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Convergence of welfare provision in Europe:

An assessment of the Monetary Integration effects

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ABSTRACT

This study investigates the dynamics of European countries social spending in the period 1980-2013, in order to assess the impact of the monetary integration on the convergence of national welfare provisions. The analysis of total social expenditure and its relative main functions for 16 Western Europe countries reveals the presence of conditional convergence patterns and an increase of its speed after the monetary integration, with the sole exception of labour policy spending. This is probably due to the achievement of a coordination among European social policies favoured by an agreement on the objectives of a European Social Model.

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KEYWORDS: EU monetary integration; social protection; convergence; welfare provision indicators; panel data.

1. Introduction

This study analyses the dynamics of European countries social spending in the period 1980-2013, to assess whether the achievement of the monetary integration drove to any convergence of national welfare provisions.

Formerly, welfare states in Europe were largely different due to countries' own political, historical and economic experience. Literature presents several examples of classification that place countries in different regimes. This is by the quantity of welfare provision, the how much dimension, and to the coverage model, the how dimension (Bonoli, 1997; Castles and Obinger, 2008; Esping-Andersen, 1990; Ferrera, 1996; Liebfried, 1992; Korpi and Palme, 2003). The latter, in particular, specifies the share of social expenditure mainly financed through contributions or taxation. Levels of protection and eligibility criteria vary throughout Europe as well as arising problems of social policy coordination and competition among European citizens.

During the last decades, the acceleration of the monetary integration process imposed deep changes in the political economy of European countries. In this new and more integrated institutional context, Governments were also expected to review their social policy actions to achieve an equal well-being condition and avoid the aspect of tightening competition among European citizens. Besides the occurrence of severe economic and demographic crises, there emerged new social risks and priorities that further fostered the reform process of the existing welfare schemes. Indeed, while the social dimension of the government policy was initially left behind, these new risks and the constraints on government balance, imposed by Maastricht Treaty in 1992 and the Growth and Stability Pact in 1997, raised serious problems of financial sustainability that required new trade-offs between different social spending items (Malinvaud, 1996). From this point of view, the convergence of national social protection systems becomes a matter of social spending convergence (Bouget, 2003) aimed to avoiding a reduction in protection levels (Cornelisse and Goudswaard, 2002).

For its part, the European Union (EU) institutions have the ambition to build a European Social Model (ESM) that aims at combining dynamism with social justice. The EU broadly define the goals and leaves member states to find the better strategy to reach them, in line with the subsidiarity principle. In particular, the major concerns of EU social policy are the fundamental rights such as education, health, mobility, social inclusion and durable pension benefits. All these goals can be achieved through an increase of labour force occupation, a higher quality of the life/work balance, the eradication of discrimination or a higher level of social protection., depending on the own socio-economic condition of each country.

The push towards the convergence of welfare provisions that is caused by a higher level of competition tends to be more pronounced within European Union where member states were committed, since the Summit of Lisbon in 2000, to design their national policies following the Open Method of Coordination (Attia and Berenger, 2007; Mosher and Trubek, 2003; Trubek and Trubek, 2005). The main aim of this policy tool was to favour an agreement on national public policies on poverty, social exclusion, pensions and health care maintaining a degree of independence among countries. However, common challenges (weak growth, aging population, unemployment) and constraints (Maastricht Treaty and Stability and Growth Pact) may have had the effect of produce more similar paths of EU member states social provision expenditures.

This new institutional context lays down a legal harmonization achieved by a ‘positive’ as well as a ‘negative’ integration (Scharpf, 1998). The first refers to the incorporation of common rules and directives on different aspects of social policy into the national legal framework (Knill and Lehmkuhl, 2002). The second refers to the removal of barriers to competition that facilitate the development of the Common Market (Leibfried and Pierson, 1995).

Finally, more similar social policies resulted in a strengthening of the globalization process that favoured governments' activity to reduce ‘unproductive’ spending. This is mainly on the welfare programs in favour of more productive expenditures with an aim to gain regarding competition (Montanari, 2001; Tanzi, 2002). This aspect of evolution drove to a social provision based on a residual model that may lead to a downwards convergence of countries' welfare programs (Busemeyer, 2009; Garrett and Mitchell, 2001).

