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Chapter Title: Trends in Social Protection Programs and Expenditures in the 1980s

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2 Trends in Social Protection Programs and Expenditures in the 1980s

Peter Scherer

In 1980, the Organisation for Economic Co-operation and Development (OECD) held a conference whose proceedings were subsequently published under the title *The Future of Social Protection* (OECD 1981). Emile van Lennep, who was then the secretary general of the OECD, specified in his opening speech what he considered to be "main principles" that should not be placed in jeopardy by the economic crisis then facing the OECD area (OECD 1981, 10):

> 1. We must surely continue to build on the principle that adequate income from work is the primary basis of well-being;
> 2. The State has a clear responsibility, in response to the common will in democratic societies, to achieve through the fiscal system a more equitable distribution of income than the market system would of itself provide;
> 3. The State must surely remain as the main guarantor against social risks such as unemployment, ill-health, disability, and old age—that is to say, "social security";
> 4. Transfers to the vulnerable groups in society can be achieved in a variety of ways: direct transfers involving states, provinces or municipalities; price subsidies leading to lower consumer prices, for example rents and transportation; and, of course, various forms of private solidarity.

However, the accompanying secretariat paper (OECD 1981, 73–83) warned that the inspiration of these ideals—the drive toward a more egalitarian distribution of income—had already started to break down. The "tax revolt" was calling the viability of some forms of social provision into question. Hence, it

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appeared that some OECD countries were about to reject many of the principles which the organization's secretary general had identified as crucial.

A decade later, this rejection has indeed occurred, but it has been less general than is often thought. Apart from the United States, only the United Kingdom and (since 1990) New Zealand have rejected the thrust of the principles van Lennep enunciated as public policy. Although there has been a general decline in trade union membership in all OECD countries (see OECD 1991), only in these three countries has collective bargaining been downplayed and even condemned in public-policy terms. These changes were related: collective determination of employment provisions was generally related to social arrangements. In fact, in many countries, this was, and is, institutionalized; many social protection measures, including workers' compensation, health insurance, and pension provision, are administered by tripartite institutions.[1]

2.1 Social Expenditures in the 1980s: The End of Growth

The crisis in the welfare state to which the OECD conference volume title referred was primarily a fiscal one. Social expenditures had grown at a faster rate than real national product during the period of rapid growth in per capita gross domestic product (GDP), which ended in the early 1970s. During the 1970s, the rate of increase in expenditure slowed but not as much as the decline in economic growth, so that social expenditures continued to rise as a percentage of GDP in most OECD countries.

The reasons for this were mixed. Pension systems instituted over the previous twenty years were maturing so that retirees had accrued more substantial pension entitlements. Some other items of expenditure, associated with education and transfers to families, could be expected to decline in the 1980s.[2]

However, other pressures seemed likely to continue. In particular, the cost of health care systems was increasing as a proportion of GDP in all countries and seemed unstoppable in the light of the development of medical technologies and the growth in expenditure on incomes of the medical profession. And the decline in the employment:population ratio in many countries was associated either with a growth in expenditure on benefits for the openly unemployed or a growth in other support for those without a job—in particular, disability pensions and various forms of early retirement pensions.

Public social protection expenditure did continue to increase as a proportion of GDP until 1983, but since then it has been relatively stable (see fig. 2.1,

1. Less often, but still frequently, they are provided through provisions in multiemployer collective bargains which are "extended" to all employers potentially covered by the negotiations and thus become subsidiary legislation. This is particularly significant for some supposedly "private" supplementary pension provision. See, for example, OECD (1992a, 1993) for discussions of such arrangements in the Netherlands and Finland.

