The Welfare State in Europe: Economic and Social Perspectives
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Social Spending

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Abstract and Keywords

There is a great diversity among welfare states in Europe. This diversity is reflected in the scale of expenditures for social protection systems, their evolution over time and the division of expenditures among programs. This chapter analyses the level and structure of expenditures for the last year for which data is available. Then, it turns to the evolution of social expenditure over time. Even though one observes some convergence, social spending is increasing in almost all countries. One of the reasons for this is the development of entitlements that makes it difficult to dismantle programs that have lost most of their raison d'être. Another issue concerns the international comparison of programs that are public in some countries and private, but heavily subsidized, in others.

Keywords: entitlement principle, entitlement programs, net social spending, social burden, convergence, mandatory schemes, out-of-pocket spending

Key Concepts

- entitlement principle
- entitlement programs
- net social spending
- social burden
- convergence

mandatory schemes
out-of-pocket spending

3.1. Introduction

There is a great diversity among welfare states in the EU. As different systems have developed within the national context, mostly after 1945, it is difficult to generalize about a 'European model' of the welfare state. This diversity—which is at the heart of this book—is reflected in the scale of expenditures for social protection systems, the division of expenditures among programs, the structure and design of benefits, the organization and the sources of financing. This chapter deals with the first two points. We first look at the level and structure of expenditures for the last year for which data is available. Then, we turn to the evolution of social expenditure over time. The financing issue is dealt with in Chapter 4. We discuss the issue of comparison of social expenditures across countries and consider the problem of entitlement that explains why dismantling programs that have lost their relevancy is so difficult.

3.2. Level and Profile

The level of expenditure on welfare states in Europe for the year 2015 varies between 34.3 per cent of GDP in France and 14.5 per cent in Latvia, as shown **(p.27)** in Table 3.1. This lower bound is quite below the 19.2 per cent in the US. Besides France, the figures for Austria, Belgium, the Netherlands, and the Nordic countries are above 30 per cent. By contrast, expenditures in the East European countries, with the exception of Slovenia and Croatia, are below 20 per cent. It is tempting to check whether there is a relation between social protection and GDP per head. For decades there was a tendency for the richer countries to have the largest welfare states. Lately, this relation has disappeared, as Figures 3.1(a) and (b) show. In 1980, there is a clear positive relation between per capita GDP and social spending per capita. In 2014, this relation has disappeared.

Table 3.1. Total expenditure for social protection as a percentage of GDP, 1995, 2005, and 2015

	1995	2005	2015
Austria	28.9	28.1	30.0
Belgium	26.9	26.8	30.3
Bulgaria	–	14.6	18.5
Croatia	–	–	21.6
Cyprus	–	16.7	23.0
Czechia	16.2	18.0	19.7
Denmark	31.4	29.5	32.9

	1995	2005	2015
Estonia	–	12.5	15.1
Finland	30.6	25.6	31.9
France	29.9	30.5	34.3
Germany	27.5	28.9	29.1
Greece	19.1	24.1	26.0
Hungary	–	21.5	19.9
Ireland	18.2	16.7	20.6
Italy	23.3	25.3	29.9
Latvia	–	12.1	14.5
Lithuania	–	13.2	14.7
Luxembourg	–	22.1	22.7
Malta	15.8	17.1	18.2
Netherlands	28.8	25.8	30.9
Poland	–	20.0	19.1
Portugal	20.1	23.8	26.9
Romania	–	13.4	14.8
Slovakia	18.2	16.2	18.5
Slovenia	–	22.6	24.1
Spain	21.0	20.1	25.4
Sweden	32.4	29.5	29.6
United Kingdom	25.9	26.2	27.4
United States	15	15.5	19.2

***Source*: Eurostat (2017a), OECD (2016c)**

Countries with more or less the same GDP now show a wide range of behaviour. This new pattern is good news. When there was a clear relation between social spending and GDP, one was facing a ‘chicken or egg’ causality problem. At the same time one could argue that higher spending leads to **(p.28)** higher national income, and conversely that successful countries with high income per head can afford generous social protection. We shall come back to this question, as it has some bearing on the alleged depressive effect of social protection on economic performance. At this point we will simply note that today there is no such relation between social protection and GDP. When there was one, one could have hypothesized that the industrialization of the economy and the ensuing social changes led to both higher levels of income **(p.29)** and to the need for more social protection. Industrialization made life uncertain; at the same time, it forced out traditional insurance mechanisms such as the family at large.

