

Recensione del volume:
***Institutions for Social Well-Being:
Alternatives for Europe*** ◇

COSTABILE L. (ed.)

Vito Tanzi*

1. - Introduction

Some cynic is reported to have stated that economics is the only field in which two economists can be awarded the Nobel Prize for advancing theories that are diametrically opposed. It is, thus, not particularly surprising that able economists may reach different conclusions about a complex issue such as the consequences of the policies associated with the welfare state.

The book being reviewed is of generally high quality and contains a lot of useful material. However, it leaves little doubt about the biases of most of the authors. They are squarely on one side of the debate: the side that believes that the welfare states, with their social policies based mostly on high public spending, have contributed significantly to the well being of European citizens. Furthermore, the high taxes that have been necessary to finance the high levels of public spending have not had negative effects on the performance of the countries' economies and on the welfare of their taxpayers. The various chapters cite economic literature that supports the above view but ignore, for the most part, the large literature that has reached opposite conclusions. This bias, however, does not make the book less valuable, as long as the reader is aware of it.

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* <vitotanzi@msn.com>, Honorary President of the International Institute of Public Finance, Munich.

In the next few pages I shall attempt to provide a brief summary of the content of each chapter, making some observations and comments. In a final section I shall draw some general conclusions.

2. - A Brief Survey of Individual Chapters

The introductory chapter written by the book's general editor, Lilia Costabile, provides a general survey of the book and of the debate concerning "institutions for social well-being". It refers to the standards argument that the European social protection system is necessary to remedy for certain economic and social failures that are believed to characterize market economies. She ignores the existence of government failure. She cites Sir Tony Atkinson to the effect that the European System of Social protection is «one of the most successful social innovations of recent centuries». Costabile mentions that the European Social Model is being challenged by a number of forces, including globalization, and «by theoretical and empirical arguments focused on the perverse incentive effects of social protection». Unfortunately the reader finds little in the rest of the book about these arguments. Thus, the European Social Model appears largely as a free lunch. The book would have been more value if a qualified critic of the present welfare state had been invited to summarize «the theoretical and empirical arguments» mentioned.

As Costabile recognizes, these are «economic arguments» and as such they are subject to quantitative analysis. Many such analyses are now available. Some conservative institutions, with obviously different biases, have compiled lengthy bibliographies on these arguments. See, for example, Mitchell, 2005, at The Heritage Foundation, and Lawson, *et al.*, 1998, at the Cato Institute. To cite, almost at random, from a paper in *The European Economic Review*, «...the more econometric problems are addressed, the more robust the [negative] relationship between government size and economic growth appears». See Folster and Henrekson (2001, page 1501).

Costabile asks whether «...economic arguments unambiguously counsel in favor of reducing social protection and cutting back the welfare state». She concludes that «the main contribution of this book consists in its conclusion that alternative routes [for providing social protection] are possible». I fully agree with her, but there is little in the book that discusses these “alternative routes” even though there are statements that “institutional fine-tuning” could remove some of the perverse incentives.

The first chapter by Professor Atkinson reflects his mastery of the topic. He has been one of the major contributors to the relevant literature and one of the strongest supporters of the welfare state. He raises the important point that an efficient social protection system could be a «productive factor» contributing to improved economic performance, because *inter alia*, it might encourage some individuals to take more risks, and, thus, contribute to higher growth, if a safety net is there to catch them in case of failure. The empirical relevance of this point is uncertain. In any case the protection offered may require high taxes and be accompanied by public spending inefficiency, of which there is a lot in welfare programs.

Atkinson addresses the relationship between globalization and the welfare state. Some economists, such as Rodrik, 1998, have argued that by increasing economic risks, globalization has led to higher public spending to protect the citizens at risk. On the other hand, in some of my own writing, I have argued that the welfare states were created when economies were relatively closed between the 1930s and the 1960s so that their creation had nothing to do with globalization. Atkinson questions this view. He believes that the welfare state was in place before 1918. Probably our difference is due to semantics. To me the welfare state was created when the share of public spending into gross domestic product became high. Before 1918 this share was extremely low, around 12 percent. High spending shares did not appear until well after World War Two, ignoring the war period (see Tanzi and Schuknecht, 2000 and 2007). Atkinson associates the welfare state with the earliest examples of state intervention in the social

sphere. We can both defend our position by quoting from chapter 7 by Bjorn Gustafsson, see page 180. Gustafsson writes that «...most of the expansion of the welfare state took place during the long period from the mid-1930s to the mid-1970s...». He also writes that Sweden was the first country to adopt a universalistic social insurance programmes in 1913. This program was then far from generous. It became quantitatively significant after 1948.

