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Welfare in Europe and the United States

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Welfare in Europe and the United States : Convergences or divergences

Gérard CORNILLEAU[1]

Abstract

The European social and welfare models are questioned in the context of the internationalization of the economy. The situation is quite different in the US where the combination of a rapid economic growth, full employment and a usually less developed welfare state seem to alleviate economic and social burden of internationalization. A comparative study of the primary distribution of economic revenue between individual's wages, recruitment of new salaries and profits show a convergence between Europe and the US since the eighties. Meanwhile, the design of welfare state continues to oppose the continental euro-model to the US model. Scandinavian and British models maintain also there specificities. But ageing will challenge welfare state in every occidental countries. As a matter of fact it implies an increase of social spending everywhere. So if structural differences are likely to remain between social and welfare models in Europe and with the US one, the regression of public social spending could be stop and a new development of welfare state could appears essential to the equilibrium between market economy exigencies and social needs.

Keywords : Welfare state; international comparisons ; social models ; social spending

JEL codes : H4, H5, I3, P5.

[1] Translated from the French by Constance Bantman.

Welfare lies at the heart of the European political debate, while the French and the Dutch rejection of the European constitution project in the spring of 2005 can largely be explained by the worries stirred by the return of the primacy of economics over the social aims of public intervention. It was because the constitution project gave too much precedence to the demands of "competition" and the "free circulation of goods and services" that eventually, and especially in France, a majority of citizens preferred to halt—at least momentarily—the political construction of Europe rather than question the "European social model." In the political debate, the social model referred to is only rarely defined with precision: it encapsulates implicitly all the dispositions which protect the workers' status on the labour market and the compulsory collective insurance systems which fund unemployment benefits, pensions, healthcare expenditures and allowances for the disabled. It is generally admitted that in Europe the judicial system of workers' protection and the system of public insurance, which consist in welfare protection against the basic risks of existence (old age, illness, handicap, unemployment), are more widespread than anywhere else in the world. It is claimed that such an extension of European welfare leads to rigidities and, ultimately, to extra costs which impair economic productivity and account for the slow pace of economic growth. With respect to less developed countries, such as China, India or Brazil, differences in welfare cannot provide a serious explanation, while differences in wage expenditures result directly from the gaps in lifestyles and are widely compensated for by differences in productivity which mostly restrain competition to low-quality products. However, the explanation may have some credibility when it comes to comparing the American and European situations.

In order to assess the relevance of these reasonings, the reality of the opposition between the European and the American welfare models should be tested.

A lot of data is available, but interpreting it is delicate. In particular, the impact of the different judicial dispositions is very difficult to evaluate. It is true that, at first sight, American—or more generally Anglo-Saxon—labour laws seem less constricting than the labour laws of continental Europe. But anti-discrimination and equal opportunity laws impose constraints with respect to both hiring and dismissal procedures which are such that the judicial pressure over employment may actually prove to be as high in America as it is in Europe.

Moreover, the direct comparison of labour costs does not highlight a lasting gap in competitivity between the American economy and the European economy. The external bilateral trade between Europe and the United States remains very favourable to Europe. The competition between the welfare models appears to have very little direct effect over the commercial competition between the European and American economic areas, and so far the international financial system has made it possible to transfer global financial surpluses towards the deficient United States without any particular strain.

The stakes of the debates over welfare models thus appear to revolve primarily on the internal consequences of these models. What is under discussion bears upon the social consequences of the national systems: is well-being higher in liberal countries, in America or in Europe?

Welfare systems were all designed to stabilise the individuals' incomes over their lifetimes, so as to prevent situations of absolute poverty from arising, and to contribute to stabilising the economy by limiting the impact of macroeconomic fluctuations. The methods used to achieve such aims are very variable and the systems have numerous idiosyncrasies which make any comparison difficult. Moreover, the economic situations and the primary distribution of the growth returns also differ in each country and period. Of course, this is not without consequences for the welfare systems, which have to face different and changing challenges.

The macro-social context and its evolution in Europe and the United States from 1970 to the present day will be introduced in turn (§1). Then, the traditional typology of the welfare systems founded on institutional comparisons**.** This typology is relatively robust, since observing the structural repartition of welfare expenditures roughly confirms institutional remarks (§3). It will then be seen that the efficiency of welfare systems from the viewpoint of the fight against poverty still depends heavily on public spending levels (§ 4). Finally, the shared challenges which the welfare systems will have to overcome over the next years, and which mainly derive from the ageing of the population will be introduced last (§5). The crisis of the welfare state is now a common theme and in this perspective it will be shown that the crisis affects private insurance systems just as much, and that an extra effort to redistribute incomes will prove indispensable in the future on both the Western and the Eastern shores of the Atlantic.

1. Primary income sharing between wages, employment and profits: from the strong opposition between Europe and the United States in the seventies to convergence in the nineties.

In order to analyse the modalities in primary income sharing, it is convenient to decompose the added value's evolution according to whether it can be put down to a rise in employment, individual wages, or profits. Added value can indeed be decomposed according to the following equation, in which AV stands for the added value, *w* for the average individual wage level, *E* for employment, *P* for the companies' profits, and *Taxes*, for indirect taxes.

$$(1)\ AV = w^* E + P + Taxes$$

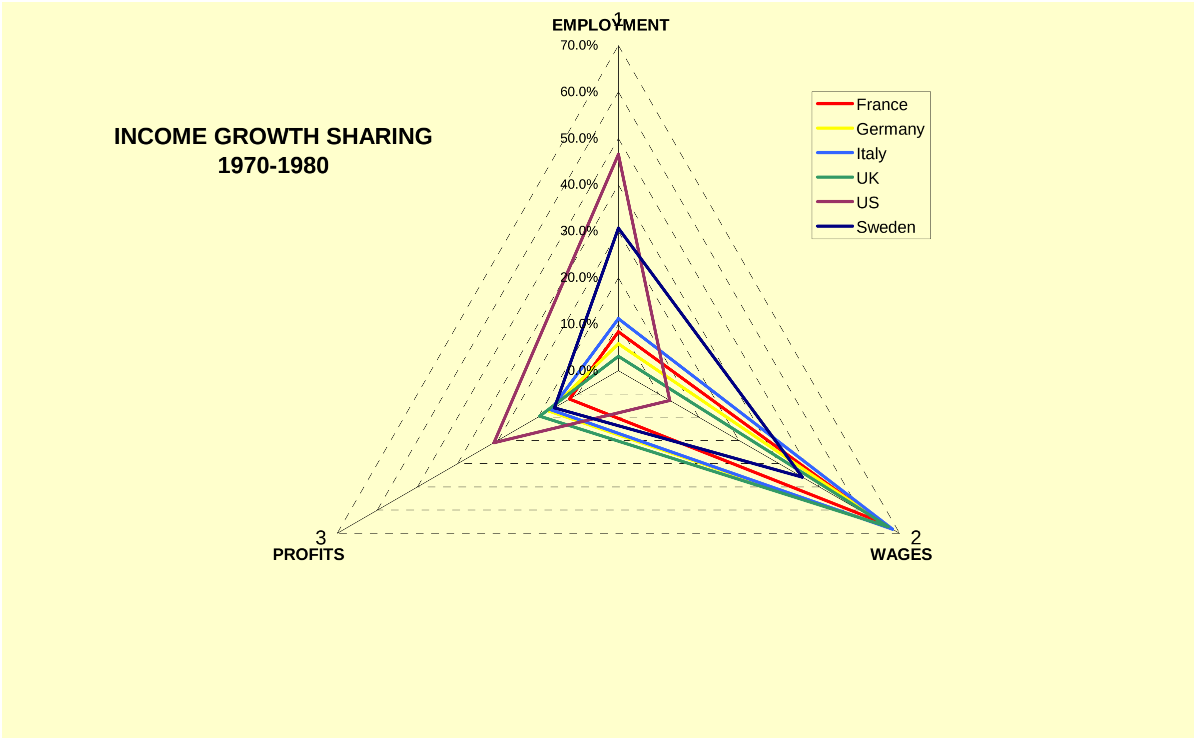
The added value's variation can then be decomposed according to whether it is associated with the individual wages' variation (1st term of equation 2), to employment variation (2nd term), to the combination of the variations of individual wages and employment (3rd term), to the variation of profits (4th term) and tax variation (5th term).

$$(2)\ 1 = \frac{\Delta w^* E}{\Delta AV} + \frac{w^* \Delta E}{\Delta AV} + \frac{\Delta w^* \Delta E}{\Delta AV} + \frac{\Delta P}{\Delta AV} + \frac{\Delta Taxes}{\Delta AV}$$

The following figures (1 to 3) retrace the evolution of the added value's growth sharing from the seventies to the nineties, between individual wages, employment and profits.[1]

In the seventies, the United States and Europe were clearly opposed with respect to primary distribution of wealth creations (figure 1). In the United States, work productivity was slow to evolve and individual wages did not increase by much. A very important part of wealth increase was thus affected to job creations. Also, the share attributed to profits was relatively high.