Given this scenario, we investigate the role played by the monetary integration in conditioning the convergence process of welfare state programs controlling for different social and economic factors. Relying on the most recent available data, covering the period 1980-2013, the analysis examines the behaviour of total social expenditure and its relative main functions (old age, survivors and incapacity-related, family, health, labour policies) for 16 Western Europe countries.

The results provide evidence of conditional convergence patterns over the whole period and reveal that the European integration strengthens the speed of convergence for all the social programs with the only exception being labour policy spending.

The study is structured as follows: section two summarizes the European legal harmonization process; section three describes the data and empirical strategy; section four presents the results and section five concludes.

2. Legal Harmonization within European countries: the social policy context

The Treaty on the Functioning of the European Union (TFEU) in 2007 declares that member states share with the Union the competence regarding the social policy of the EU (art.4. paragraph 2b). The main purpose of this is to achieve the highly competitive social market economy that should favour full employment and social progress. The EU social policy framework highlights three different concerns. From a social point of view, all countries should accept the responsibility for the social needs of their citizens and agree with the idea of a common ESM. Second, from an economic perspective, countries have to promote competition and avoid distortions due to differences in social levels caused by discrimination regarding education and labour mobility. Finally, the political concern refers to the presence of an EU active social policy as a condition sine qua non to obtain citizens' consensus on the political and economic integration.

The new context pushed to consider the specific social policy actions, which are largely a competence of the single EU member state according to the subsidiarity principle, as a very important topic of European Union Institutions ‘agenda.

The pension system is a matter of common concern in EU due to the demographic crisis and the sharp decline of employment level that drove to severe sustainability problems. This issue is particularly crucial because if one of the EU countries fails to reform its pension system, there could be negative externalities spilling over the others. For this reason, the European Commission (EC, 2012) suggests different initiatives aimed at: achieving a better balance between time in work and time in retirement; ensuring the portability of pension rights when moving to another country; encouraging people to save more, through supplementary pension schemes, in order to maintain an adequate standard of living in the retirement period.

Labour market policy has been influenced by the presence of strong constraints imposed by international treaties like the European Employment Strategy (EES), started in 1997, and Lisbon Strategy 2000-2010. Their main aim was to make the EU ‘the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion’[1].

Then, the EC proposed the Europe 2020 strategy to enable the Union to get out stronger by the financial and economic crisis started in 2008, which caused a significant loss in jobs and potential output.

About family policies, the Council of the EU on Employment, Social Policy, Health and Consumer Affairs expressed itself in favour of a Reconciliation of work and family life. Similarly, regarding healthcare policy, the Health 2020 framework supports action across government and society to: ‘significantly improve the health and well-being of populations, reduce health inequalities, strengthen public health and ensure people-centred health systems that are universal, equitable, sustainable and of high quality’ (WHO, 2012).

All these European directives are a consequence of a changed social context characterized by higher unemployment rates, demographic crisis, and increasing female labour market participation. The latter, favoured by the transition to the post-industrial era characterized by a greater specialization in the services sector (Armingeon and Bonoli, 2006), led to a different gender division of labour, with a further negative effect on the family's very stability (Iversen and Cusack, 2000; Taylor-Gooby, 2004).

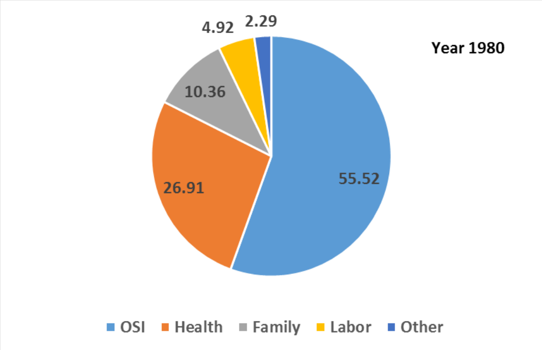
3. Data and Empirical strategy

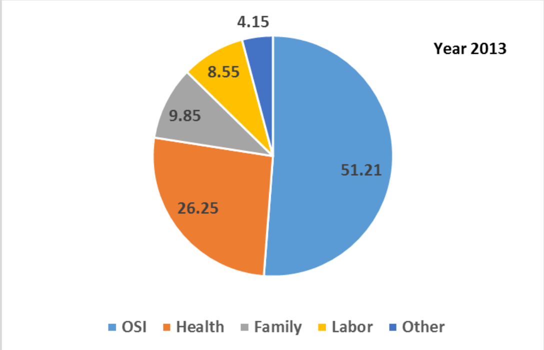
The impact of the monetary integration on the convergence of different European welfare programs is evaluated through a conditional convergence model. It is based on the hypothesis that steady-state levels of welfare provision are strongly influenced by countries' specific characteristics (Alsasua et al., 2007; Attia and Berenger, 2007; Caminada et al., 2010; Paetzold, 2013; Schmitt and Starke, 2011; Starke et al, 2008).