2. For a discussion of these prospects as they appeared a decade ago, see OECD (1985).

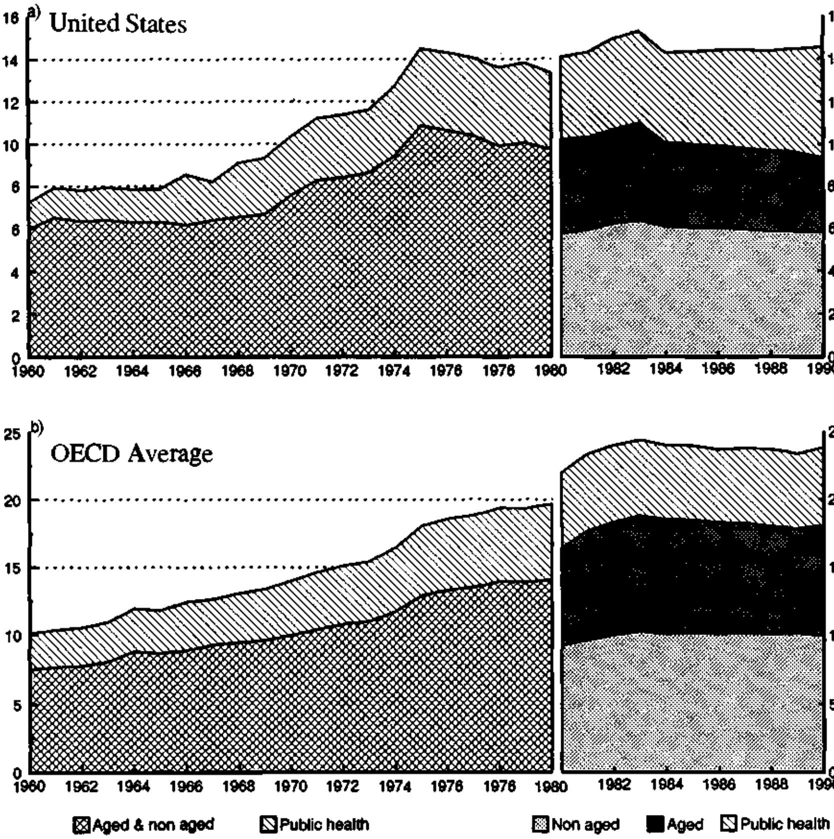


Fig. 2.1 Public expenditure on social protection as a percentage of GDP in the United States and the OECD

Source: OECD 1994.

Note: 1960–1980 excludes Iceland, Luxembourg, Portugal, Spain, and Turkey; 1980–1990 excludes Iceland, Switzerland, and Turkey.

which shows the trend in social expenditures over the past three decades as an unweighted average of twenty-one OECD countries). Furthermore, this stability applies to each of the three components of expenditure into which expenditure data can currently be disaggregated: health care, expenditure on the aged (predominantly public old-age pensions and related survivors' benefits), and transfers to the non-aged, which include family allowances and unemployment benefits, support for single parents, and disability and early retirement pensions.[3] In the case of the United States, a fall since 1983 in expenditure on the non-aged, associated with the improved labor market situation, was balanced

3. Work continues on developing comprehensive data series for each of these individual components of expenditure, but data on a comparative basis are not yet available.

by an increase in public expenditure on health care—an increase reflecting the general inflation in health care expenditures in the United States.[4]

However, this apparent stability in the OECD average is the result of a considerable variety in trends and levels across OECD countries (see appendix). In 1988 (the latest year for which data are available for all the twenty-one OECD countries included in the data base at the moment), social protection expenditures as a percentage of GDP range from 11.8 (Japan) and 12.2 (Australia) to 28.1 (Norway) and 33.3 (Sweden). The sources of this cross-country variation are too extensive to discuss in detail here. Variations in public expenditures on health—which range in percentage of GDP from 4.7 (United States) and 4.9 (Japan) to 7.4 (Norway) and 7.6 (Sweden)—are not the main cause. Differences in the extent and generosity of public old-age pensions are greater, and expenditure on the aged varies from 3.8 percent of GDP (Australia) to 14.1 percent (Italy). However, an equally important source of variation lies in public social protection expenditures for the non-aged, which vary from 2.1 percent of GDP in Japan and 3.2 percent in Australia, to 13.3 percent in Denmark and 13.9 percent in Sweden. In general, the countries of Europe fall between these extremes, with average expenditures in the European Community for these three components being 5.6, 9.7, and 7.7 percent of GDP, respectively.