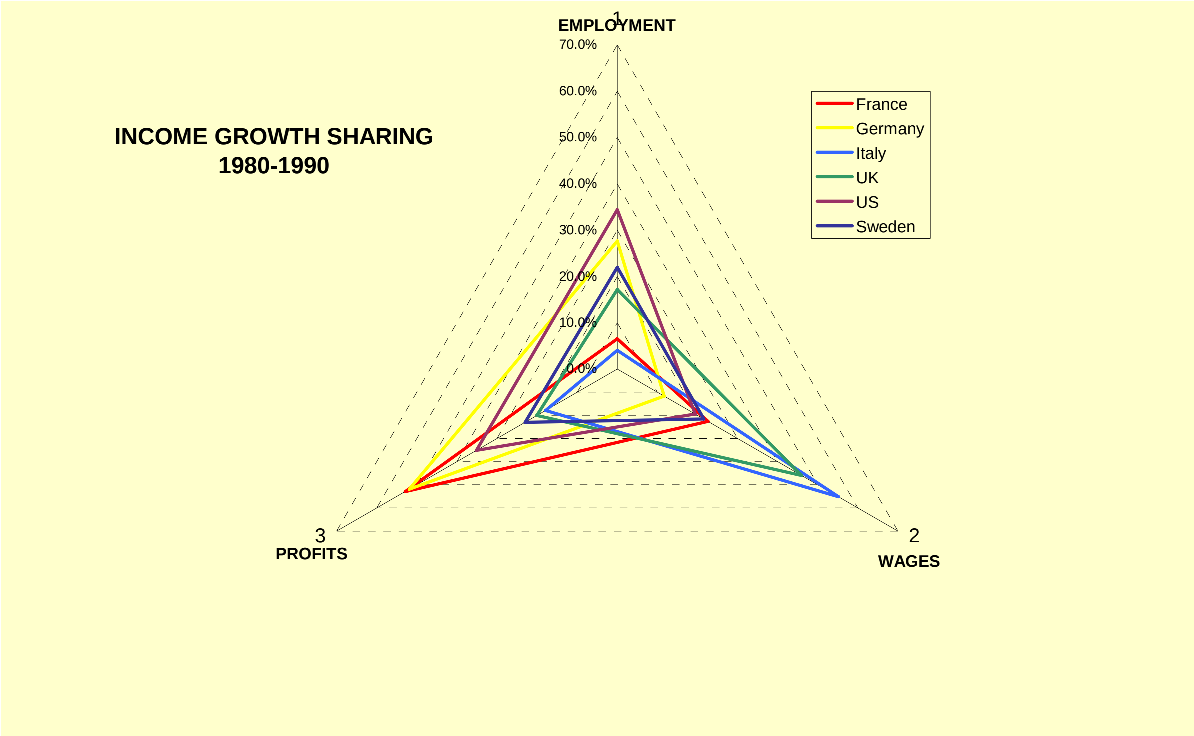
Figure 1: Distribution in the seventies: the strong opposition between the United States and Europe



On the contrary, in Europe, in the four largest countries, the largest part of income growth was used to improve individual wages, while the share attributed to employment was very weak and that of profit slightly less important than in the United States. Sweden presented slightly different characteristics, with a primary income sharing more propitious to employment than in the other European countries. Figure 1 highlights the very strong polarisation of the European and the American models in the seventies. Such a configuration of income growth sharing can be given a simple explanation, which rests on the gap in development between Europe and the United States. At the end of the war and up to the late seventies, the United States was far ahead of Europe. Individual wages were much higher there. However, because it was at the cutting edge of technological development, and these years did not see any technical upheaval, the increase of work productivity was relatively low. In the same period, Europe was in a very different situation; it had to catch up on its technological backwardness. Most of its employment growth resulted mainly from production increase, while a very sharp increase in work productivity made it possible for the individual wages' purchasing power to gradually meet that of the United States. Moreover, a very steep increase in production ensured a sufficient progression in profits despite the weaker growth share attributed to it.

The opposition between the American and the European growth models gradually disappeared from the eighties onwards (figure 2). In France and Germany at first, the evolutions following the oil crises did indeed lead to a major slowing down of individual wages, which saw their economic growth share brought down to the level of what could be seen in the United States.

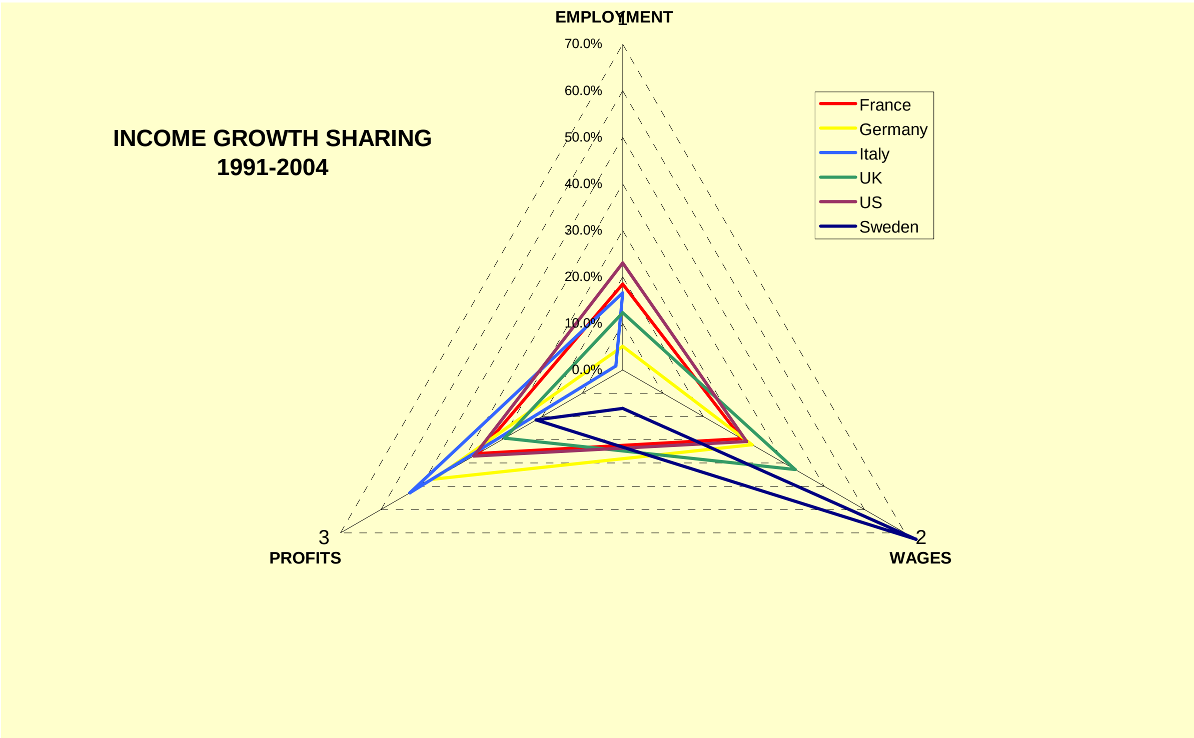
Figure 2: Distribution in the eighties: France and Germany align themselves on the United States



This change was accompanied by the attribution to companies' profits of most of the growth returns. In Germany, employment saw its contribution rise and the distribution scheme became almost identical with that of the United States, whereas in France job creations remained weak. In the United States, in Italy, the United Kingdom, and in Sweden, the primary income distribution pattern went through fewer changes than in the previous period. These stylised facts were characteristic of a period of structural adjustment in Europe within the countries which had previously experienced a very high growth, which had made it possible to catch up on American productivity and provided for a strong wage increase. But the mid-seventies and early-eighties oil crises had caused strong macroeconomic imbalances there because the wage increase had been going on and profits had been strangled by the rising energy costs. To some extent, the decrease of the wages' share and the increase of the profits' share in the distribution of growth returns therefore resulted from a delayed adaptation to the crises' consequences over energy-related production costs. In this respect the evolutions witnessed in Italy, the United Kingdom and Sweden only resulted from a longer adaptation lag. But, in addition to the necessity of adapting to the changing energy costs, the modification of the European distribution pattern and its increasing similarity with the American model corresponded to a deeper maturation trend of the European economy which was completing its phase of catching up with the American development level in the late eighties. The European economy's newfound maturity thus translated into a lasting slowing down of the work productivity growth which, through the threat of a widening of macroeconomic imbalances, forbade a quick increase of work returns from then on – all the more as the rise of unemployment made for a sharing of growth returns which was more favourable to job creations.