For our purposes, we estimate a panel data model with fixed effects, using a sample of 16 countries, namely Austria, Belgium, Denmark, Finland, France, Ireland, Italy, Germany, Greece, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom observed over the period 1980-2013. The advantage of this procedure, compared to a simple cross-section, is the possibility to account for time invariant countries heterogeneity (Evans, 1997).

The total amount of public social expenditure and its main functions are used as indicators of the countries' welfare provision. The choice of these measures is based on two objective criteria, the relative size and the responsiveness to changes in social policy. In particular, among all functions, it is worth to consider the categories attracting most of the financial resources devoted to social policy as displayed in Figure 1: old age, survivors, and incapacity-related (OSI), Family, Health, active and passive labour policies (Labour). Figure 1 shows evidence that the shares of OSI (55.52% in 1980 and 51.21% in 2013) and Health (26.91% in 1980 and 26.25% in 2013) cover more than 80% of the total social spending. The most relevant changes over the period appear to be the reduction of OSI and the increase of Labour spending commitments.

Figure 1. Average Social Expenditure by function as a percentage of total Social Spending in 1980 and 2013.





Source: Our elaboration on OECD SOCX statistics.

Table 1 presents some stylized facts on the total social expenditure and its main functions, both expressed in percentage of GDP, describing the evolution of social programs for each country and the sample as a whole.

The total social expenditure greatly increased (average sample change 44.28%) because of the demographic crisis and the worsening of unemployment during the 1970s and early 2000s economic downturns. OSI, Health, and Family expenditures follow the same pattern (36.43%, 40.73%, and 32.94%, respectively). Of particular interest is the consistent change, far larger than the sample average, recorded above all in Mediterranean countries, that became protagonists of a remarkable catching-up process in welfare policy.

Table 1. Descriptive analysis of social indicators 1980-2013

	SE			OSI			Health			Family			Labour*		
	1980	2013	**Δ1980-2013**	1980	2013	**Δ 1980-2013**	1980	2013	**Δ 1980-2013**	1980	2013	**Δ 1980-2013**	1985	2013	**Δ 1985-2013**
Austria	22.00	27.60	**25.45**	13.35	16.28	**21.90**	4.73	6.49	**37.07**	3.17	2.57	**-18.83**	1.19	1.74	**46.26**
Belgium	23.10	29.30	**26.84**	12.39	13.42	**8.34**	5.13	8.02	**56.43**	2.94	2.86	**-2.69**	4.36	3.96	**-9.20**
Denmark[a]	20.30	29.00	**42.86**	12.12	14.85	**22.59**	5.10	6.68	**30.93**	2.75	3.66	**33.09**	0.79	1.81	**129.90**
Finland	17.70	29.50	**66.67**	9.35	16.13	**72.54**	4.61	5.79	**25.74**	2.04	3.21	**57.49**	1.98	2.95	**48.44**
France	20.20	31.50	**55.94**	12.08	15.98	**32.32**	5.36	8.61	**60.57**	2.39	2.91	**22.18**	2.85	2.49	**-12.79**
Germany	21.80	24.80	**13.76**	12.59	12.19	**-3.19**	6.30	7.94	**26.00**	2.01	2.17	**7.90**	1.44	1.69	**17.90**
Greece[b]	9.90	26.00	**162.63**	6.14	18.45	**200.72**	3.15	6.07	**92.76**	0.30	1.28	**329.43**	0.45	1.31	**193.95**
Ireland	15.70	20.20	**28.66**	7.79	7.45	**-4.37**	6.06	5.47	**-9.79**	1.05	3.29	**213.23**	4.27	3.41	**-20.22**
Italy[c]	17.40	28.60	**64.37**	10.44	18.08	**73.15**	5.33	6.81	**27.73**	1.04	1.42	**36.31**	0.80	2.11	**164.25**
Netherlands	23.30	22.90	**-1.72**	12.61	9.50	**-24.64**	4.83	7.86	**62.66**	2.35	1.35	**-42.66**	4.34	2.45	**-43.45**
Norway	16.10	21.80	**35.40**	8.95	11.55	**29.05**	4.28	5.55	**29.49**	1.78	3.02	**69.58**	1.05	0.85	**-19.52**
Portugal[d]	9.50	25.50	**168.42**	5.57	15.94	**186.00**	2.99	6.05	**102.58**	0.64	1.20	**88.09**	0.47	2.11	**348.09**
Spain	15.00	26.30	**75.33**	8.43	14.51	**72.17**	3.97	6.37	**60.45**	0.46	1.33	**189.57**	2.98	3.73	**25.34**
Sweden	24.80	27.40	**10.48**	12.36	14.21	**15.01**	7.21	6.55	**-9.14**	3.51	3.64	**3.53**	2.77	1.82	**-34.46**
Switzerland	12.80	19.20	**50.00**	7.60	8.90	**17.17**	3.29	6.63	**101.28**	0.94	1.56	**65.39**	0.40	1.34	**233.33**
United Kingdom	15.60	21.90	**40.38**	6.59	8.58	**30.11**	4.41	7.15	**61.94**	2.18	3.80	**74.56**	2.58	0.53	**-79.50**
Mean	17.83	25.72	**44.28**	9.90	13.50	**36.43**	4.80	6.75	**40.73**	1.85	2.45	**32.94**	2.04	2.14	**4.80**
CV	0.26	0.14	**-46.25**	0.27	0.26	**-4.54**	0.24	0.14	**-42.31**	0.54	0.39	**-27.58**	0.70	0.46	**-34.65**

