However, high youth unemployment rates can also be seen as an endogenous response of the system to a lack of broadly based unemployment benefit systems. To the extent that only the job of the breadwinner is protected (by EPL) and insured (by UB covering only workers with long tenures), the provision of income support to the unemployed is ultimately assigned to the family (see Boeri and Perotti, 2001). In the Nordics instead unemployment benefits are particularly generous and comprehensive, notably they are available for long durations, while the strictness of EPL is lower than the EU average. Continental Europe is having slightly more of both than the EU average, while the Anglo-Saxon model would seem to be on a different “indifference curve” as it provides comparatively less protection than the others. Significantly, it is biased more against EPL than unemployment insurance.

Limited to these institutional features, comparison with the US is straightforward. The difference between the EU average and the US is striking. On average, the EU countries provide averagely generous benefits, to a large proportion of unemployed, and for quite a long period of time, while in the US benefits are barely existent (very poor and provided for a very short length) while employment protection provisions are mainly subject to firm-level bargaining.

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4 In Spain EPL has been eased in the second half of the 1980s and during the 1990s while the coverage of UB has been expanded.
5 France is the only OECD country having increased the strictness of EPL between the mid-1980s and the mid-1990s. See OECD 1999.
How efficient are these combinations of EPL and UB in protecting workers against labour market risk? One way to assess this is just to let workers decide it. A section of the ECHP questionnaire is particularly useful in this respect insofar as it asks employees with a permanent contract whether and to which extent they are satisfied with their present level of job security (rather than simply asking as other questionnaires about the perceived stability of their current post).

The histograms in Chart 6 measure the fraction of working individuals in the survey stating that they are dissatisfied with their present level of job security in the various countries. Nordic countries come out once more as those providing stronger protection against labour market risk, together with Continental countries, while workers in Anglo-Saxon and, above all, Southern countries are more concerned about job security. If we compare the information provided by this chart with the position of the various countries along the EPL/UB trade-off, it would seem that the right combination of EPL and UB from the standpoint of workers should envisage about average unemployment insurance and slightly lower employment protection than currently provided in Europe.
Finally, the four clusters of labour and social policy institutions which are present in Europe generate very different rewards from participation in the labour market, the third social policy objective listed at the outset. Incentives to work vary significantly from country to country as hinted by the large dispersion within the EU of employment-to-population ratios and unemployment rates. As shown by Chart 7, to attain the target set at the Lisbon Summit of at least a 70% employment rate by the year 2010 (65% by 2005), some countries would have to increase their employment to population ratios by about 2 percentage points per year. More importantly, in many countries (Italy, Spain, Luxembourg, Greece, Belgium, Ireland and France), this will require increasing labour force participation rather than simply absorbing unemployment. The type of “de-commodification” operated by social policies (Esping-Andersen, 1999), that is, the freeing of individuals from the need to toil and work to survive, will have to be reconsidered, notably in the Southern country group, if the targets agreed upon in Lisbon are actually to be achieved.
Another factor statistically reducing employment rates in Southern Europe is the presence of a large informal sector. There is not much deep economic thinking on this phenomenon. The puzzle to be investigated is why the “shadow sector” has increased in many countries (Schneider, 1999) in spite of improvements in tax collection technologies, which make it easier to detect and repress irregular employment. One explanation is that the informal sector is mainly composed of low-productivity jobs, which are viable only if employers and workers can evade paying labour taxes or operating at the contractual wage minima. Under these circumstances, repressing the informal sector may backfire increasing unemployment (Boeri and Garibaldi, 2000). Appropriate policies dealing with it are those reducing labour taxation at the low-end of the wage distribution, such as wage subsidies or reductions of social security contributions. Given that a system of social security contributions is already operating and involving relatively high payroll taxes in Southern Europe, there seem to be obvious administrative advantages in choosing a reduction in employer contributions over a standard wage subsidy. The only downside is that an employer contribution reduction has an upper limit: the implicit subsidy cannot exceed the current rate of contribution. But this does not seem to be an issue in Southern Europe, as statutory contribution rates are fairly high in this part of the Old Continent.