During the nineties and in the early two thousands, distribution patterns in Europe and the United States became very close while the Scandinavian model appeared increasingly autonomous.

Figure 3: Distribution in the nineties; the large European countries and the United States eventually converge, Sweden takes another direction



The macroeconomic adjustments being over in Europe, the single distribution pattern then became a very balanced sharing of the growth returns between individual wages, jobs, and profits. The share devoted to wages was slightly higher in the United Kingdom and the share affected to profits was slightly higher in Italy (where the adjustment had taken place later) and in Germany (the reunification implied a high level of investment and of productive capital accumulation), but there was an almost perfect superposition between the triangles of the European countries and that of the United States. On the contrary, in Sweden, the share corresponding to job creations became negative and that affected to individual wages became very prominent. This evolution resulted from the adaptation of the Swedish job market through the lowering of workforce activity. The early nineties' macroeconomic shock was very important in Scandinavia and led to strong employment cuts which could not be made up for in the early two thousands despite the increased competitivity made possible, in Sweden, by an important and lasting monetary devaluation. In order to cut unemployment the only solution then consisted in lowering the working population, which was provided for by social policies excluding the 'disabled' from the job market. These policies also made it possible to bring unemployment back to a low level, but they also contributed to the rise of social contributions. The originality of the Scandinavian model stands out clearly: in the event of macroeconomic difficulties, the size of the countries involved makes it possible to look for a solution through the increase of competitivity founded on currency adaptation and important rises in productivity. These allow for a wage increase, but important takings must be operated in order to fund high benefits meant for those excluded from the labour market.

The evolutions and changes in these primary distribution patterns have influenced social evolutions, the need for benefits and the conditions of its funding.

The primary sharing of the economic growth returns influences social evolutions through its impact on employment, unemployment and the evolution of incomes. When the economy and work productivity rise quickly, full employment is another consequence, since many jobs are created due to the growth, as well as a quick income increase, since productivity gains make it possible to fund wage increases without inflation and without evicting profits. This situation, which was characteristic of Europe up to the seventies, is conducive to social progress in all its aspects: increase of individual purchasing power, reduction of working hours, possible lowering of the retirement age, etc. However, when economy has joined a weaker long-term growth path, full employment can only rest on a strict sharing of wealth creation, which limits individual earnings and reserves an important part to job creations. Subsequently, even if the level of wages and individual purchasing power are high, their growth can only be limited. Similarly, there is little leeway to improve work conditions or distribute extra social benefits. The prolongation for a relatively long time of the sharing pattern inherited from the high growth, while economy had slowed down its progress because of the end of the catching up phase, accounts for the rise and then the maintaining of high level of unemployment in Europe, whose absorption was not finished yet. The lack of an efficient accompaniment to structural changes through relevant economic policies also explains the European difficulties. Restrictive policies were justified during the sharing pattern's first phase of adaptation to the slower rhythm of work productivity. Since the beginning of the nineties' the macroeconomic imbalances are absorbed, as shown by the disappearance of inflation, and the profit level is now compatible again with the funding needs of capital accumulation in the long term.

Over the same period, the United States encountered far lesser difficulties, since it only had to overcome the effects of the oil crises, without having to profoundly modify its income sharing pattern. The transitory nature of macroeconomic difficulties can also be explained by a much better adaptation of economic policy, which was traditionally used more massively and more quickly in the event of a rise of unemployment.

The consequences of overall economic evolutions and of the primary income sharing over welfare were important. In the United States, the emphasis laid on full employment made it possible to limit the need for unemployment benefits while the wages-profits sharing remained stable. On the contrary, the existence of an important work pool has made it possible to implement social policies geared towards welfare-to-workfare initiatives and income support for the most disadvantaged (through the earning income tax credit). However, in the European countries where unemployment rose the most as a result of the macroeconomic maladjustments amplified by inappropriate responses, economic policies were forced to increase their income support spending for the unemployed and people involuntarily driven out of work.

2. Institutional typology of the welfare systems

The art of classification and typology relies on a reduction of the complexity of reality which evidences the distinctive features of "opposite" models. In terms of welfare there is a traditional opposition between "Bismarckian" countries, in which insurance against the major social risks (illness, unemployment, old age) is organised within the job sectors or activity branches and financed by contributions taken from wages, and, on the other hand, Beveridgian models in which social protection comes from the state.

In Bismarckian systems, the guarantees given by social protection are delivered to the workers and their families, whereas those who live outside the world of labour are excluded *a priori* and must either ensure personally that they have sufficient incomes, or fall back on the poor relief organisations generally granted by local authorities and financed by taxes.

In Beveridgian systems, the state guarantees to the resident population income minima in case of unemployment, illness and during retirement. It also generally provides free healthcare.

Since Esping-Andersen,[2] these two basic models have usually been opposed to a Scandinavian model characterised by high levels of contributions and redistribution and by substantial state intervention. In this model, citizens have acquired rights, just as in the Beveridgian model, but they are far more important and they go far beyond the mere a minimum protection against social risks.

These three basic Welfare State models are coupled with economic organisation regimes which are also different, so that, in the end, three broad social and economic models are defined:

The "liberal" model, which combines greater economic freedom (few regulations on the goods and services markets, few public companies, reduced State intervention), with a minimal welfare state of Beveridgian inspiration.

The so-called "conservative" or sometimes "corporatist" model, in which the State plays a much greater part, and economic regulations are stronger (especially in the sphere of labour legislation) and the welfare state derives from Bismarckian inspiration.

The Northern European countries' "social-democratic" model, in which the state plays an important—but different—role. Indeed, it is geared towards redistributing incomes and securing high social guarantees (especially in the event of unemployment) rather than market regulation.

This typology is helpful to understand what national debates about welfare revolve around. A liberal-leaning country will debate above all the realm of application and the limits of welfare. Indeed, in such a system, the central questions hinge above all on determining the income level below which some intervention and state help are required, and the situations which must be covered by social intervention (unemployment type, family situation…). In a country with a conservative tradition, the debate will naturally be more about judicial regulations and their simultaneous impact on the economy and workers' security. The question of the connection between welfare and employment costs will also be more emphasised because of the high level of social contributions. In social-democratic countries, the question of the cost of welfare and of its potential questioning by the opening up of national economies and globalisation will logically fuel debates, as will the impact of benefits and contributions over economic behaviours.

As all typologies, Esping-Andersen's has the inconvenient of simplifying reality. On at least one point, it must be added on to cover roughly all the systems which may be encountered in developed western countries. In the south of Europe, indeed, there are systems which often have a mixed inspiration, but are less developed than the northern countries'. These Euro-Mediterranean systems are applicable to societies in which families often provide private welfare for their members, thus making the existence of a public system less necessary. There is no doubt that this is an original system which has its place within a more thorough typology of welfare system.

Lastly, four broad models can be considered to structure the European and American welfare states (table 1).

Their geography unambiguously evidences the fact that this opposition between Europe and the United States is not so clear-cut. Indeed, Great-Britain is spontaneously listed with the United States in the liberal type. On the contrary, continental Europe appears to be divided into three, between the "conservative", "social-democratic" and "Mediterranean" countries. The analysis developed here leaves aside the central European countries which have recently joined the European Community. Taking them into account would probably make the European map of welfare states even more complex. Therefore, this is very far from the opposition between some American model on the one hand and some European model on the other, and the institutional viewpoint evidences above all Europe's heterogeneity.

Table 1. Welfare systems in Europe and the United States

	Liberal or residual	Social-democratic	Conservative or Corporatist	Mediterranean or Familialist
Geographic situation	United States, United Kingdom, Ireland	Scandinavia, Netherlands	Continental Europe (Austria, Germany, France, Belgium)	Southern Europe (Italy, Spain, Portugal, Greece)
Historical reference	Beveridge	Beveridge	Bismarck	Mixed. Often Beveridge since the reforms of the 1980s.
Targets	Fight against poverty	Ensuring an income for everyone, egalitarian redistribution	Keeping up the workers' income	Vary according to the systems. Fight against poverty, but also keeping up incomes.
Level of social expenditures	average	high	high	low
Functioning principle	selectivity	universality	contributivity	Selectivity/ contributivity
Technique	Targeted benefits	redistribution	Social insurances	variable

3. Typology from quantitative data

Beyond the institutional differences on which the above typologies are based, the developed countries' systems of welfare fulfil identical function. They aim at insuring individuals and families against the four major generic risks of life, which are:

- Children upbringing, which affects the families' income level while incomes from work do not vary according to the families' expenditures;
- Unemployment and poverty resulting from lack of work
- Illness and handicap;
- Old age.