* Because of unavailability, data on labor policies start from 1985.

a. For Denmark data on Labor in 1980 is not available and is substituted by that of 1986. Unemployment insurance is organized on a voluntary basis and one can become member of a UI-insurance fund when he is between 18 and 65 of age and has residence in the country. Hence, Labour data include only active policies information (Westergaard-Nielsen, 2002).

b. For Greece data on OSI, Family and Labor are available till 2012.

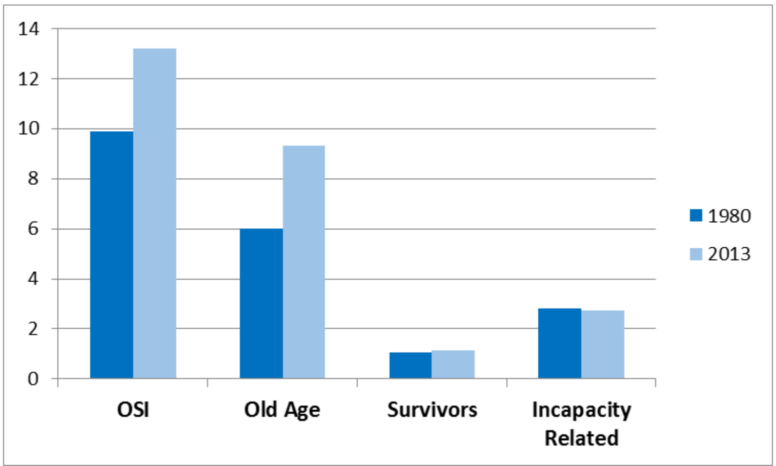
c. For Italy data on Active Labor Policy are available from 1990, therefore the 1980 value is substituted by that of 1990.

d. For Portugal data on Labor in 1980 is not available and is substituted by that of 1986.

Moreover, total social spending and OSI and Health functions have a relatively low coefficient of variation, implying higher similarity, while Family and Labour show greater differences among countries. The general increase of similarity suggests the presence of an absolute convergence process. The trend over time of the social indicators evidences a convergence process beginning in the middle of the 1990s when European countries were invited to join the cohesion policy in the light of a monetary integration. As regards OSI policies, Greece, Ireland, Italy, the Netherlands, Switzerland, and UK diverge from the common path the plots are not presented but are available upon request.

It should be noted that the principal determinant of OSI is the expenditure for old age pension, as evidenced in Figure 2.

Figure 2. OSI and its components in 1980 and 2013 (average values, % GDP).



Source: Our elaboration on OECD SOCX statistics.