The Lisbon target was fixed having as a benchmark the US employment rate, which clearly outperforms Europe in this respect. To be fair, some European countries, and the Nordic and Anglo-Saxon models if we look at the groupings, are above or not that far from attaining the same participation scores of the US. Yet, out of the 3 criteria, this one, I let you decide whether or not it is the most important, has a clear winner on the other side of the Ocean (as viewed from a Brussels perspective).
Overall, our admittedly rough characterisation of Social Europes suggests that the same goals can be pursued in a variety of ways. The heterogeneity of European social policy models – which means both design and enforcement -- can be very valuable in identifying better (in terms of public expenditure savings and minimisation of deadweight costs) instruments to achieve these goals. Some very broad indications already emerge from our summary evaluation of the performance of the various models. Fortunately, models do not seem to be in conflict across the different criteria. The Nordic and the Anglo-Saxon models, in particular, obtain relatively good scores along all the various dimensions which were explored. The Continental model and, above all, the Southern social policy mix provide a comparatively rather poor performance in terms of redistribution, protection against labour market risk and mobilisation of the workforce.

2. Still Different?

The previous section indicated that the four Social Europes yield much different outcomes in terms of poverty reduction, redistribution, protection against un-insurable labour market risk and rewards from labour participation. An obvious question raised by this observation is whether a convergence is occurring towards a sort of pan-European social security model, progressively eroding away the differences across the various institutional clusters. This is the task set out for this section.

2.1. Assessing Convergence

To shed some light on convergence in social spending, we regressed the growth in social expenditure as a per cent of GDP over two sub-periods: the period 1980-90 (where we can draw on the OECD Social Expenditure database) and the period 1990-99 (where ESSPROS data are available). In particular we regressed the average yearly growth rate in social spending over GDP against its initial level for the cross-section of countries provided by the two datasets. Convergence in the unconditional sense is implied, according to this methodology, if the coefficient for spending in the base year is negative and statistically significant.

The results of this exercise are displayed in Table 3. We cannot reject this beta unconditional convergence for the OECD countries as a whole. However, the beta coefficient implies a very low convergence rate (-0.0015) and is barely statistically significant. The same type of conclusions can be obtained with reference to the second sub-period and for the ESSPROS country panel (which includes the EU-15, plus Iceland, Norway and Switzerland). Furthermore, in both cases the interaction variables for the EU area (or the EMU group) and the initial level of social spending are not significant, which suggests that there has not been an additional effect of European integration or the Monetary Union on the convergence in the size of the welfare state.
We also analysed convergence in terms of specific programmes and we tested another type of convergence, that is, *sigma-convergence*, i.e., whether the standard deviation in the logarithm of social spending had decreased or increased over time. These results are available, upon request from the author. Finally we looked at qualitative information on the nature of reforms, by drawing on a recent inventory of social welfare reforms in Europe.

Beta convergence would seem to be occurring only in two policy areas, namely social assistance and non-employment benefits. At a closer look, it appears that in the first case convergence is towards the top levels of provision while for non-employment benefits convergence involves a retrenchment of this programme category (Bertola et al., 2001).

Sigma convergence is useful is to assess the extent of convergence within and between the various country groupings. Significantly, convergence occurred mainly *within* the various social Europes, namely the four groups of countries typically used by taxonomies of the European welfare states rather than between them: the cross-country variation between social expenditure as a per cent of GDP decreased over the 1996-1980 period in all these groups of countries. In conclusion, there are some indications that the cross-country variability in the size of the welfare states is decreasing. However, this is occurring mainly within the various "Social Europes" rather than across them.

Finally we looked at the above mentioned inventory of reforms. The latter is based on a variety of sources (including country economic reviews carried out by OECD, Income Data Source studies, EC-MISSOC reports, etc.), and takes stock of reforms carried out in Europe over the period 1987-1999 in three domains: non-employment benefits, employment protection and pensions. Reforms are classified on the basis of their broad orientation, that is, whether they tend to reduce or increase

### Table 3

<table>
<thead>
<tr>
<th>Unconditional beta convergence</th>
<th>Average growth rate of social spending over GDP 1980-90</th>
<th>Average growth rate of social spending over GDP 1990-99</th>
</tr>
</thead>
<tbody>
<tr>
<td>constant</td>
<td>0.0438 ***</td>
<td>0.0463 **</td>
</tr>
<tr>
<td>social policy exp over GDP 1980</td>
<td>-0.0015 *</td>
<td>----</td>
</tr>
<tr>
<td>social policy exp over GDP 1990</td>
<td>----</td>
<td>-0.0014 *</td>
</tr>
<tr>
<td>EU15 * base year soc.exp/GDP</td>
<td>0.0001</td>
<td></td>
</tr>
<tr>
<td>euro11*base year soc.exp/GDP</td>
<td></td>
<td>-0.0003</td>
</tr>
<tr>
<td>R2</td>
<td>0.45</td>
<td>0.26</td>
</tr>
<tr>
<td>number of observations</td>
<td>22</td>
<td>18</td>
</tr>
</tbody>
</table>
the generosity of non-employment benefits and make employment protection more or less stringent, and their radical or marginal nature. Details on the inventory of social policy reforms produced at the Fondazione Rodolfo Debenedetti are available at www.frdb.org.