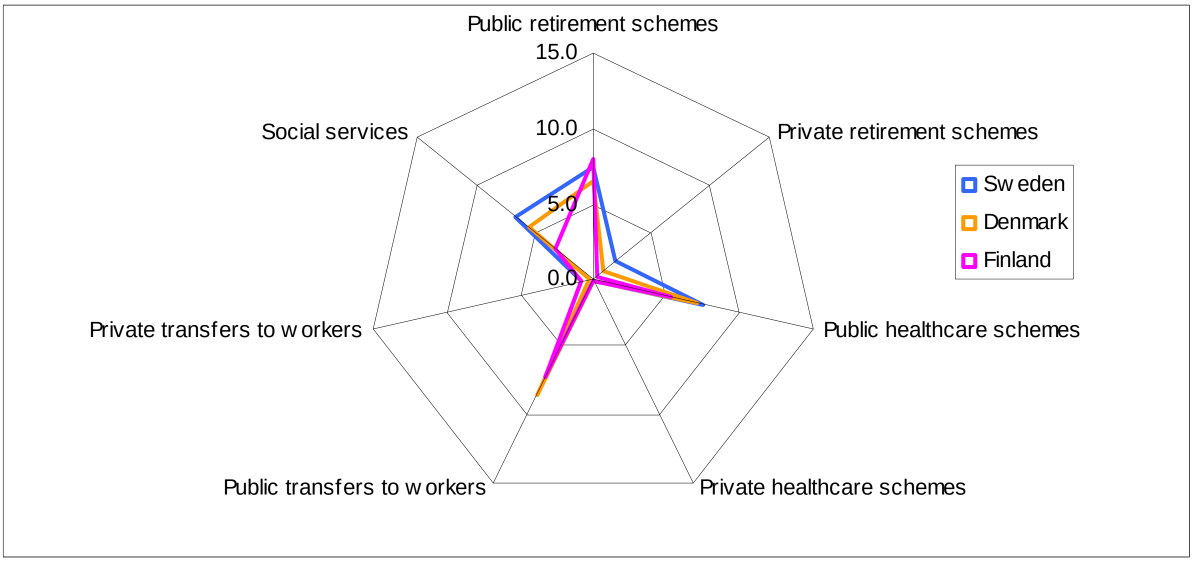
Therefore, welfare states always include social advantages for families with children, some public unemployment benefit, a system of minimum income for the poor, public protection, (more or less extensive), healthcare spending, public pensions, and complementary private systems.

What distinguishes systems from one another is related to the extent of the collective systems which may cover more or less large fractions of the risks incurred, and the modalities of the benefits' delivery, which may be centralised or decentralised, be given in the shape of monetary benefits or as social services in kind, and which may be given by public institutions or by private or more or less compulsory company insurances. In order to compare European countries and the United States quantitatively, a 7-categories nomenclature of social spending can be retained:

- Public monetary benefits in favour of those in employment, including mainly unemployment benefits and income support for the poorest;
- Private monetary benefits for those in employment on top of the latter;
- Public healthcare benefits, monetary or through services in kind;
- Public pensions;
- Private pensions;
- Service expenditures in kind other than healthcare (which include nursery spending among others).

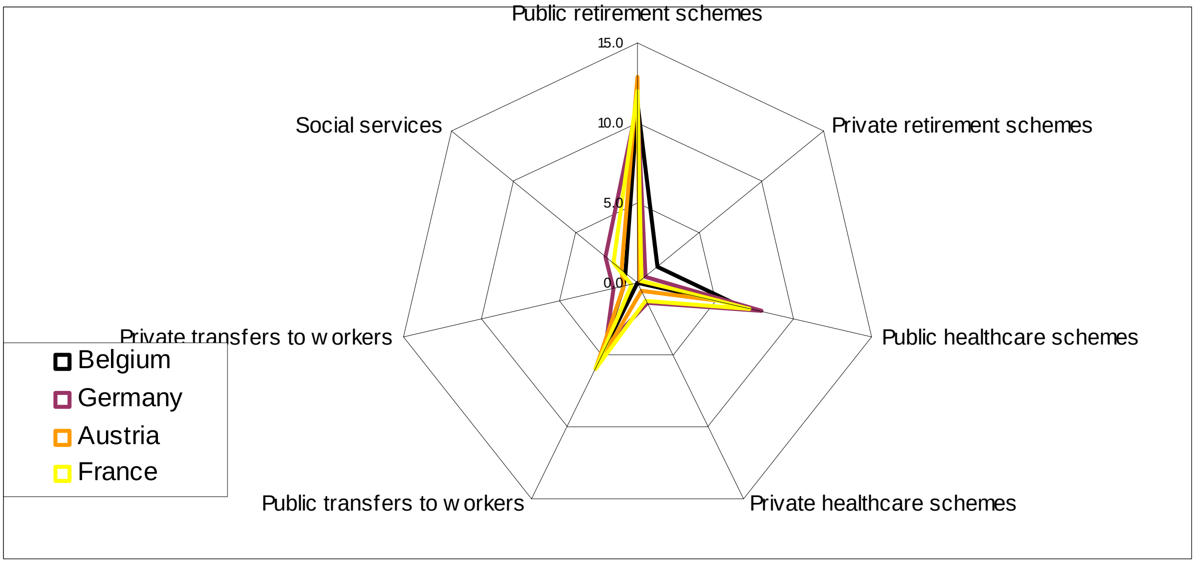
Graphs 1.1 to 1.5 make it possible to visualise the importance and the repartition of welfare expenditures among the main Western European countries and in the United States.

