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Social Benefits Spending in the Euro Countries

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I. Introduction

European countries emerged from the ruins of the World War II facing two immediate challenges. The first challenge was to avoid another World War. The second challenge was to avoid internal civil conflicts and even civil wars arising from the plight of the less fortunate and the unequal distribution of wealth. The first half of the 20th century is the history of blooding wars and conflicts between the European populations. The current economic crisis brought back in memory the old conflicts in Europe. As Cuperus (2012, p. 13) has put it the common language of Europe includes "memories of war and prosecution".

In 1957 the Common Market (the predecessor of the European Union) was formed among six countries which included the "troublemakers" of Central Europe France and Germany[1]. This was the European response to the first challenge. It was seriously considered that if the countries are bonded together with economic ties, then another will be almost impossible. Apart from the economic benefits of a creating a free trade area, peace across Europe was considered even a more important achievement of a Common Market[2]. With this in mind the European leaders at the time developed permanent institutes to run the project Europe and established Brussels as the capital city of Europe. Institutions such as the European Council of the European Union, the European Commission and the European parliament are considered very strong institutes of legislative power. It seems that the European Union has worked well in meeting the first challenge.

The response to the second challenge was both national and pan-European. The European Union since its inception in 1957 established two more institutes: the European Economic and Social Council (ECOSOC) and the Committee of the Regions. The first represented the interests of social forces of the member states of the European Union such as Trade Unions. Farmers' Associations, Employers' Association and other organization of civil society. The second represented the interests of local governments. Both institutes work well in echoing the organized interest of the civil society at the highest level of decision making in the European Union. ECOSOC's practical aim was to promote social dialogue across Europe and ideally create a pan-European social model which will mitigate the inequalities inherited in the unfettered development of the private capitalist economies. The idea was to develop and homogenize the existing social policies in an attempt to create a pan-European social model. Even though this was not achieved some homogenization does exist. Differences do exist and this is the reason that researchers and policy

[1] Actually, an important development occurred much earlier by the establishment of the Coal and Steel Community in May 1950 proposed by Robert Schuman.

[2] It is interested how Wikipedia defines the European Union as "…a geo-political entity covering a large portion of the European continent. It is founded upon numerous treaties and has undergone expansions that have taken it from 6 member states to 27, a majority of states in Europe". Not an economic union but a **geo-political** union.

makers propose a taxonomy of at least four European Social Models. If there is a common element in all of them is their distinct difference from an alleged American Social Model, which most Europeans consider either non-existent or inadequate[3]. To the extent that internal social conflicts and civil wars have disappeared from Europe, one can conclude the second challenge was also met with great success as well. The two challenges are interrelated. European Integration promotes peace and economic growth via the free trade, releasing resources to be used for social policy purposes. Spending on education, health, welfare and unemployment insurance spending became an important part of European countries social policy. The period of the 1950-1980 were the heydays of the social benefits spending. The crisis of the 1980s put a halt on this but the discussion on furthering the European integration through the development of an internal market and the establishment of the European Monetary Union was considered that will give a new impetus to the development of Social Europe. The introduction of a common currency was considered the next big step in deepening the European integration. It came into circulation 1 January 2002 across 12 countries members of the European Union. U.K. opted to stay out and keep its national currency. Has the introduction of euro affected the homogenization of the social benefits spending? This spending remained the responsibility of national states members of the eurozone. Fiscal policy, part of which is social benefits spending, was a national responsibility but restrictions were imposed on the extent of national public deficits and public debts. The eurozone countries were "free" to determine their social benefits spending but they could do this by keeping their public deficits below 3% and their public debt below 60%. Under these fiscal circumstances and the restrictive monetary and exchange rate policy followed by the European Central Bank (ECB), it is interested to investigate how the social benefits spending have developed in the euro years.

