THE ROLE OF WELFARE STATE IN A GLOBALIZED WORLD AND WITHIN THE EU

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BUILDING WELFARE SOCIETY

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1. Introduction

The current crisis in the EU has been identified in a **insufficient fiscal discipline** of governments and the so-called **market rigidities**. The default risk of some peripheral countries has become an opportunity for countries to impose those **structural reforms** - the flexibility of the labor market and the reduction of the welfare system - only partially implemented in the early years of the euro.

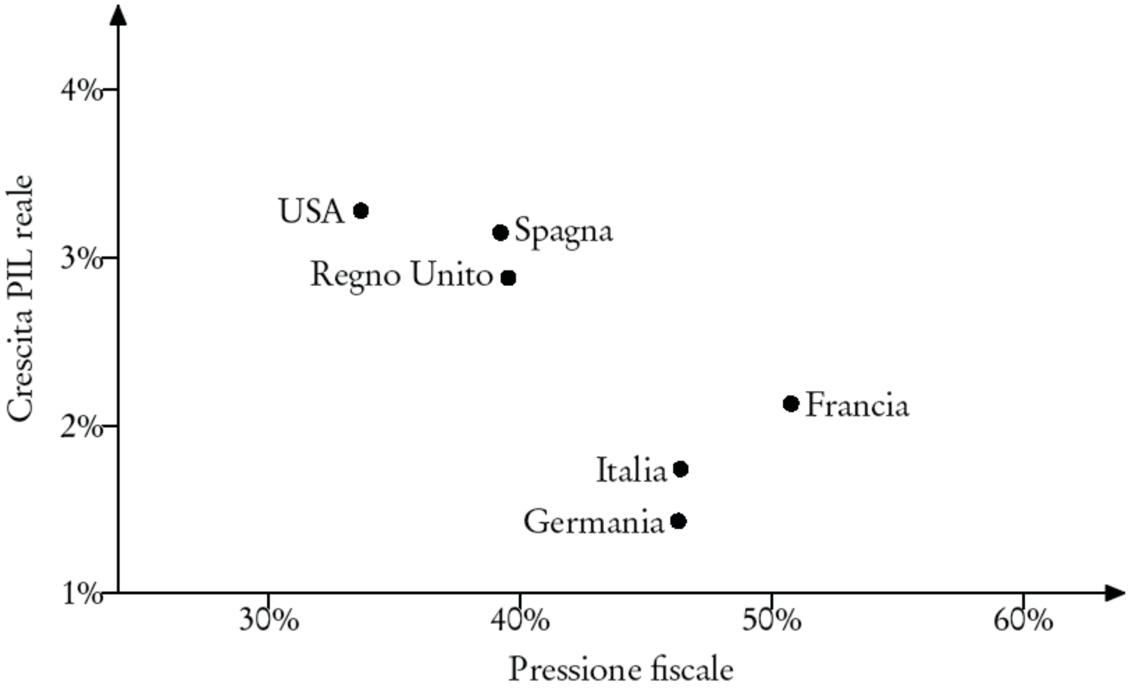
Distinguished personalities (Mario Draghi, King Willem-Alexander of the Netherlands) have openly declared **the end of the European social model**, i.e. a model characterized by high levels of social spending and regulation of markets and therefore incompatible with the requirements of sound public finances and international competition.

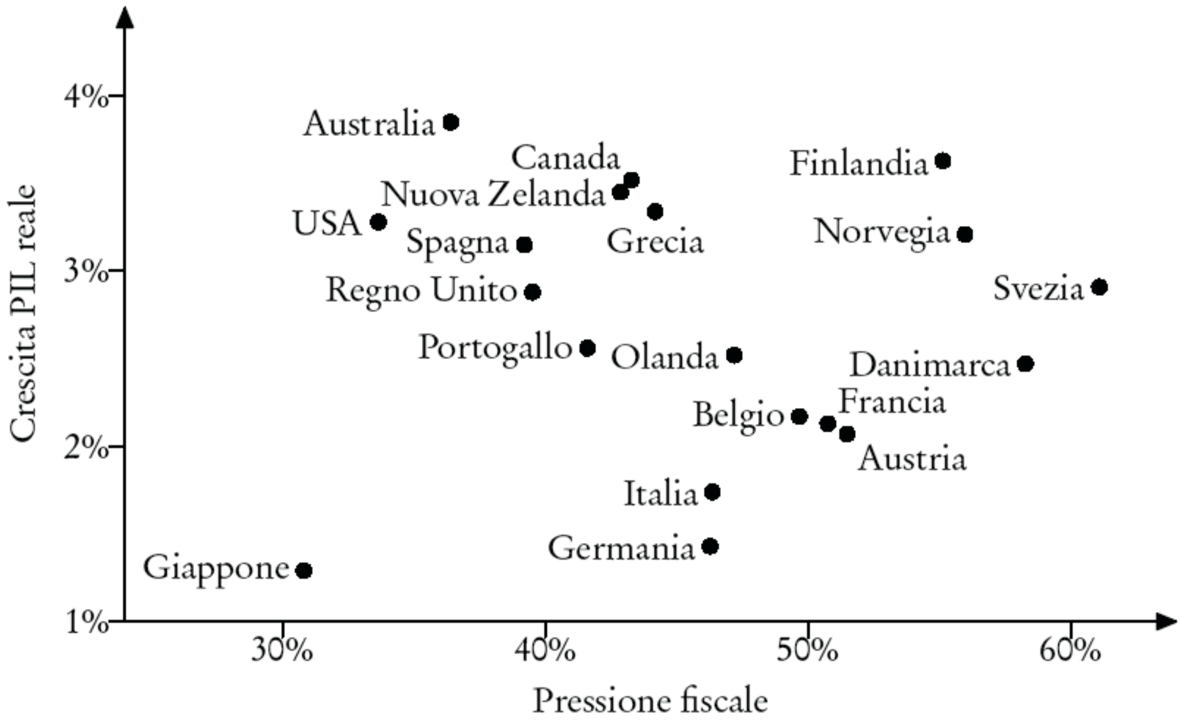
How solid is the argument that **public spending is an obstacle to growth**? Is there still room for the **European social model**, or we must resign to its decline?