Graph 1.1. : Welfare expenditure in GDP % in 2001; the Scandinavian model



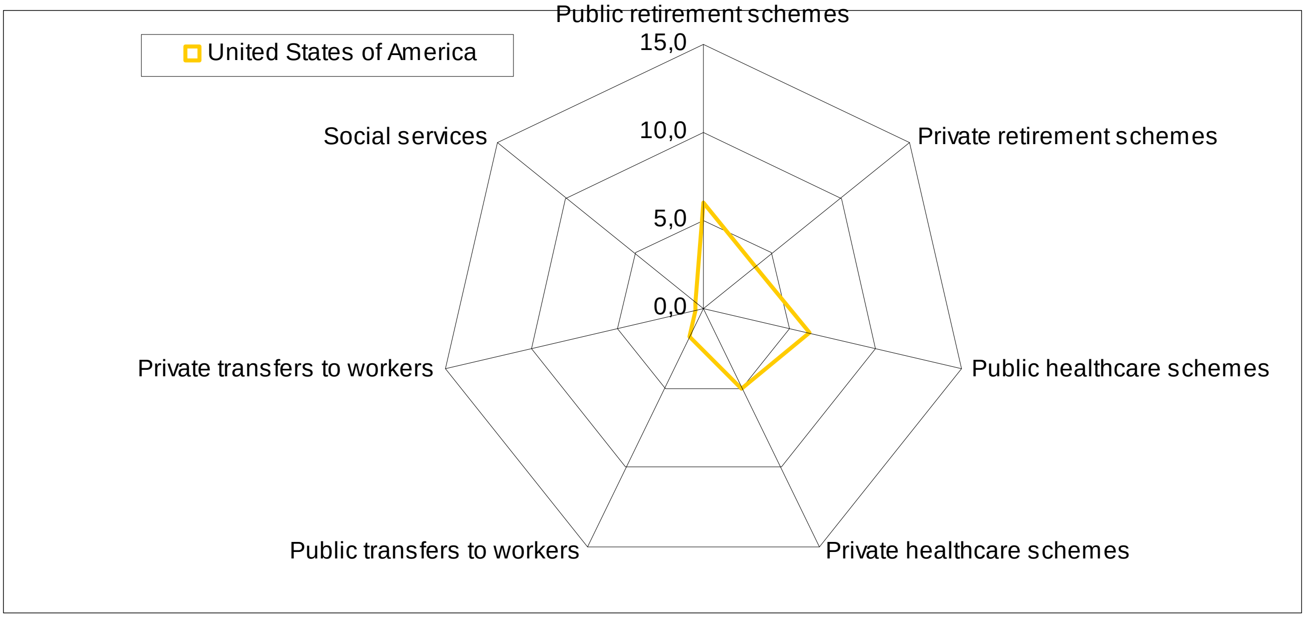
Source: OECD

Graph 1.2. : Welfare expenditure in GDP % in 2001; the continental model



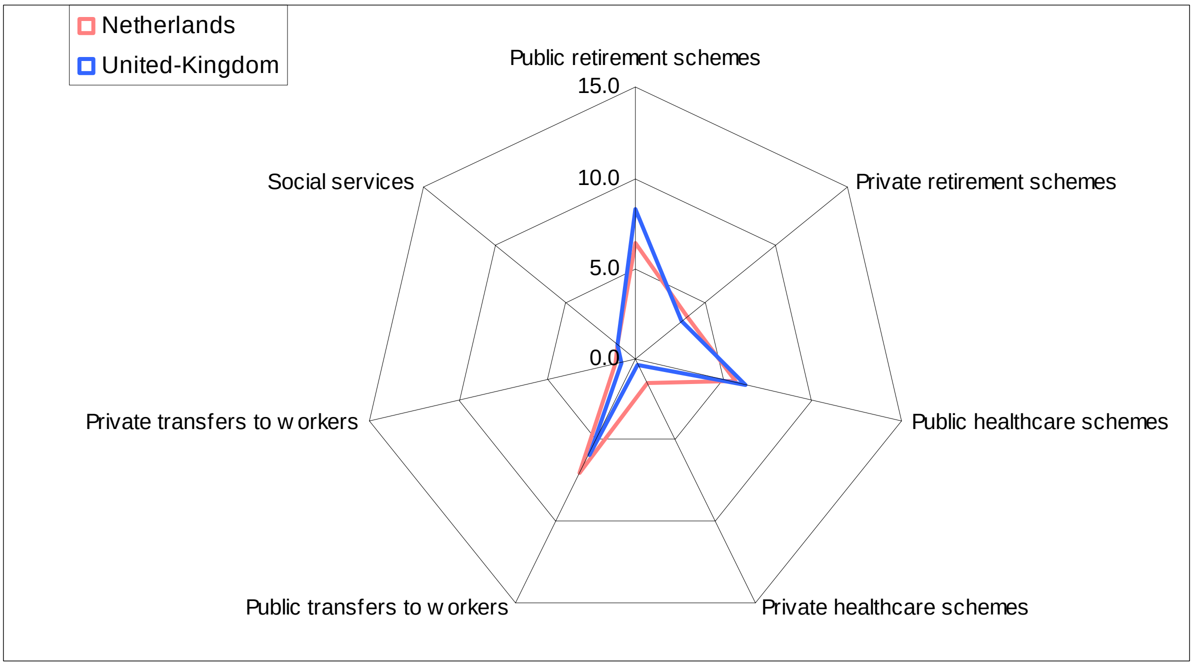
Source: OECD

Graph 1.3. : Welfare expenditure in GDP % in 2001; the American model



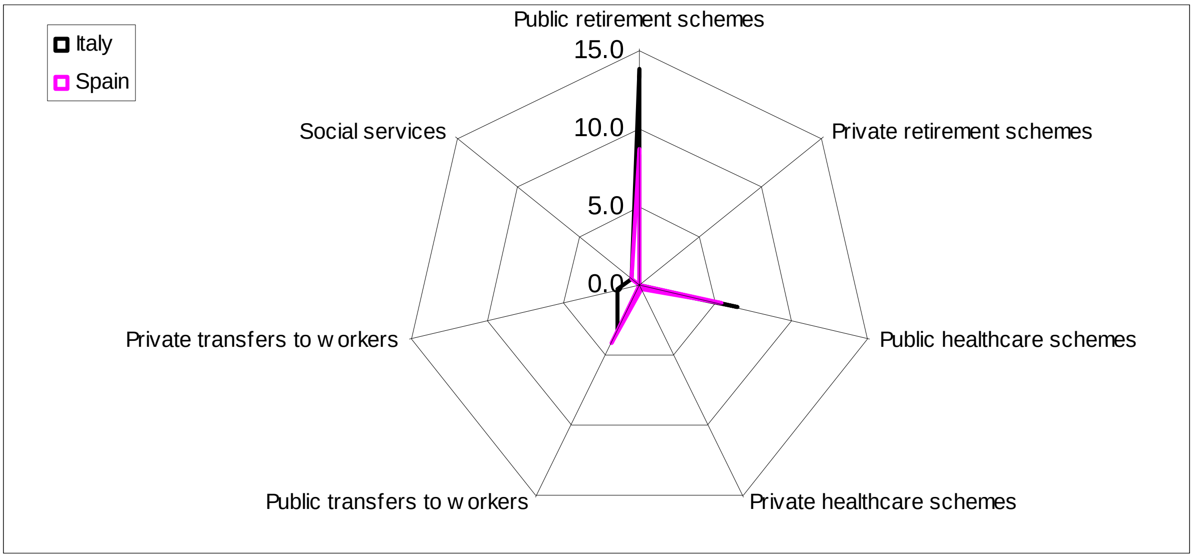
Source: OECD

Graph 1.4. : Welfare expenditure in GDP % in 2001; the Anglo-Dutch model



Source: OECD

Graph 1.5. : Welfare expenditure in GDP % in 2001; the Euro-Mediterranean model



Source: OECD

Looking for a typology now resting on the observation of welfare expenditure evidences five relatively homogenous “models” which overlap quite accurately the typology resulting from institutional observations. However, while the American model can easily be paired off with the British liberal model, it appears much more isolated when a reference is made to the level and the distribution of actual expenditure.

The United States is therefore distinguished from the other models by the very low spending—whether public or private—on transfers in favour of those in work. The low level of this spending—unemployment benefits, family and housing benefits, transfers to deprived adults—, is partly compensated for by “tax” credits such as the earning income tax credit for those with a low work income. But it remains that American welfare is hardly oriented towards the fight against poverty and that there ensue, as we shall see, much more marked inequalities than in Europe, and a much higher level of poverty.

For other countries, it is relatively easy to derive the traditional typology again from welfare expenditure data. Scandinavian countries find themselves spontaneously within a model characterised by a high level of overall spending and a very high share of social services. The “continental” model (Germany, Austria, Belgium, and France) is characterised by an important share of pensions spending and, by comparison with Scandinavian countries, a small share of social services spending. The Mediterranean model (Spain and Italy) constitutes a zone with a low spending level, mostly public and almost restricted to pensions and healthcare expenditure. Finally, a “British-Dutch” model emerges, characterised by a high level of private pension spending, which brings it closer to the North-American model, but which is distinguished from it by to a much more important level of income support for the workers.

The institutional organisation of the welfare state and the structure of welfare spending vary greatly according to the countries. However, the total amount of net welfare expenditures is comprised in a reduced interval which, except for Ireland, a very atypical small country, ranges from 18.9 percent of GDP in Spain, to 31.2 percent in France (table 2). This comparison of the weight of welfare spending, both public and private, rests on assessing the rate of net welfare expenditure divided by GDP ‘at factor cost’. It makes it possible to correct the results obtained by comparing untaxed spending levels which are biased, firstly because in some countries a significant share of welfare expenditure takes the shape of a tax expenditure (such as the American Earning Income Tax Credit) and also because the variable level of contribution applied to outgoing benefits is very uneven. A country with a low rate of compulsory contributions may therefore give out low untaxed pensions, but whose purchasing power may be identical to those of a country with a much higher contribution rate giving out more substantial untaxed benefits. Of course, it must be expected then that the redistribution of income between the highest and the lowest one on the scale will be lower in the countries with a low contribution rates. By relating expenditure to the GDP at factor cost (that is to say by not taking into account the indirect taxes which put a strain on market prices), the actual economic impact of the contributions to be taken from producers in order to finance welfare expenditure can be measured. This comparison between the net rates of welfare expenditure in GDP reduces the differences between the countries and slightly modifies the hierarchy: once taxes are taken into account, Denmark, which is the highest spending country in untaxed amount, goes behind France and Germany. As for the United States, it joins the main European group: it overtakes Finland and finds itself just behind the Netherlands.