This paper looks at the social benefits spending in the initial 12 euro countries from 1995 to the most recent available year, actual and forecasted (estimated) by the AMECO database. The focus is on the convergence of the social benefits spending as a share of GDP. Convergence of social benefits spending, however, does not necessarily imply a harmonization of social polices across the eurozone and a further homogenization of the so called European Social Model. It might imply a social dumping effect of the leading countries of the eurozone in order to attain an unfair comparative advantage at the expense of their partners in the eurozone. The discussion of these issues is provided in Section II of this paper. These issues have been debated for long in the relevant literature on European Integration in general and more recently on euro. Section III provides a descriptive analysis of the social

[3] Sapir (2006) summarizes the arguments on the European Social Models. This paper does not aim at discussing these models and the differences across the euro countries. Assuming that a such model existed how the model had performed in the euro and recent crisis years looking at only the social benefits spending trends and differences across euro countries.

benefits spending in the eurozone. In particular it looks at the convergence of (a) the ratio of social benefits spending to GDP across the eurozone countries, (b) the real social benefits spending per capita and (c) the real GDP per capita. Section IV provides some thoughts on the European Social Model during the recent eriod of economic crisis and section V concludes.

II. The European Social Model and Social Benefits Spending

Trade unions was the main force behind the development of the European Social Model and the welfare state (Hyman, 2005 and Radcliff, 2005). Even though the current debate is on the development of a European social model which meets the globalization challenge, the real concern is to reduce government spending on social benefits. This is based on two arguments: the fiscal and competitiveness argument. The fiscal argument relates to huge government deficits and debts accumulated over the last years by most eurozone countries. One way to reduce them is to reduce social benefits spending. The recent economic crisis has made things worse because government revenues have been decreased. The economic decline has put a pressure on national governments to reduce public spending at a time that they were needed most.

The second argument is based on the impact of social benefits spending on the competitiveness of a nation. Social benefits such as unemployment insurance have a negative impact on the global competitiveness of a country. Reducing them is one way to get out of the economic crisis.

Even if the above analysis is correct the key question is who decides on how much and what to cut from the social benefits spending. Up to the introduction of euro with the establishment of the European Monetary Union, the European Union had built the appropriate institutions to decide taken into consideration the vested interests of the European societies. As mentioned in the introduction, decisions were made by the European Council, the European Commission and the European Parliament. In addition, since its establishment in 1957, European societies and regions could influence policy and decision making via the institution of the European Economic and Social Council and the European Committee of the Regions. The first was promoting social dialogue across Europe and it was seen as the guardians of the European Social Model.

The introduction of euro necessitated the establishment of a new institution: the European Central Bank (ECB). In the name of the independence of ECB from vested interests, its decisions lack any political legitimacy and accountability. The first decade of the euro has demonstrated that this democratic deficit resulted in a monetary and exchange rate policy which made very happy a handful of countries - the so called GLAD countries (Germany, Luxemburg, Austria and the Dutch). Germany is leading the way by exercising its political and economic power to apply a very restrictive monetary policy in the eurozone. This led to an unprecedented rise in the value of euro relative to US dollar and British Pound. This has had devastating impacts on the South European countries balance of trade and public finance. The GLAD countries manipulated the high rate of euro with two deliberate policies. First, they restricted the wage growth of their workers and they outsourced part of their production to the new members of the European Union of Eastern Europe. Second, they reduced their social benefits spending. Since there is common wage and social benefits policy, the GLAD countries were free to apply at the expense of the other countries of the eurozone. Social dumping is what their practicing. Unfortunately, the south European countries of the eurozone were politically too weak to react to Germany's conservative policies. France was expected to be the countervailing force in the ECB isolated headquarters but its leader could not resist the "charms" of Germany's Chancellor.

Social dumping has been consistently practiced by Germany and their satellite countries in the eurozone years in order to get a competitive advantage against their eurozone partners. They were able to reduce both the direct (wages) and indirect (social benefits) labor costs. Given that Germany entered the eurozone with higher average labor productivity, mainly because of (a) economies of scale determined by its larger population in the eurozone, (b) its geographical proximity to the cheap labor of the new members of EU from eastern Europe and (c) the millions of European and non-European migrant workers. Thus, what in the beginning appeared a very promising project, Germany's practices made the euro experiment a nightmare for South European countries. This was made possible because decisions at the ECB are not democratic. A democratic decision making, would have implemented a different policy.