Contrary to popular wisdom and to the belief that labour market and social welfare institutions cannot be modified, many institutional changes have occurred over the observation period. We counted almost 200 reforms, that is, more than one per year and country. However the changes have often been marginal (172 out 198 reforms, that is roughly 85 per cent of the regulatory changes did not pass our two-stage procedure identifying radical reforms). Moreover the reforms are almost evenly split between those reducing generosity and protection (107 out of 198, that is, about 55 per cent) and those increasing generosity and employment protection. It is also not infrequent to find reforms going one against the other just a few years apart. These inconsistencies and the marginal nature of most reforms have significantly increased the institutional complexity of the European landscape. In the field of employment protection, for instance, we have assisted to a multiplication of contractual types, with a number of fixed-term and unstable jobs going hand-in-hand with permanent and still heavily protected positions. All this has increased the dualism of European labour markets, making them more segmented not only between insiders and outsiders but also among various types of outsiders.

Overall, there are indications of a very mild convergence in the size of the welfare state across OECD countries, and the EU integration process does not seem to play an additional role in this process. The four institutional clusters described in the previous section are not losing explanatory power in coping with European institutional heterogeneity. Action is occurring in terms of institutional reform, but it is rarely comprehensive and does not involve radical reforms. More frequently, reforms are segmented in the various fields, rather than playing over the trade-offs involved by the design of social policies. Among the various programme categories, the most significant changes are occurring in the field of non-employment protection and social assistance. Unemployment benefits are becoming less generous or at least involve tighter enforcement of work-tests and there is a tendency towards the reduction of the system of job-guarantees offered in the past to employees, although this happens mainly “at the margin”, while grandfathering existing entitlements. In social assistance, the trend goes just the other way round: the generosity of provisions is increasing over time and convergence is occurring towards the top rather than the end of the distribution.

2.2. Preferences and political obstacles to pension reforms

Slow convergence in Europe may be due either to persistent differences in preferences of households as to the size and composition of the welfare state, to status quo bias or combinations among various types of political economic constraints.
Ongoing work assessing attitudes of European citizens towards the size and composition of welfare state (Boeri, Boersch-Supan and Tabellini, 2001 and 2002) would seem to downplay the first explanation. Citizens of countries with the smallest welfare states (e.g., Spain) are more prone than others to support an increase in social security contributions and taxes than French and German citizens who already have a generous welfare system. Preferences over reform options in specific areas are also in line with similarity in preferences. To give an example, an increase in retirement age finds a majority in Italy, where the effective retirement age is lower, whilst it sounds as a rather unattractive option to German workers. Similarly, a reduction in the replacement rate offered by public pensions finds a slim majority in Germany, where pension benefits are higher, but it is the most disliked option among Italian workers.

Other indications on attitudes of EU citizens come from a special wave of the Eurobarometer survey entirely devoted to elicit preferences over social welfare reforms. Unfortunately, many questions/answers are not very informative insofar as they do not put the interviewees in front of the relevant trade-offs. Those that do so, confirm that preferences are not inconsistent with convergence. Chart 8, for instance, display answers to a question embodying the budget constraint (“Current pension levels should be maintained even if this means raising taxes or contributions”). Interestingly enough, the countries where there is a stronger support for a retrenchment in pension expenditure are just those (we know from Section 1 that it is Continental and Southern Europe) where pension spending over GDP is larger.
The above example is relevant because pension expenditure is what is ultimately preventing the weaker institutional clusters in Europe – the Southern and the Continental models – to get closer to the Nordic and/or the Anglo-Saxon welfare systems, offering a better performance on many grounds, as discussed in the first section. The fact that there are more citizens in favour of reducing pension spending in countries like Italy, France, Germany and Spain than elsewhere, however, is not always sufficient to yield reform pointing decidedly in that direction. Italy and more recently Germany have implemented parametric reforms of their pension systems. Parametric means that these reforms are just too slow and shy to free resources for the expansion of other social programmes. At most, they stabilise pension spending, while pension to GDP ratios should decline in spite of an ageing population in order to accommodate more welfare and family-friendly employment policies.