Table 2: Welfare expenditure in 2001 in GDP % at factor cost

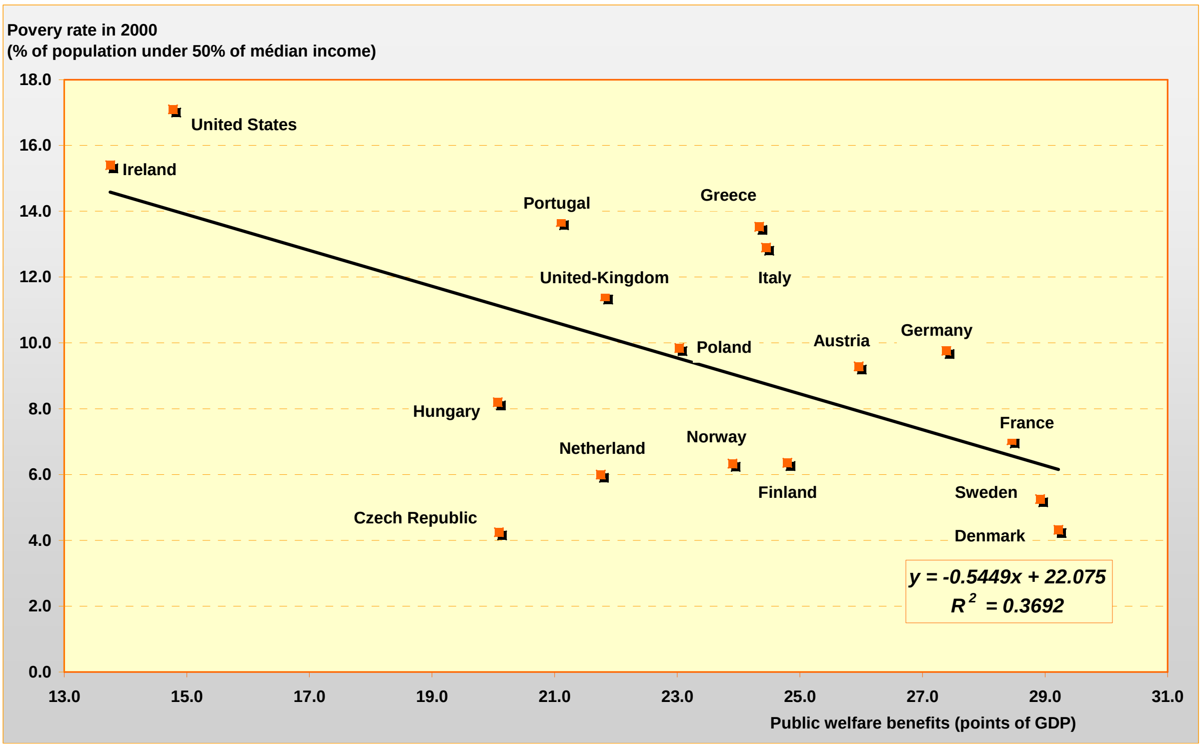
	Gross public expenditure	Gross private expenditure	Gross total expenditure	Net total expenditure
Austria	29.6	1.8	31.4	24.8
Belgium	28.0	2.8	30.8	26.3
Denmark	34.2	1.5	35.7	26.4
France	33.0	2.3	35.3	31.2
Finland	28.0	1.3	29.3	22.6
Germany	30.6	3.9	34.5	30.8
Italy	28.3	1.7	30.0	25.3
Ireland	15.3	0.5	15.8	13.9
Netherlands	24.3	7.1	31.4	25.0
Spain	21.7	0.3	22.0	18.9
United Kingdom	25.4	5.1	30.5	27.1
United States	15.7	9.8	25.5	24.5

Source : OECD.

4. A marked connection between poverty and public welfare spending

If private welfare spending is taken into account and the impact of taxes is integrated, the United States matches the average of the main European group, with a level of welfare expenditure of 24.5 percent GDP, placing them slightly below Denmark but above Finland. From this viewpoint, American citizens thus have access to a welfare protection not unlike what is to be seen in Europe. It could be inferred from this overall observation that the nature of welfare, public or private, universal or category-based, centralised or decentralised, matters little. In reality, it appears that despite the convergence of welfare spending rates, important differences remain with respect to the welfare's eventual impact over income distribution and poverty. Therefore the variation of public welfare rates in GDP accounts for more than a third of the variation of poverty rates observed in the United States and in a sample of European countries (figure 4).

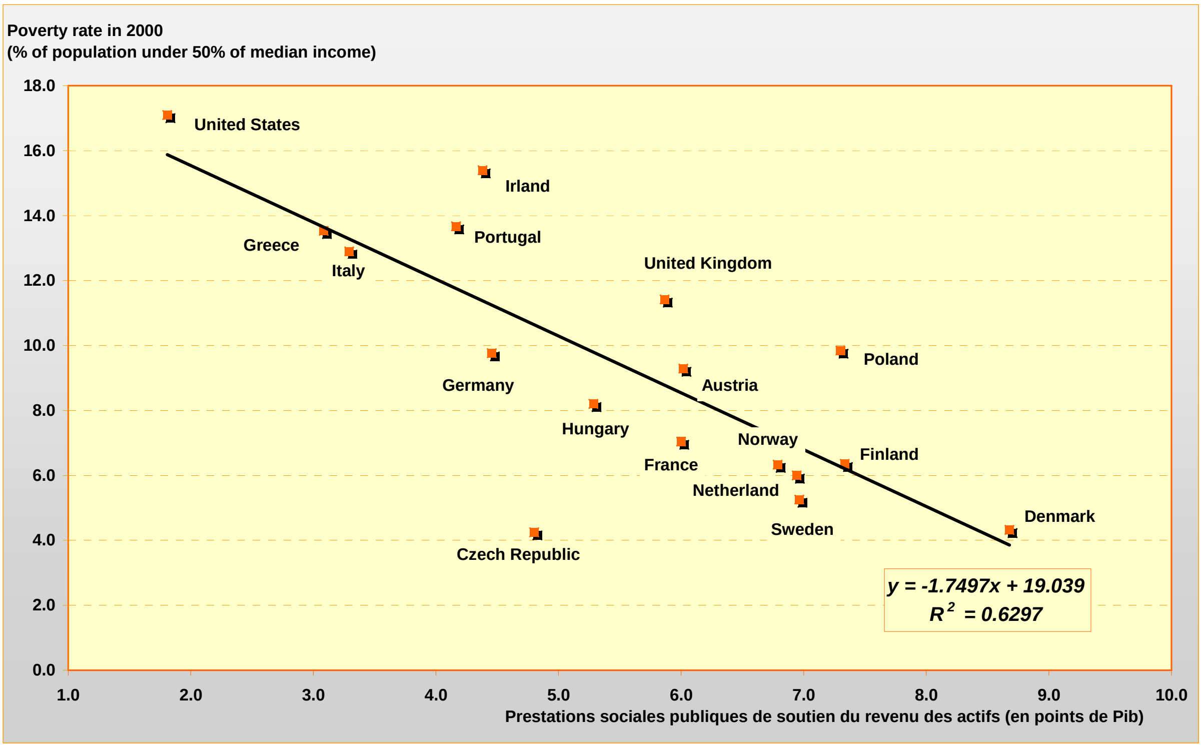
Figure 4. Poverty rate and public welfare benefits.



Source: OECD and author's own calculation.

With a more specific analysis, the reason for this statistical relation can be identified. It can be attributed to the great gaps between the rates of effort towards the workers in all countries. This specific welfare spending, which includes unemployment benefits, but also income support spending for the poorest, makes up the basis of the redistribution which aims at reducing income inequalities and wipe out situations as extreme poverty as much as possible. On their own, they account for 63 percent of poverty rates variations in the sample of countries previously used (figure 5). The United States is strongly opposed to the core of the European countries, France, Germany, the United Kingdom and even more to the Scandinavian countries. The "European social model" appears quite characteristic, and in this respect it is neatly opposed to the North-American model, through a high level of protection for the poorest which restricts poverty significantly. Only the south European countries are slightly closer to the United States. But even these countries spend more for the workers and consequently have a lower poverty rate.

Figure 5. Poverty rates and income support public welfare benefits for the workers



5. A share challenge: population ageing

In all western countries, the reform of welfare systems has been on the agenda since at least the early nineties. These reforms originate in several factors, the most important of which is population ageing. Demographic evolutions, both in Europe and the United States, indeed lead necessarily, without any major reform, to an increase of the financial burden linked to welfare funding which is heavy on the workers—and will become increasingly so.