The above analysis is very important in understanding the empirical findings of convergence of social benefits spending. Evidence of convergence of social benefits spending might also be evidence of Germany's social dumping practices. This is taken into consideration in analyzing the results by examining additional indicators such as the convergence of per capita income and per capita social benefits spending.

III. Convergence of Social Benefits Spending in the Eurozone

There are two methods of measuring convergence: σ-convergence and β-convergence. The first uses the evolution of standard deviation over time of a variable of interest. In the context of this paper, σ-convergence exists if the standard deviation of social benefits spending has declined during the euro years. Social benefits spending is measured as a percentage of GDP. This measure is considered more appropriate when the issue is the equitable distribution of social benefits across the eurozone countries. The σ-convergence is affected by the level of the values. It rises with a rise in the values of the data. To avoid this problem the coefficient of the variation (defined as the standard deviation divided by the mean) is also used.

Table 1 gives actual and projections of social benefits spending as a percentage of GDP from 1995 to 2013 provided by the European Union's data base of AMECO[4]. The last column gives the growth of real social benefits spending of the euro years, 2002-2011. The decennial growth of social spending of Table 1 and the evolution of the ratio of spending to GDP is of great interest and a number of comments need to be made. First, Germany, the Netherlands and Austria had the lowest growth in social benefits spending. In real terms and over the entire period Germany's social benefits spending has decreased by 5.7%. It increased by 16.6% in the Netherlands, 18.2% in Austria and 26.7% in Finland. Secondly, in South Europe social benefits spending increased by a rate close to 50% with the exception of Italy and France where they increased by 20% and 25% respectively. In Ireland the increase was almost 100% over the decade. Thirdly, the eurozone countries differ in their experience of the changes in the share of social benefits spending to GDP during the euro years. This can be seen better in Figure 1.