While survivors and incapacity related pension spending remain stable, the retirement spending registers over the period a large increase from 6.0 to 9.3(% of GDP).

By means of a panel data structure, the impact of the European monetary integration on countries' social provision is tested using the following conditional convergence model:

$$\Delta Y_{i,t} = \alpha_i + \beta Y_{i,t-1} + \gamma DEurope_{i,t} + \delta_k \boldsymbol{\pi}_{i,t} + \varepsilon_{i,t} \qquad \textit{with } k{=}1, \ldots 7 \qquad (1)$$

where $\Delta Y_{i,t}$ represents the annual growth of the social indicator of country $_i$ (with i=1,…,16), at time t (with t=1, …,33) and $Y_{i,t-1}$ is the lagged value of the social indicator so that the coefficient β, depending on its sign, reveals the presence of convergence (if negative) or divergence (if positive) among countries. *DEurope* is our variable of interest, equal to 1 from 1992 onwards and zeroes otherwise, enabling us to account for the impact of the European monetary integration process. Specific time invariant characteristics and structural differences are captured by country fixed effects α_i. The vector $\boldsymbol{\pi_{i,t}}$ includes a set of variables controlling for demographic, economic and institutional factors. The first are accounted by the old dependency ratio, i.e. the ratio of the population older than 64 to the working-age population (those ages 15-64), and the birth rate. These factors may drive changes in social expenditure for pension, health and education services for children and young people. The economic determinants included in the model are the following: the GDP growth rate, that improving social well-being favours a reduction in resources devoted to social functions; the unemployment rate which causes an increase in most of the social spending functions; the trade openness, i.e. the sum of imports and exports in terms of GDP, which may reduce social spending in favour of more productive uses to gain competitiveness. Institutional factors are accounted by the government debt as a percentage of GDP, as the implementation of austerity measures, laid down by the EU, causes an obvious rationing of all public expenses. Finally, we control also for the female labour force participation rate which changes may imply a different reorganization of family needs and labour market policy.

To capture the impact of European Monetary integration process on the welfare programs convergence, we first estimate a baseline model and then add our variable of interest *DEurope*. All data are taken from OECD statistics.

The variables are considered in level or at differences according to the results of different unit root tests, namely Levin et al. (2002), Im et al. (2003), ADF Fisher $\chi2$ and Fisher-PP tests defined by Maddala and Wu (1999), where the null hypotheses are ‘non-stationary’[2].

4. Results

Empirical results reveal the presence of conditional convergence for all the social provision categories as shown by the negative and highly statistically significant coefficients of their lagged levels in Table 2. The size of β is particularly high for labour policy (-7.9) and family (-7.08), denoting a stronger convergence process for social expenditure devoted to these functions. The inclusion of *DEurope* demonstrates that European integration gives more strength to this convergence process in most of the social programs. This rise in the speed of convergence is probably due to an increase in the number of policy areas under the responsibility of EU Institutions. Since the implementation of Maastricht treaty (1992), European Central Bank and European Commission have the task to control the compliance of deficit criteria with an indirect impact on member states fiscal policies. Therefore, national social policies, being a component of the public budget, are induced to follow similar patterns.

The control variables, when statistically significant, have the expected signs. However, some unexpected outcomes need clarification. First, the old dependency ratio does not have any statistically significant impact on OSI, even though it is mainly driven by pension benefits. In a legal harmonization context, this can be understood as the consequence of the EC encouragement (EC, 2012) to maintain an adequate standard of living through private supplementary pension schemes. Second, the positive and significant government debt coefficient for all social indicators implies that these programs are largely financed using government bonds. Finally, particularly interesting is also the negative impact of female participation in the labour market and Health policies. These may be due to the resulting greater household income availability that reduces the requests regarding these typologies of social services.