Three demographic events lead to ageing:

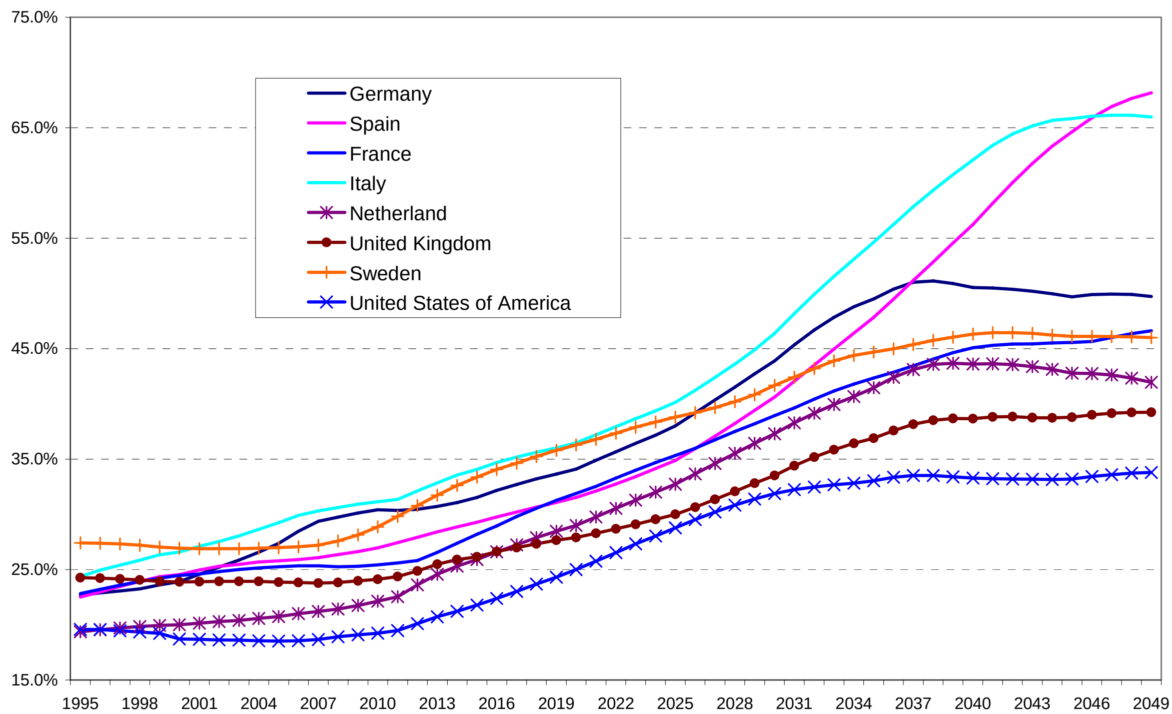
- The post-WW2 baby-boom (which took place slightly earlier in Germany for obvious reasons) constituted a demographic surge whose progress upset long-term demographic trends. At first, up to the seventies, it led to an important rejuvenation of the population, while impairing the balance between the active and the non-active part of the population: the baby boomers did not work yet. Then, from the seventies to the noughties, it strongly diminished the ratio between workers and non-workers: the baby boomers were in employment, they had fewer children than their parents, and the latter, who were gradually leaving work, were far less numerous. This phase was a boon for welfare, since pension spending was spontaneously contained, which made it possible to improve benefits with relatively weak contributions. Finally, since the early eighties, the baby boomers' transition to retirement age has led to sudden ageing and financing welfare benefits is becoming an increasingly heavy financial burden. The transition of the baby boom wave has partly reversible consequences: once the wave is over, the working/ non-working ratio should return to its structural level which depends on average life expectancy and birth rate, and which is below the level reached during the baby boomers' retirement period. The degradation of welfare funding structures is therefore partly circumstantial (even if the duration of the ‘cycle’ stretches over 30 to 40 years) and may as a result be compensated by a new immigration wave which is already well-advanced in the United States.

- The extension of average life expectancy is the second factor of demographic ageing. On average, in western countries, life expectancy increases by a term every year. This is a structural movement whose end is difficult to forecast because of the great uncertainty relative to the asymptote that is the maximum duration of life (120 years?) and the difficulty of predicting the evolution of the population’s health, as on the one hand it benefits from improved medical treatments and on the other, suffers from unfavourable behaviours (cigarette addiction, alcoholism, poor eating habits), or even from the degradation of the natural environment. Nonetheless, the evolutions observed rather tend to confirm the hypothesis of the continued extension of life expectancy, which implies a structural adjustment of welfare. Contrary to the effects of the baby boom, which are transitory, this is a lasting constraint which can not be bypassed by population movements (immigrants too age, and the duration of their retirement is on the increase too). The normal reaction to such ageing through the extension of life consists in a proportional extension of the time spent in employment, so as to maintain the ratio between the number of those retired and those in work to avoid having to increase too much the contributions taken from the workers’ incomes. This balancing out is quite natural since, in addition to the fact that the increase of life expectancy extends retirement time, the latter tends to improve in quality since it is an increase of life expectancy in good health. All the countries have thus implemented reforms which incite many people to postpone retirement age. Some, by pushing back minimal ages (United States, Germany, United Kingdom), others, by broadening individual freedom of choice through a reform guaranteeing the actuarial neutrality of the retirement age (Swedish, Italian and French cases) and which, coupled with parameter changes (level of the replacement of employment income according to the time spent in employment), incites individuals to postpone their departure from working life.

- The lowering of the birth rate is the third factor of population ageing. This evolution is very negative in Europe, except in Ireland and in France. Like in the United States, the birth rate remains close to 2 (1.9 on average from 2000 to 2005 in France and 2.0 in the United States), which suggests that there is no risk of a population decrease. The situation of the other European countries is especially critical on the contrary, since the generations’ renewal is guaranteed nowhere. Two groups can be made out: the first one, which includes the United Kingdom, Scandinavia and Benelux, retains an average birth rate, between 1.6 and 1.75; the second group, which comprises ex-Communist Eastern European countries and all of Mediterranean Europe, shows an extremely weak birth rate ranging from 1.2 to 1.5 children per woman in child-bearing age. Such a low birth rate has delayed effects on demographic balances which are not affected yet. But over the next twenty years, its consequences will be disastrous in countries like Italy or Spain. The decline of the birth rate will naturally make the funding of welfare more problematic eventually, all the more as, just like the increase of life expectancy, it cannot be lastingly made up for by immigration. And while the correction of this unfavourable evolution certainly implies an increase of the spending targeted on families, especially through an increase of the child-minding services on offer, the only efficient way of making women’s aspirations to work compatible with motherhood, imply more public expenses.

As a result of demographic ageing, in the course of the twenty-first century, and from its first years, welfare systems in Europe and the United States will all be facing a sharp increase of the needs for social transfers with respect to pensions and healthcare. Figure 6 shows the evolution of the ratio between population above sixty four and those between fifteen and sixty four from 1970 to 2050. It clearly evidences the general character of the demographic challenge which concerns all the country, but with a very significant difference between the much degraded situation of Mediterranean countries and the less unfavourable evolution of the United States.

Figure 6: The ratio between the population above 64 and the population from 15 to 64



Source : UN population perspectives.

The increasing weight of pension benefits resulting from demographic evolutions may be partly contained by the gap between the retirement age and a certain peaking up of immigration, but the low European birth rate calls for a raise of healthcare spending. The latter, which is general, is especially significant in the United States, partly as a result of the absence of any control of medication prices. The projections of healthcare needs are uncertain, since the progression of the available therapeutics is hard to predict. However, recent-years observations show that the increase of life expectancy in good health and without any incapacity also results from the increase of healthcare costs.

If the demographic trends are extended, and by supposing that the average benefits or refunding costs remain constant, future needs in terms of welfare in retirement and healthcare can be assessed. With a few simple hypotheses about the likely evolutions of spending for family and unemployment benefits, the projection of the share of all welfare expenditures in GDP can be made more complete (table 3).[3]

Table 3: Spontaneous evolution (i.e. before any reform) of the share of welfare expenditure in GDP between 2000 and 2050

	2000					2050					
% of GDP	Family	Unem-ployement	Pensions	Health-care	**Total* (1)**	Family	Unem-ployement	Pensions	Health-care	**Total* (2)**	Variation **(2) - (1)**
Germany	3.0%	2.4%	12.0%	10.3%	29.5%	2.3%	1.2%	17.1%	13.6%	36.0%	6.5
Spain	0.5%	2.4%	9.1%	7.3%	20.1%	0.4%	0.7%	15.7%	10.3%	27.9%	7.8
France	2.7%	1.9%	12.4%	9.8%	29.7%	2.0%	0.8%	17.2%	12.7%	35.6%	5.9
Italy	0.9%	0.4%	15.4%	7.5%	25.2%	0.6%	0.2%	22.9%	10.5%	35.2%	10.0
Netherland	1.2%	1.3%	10.9%	10.6%	27.4%	0.9%	1.3%	16.6%	13.8%	36.0%	8.6
United Kingdom	1.8%	0.8%	12.3%	9.1%	26.8%	1.4%	0.6%	18.6%	11.5%	34.9%	8.1
Sweden	3.3%	2.0%	11.8%	11.8%	30.9%	2.6%	1.4%	16.4%	14.1%	36.5%	5.6
USA	0.5%	0.4%	8.9%	13.1%	23.5%	0.4%	0.5%	12.8%	16.5%	30.8%	7.3

Source : OFCE calculations for the French "conseil d'orientation des retraites".