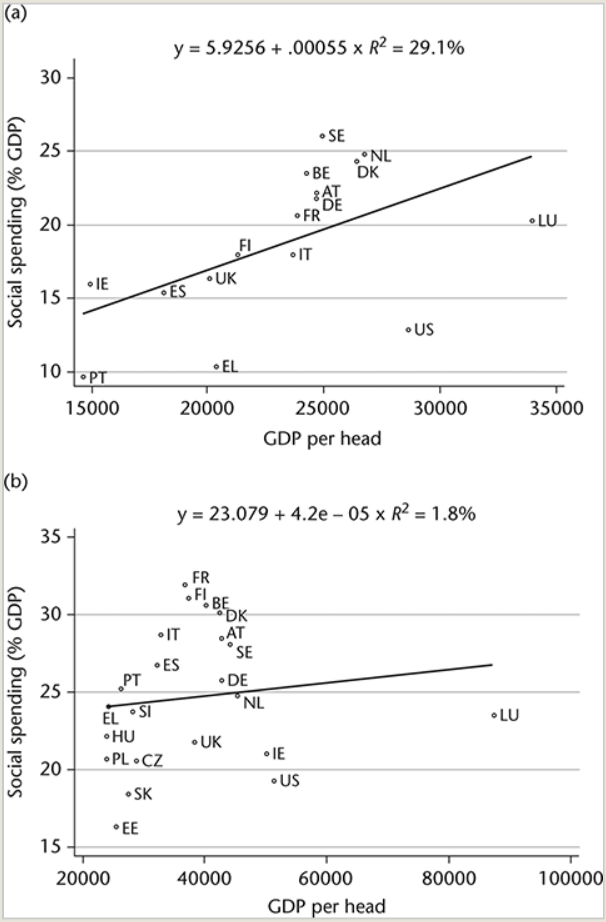

Figure 3.1. Social spending and GDP per head, (a) 1980, (b) 2015

Sources: Eurostat (2017a), OECD (2016c)

The breakdown of total social expenditures into individual programs reveals interesting similarities and specificities, as presented in Table 3.2.

Table 3.2. Social protection benefits by function, 2014

Country	Health	Old-age	Family /housing	Labour market	Others	Total
Austria	32.94	50.22	10.25	5.14	1.45	100
Belgium	36.61	39.65	8.34	12.54	2.86	100
Bulgaria	34.05	50.29	10.57	3.57	1.51	100
Croatia	52.16	38.04	7.38	2.21	0.2	100
Cyprus	25.23	52.32	9.92	6.75	5.77	100
Czechia	37.35	48.01	9.79	3.23	1.63	100
Denmark	34.56	41.04	14.25	6.17	3.99	100
Estonia	39.95	44.46	11.74	3.06	0.79	100
Finland	36.81	40.67	12.82	6.94	2.76	100
France	35.35	45.72	10.47	6.04	2.42	100
Germany	41.74	40.22	13.31	4.17	0.57	100
Greece	25.91	59.31	6.31	6.33	2.14	100
Hungary	31.11	51.91	13.89	2.63	0.46	100
Ireland	38.25	29.31	15.83	15.43	1.19	100
Italy	29.62	59.76	4.28	5.68	0.67	100
Latvia	30.57	56.17	8.18	3.69	1.4	100
Lithuania	37.06	46.75	8.78	2.72	4.7	100

Country	Health	Old-age	Family /housing	Labour market	Others	Total
Luxembourg	36.59	37.89	17.46	5.8	2.26	100
Malta	33.5	55.37	6.67	2.99	1.48	100
Netherlands	43.91	41.69	4.82	4.75	4.84	100
Poland	32.37	60.08	5.12	1.66	0.77	100
Portugal	32.39	54.77	4.9	6.81	1.14	100
Romania	34.71	54.26	8.72	1.13	1.18	100
Slovakia	39.4	44.06	10.16	4.02	2.36	100
Slovenia	38.61	47.14	8.55	3.07	2.62	100
Spain	33.49	45.62	6.01	14.03	0.84	100
Sweden	38.08	43.34	12.14	4.12	2.32	100
United Kingdom	36.51	42.11	16.1	2.36	2.92	100

***Source*: Eurostat (2017b)**

Pension benefits account for the largest share of social expenditures in welfare states, this level being particularly high in Italy and Greece, and particularly low in Ireland. The second largest component is health care: above 40 per cent in Ireland, Luxembourg, the Netherlands, Sweden, the UK, and Portugal, and equal or below 30 per cent in Greece and Austria. Together social security and health care account for over 75 per cent of social spending in all European countries. For the other functions, there is a large diversity that can be explained by social policy objectives. Unemployment benefits make over 10 per cent in Belgium, Slovenia, and Ireland, but are negligible in Portugal. Maternity and housing benefits represent more than 15 per cent of social spending in Ireland and Lithuania.