Table 1. Social Benefits Spending (% of GDP) in the Eurozone Countries

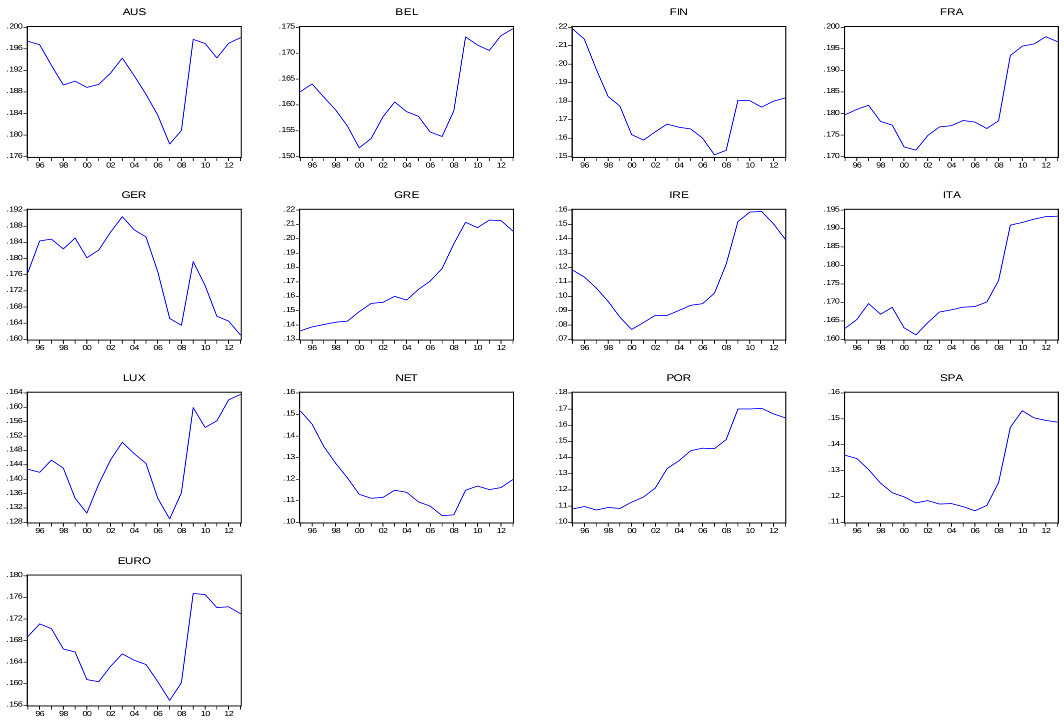
	2013	2012	2011	2010	2009	2008	2007	2006	2005	2000	1995	02/11
EURO	17.30	17.42	17.41	17.65	17.67	16.02	15.69	16.04	16.36	16.07	16.87	16.4
BEL	17.47	17.34	17.05	17.15	17.31	15.89	15.39	15.48	15.78	15.17	16.25	26.4
GER	16.11	16.45	16.57	17.33	17.93	16.35	16.52	17.67	18.54	18.02	17.65	-5.7
IRE	13.96	15.05	15.90	15.85	15.19	12.23	10.21	9.48	9.37	7.69	11.82	99.3
GRE	20.53	21.26	21.30	20.77	21.14	19.64	17.93	17.05	16.48	14.92	13.60	46.9
SPA	14.87	14.94	15.04	15.31	14.67	12.53	11.65	11.45	11.61	11.99	13.59	50.7
FRA	19.66	19.78	19.61	19.56	19.34	17.83	17.65	17.80	17.84	17.23	17.97	25.1
ITA	19.33	19.32	19.25	19.16	19.09	17.60	17.01	16.89	16.87	16.32	16.30	19.9
LUX	16.36	16.21	15.62	15.44	15.99	13.62	12.89	13.47	14.44	13.06	14.28	53.8
NET	11.99	11.61	11.52	11.69	11.49	10.35	10.31	10.75	10.95	11.30	15.17	16.6
AUS	19.81	19.70	19.43	19.70	19.77	18.08	17.84	18.37	18.76	18.88	19.74	18.2
POR	16.46	16.71	17.04	17.01	17.00	15.11	14.55	14.59	14.43	11.25	10.83	46.9
FIN	18.18	18.00	17.68	18.03	18.05	15.35	15.10	16.01	16.50	16.19	21.91	26.7

Figure 1 shows that there exist three models of social benefits spending in the 12 euro countries. In the first group of countries (France, Italy, Spain, Greece, Portugal and Ireland) the share of social spending to GDP has increased in most part of the euro years. The crisis forced these countries to cut on social spending as a percentage of GDP. The second group's share (Germany, the Netherlands, Finland) was declining in the early years but more recently has started picking up. In the third

[4] The variable examined here is "Social benefits other than social transfers in kind: general government :- ESA 1995 (UYTGH)".

group of countries (Austria, Belgium and Luxembourg) the share does not show any definite trend.

Figure 1. Share of Social Benefits Spending to GDP in the Eurozone Countries, 1995-2013



This leads to the fourth point. Convergence of social benefits spending has occurred because the richer countries of the eurozone spend relatively less as a percentage of their GDP than the rest of the euro countries. This is shown clearer in Table 2 and Figures 2-4.

Figure 2a shows the convergence of social benefits spending in the eurozone using the standard deviation of social spending of the 12 euro countries from 1995 to 2013. Figure 2b shows the same variable but instead of the standard deviation, the coefficient of variation is used to evaluate convergence. Figure 2 shows that up to the actual introduction of euro, social benefits spending differences across the euro countries either remained stable or they were slightly diverging. Figure 2b shows a clearer divergence while Figure 2a shows ups and downs up to 2002. Thereafter, both indicators show that there is a convergence up to 2010 and divergence thereafter. These results in combination with the trends of Figure 1 show that it was the rich countries of the euro countries, primarily Germany, which they had their social benefits spending reduced and the less prosperous countries had their rates increasing during the euro years till the crisis years. This is social dumping.