All the European countries[4] and the United States thus have to face strongly growing welfare needs. The differences in the demographic configurations play a relatively small part when the examination focuses only on the question of needs' pressure. Therefore, the fact that the United States retains a higher birth rate and that the ratio between the elderly non-workers and the workers is not degrading as much as it is in Europe does not lead to a much more favourable relative situation. Many European countries, and particularly France, can indeed make up for the increasing pensions and healthcare funding needs through a decrease of unemployment and family spending, while the United States already has full employment, fewer advanced retirement and family benefits, and therefore affords little leeway. It must be added that the funding needs of welfare depend little on the functioning of pension schemes. Thus, American companies' defined-contribution schemes have to deal with an insufficient provisioning which has already reached $850 billion, which will entail the intervention of the federal organism's pension guarantee and imply an increase of direct and added taxes. Similarly, the British pension reform is called into question by the lack of voluntary contributions, which is likely to lead to an increase of compulsory contributions. In the countries which have implemented mechanisms of automatic stabilisation of pay as you go pension systems modelled on individual notional accounts (Sweden and Italy in particular),[5] pension schemes may give out only very low pensions (especially in Italy, due to a very degraded demography), unless, as in some countries, the balance is re-established through an increase of contributions.

In the end, the current pension reforms have shared characteristics. Whereas, in the eighties, the debate focused on systemic solutions to the population ageing challenge (partial privatisation of welfare and pensions, substitution of funding for repartition), it seems that a parametric arbitration is increasingly favoured: the point is to find out, today, while the baby boomers are drawing near retirement age, how to distribute the effort of financial adjustment between the age of retirement, the average pensions level, and the contribution level. The political debate on this question remains confused because the liberals have not relinquished the perspective of a systemic reform, especially in the United States. But it is now too late to apply it to the baby boomers, so that the solution will undoubtedly imply, at least partly, an increase of welfare contributions. This seems all the more likely as the funding needs of healthcare systems will probably not be contained over the next years. The impact of population ageing and the increasing treatment costs will combine to increase the pressure while in this sector the prospect of an efficient systemic reform is unlikely. Northern European countries may have achieved significant results over the past few years, but the American example of the HMO[6] shows that the effects of the rationalisation of healthcare provision are transitory and that, once they have been obtained, spending increases more quickly than incomes do.

How will the various European countries and the United States respond to this situation—all the more as welfare contribution levels are already high, and the dominant trend points towards liberalisation, the reduction of the state's involvement, and competition between the nations and social systems? It is obviously very difficult to picture an opinion change today in favour of an extension of welfare provision. However, a strong resistance in public opinions against any substantial cut in public pensions and healthcare is also manifest. In the United States, it is therefore unlikely that the contemplated public pension reform which should lead to account individualisation will see the light. Similarly, the British could quickly move towards a strengthening of the obligatory pillar of the pension system after having widely individualised the system in the eighties. In France, as in Germany, the option for a parametric reform already forecasts a rise of contributions. In Italy, the transition to notional accounts is very slow and a contribution increase is certainly unavoidable. For now, no country seems able to take on the risks associated with a brutal reform without a contribution increase, which would lead to a massive impoverishment of pensioners in some countries (Italy), and a significant one in all the others. The fact that all the countries are confronted with the same challenges almost at the same time makes it possible to contemplate a balanced reaction: a combination of parametric pension reforms and care efficiency improvement could limit, without cancelling it altogether, the necessary contribution increase. It is certainly possible, by lengthening the working life, resorting to immigration and rationalising healthcare systems, to cut by half the funding needs presented in table 3. As a result, the progressive increase of social contributions, if it is also accompanied by a rationalisation of other public spending, becomes absolutely likely. The neo-liberal present could give way, under the pressure of needs, to a new extension of the Welfare State. The United States, a homogenous power protected by a strong and flexible currency, could deal with it easily enough. In Europe, the difficulty is no doubt much greater, because of the weakness of the institutions which weigh down the efficiency of economic policy and may lead the states to play on tax rate competition and, eventually, on social competition, to re-establish their economic and financial balances. This could lead to a paradox: because they fail to coordinate efficiently, the European states could yet, through competition, destroy the social balances which they are all trying to reach. The cost of this "non Europe" could thus become exorbitant. Fortunately, there exists a more favourable scenario in which the shared constraints linked to population ageing and the attachment to the welfare systems' solidaristic values lead to balanced reforms. Which of these two scenarios will prevail? The arguments in favour of one or the other's success seem to balance out nowadays. The next few years will be crucial for Europe. More than ever, institutional reform is a *sine qua non* to enable the debate to develop clearly.

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Comparing welfare systems on both sides of the Atlantic shows that while solutions differ, the problems to be solved are widely shared: population ageing is a major challenge everywhere. The growth of inequalities made worse by globalisation and bitter competition imply greater income redistribution everywhere. The growth of age-related healthcare spending, but also, and above all, the improved medical techniques, increase mutualisation needs everywhere. Overall, these evolutions all imply an increase in welfare spending in a context of tensions over public spending linked to reluctance to taxes and the search for competitive labour costs. Over the last decade, new solutions have emerged, which mix a hidden rise of contributions through the privatisation of part of welfare protection (such as the increase of the healthcare funding by private insurances or the reduction of public pension systems and incentives to individual pension benefits), the refocusing of social transfers on the most deprived parts of the population, often paired with the activation of passive spending (work incentives). These measures, which translate *in fine* into a cut in welfare, do not avoid the increase of compulsory or voluntary contributions linked to the growth of welfare needs. On the one hand, these measures appear to be justified above all by the various notions in each country of the place of the state, rather than by the necessities of improving the systems' efficiency. In this debate, the United States seems quite far from Europe, while public opinion there is much more receptive to the liberal theses than European opinion (see Chapter 7 on values, and the concluding chapter). But beyond ideology, welfare systems prove enduring, and they should not regress, whether in the United States or in Europe, because they appear indispensable in modern societies. In this respect, the promotion of the Scandinavian flexi-security model (which in reality is restricted to Denmark), which mingles economic liberalism and a strong individual protection against social and economic risks, only reemphasises the original mission assigned to welfare protection: enabling the market economy to function while warranting the citizens' welfare.

Notes

1. The term of covariation of employment and wages is of secondary importance and can be omitted. The term which can be attributed to taxes is weak in all the countries and does not modify the conclusions of this general analysis. It was therefore left aside to avoid weighing down this presentation. Another solution consisted in reasoning at 'factor cost', that is to say, from the evaluation of added value without taxes.

2. The Three Worlds of Welfare Capitalism, Princeton University Press, 1990.

3. These projections were carried out by the OFCE in 2004, for the *Conseil français d'orientation des retraites.* They rest on the following hypotheses: for pensions, the actual age when work is topped is maintained at the level reached in 2000 and the average pension allowance evolves like the average net salary; for healthcare, spending per person evolve like the GDP per head and increase according to population ageing by supposing that the ratio of spending per age observed in the early 2000 remains constant; spending for families is indexed on the population under 18; lastly, unemployment benefits evolve like unemployment whose rate is supposed to converge in the long term towards a uniform 5% level.

4. The spending projections were carried out only for the large European countries and the United States, but the orientation of demographic evolutions is identical in the other countries, so that the conclusions can be generalised to all the countries.

5. Individual notional accounts simulate the functioning of a defined-contribution scheme in a defined-benefit pension system**.** Future benefits are not funded but the yielding of the subscriptions inscribed for each working individual depends on how the demographic ratio evolves, which ensures that the system remains stable. When life expectancy increases, if those in work retain the same retirement age, the amount of their pension benefit diminishes.

6. Implementation of integrated care managed by insurers for the benefit of insurers.