The reason why more radical pension reforms are not taking place in the high pension spending countries may be then that there is a sort of status quo bias preventing the support for the retrenchment of these programmes to gain a majority. Political scientists, such as Pierson (1996), suggest that the citizens preferences over the welfare state adapt to the status quo as voters suffer from a “negativity bias”: once they get something, they don’t want to give it up. If so, the voters’ psychology induces path dependence in politics. An alternative interpretation is that some powerful lobbies (e.g., employers and employees’ organisations to start with) impose the status quo even when this goes against the preferences of a majority of citizens. Clearly, both of these political economic mechanisms – endogeneity in preferences and problems in the representation of voters – may be present jointly obstructing reforms of those Social Europes which would need heavier restructuring.

3. Final (and normative) remarks

While we leave the task to better identify political obstacles to pension reforms to political economy scholars, we prefer to be normative as we are, after all, approaching the end of the paper.

The key issue is: are there mechanisms which could provide a “voice” to these minoritarian groups of citizens who seem to form their preferences over pension reforms in a way which is consistent with a convergence of EU social policies towards the best performing models?

One of these mechanisms is sheer pressures from supra-national European authorities. Supranational bodies may be in a better position to assess pros and cons of the various models, are not subject to pressures of local lobbies and have typically longer horizons than national governments (and horizons are crucial in areas like pension reforms). However, delegating authority to Brussels on these issues runs against basic principle of democracy, given that most EU supranational authorities lack, as yet, political accountability. Moreover, there are important counter-indications to imposing convergence “from the top”, which are dictated by our analysis in Section 1. As Social Europes are so different (and still so) one of another, reforms ought to be respectful of the initial conditions, that is, they have necessarily to adapt to the various Social Europes. By imposing the same pattern of reforms to the different European social policy models there is a high risk of jeopardising altogether reform efforts. An additional reason for not imposing a single European social policy model is that social policy reforms need to be comprehensive, hence they should necessarily work on country-specific institutional clusters. Otherwise, they are bound to fail.

All this makes a strong case for maintaining EU-level decision-making on social policy reforms under unanimity rule. Majority voting on these issues, after all, may just end-up providing the
worse of each welfare system with the countries with the best social policies being always in minority.

Does this mean that nothing can be done at the EU level to support reform efforts aimed at improving the efficiency of European welfare states? There is a way to reconcile stronger conditionality on the part of European supra-national authorities with country-specific reform trajectories. This involves assigning to the European Commission powers in imposing improvements in the administration of welfare policies in the various countries, e.g. in conditioning cash transfers to able-bodied individuals in working age to stringent work-tests. Pressures to reform may also come by imposing more transparency in social policy expenditure accounts. Common standards may be adopted to estimate the debt of public pension systems, develop social policy expenditure projections and provide generational accounts which can best isolate the various (often improper) functions played by public pension in the EU countries. Open co-ordination mechanisms as those devised at the EU level in field like labour policies and social protection (mainly social inclusion) are also likely to be important in this respect.

Another important mechanism to favour convergence to the best practices is to allow these marginal EU citizens to “vote with their feet”, arbitraging away some of the most undesirable differences in social policy models. This can only happen if citizens are allowed to gain access to the welfare of the country of destination at least on a flow, pro rata, basis. Although the enforcement of this principle is problematic in some areas, it allows individuals to choose the welfare system, the combination of taxes and transfers, that they prefer.

This “Equal Treatment” (of foreigners and nationals) principle is rarely enforced, although it is perfectly in line with EU rules. Significant costs in terms of foregone social security entitlements are still associated with migration of EU workers. This occurs especially in three crucial areas: i) lack of co-ordination of regulations concerning pension funds (notably in terms of length of vesting periods, indexation rules and bilateral agreements as to the actuarial valuation of accrued benefits); ii) the presence of national restrictions in the allocation of the pension fund portfolios, and iii) the absence of common rules as to the taxation of private pensions, e.g., specifying that the tax base is represented only by benefits and lump-sum payments (rather than contributions and capital gains).

In other fields, the equal treatment principle is applied only in a stock version. This means that a favourable treatment is offered to individuals moving from countries with a less generous system to a country with a more generous welfare state who obtain entitlements as if they had been living (and contributing) always therein. This stock version of the equal treatment principle clearly puts a high tax on the citizens on the immigration countries, notably on its immobile workers, who have to bear the costs of a larger social security budget. Native and immobile workers are, perhaps just because of this reason, less keen to allow migrants in.