2. Public Expenditure and Growth

The assessment of the **effects of public intervention on growth** has always been one of the most debated and controversial topic in economics (Temple, 1999)

The prevalence of one position or another was more often determined by external events and by cultural and political influence. The latter was the result of an **intense action of dissemination and propaganda**.





The premises of the **negative bias** towards public spending that has prevailed in recent decades is less solid than we might think (Bergh and Henrekson, 2011)

Reasons why the link between spending and growth is so elusive:

1. Many studies have focused on the **aggregate size of public intervention**, which is misleading measure of the actual size of public intervention, given the institutional differences and the plurality of ways in which is possible to organize a welfare system.

2. The size of public spending says little about its **redistributive content** and its potential distortionary effects. Different levels of redistribution may be associated with the same level of spending.

Universalistic vs. selective welfare state: is the latter less distorsive and more redistributive?

i. The fact that with the increase in income free welfare benefits are eliminate is a form of implicit taxation that ends up distorting individual incentives (Moene and Wallerstein, 2001)
ii. **Paradox of redistribution**: the abandonment of universalism ends up eroding the sense of belonging to the same community and undermines the basis of consensus in favor of public provision of goods and service (Hirshmann, 1970; Rothstein and Uslaner, 2005).

3. The insurance role of social spending

The identification between public spending and redistributive purpose is partial and misleading.

Social spending needs to be properly understood even in its **basic insurance function**, i.e. as a response to the failures of private insurance markets and to their inability to provide basic protection against health risks, old age, unemployment.

The **reasons for market failures** are due to the presence of asymmetric information, possible correlation of risks (systemic factors), high transaction costs, etc.

Redistribution and insurance can be considered two sides of the same coin: the redistributive activity has the effect of reducing the variability in the standard of living of the members of the community and thus reducing the risks associated with the prospect of not enjoying a successful career.

"*The state budget is by far the largest available mechanism of risk-absorption*" (Sinn, 1996, p. 260)

4. Welfare, globalization and risk-taking

Effects of globalization

Two effects:

i. increasing competition has led to pressure to **reduce production costs** (= reduce tax-burden on labor).
ii. high mobility of capital triggered mechanisms of **tax competition** in order to attract resources (= higher tax on less mobile factors like low-skilled workers).

What about empirical evidence?

Rodrik (1998): **positive correlation** between the degree of openness to foreign trade and the size of public spending. This is particulary evident in case of small open economies (Austria, Netherland, ...) but the same regularity is found for all the OECD countries.

Why? Public spending plays a **role in the absorption of shocks**, which are larger the more the economy is exposed to perturbations that are generated in international markets. The increased international exposure determines therefore a greater demand for protection by the state.

The link between globalization and reduction of social protection is not obvious. If mobility results in a shift of risk from capital to labor, it also leads to an increase in demand for protection. Taking into account this “insurance tax”, the **optimal level of taxation** could therefore be even higher than in case of closed economy (Arachi and D’Antoni, 2004).

Public spending and productivity

An insured person/firm will be **more incline to take risks**. Since riskiest options are also those with higher average productivity. Social protection encourages risk-taking and thus encourages investment, especially in human capital, i.e. the factor that modern economic analysis considers a crucial variable for growth (Barro and Sala-I-Martin, 1995).

5. Welfare State in the future of Europe

The **dismantling of the welfare systems of EU**, far from being the condition to overcome the crisis, is likely to be the final blow for the project of European integration (D'Antoni and Mazzocchi, 2013).

Distribution: opening international markets does not distribute advantage/disadvantage in a fair way.

i. Effects of globalization on the level of inequality in an example
ii. Risk of growing gap between interest of some citizens (cosmopolitan) and others (provincials).

What can we learn from the history of nation-states? Agrarian societies were characterized by a strong cultural diversity, both geographical and social. These made difficult for people to use some skills outside of the local context. The novelty introduced by nation-states was to spread homogenous culture and traditions, by removing barriers that restricted the mobility.

Cultural homogenization and the creation of a common national identity was not the only tool in the hand of nation-states. They created a **protection system** that can absorb the risks arising from the creative-destruction process of capitalist development.

Current situation in Europe: High level of solidarity within individual states and strong cultural and linguistic diversity among them. Moreover **mobility is very low**.

i. these two characteristics cannot provide a substitute for social protection, but …
ii. … at the same time the weak sense of belonging to the same community make the mutual insurance among European states less relevant than in US.

Forms of insurance and mutual inter-state transfers will be needed to ensure the **sustainability of the EMU**. Nevertheless, for the realization of this project it would take a very different political determination and a greater solidarity among European citizens. In the meantime, it is good to **keep national systems of social protection**.

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