Figure 3 shows a different picture. Real social benefits spending per capita show a general divergence across the 12 initial euro countries. Figure 3a shows that σ-indicator reveals a divergence throughout the period but the coefficient of variation indicator shows a divergence throughout the period and up to the beginning of crisis in 2008. In the initial crisis years, there was a convergence but the indicator remained stable in recent years. One reason might be the trend in per capita income. Divergence in per capita income relates to the divergence in social benefits spending per capita. Figure 4 shows that there was divergence in per capita income throughout the period but in the crisis years this divergence stopped and actually there was a divergence.

Table 2. σ-Convergence and CV-Convergence of Social Benefits (SB) Spending, Per Capita SB and GDP per Capita in the Eurozone Countries

	σ-SB	**CV-SB**	**σ-SB/POP**	**CV-SB/POP**	**σ-GDP/POP**	**CV-GDP/POP**
1995	0.032	0.205	1569	0.430	8673	0.380
1996	0.032	0.206	1578	0.426	8641	0.370
1997	0.032	0.206	1588	0.423	9093	0.375
1998	0.031	0.207	1593	0.420	9615	0.383
1999	0.034	0.228	1669	0.430	10451	0.399
2000	0.033	0.231	1659	0.426	11331	0.413
2001	0.032	0.223	1703	0.426	11461	0.411
2002	0.032	0.218	1822	0.439	11911	0.422
2003	0.033	0.215	1936	0.451	11948	0.420
2004	0.031	0.206	1893	0.436	12354	0.424
2005	0.031	0.202	1916	0.434	12969	0.437
2006	0.030	0.201	1885	0.421	13429	0.439
2007	0.029	0.194	1877	0.412	14223	0.451
2008	0.028	0.180	1952	0.418	13988	0.446
2009	0.026	0.152	2128	0.424	12805	0.432
2010	0.025	0.144	2119	0.421	12963	0.433
2011	0.026	0.151	2144	0.431	13107	0.434
2012	0.027	0.154	2251	0.450	13130	0.435
2013	0.026	0.153	2319	0.461	13264	0.434

Figure 2. σ-Convergence and CV-Convergence of Social Benefits (SB) Spending, 1995-2013