(p.30) 3.3. Evolution

A number of articles and books published over recent decades talk of the dismantlement (Pierson 1997),[1] the rolling back (Atkinson 2000), the end (Taylor-Gooby and Svallfors 1999) of the welfare state. In this section, we try to determine to what extent this scenario has been borne out.

Real social expenditures increase in all countries. But this upward movement proves to be far from homogeneous across time and countries. In any case, the most relevant comparison must concern social spending as a percentage of GDP, sometimes labelled ‘social burden’ for short.

Globally, the social burden goes up in all countries over the period 1995–2015, except in Sweden. But time trends are not linear. In the decade 1995–2005, it declines in a number of countries, particularly in the Netherlands, Ireland, and the Nordic countries, but in the decade 2005–2015, it only decreases in Poland and Hungary. In the US, the social burden increases from 15 to 19.2 per cent during those two decades.

Beyond a number of national differences, it is nevertheless possible to statistically identify three rather homogeneous subgroups[2] in Europe. Homogeneity is measured in terms of level of and change in social burden. The period is 1980–2015. Figure 3.2 represent the evolution of social spending in these countries. In each case, the thick line represents their average.

- High spending countries (Austria, Belgium, Denmark, Finland, France, Germany, the Netherlands and Sweden) display both the largest social spending rates and per capita incomes of the Union. We observe an important increase till the mid-nineties. Then a decline and again an increase in 2007, the start of the financial crisis.
- Medium spending countries (Spain, Italy, Luxembourg, Hungary, Poland, and the Netherlands) lie halfway between those of the other two subgroups. The Netherlands experiences a decline till 2007. The other countries have a slowly increasing pace.

- Low spending countries (Greece, Portugal, Czechia, Estonia, Slovakia, and the United Kingdom) remaining ‘laggards’ in terms of social protection while experiencing the highest growth rates (particularly Greece and Portugal).

(p.31)

(p.32) What have been the implications of those contrasted evolutions for existing international differences? The usual statistics and econometric tests show that they have markedly declined over time (see Table 3.3). On the one hand, the 25 per cent increase in the minimum to maximum ratio indicates that the gap between extreme social expenditure rates has fallen somewhat over the twenty-year period. It reached a peak in 2009 as a result of the financial crisis to which different countries reacted differently. On the other hand, there has been a certain reduction in the overall range of the European social burden, as illustrated by the fall in the coefficient of variation (from 22 to 17).