Atkinson's chapter provides a useful description of relevant developments within the European Union and addresses the question of whether globalization may make it more difficult for countries to raise the revenue needed to support high public spending. He maintains that, should the need to reduce total public spending become inevitable (because of lower tax revenue), it is not obvious that «the welfare state has to bear the entire burden». He also believes that fine-tuning existing institutions could go a long way to reduce disincentive effects as well as inefficiencies that increase with spending. I agree with the him in both of these points.

Chapter 2, by Menzi and Smeeding, provides a lot of detailed statistics on poverty and inequality for 33 countries, using the Luxembourg Income Study database. The chapter discusses various measures of poverty stressing that «there is no one absolute poverty measure». Thus, it focuses on Gini coefficients of income concentration. Gini coefficients must be estimated in relation to specific measures of income. There are several such measures, such as “money income”, “market income”, “post-social insurance income”, “disposable income” and others. See US Census Bureau, March 2007. This makes comparisons across countries difficult. The chapter presents various macroeconomic comparisons among countries including *per capita* incomes, employment rates, labor force participation, weeks of work per years, hours of work per week and so on. Large differences are shown to exist between countries.

Relative poverty rates are also shown to diverge significantly across countries. The lowest poverty rates are shown by smaller, highly developed, high spending, and ethnically homogenous

countries, such as Sweden and Finland. The role that pensions play in reducing poverty rates is shown. The authors discuss the anti-inequality and anti-poverty effect of public programs. They conclude that «countries are more similar in their levels of pre-governmental or market income inequality than in their after tax and transfers' Disposable Personal Income (DPI) inequality. Thus governmental action reduces inequality. They admit that «the relationship between anti-poverty spending and poverty rates is...complicated». The United States is shown to have a relatively high poverty rate however its «economic performance ... has been ... outstanding [over the years]». Thus, the poor may be poor in relative terms but richer in *absolute* terms.

Chapter 3, written by Samuel Bowles and Arjun Jayadev is a theoretically interesting paper but of questionable practical relevance for the rest of the book. The theory presented is stretched somewhat to accommodate a particular point of view. The theory assumes that any society needs two sets of individuals: those who produce the goods and services; and those that maintain order. This part is not controversial. Then they go on to assume that more equal countries need fewer people to keep law and order. They argue that some crimes increase with unemployment and with higher inequality and that this leads to a higher share of the population needed for “guard labor”. Thus there is an “enforcement-equality trade off”.

They attempt to measure “guard labor” for 18 countries. For the United States they also show the growth of “guard labor” from 1890 to 2002. For the 18 countries the share of “guard labor” in the workforce varies from 9.7 percent in Switzerland to 24.0 percent for Greece. They classify the countries into three groups:

«social democratic countries which display low levels of guard labor, English-speaking countries which display high levels of guard labor... and Southern European economies which exhibit high unemployment rates and thus large amounts of guard labor» page 83.

Bowles and Jayadev find that a negative correlation exists between social and welfare spending, on one hand, and guard

labor, on the other hand. They conclude that countries that, through high public spending, promote more equality do not need to allocate many workers to guard labor.

This is an interesting hypothesis that might have some plausibility under particular circumstances. However, forcing income equality in a society that, before the intervention of the government, would produce unequal «market income» distribution, also requires guard labor. Those who produce high incomes must be forced to release some of that income to the government. Depending on their reaction, this may require a lot of coercion. Just think of the guard labor needed in Cuba today or in the Soviet Union earlier. Additionally there are questions about the data collected. For example the large increase in the share of supervisors in the labor force reported for the United States — from 0.8 in 1890 to 15.7 in 2002 — may simply represent the transition from an agricultural society to an industrialized society with large corporations and different managerial structures.