Figure 2a. σ-Convergence

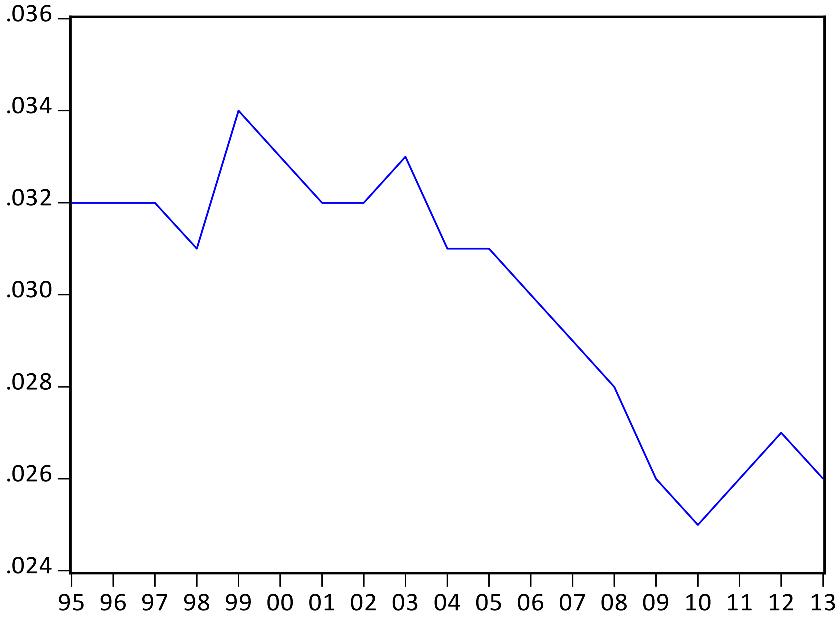


Figure 2b. CV-Convergence

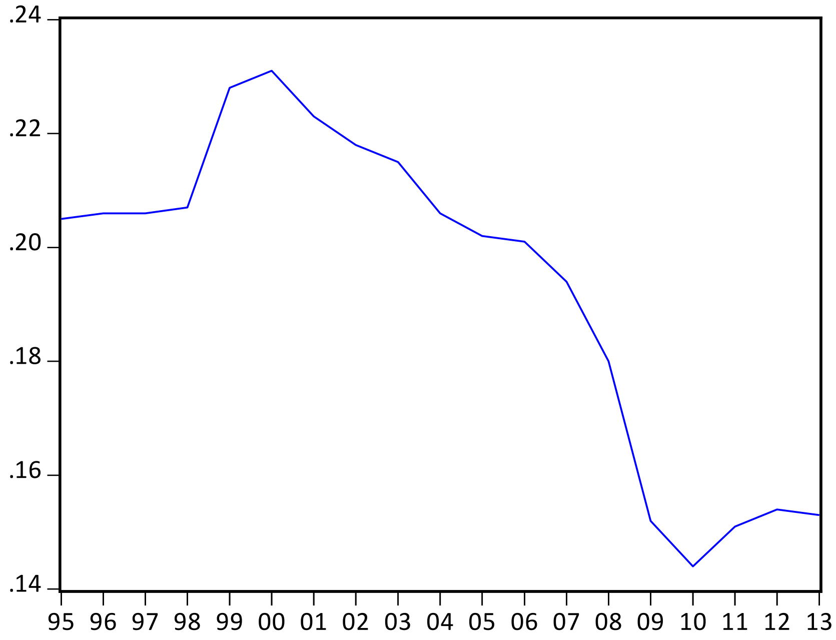


Figure 3. σ-Convergence and CV-Convergence of Social Benefits (SB) Spending per Capita, 1995-2013