The sources of the stability in the overall average since 1983 are mixed. With the exception of the United States, Iceland, and Finland, OECD countries generally stabilized public health expenditures as a percentage of GDP in the latter part of the 1980s. The maturation of generous public pension systems in Japan, Italy, and Greece led to a growth in the proportion of GDP transferred to the aged (particularly in Italy and Greece, where, in contrast to Japan, changes to the structure of public pensions also increased the expenditure levels). In some other countries, a tightening of means tests for pension provision (Australia) or a narrowing of entitlement (West Germany and Denmark) led to a slight reduction in this ratio. Hence, the overall average for this component increased only very slightly. Transfers to the non-aged were the most volatile, largely because unemployment benefit payments and other transfers to people without employment fell as labor market conditions improved during the decade, while other transfers (particularly various forms of assistance to families) increased faster than GDP in the Nordic countries.

Developments over the past decade have established that social protection expenditures are not, in general, out of control, in the sense that their previous tendency to increase at a rate greater than GDP has been controlled. However, this apparent equilibrium is an uneasy one; many countries are experiencing pressures, such as the following, that could well result in this apparent stability being only temporary:

4. Unlike all other OECD countries except Turkey, expenditure on health care in the United States is largely private.

- Slowdown in economic growth combined with continuing growth in demand for health care and a possible growth in income transfers to the unemployed and other jobless people can result in cyclical increases in expenditures that can easily become structural.
- Inflationary tendencies in medical services, familiar in the United States (where they are largely met by private insurance), are also evident in the rest of the OECD, where public systems bear the financing burden. Such tendencies are particularly intense in those systems (such as France's) that are based on fee-for-service reimbursement. Many countries are responding by introducing or expanding direct contracts between suppliers and public third-party payers, but others are shifting the burden of some payments to the private sector by requiring higher copayments for some services. Higher copayments have also been imposed for pharmaceutical products sold at prices higher than their generic equivalents.[5]
- The aging of populations in OECD countries as the postwar "baby boom" generation retires will threaten the apparent stability in old-age function expenditure. In particular, in a number of southern European countries (Greece, Italy, Spain, and Portugal), the net replacement rate (the ratio of pension received to final salary net of taxes and charges) is above 80 percent and is no lower for those with high salaries than for those with low ones (Eurostat 1993).

These public social protection provisions are, of course, additional to the systems of employment protection contained in employment laws or in collective agreements. However, they are closely related. While it is possible to build up a system of employment regulation without an employment-related social protection system,[6] this is unusual. Concern for security outside or after the employment relationship has in most cases led to public underwriting of various forms of social insurance—and in particular to the assurance of old-age pensions that guarantee the replacement of a substantial part of earnings after retirement.

2.2 Interpreting Differences in Social Protection Arrangements

Recent analytic work in this field (for a brief survey, see Mitchell 1992) has tried to analyze social protection policies and their outcomes by categorizing countries into groups: Mishra (1990) uses two ("social corporatist" as in Sweden and Austria and "neoconservative" as in the United States and the United Kingdom), while Esping-Anderson (Esping-Anderson and Micklewright

5. See OECD (1992c) for further discussion of the "internal" reforms of publicly funded health care systems in seven OECD countries.

6. Australia, with its means-tested approach to public income security, is one example—although the mandating of retirement provisions by employers since 1992 has modified even this case.

1991) suggests a three-way typology ("liberal residual" as in the United States, "conservative" as in West Germany, and "social democratic" as in Sweden). Lødemel and Schulte (1992) add a fourth—a "Latin" (i.e., Mediterranean) group—to complete the typology. This group approach has a certain attraction: the countries with the highest ratio of GDP to social expenditures fall in the "social democratic" group, with the "conservative" group intermediate and the "liberal residual" group the lowest, and "Latin" countries show high expenditure on the aged but not on other functions. However, closer examination of the patterns and trends suggests that these typologies are not very useful for explaining expenditure differentials and trends. Most of the significant differences are due to the presence or absence of particular types of transfers (notably family allowances), and some particular components of social expenditure in countries in the "liberal" economic camp (e.g., old-age pensions in the United States and Japan) are clearly not at all "residual." Social transfer patterns are the outcome of historical processes within each society, and there are considerable divergencies between countries in these processes from one type of expenditure to another.