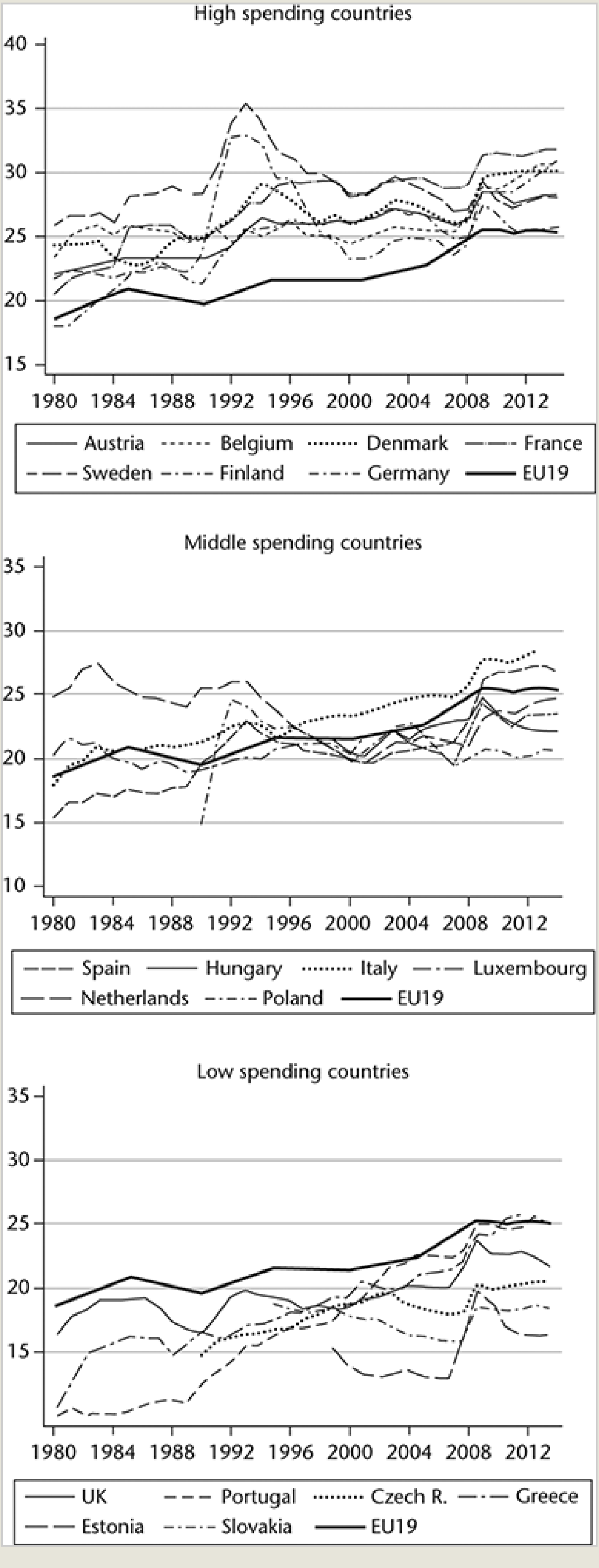

Figure 3.2. Social spending as a share of GDP, 1980–2014

Source: Eurostat (2017b)

Table 3.3. Convergence of social spending (1995–2014), EU 28

Year	Min/Max ratio	Coefficient of variation
1995	47.30	22.48
1996	47.32	21.94
1997	47.88	21.13
1998	48.19	20.59
1999	47.52	21.06
2000	46.29	20.92
2001	45.88	20.54
2002	43.81	20.29
2003	43.37	20.66
2004	45.34	20.37
2005	44.14	20.29
2006	43.72	19.92
2007	44.09	19.30
2008	53.82	17.13
2009	58.81	15.25
2010	57.93	15.50
2011	53.50	16.47
2012	51.53	17.23
2013	50.48	17.82
2014	51.01	17.94
	Initial social spending and subsequent annual growth rate	
EU15		
Correlation coefficient	–0.53	
Regression		
Constant	24.5	(20.73)
Slope	–0.16	(−2.73)
EU28		

Year	Min/Max ratio	Coefficient of variation
Correlation coefficient	–0.8	
Regression		
Constant	23.5	(21.22)
Slope	–0.1	(−5.64)

Note: *t*-statistics between brackets

This reduction in dispersion results mainly from the fact that less generous social systems (Greece, Portugal, Spain and Italy) in the early eighties experienced globally higher growth rates than more thriving systems (northern states). The existence of such a converging scheme is widely supported by the strong negative correlation between the initial social burden and the **(p.33)** subsequent growth rate as well as by the regression presented in Table 3.3. As one observes, the convergence is sharper in EU15 than in EU28.

To sum up, social burdens in Europe have been following a converging and globally increasing path since 1980, with some stagnation between 1993 and 2007. In the chapters devoted to specific social spending, we shall see whether these evolutions can be explained in part by an increase in the risk related to that particular spending. For example, one would expect the evolution in unemployment benefits to be linked to the rate of unemployment, and the evolution in social security spending to the increase in the dependency ratio. Figure 3.3 indicates that all functions except unemployment insurance have increased quite smoothly.

3.4. Problems of Comparison

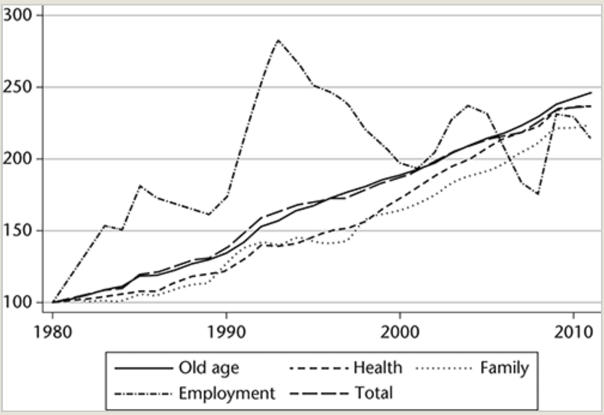

Figure 3.3. Real growth of social spending by functions at the EC level (1980=100)

Source: Eurostat (2017b)

Throughout this book we use social expenditure data made comparable over time and across countries by both OECD and Eurostat. Yet, this data may fail to reflect the true effort of a country in providing social support during a given year. Account should be taken of the role of taxes of benefits and of the transfers, which, although mandatory, are not paid by government. In other words, ideally, we should use a net rather than a gross concept of social expenditure. To do so, various delicate adjustments to raw data are needed. As it will appear, after correcting for differences in tax and institutional arrangements, some international disparities are less sharp than they appear at first sight.