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6 Although not explicitly stated, open coordination is sometimes considered as a kind of preparatory stage for the “enhanced cooperation”, already mentioned in the Treaty of Amsterdam and now explicitly called for by the Nice Treaty: after a breaking-in period, a certain number of countries more interested and open to the idea of a federal Europe could move on from open coordination to enhanced cooperation - that is greater integration as concerns substance and decision-making instruments.

7 Difficulties arise for the defined benefit schemes, such as unemployment insurance and many occupational pension schemes. Even more serious problems arise for the non-insurance components of welfare systems, such as the unemployment assistance benefits offered to persons under long-term unemployment (the European plague) and social assistance, which is typically open-ended (in which case only the stock interpretation of the equal treatment principle is applicable).

8 The Equal Treatment principle is stated by art 51 of the EC Treaty.
Non contributory parts of the welfare state can be put under pressure by the immigration of individuals who are likely to become beneficiaries of some sort of income support scheme, e.g., because they live in large families or have low levels of education and face a higher risk of unemployment than the average native worker.

There is some evidence that immigrants to the EU from non-EU countries are indeed receiving proportionally more social transfers than the native population (Sapir, 2000). Moreover not all the differences in access to welfare can be explained by observable characteristics of migrants (i.e., the number of dependent children, their marital status and skill level). In some of the European countries with the most generous welfare state (Denmark, Belgium, The Netherlands, Austria and France) there are indications that "residual dependency" is present thereby non-EU citizens receive social transfers more than what can be predicted on the basis of their characteristics (McCormick et al., 2002).

Fears of “welfare shopping” by migrants in the countries (e.g., many “small” EU members) with the most generous systems in place are widespread and are often used as arguments to reduce the scope of integration within the EU or to adopt overly restrictive migration policies (e.g., as in the case of the Danish elections). They also provide support for adopting very restrictive provisions as to the portability of social security rights. The German Council of Economic Advisors to the Ministry of Finance, for instance, recently recommended to replace the Equal Treatment Principle with a so-called Delayed Integration Principle (Richter, 2001), postponing access to welfare by immigrants for a few years after their entry. Others go as far as to advocate the so-called Origin Principle which forces migrants to “carry with them” social security rights and rules of the country of origin (Sinn, 1998). This type of arrangements are politically disruptive and may discourage migration which is essentially a supply-driven phenomenon.

The above concerns should not be overlooked even if migration within the EU involves small numbers. Europe is a Continent whose citizens are much less keen to change residence than in the US: less than half-a-percentage point of the European labour force changes region of residence within a year (compared with 2.5 per cent moving across states in the US). Actually, more mobility of the European workforce would be required to deal with the huge and persistent regional labour market asymmetries. Acute skill shortages and high labour slack tend to become chronic conditions of specific regions, they coexist within the same country even a few kilometers apart. More regional mobility in the EU is a key condition to “arbitrage away” part of these regional differences, which would also significantly contribute to growth by “greasing the wheels of the European labour market” (Borjas, 2002).

As Europe needs more mobility of its workforce, but there are fears of excessive mobility by those who are concerned about welfare shopping, the issue is to reconcile policies promoting mobility with the needs of the immobile citizens. The Equal Treatment principle, when rightly applied on a pro-rata basis, and accompanied with a co-ordination of EU social assistance policies, can achieve all this. More precisely, the ET principle should be fully applied only to the contributory or insurance part of the system whilst the components which have a most explicit redistributive nature and are financed out of general government revenues, e.g., social assistance of the last resort, could be co-ordinated at the EU level, e.g., by establishing common standards in terms of minimum guaranteed income schemes (Bertola et al., 2001 and Bean et al., 1998).

This type of arrangement would minimise welfare shopping and maximise intra-EU migration from countries with an inefficient to a more efficient welfare state. There is some evidence that the intra-EU migration of Europeans tends to be very selective in terms of its composition. Those going to
the Nordics or to the Anglo-Saxon countries are more skilled and younger than the natives, while
the EU population flowing to Continental Europe is older and less educated.

The mobility of the European workforce can be enhanced by increasing the portability of social
security rights and actually enforcing the ET. Although intra-EU migration will never become so
large as to arbitrage away the differences in the efficiency of the welfare state, the competitive
pressures which can be exerted by this mechanism are likely to be substantial, particularly at a time
when the European population is ageing. Not all migration is unpopular. A young and relatively
well-educated European workforce is a relatively scarce factor in many countries and regions. In
an attempt to attract these migrants Governments can be induced to reform the most inefficient
welfare states by drawing on the wide array of solutions which are currently available in Europe.
Selective migration policies cannot do this job as they can only deal with extra-EU migration and
inevitably are bond to be co-ordinated at the EU level.

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