Chapter 4, by Roberto Artoni and Alessandra Casarico, is a useful chapter that discusses several relevant issues. The chapter provides a definition of the term «welfare state», a term that is given different meanings by different people. For Artoni and Casarico the term:

«...refers to the group of institutions that perform two main functions: redistributing resources, and providing insurance against specific risks. The actions undertaken to reduce the inequalities present in a particular society and to strengthen social cohesion enter into the *redistribution function*. The institutions that furnish coverage against the risks of illness, old age, disability and unemployment are included in the *insurance function*; and so are the mechanisms that allow income smoothing over the life-cycle» page 96. Italic added.

This definition raises immediately some questions: first, how much redistribution can or should take place? Second, how much

more efficient is the public sector than the private sector in providing insurance against specific risks, once redistribution has taken place? Third, must the institutions be public or could they be private? The authors do not address these questions. They do, however, recognize that «...a large part of welfare...derives from transfers from employers to employees... so that the boundaries of the welfare state are not easy to define...» page 97.

There is another issue. The state can improve the market income distribution by making the market more efficient (through its regulatory function); or it can improve the *disposable* income distribution through its taxing and spending actions. Once this second alternative is chosen, questions of disincentives and inefficiencies become significant. It is thus difficult to agree with the authors that «if the primary function of the state is redistributive», efficiency becomes less important, pages 97-98. In fact, how truly redistributive is a welfare state depends in part or how efficient is the process of redistribution. (see Tanzi, 2008).

The chapter has several other interesting observations related to the impact of the welfare state on incentives, the link between individual's savings and pay-as-you-go pension systems, and the macroeconomic effects of the welfare state. In all these aspects the discussion is interesting but one is left with the impression that the authors make an extra effort to refute arguments that conclude that the high public spending and level of taxation associated with the welfare state in European countries may have had negative macroeconomic consequences.

The next chapter — Chapter 5, by Lilia Costabile and Roberto Scazzieri, is a bit of an outlier. They argue that the American Model of social protection cannot be a successful alternative to the “European Social Model”. In their view, particular circumstances, rather than the relative weight of the European welfare state, have been at the base of the better macroeconomic performance in recent decades of the American economy. These circumstances are (a) the position of the dollar as the key international reserve currency, which means that the US can issue debt in its own currency, can draw more seignorage from money creation, and

can avoid what is called the original sin; and (b) the fact that EMU has constrained «European macroeconomic policies... by the need to strike a difficult balance between “credibility” and “economic expansion”» page 135. A more relaxed monetary policy and a more lax fiscal policy would have generated more growth in Europe. This is surely a radical theory of long run economic growth. There is no objective way of providing or disproving the above assertions; there is no Popper test. Thus, the readers must rely on their “gut feelings”. This reviewer is not convinced by the above hypothesis.

The chapter has other interesting things to say. Welfare policies can be related to “capacity promotion” or “well-being promotion”. However, capacity promotion policies are really supply-side policies which may have little to do with whether a country is or is not a welfare state. The authors state that «[a] welfare policy based upon capacity promotion may induce increased competitiveness» page 142. This, of course, is correct although it is not clear why such policies would be called “welfare policies” rather than structural or supply-side policies. The reality is that most welfare policies transfer large purchasing power to individuals already retired who are thus unproductive (see Italy) or incapable of being productive (invalids). These policies may be justified but are not likely to increase the competitiveness of countries. In the concluding section the authors point to the need for European institutions to combine “capacity promotion” with social well-being. One can agree with them, as long as the balance between the two is right and the so-called capacity-promoting policies are the right ones.

Chapter 6, written by Francesca Bettio and Jannelle Plantenga, deals mainly with “social care”. The issue here is how the responsibility for “social care” ought to be distributed among the family, the state, and the private market. The role that charitable institutions play is ignored. The specific groups in need of social care are (a) the very old; (b) the very young, and (c) individuals who cannot take care of themselves because of physical or mental limitations. Traditionally the family has been

the main caretaker. In recent years, in advanced countries, this responsibility has been shifted in part or, in some cases, totally to the state or to paid services available through the market. The authors ask what “care strategies” are followed by different countries.