(p.34) Following Adema et al. (2011) and Adema (1999, 2001), we look at four examples where adjustments are needed. To do so we consider two fictitious countries: Borduria and Syldavia.

- Borduria and Syldavia have a sickness benefit program involving contributions by employers to a social insurance fund as well as payments from that fund to qualified individuals. Borduria decides to abolish this program and by law to force employers to make payments to qualified individuals. As a consequence, social spending falls in Borduria relatively to Syldavia.
- Borduria and Syldavia do not tax social security benefits. Borduria decides to impose the regular income tax to retirees, but to increase their benefits so as to keep their net income unchanged. Social spending increases in Borduria.
- Borduria’s social security system consists of a meagre flat benefit, but it gives large tax advantages on contributions to private pension plans. As a consequence, social security spending is much lower in Borduria than in Syldavia even though the total flow of public money is the same in the two countries.
- Borduria and Syldavia are identical economies in all respect, except that Borduria experiences a great deal of volatility in GDP. As a consequence, social spending is much higher in Borduria in a period of cyclical bust, than in Syldavia, because of a higher demand for unemployment benefits.

Table 3.4 gives some results of these adjustments for a number of European countries plus the US for the year 2011. It can be seen that the magnitude and the sign of the adjustments of social spending vary quite a lot across countries. However, one should note that if two countries provide the same amount of social spending in net terms, this does not mean that the two systems have the same allocative and distributive effects. Take the case of the US and of Belgium. Based on gross figures, Belgium has clearly a more generous social protection system than the US. After the adjustments we have the opposite result. The reason is that in the US there are mandatory private schemes in the health care and the pension areas and that in Belgium most social benefits are subject to taxation. To the extent that private schemes are earnings related, one would expect the 'net' US social protection to be less redistributive than that of Belgium.

Table 3.4. Gross to net social spending as a percentage of GDP, 2011

Country	Gross	Net
Austria	27.7	24.3
Belgium	29.4	27.4
Czechia	20.1	19.3
Denmark	30.1	26.1
Finland	28.3	23.4
France	31.4	31.3
Germany	25.5	25.3
Greece	25.7	23.7
Hungary	22.6	20.6
Ireland	22.3	21.9
Italy	27.5	25.4
Luxembourg	22.5	19.1
Netherlands	23.5	25.8
Portugal	24.8	24.0
Slovenia	24.0	21.6
Spain	26.8	24.8
Sweden	27.2	24.6
United Kingdom	22.7	26.1

Country	Gross	Net
United States	19.0	28.8

***Source*: Adema et al. (2011)**

This type of adjustment has led some people to think that the US is after all not that different from many European countries. Focusing on health care, Kirkegaard (2009) notes that the share of total medical expenses that Americans pay out-of-pocket is lower than in the vast majority of European countries. He concludes that Americans are *more* likely to ask someone else to pay for their health care than people in many other countries and hence that their system is more 'socialized' than in most European countries. At the same time, we should keep in mind how inequitable is the American health care system.

(p.35) In Figure 3.4, we illustrate more clearly the difference between net and gross social spending in six countries. It is interesting to observe that gross social spending seems to converge more than net social spending. This is illustrated on Figure 3.5. To a certain extent, net social spending seems to correspond to a **(p.36)** stationary equilibrium, an equilibrium balance between the public and the private (mandatory) sectors.