Figure 3a. σ-Convergence

Figure 3b. CV-Convergence

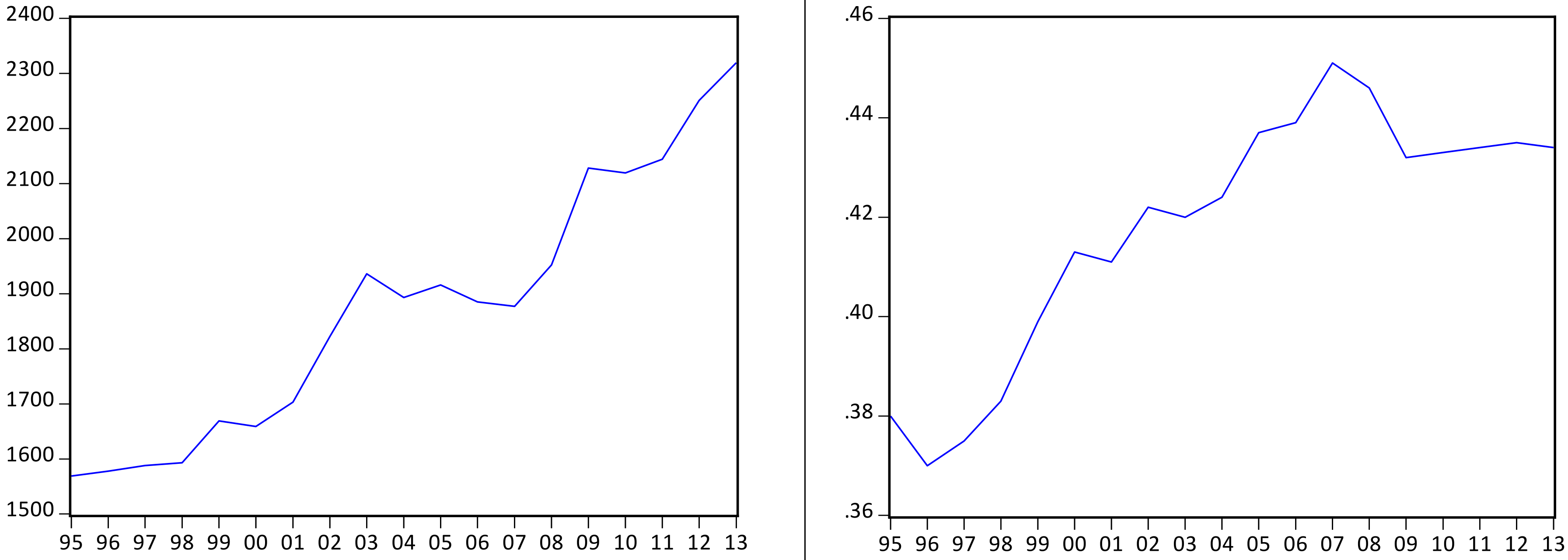


Figure 4. σ-Convergence and CV-Convergence of per Capita GDP, 1995-2013

Figure 4a. σ-Convergence

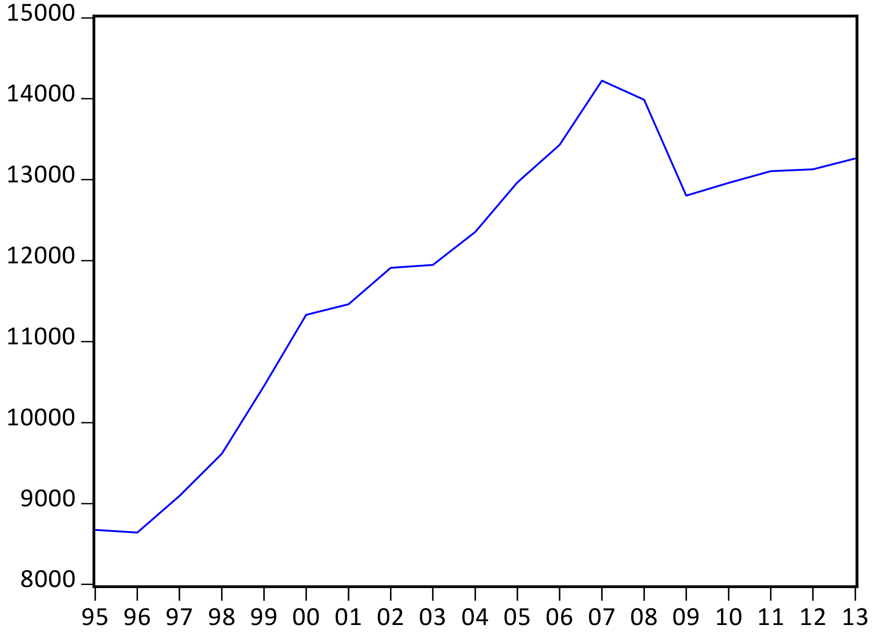
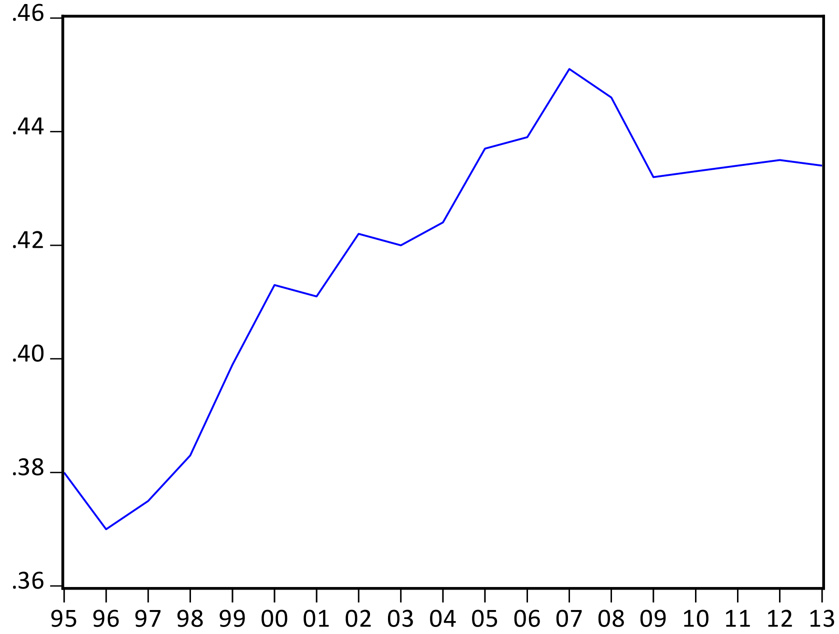