They identify two different models, the Nordic one and the Mediterranean one. The Nordic model relies mostly on the state to provide social care. The Mediterranean model continues to rely significantly on the family. The consequence is that in the Nordic countries (especially) female employment is very high. In the Mediterranean ones, it is much lower. Since, as Atkinson points out on page 23, it is employment that is the target established by the Lisbon initiative, this lower employment of women in Mediterranean countries is seen as a shortcoming.

It should, however, be recognized that in the Nordic countries many working women work for the state and are engaged in state-supported social care activities. Thus, in many cases, they end up performing the same main tasks, *vis à vis* strangers, that they would have performed in the family, *vis à vis* family members in need, in the absence of the state programs. It is difficult to determine which option is socially preferable. The reply may depend on cultural attitudes and on whether one gives more weight to the preferences of those who provide or receive the services.

There are two related issues that could have deserved some attention in this interesting chapter. The first is the effect that the state’s free (or cheap) “supply of care goods and services” may have on the demand for these services. Could there be a variation of Say’s Law at work in this area that might result in the supply creating some extra demand? (see page 189 of Chapter 7). The second is the impact of the increased supply of public services on measured welfare. These two aspects are discussed briefly.

There is a lot of evidence, from several countries, including Sweden, the Netherlands and others that the number of some of those demanding “social care”, especially when the classification involves cash-benefits, is elastic with respect to the supply. Make invalidity a criterion for qualifying for benefits and the supply of

«invalid» will increase. Make older people in need of care a criterion for assistance and their number will increase. Less surely, increase child care, and the number of new babies will rise. It would have been useful to have some data on, and some discussion of, this issue.

The other question is the impact of different «care strategies» on welfare and on the measurement of national income (see on this Tanzi, 2005). When (especially) the state assumes much of the responsibility for social care, and this activity is transferred from families to the state, this is followed by a large increase in the proportion of working women, as happened in Sweden, working for the public sector. Many of these women end up doing, *for payment*, the same jobs they were doing in the family *for free*. However, now they get paid and their services are counted in the national income statistics. This is likely to distort the comparability of national accounts statistics and to convey the impression that the country that has chosen this strategy is richer and has grown faster, during the change, than the country that continues to provide the same services within the family.

Chapter 7, by Bjorn Gustafsson, on the Swedish Model is a particularly good one that describes, in some details, the rise of the Swedish welfare state model, its progressive maturation and adaptation in the 1970s and 1989, and some of the changes that followed the financial crisis of the early 1990s. This chapter makes it clear that the Swedish model has changed significantly over the years and much more than conveyed by the rest of the this book. The chapter provides a useful description of the initial creation of the Swedish model from the first seed, in 1913, when a very modest universalistic social insurance programme was introduced, to its maturing in the 1940s and especially 1950s, and to its revisions in the 1970s and later.

The author recognizes that the social services offered by the state are typically provided by women, making the Swedish welfare state not gender neutral. He also reports that for at least four decades, from the 1950s to the 1980s, when the share of public spending and of taxes into GDP was growing rapidly to reach world records, «economic growth in Sweden was slower

than in many rich countries» page 177. During this period Sweden's standing in the world's *per capita* income league fell from one of the top 2-3 spots to around 20th, as Assan Lindbeck pointed out (see Lindbeck, 1997). This fact, and the financial crisis of the early 1990s, prompted the various governments to rethink some of the more damaging features of the system and begin to make important corrections.

In 1976 a non-Social Democratic government replaced the social democratic rule that had lasted four decades and that had been responsible for the expansion of the Swedish welfare state. As Gustafsson puts it «the first impulses of movement away from the Swedish Model came...in mid-1970s» page 184. The model was not abandoned but reformed in several significant aspects to reduce perverse incentive effects. The reforms were accelerated in the 1990s. Unfortunately, there is no space here to list the many changes. It may be sufficient to report that, between 1992 and 2007, the Swedish share of public spending into GDP fell by an extraordinary 16.7 percent of GDP. (see Tanzi, 2008). During this period «the public sector was no longer the dominant provider of social services; market allocation has come to play a larger role within the public sector» (see Gustafsson, page 194). This was the period when Sweden started growing again at a faster rate than the rest of Europe, benefiting from the many disincentive-reducing reforms and from the cuts in public spending and in taxes. This validates a point made by Atkinson in his chapter, that one need not abandon the objectives sought by the welfare state. But significant reforms are possible. I would go as far as saying that the reforms may accommodate a much larger role of the private market, if an intelligent use of regulations is made (see Tanzi, 2006).