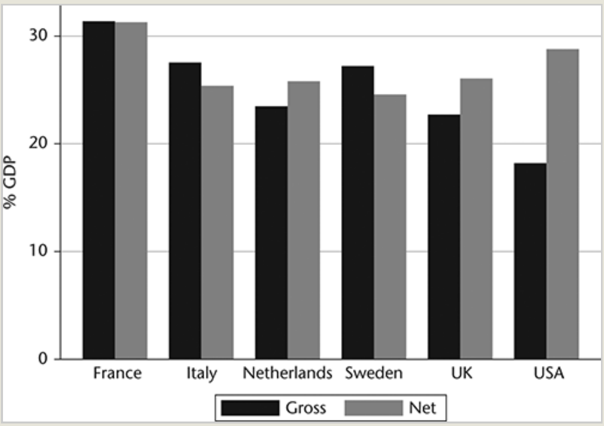

Figure 3.4. Gross and net social spending as a percentage of GDP, 2011

Source: Adema *et al.* (2011)

3.5. The Entitlement Problem

It is somehow surprising to observe that in almost all EU countries, even the high spenders, social spending as a percentage of GDP is increasing. As we see below, there are a number of factors acting against such an evolution. The main reason for the continuous increase of the social burden is the growth of entitlements.

(p.37) Entitlements are government programs providing funds to those who qualify, rather than appropriating a fixed amount of money for a program. For example, unemployment compensation is paid to those unemployed individuals who qualify; there is no set budget for the program (although there is an estimate of how much the program will cost). Entitlement spending is sometimes referred to as uncontrollable, because once the program is in effect, the level of expenditures depends upon external conditions. As a matter of routine, recent entitlement expenditures have exceeded estimates in all sectors of social protection, except family allowances. But this has not always been the case. In the beginning of social protection, programs made surpluses that were accumulated in funds.

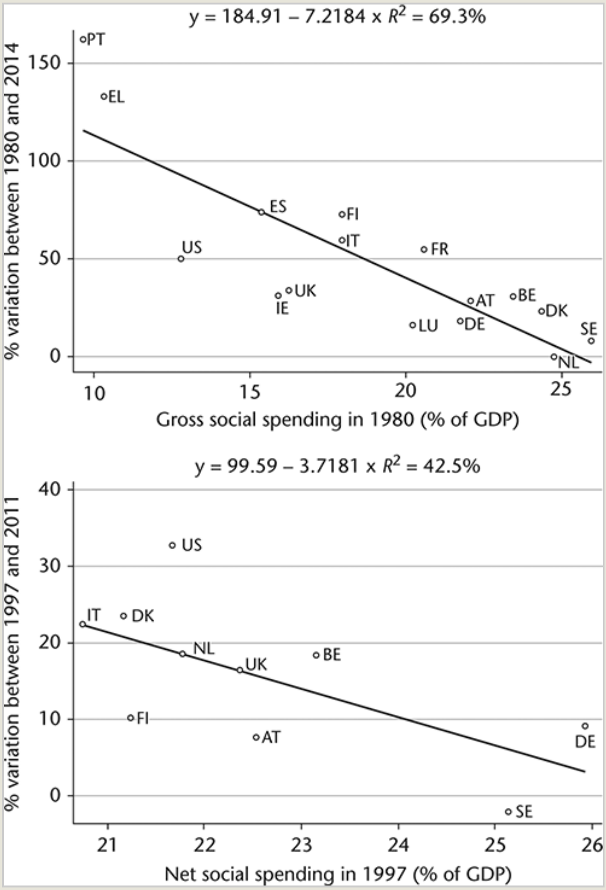

Figure 3.5. Convergence of gross and net social spending

Source: Adema *et al.* (2011)

The fact is that entitlement program spending is really not uncontrollable. At any time, public authorities can raise the eligibility requirements for any program, modify it, or cancel it altogether. But in order to do that, they face powerful lobbies. Cutting back entitlement programs when costs can be displaced onto future generations is particularly harsh in terms of political feasibility.

We shall come back to this difficulty, which is at the centre of the crisis of the welfare state, and specifically of the social security systems.

3.6. Conclusion

This chapter has provided an overview of the level, pattern, and evolution of social spending in Europe. Even though one observes some convergence, social spending is increasing in almost all countries. One of the reasons for this is the development of entitlements that make it difficult to dismantle programs that have lost most of their *raison d'être*. Another issue that has been discussed concerns the international comparison of programs that are public in some countries and private, but heavily subsidized, in others.

Notes:

([1]) Pierson (2001) is one of the political scientists in favor of the so-called 'new politics' of the welfare states. His view focuses on two factors limiting the decline of welfare states: the popularity of the welfare state and the existence of formal and informal institutional veto forces. As a consequence, he finds evidence supporting the effects of partisan politics. In contrast, there is another school of thought adopting the 'amended' power resources approach for which partisan politics plays a decisive role in the decline of modern welfare states. Korpi and Palme (2003) adopt this view in their analysis of the British case.

([2]) The F-test indicates that subgroup mean values are significantly different from each other for each year and for the entire period.