Table 2. Conditional β-convergence results

VARIABLES	SE	SE DEurope	IVS	IVS_ DEurope	LABOR	LABOR DEurope	HEALTH	HEALTH DEurope	FAMILY	FAMILY DEurope
L.Soc_exp	-0.637***	-0.659***	-0.886***	-0.893***	-7.913***	-7.372***	-1.726***	-2.366***	-7.084***	-7.746***
	(0.0724)	(0.0744)	(0.118)	(0.119)	(1.247)	(1.243)	(0.593)	(0.598)	(2.010)	(2.127)
Old dependency	0.153**	0.121	0.0685	0.0445	-0.792**	-0.139	0.0850	-0.227	0.117	-0.0416
	(0.0760)	(0.0804)	(0.0629)	(0.0694)	(0.374)	(0.419)	(0.193)	(0.201)	(0.327)	(0.367)
Δbirth_rate	1.369***	1.365***	0.948**	0.955**	0.0963	-1.770	1.139	1.440	6.962***	7.034***
	(0.474)	(0.474)	(0.411)	(0.411)	(2.630)	(2.659)	(1.232)	(1.209)	(2.384)	(2.385)
GDP growth	-0.870***	-0.866***	-0.913***	-0.911***	-1.472**	-1.552***	-0.894***	-0.902***	-0.876*	-0.873*
	(0.100)	(0.100)	(0.0875)	(0.0875)	(0.590)	(0.584)	(0.264)	(0.259)	(0.511)	(0.511)
Δtrade_openess	-0.123***	-0.125***	-0.0637**	-0.0661**	-0.302	-0.233	-0.0784	-0.103	-0.257	-0.266
	(0.0337)	(0.0337)	(0.0290)	(0.0291)	(0.191)	(0.190)	(0.0885)	(0.0869)	(0.170)	(0.171)
Δdebt/GDP	0.676***	0.683***	0.0583**	0.0588**	0.0729	0.0504	-0.112	-0.0954	0.508***	0.517***
	(0.177)	(0.177)	(0.0255)	(0.0255)	(0.168)	(0.166)	(0.0765)	(0.0750)	(0.149)	(0.149)
Δunemployment rate	0.0473	0.0496*	0.359**	0.361**	3.695***	3.734***	-0.168	-0.0927	-2.157**	-2.127**
	(0.0295)	(0.0295)	(0.154)	(0.155)	(1.036)	(1.024)	(0.465)	(0.456)	(0.902)	(0.903)
Δwlfp	0.0996	0.112	0.0183	0.0274	-1.933*	-2.218**	-0.825*	-0.650	-0.685	-0.626
	(0.176)	(0.176)	(0.153)	(0.154)	(1.030)	(1.021)	(0.454)	(0.447)	(0.894)	(0.897)
DEurope		0.495		0.284		-7.932***		4.567***		2.023
		(0.407)		(0.345)		(2.383)		(1.010)		(2.130)
Constant	13.19***	14.10***	11.24***	11.73***	44.80***	32.59***	10.95**	19.24***	16.52*	20.50**
	(1.758)	(1.912)	(1.576)	(1.684)	(9.974)	(10.52)	(4.520)	(4.793)	(8.977)	(9.909)
Observations	476	476	475	475	451	451	488	488	475	475
R-squared	0.512	0.513	0.523	0.524	0.269	0.288	0.068	0.108	0.095	0.097
Number of countries	16	16	16	16	16	16	16	16	16	16

Standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1

5. Conclusions

This study explores the impact of the achievement of the monetary integration on the convergence of welfare provision among European countries, controlling for the specific contribution of economic and demographic factors. To this end, we analyse the dynamics of total social spending and its main functions, as indicators of welfare provision, over the period 1980-2013 for a sample of 16 Western European countries.

The stylized facts on the social indicators highlight an increase in social expenditure, total and by functions, over the sample period. The most substantial changes are recorded in Mediterranean countries which became protagonists of a catching-up process in welfare programs.

To highlight the impact of the European monetary integration, since the Maastricht Treaty of 1992, the study tests the presence of a conditional convergence process using panel data estimation approach. The results give evidence of conditional convergence patterns and reveal that the European integration strengthens the speed of convergence for all the social programs, with the only exception of labour policy spending. This is probably due to the achievement of the coordination among European social policies, as stated by the ESM that allowed overcoming the large differences in welfare regimes to which countries belong. This outcome is robust to controls for the demographic crisis, the changes in economic and institutional conditions and the gender composition of labour force generating new social risks and needs.

To evaluate whether this process also has an impact on the competition among European citizens, one should evaluate the effectiveness of each system and compare the respective degree of risk and needs coverage. In fact, the main aim of ESM is ‘to bind Europe together’ ensuring that citizens of each member state feel equally protected, regardless their residence-country. Further analyses could be performed to verify whether the convergence regarding financial efforts goes together with a convergence of the beneficiary's well-being.

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