Figure 4b. CV-Convergence



IV. The Future of the European Social Model

The above discussion has shown that the convergence of the social benefits spending is due to Germany's social dumping in order to gain an unfair comparative advantage at the expense of its partners in the eurozone. This is one of many policies Germany has followed during the euro years to promote its exports. In order to keep its unit cost low has suppressed both private and public wage rate growth and it has outsourced parts of it production to the neighboring countries of East Europe where wages are much lower. But the most disturbing policy has been its support for a monetary and exchange rate policy which serves its interests at the cost of huge trade and public deficits of the South European countries. This conservative policies must be stopped sooner rather than later, otherwise the eurozone will collapse. I have examined elsewhere these issues in detail, see Papanikos (2012a & 2012b).

A European Social Model has no meaning in such a political environment. The political solution is to coordinate a policy mix which will include a common policy on social, wage, trade, fiscal and monetary (exchange rate) issues. These policies must be coordinated by the European Council and the European Parliament. These policies need not be the same but it should permit redistribution across the eurozone countries. For example, an overvalued euro has helped Germany to build up over one trillion euro in trade surpluses. These funds are more than sufficient to compensate the losses of the south European countries which have suffered from such a policy. The cost of such redistribution could be in the area of 500-600 billion euro.

The eurozone and the European Union are at a crossroads. As Pisany- Ferryy, Sapir and Wolff state (2012, p. 5) "[T]here is a general agreement that the current state of affairs is unsatisfactory". But their suggestions for the future are completely missing the point. There is only one issue. This is the mercantilist German policies. Social benefits spending is only one of many tools Germany and its satellite countries in the eurozone has been used to obtain an unfair comparative advantage in order to promote their exports. If the other countries of the eurozone had followed the same policies, then the whole eurozone would have collapsed. Not only there would have been a social benefits spending war but the South European countries would have asked for a very strong euro but with an undershooting value relative to its current course of overshooting. In political terms these eurozone countries which lost most in terms of trade and public deficits have the majority both in terms of population, number of countries and most importantly they share a long tradition of being socially responsible to their citizens who happened to be less fortunate. If culture, civilization and social responsibility was used to form unions, ant unions, Germans would hardly qualify to belong in a union with Portugal, Spain, France, Italy and Turkey. The cultural differences are so deep and the Germans with their actions and attitudes have done nothing to fit in. On the contrary, it seems that they want to diverge and use their economic strength to dictate their rules. It was unfortunate that France during this period was ruled by a weak and conservative President. The only hope is that leaders of the caliber of previous French Presidents emerge in the impending elections to rectify what appears a disobedient and unconcerned Germany.

V. Conclusions

This paper examine social benefits spending the eurozone countries for the initial 12 countries. It was found that there is a convergence in social benefits spending but this is due to Germany's deliberate attempt to promote its exports through a social dumping process. Both the per capita social benefits spending and the per capita output have diverged during the euro years. During the crisis years, there is an indication of inverse results: divergence of social benefits spending and convergence of the two per capita measures.

Social benefits spending is only one aspect of a multi facet policies adopted by Germany to promote its exports at the cost of its other partners in the eurozone. However, this would not be the case if Germany and its satellite countries were not able to dictate a monetary and exchange rate policy in the eurozone which serves its trade interests. The European Central bank which takes the decision over monetary and exchange rate policy is the only European institution with weak if not non-existent democratic-legitimacy. The problem is not a strong euro but an overshooting value of euro. This should be rectified before any other actions are taken.

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