Chapter 8, written by Massimo D'Antoni and Ugo Pagano deals with a topic that has attracted a lot of attention over the years, namely the relationship that exists or may exist between cultural homogeneity (or heterogeneity) and economic solidarity. Looking at Gini coefficients for groups of countries, one cannot fail to notice that, by and large, the countries with lower Ginis — *i.e.* with greater equality of disposable income — are small and homogeneous countries. The view has been that it is easier for

governments of smaller and more homogenous countries to promote policies that redistribute incomes and promote more solidarity. Redistribution within families is easier. In some sense homogeneous countries can be seen as extended families.

Economists generally consider cultural diversity (heterogeneity) as exogenously given. However, over a period of time, national states may create a greater degree of cultural homogeneity that later facilitates the task of introducing income redistributing policies. Thus, under particular conditions, and over the long run, homogeneity may become endogenous. This may have happened in France over the centuries. It promoted a standardization of language and culture over the whole territory over a long period of time. By forbidding the use of dialects, it promoted more cultural uniformity and in recent decades this made possible larger levels of public spending and more redistribution.

This chapter contains an interesting discussion of the fact that technological development requires specialization on the part of workers. But specialization implies risks especially in a globalized world. Those who learn how to make, say, GM cars may face difficulties, when Toyotas replace GM cars. The workers cannot use their job specific skills in other jobs therefore, the government budget must be “the largest risk-absorption device available”. The trouble is that, as the author of this review has pointed out in various papers, globalization, by creating “fiscal termites” may also reduce the government ability to raise taxes, thus reducing this ability to be a shock- absorber (see *inter alias*, Tanzi, 2002). Thus, globalization «increases the cost of redistribution, and therefore jeopardizes the sustainability of European-style welfare state» page 210 (on this issue see also Hines, 2006).

The chapter contains several other interesting observations that lack of space makes it difficult to summarize or comment on.

3. - Concluding Remarks

As I indicated at the beginning, this is an interesting book that contains a lot of good information on an issue of great

importance and actuality. It covers many topics generally in a sophisticated way. The reader will gain a lot of specific knowledge by reading it. The book stresses the benefits that public spending, through so-called “institutions for social well-being”, can provide or has provided to the European populations in recent years. In this reviewer’s view the book would have been even more valuable if, in the benefit-cost evaluation of the welfare state, the cost side had received more attention. Surely there were significant costs on the populations associated with the high taxes that they paid, with the possibility that the growth rates of these countries were reduced over the long run, and with the growing inefficiencies that have accompanied high public spending. This benefit cost evaluation might have concluded that in spite of these costs, the welfare states were worth their costs, but this conclusion would have been an *a posteriori* rather than an assumed one.

There is evidence that some of the socio-economic indicators that governments attempt to promote with their spending programs could have been achieved with lower public spending. See, *inter alia*, Afonso *et al.*, 2005. There is also evidence that many of the objectives sought by governments could be reached through the use of well-designed regulations and tax expenditures. These alternative institutions deserve more attention in a world that has become more globalized and that, because of this, will make it more difficult for high-tax countries to maintain their current tax levels. This will force countries to make a choice: to abandon some of their social objectives or to promote them in different ways and through different instruments.

Good socio-economic indicators can be achieved with much lower levels of public spending. For example Norway, Australia, Canada and Ireland are in the top four places in the Human Development Index, published in the United Nations *Human Development Report* in spite of levels of public spending that are 15 to 20 percent of GDP below that of Sweden. This raises questions about the statement in the book’s Conclusion (page 229) that «the Nordic Model...as the “ideal type” for social policies....emerges as the most successful from every perspective

considered in this book...». It should be added that Norway and Canada had the number 1 and 3 ranking in the latest UNDP Report in spite of the fact that between 1992 and 2007 they had cut the share of their public spending into GDP by 14.7 and 14.2 respectively and that Sweden kept its good ranking in spite of a reduction in public spending equal to 16.7 percent of GDP (see Tanzi, 2008).

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