However, an important part of social expenditures comprises what might broadly be called social insurance—coverage against particular risks for all persons in a particular category.[7] Social insurance is often analyzed as an alternative to private insurance markets. Its advocates argue that social insurance avoids the externalities inherent in private insurance markets (risk selection on the part of providers, moral hazard on the part of consumers) through universal provision (eliminating risk selection) and administrative controls (substituting for private litigation to ensure the insurance contract is not undermined). This perspective orients analysis toward the relative merits of universal public and voluntary private provision in achieving the satisfactory mechanism for dealing with *individual* risk.

In reviewing the relative merits of different systems of social protection against risks, it is important to recognize that the contingencies individuals might face are different on the Continent and in Japan than in Anglo-Saxon countries. The law in most of the non-Anglo-Saxon countries specifies that families are responsible for the upkeep of their indigent members. In English-speaking countries, this obligation is confined to the nuclear family: the spouse while the marriage is intact, children until age of majority (now generally 18). In the case of children, the recent emphasis on child support has led to attempts to enforce obligation on absent parents. But the obligation stops when children reach maturity and is not reciprocal. It is possible to regard these responsibilities as being absorbed into a production unit—the family—which is jointly managed and responds as a unit to market signals. It is therefore possible to envisage that such a unit should be able to manage its lifetime income stream

7. These categories can comprise all citizens (paying through taxation) but more usually comprise labor force participants who pay (or whose employers pay) compulsory levies.

and to assess social insurance arrangements in the light of alternative individual insurance arrangements and lifetime consumption patterns.

Elsewhere, however, the responsibility does not stop at the boundaries of the nuclear household. The Napoleonic Code—which formalizes legal obligations which existed previously and continues to influence contemporary legal codes throughout Europe—refers to an *obligation alimentaire:* a legal responsibility under which the obligation of parents to maintain their children is matched by an obligation by adults to maintain their aged parents. In Germany and Austria, this obligation goes further: children are jointly responsible for their indigent grandparents, and parents are liable for the maintenance of their indigent adult children. In Luxembourg, these responsibilities extend to further kin relationships. Similar provisions exist in Japanese law and in the laws of most other European countries—though they have been abolished in Nordic countries.

Historically, these responsibilities were exercised through cohabitation: the extended family was an extended household, which operated as a unit. However, today this is only true in Japan, and even there cohabitation between generations is in decline (OECD 1994). It is difficult to reconcile mutual family responsibility with separate living arrangements and personal autonomy. How does an individual insure against parents becoming indigent or children (or grandchildren) bankrupting themselves? The moral hazard and risk-shedding features of such a market would be insuperable.

A concrete instance of such concerns is currently the subject of intense public debate in Germany. Long-term care of the frail aged is not currently covered by social insurance in that country, and the German government has committed itself to extending statutory health insurance to cover this risk through a new levy of 1.7 percent of "insurable" earnings, to be shared equally between the insured and the employer. One of the authors of the law has noted that it is being proposed in part because "becoming dependent on long-term care puts the persons affected and their families in a precarious and often quite hopeless financial position" (Vollmer 1993).[8]

2.3 Working Life Reduction

Social insurance evens out income over the lifetime, reducing disposable incomes while in employment in order to ensure adequate incomes when not. This carries the risk that the relative price of leisure (sometimes enforced through layoffs) is reduced so much that significant withdrawal from the labor force occurs—resulting in a narrowing of the base for employment levies, forcing an increase in the rate of levy to keep budgetary balance, which in turn reduces further the relative price of leisure. . . . This sort of process has brought

8. At the time of writing, actual passage of this measure is blocked through debate on how to compensate employers for the cost of the levy: The government parties have proposed that payment for the first two days of sick leave should be dropped, but the unions oppose this.

pension systems in a number of European countries (notably France) to a point of crisis.[9]

A general symptom of this trend is the "leakage" of provision for old-age income into working life. This has been happening in a number of countries through public pension provisions. These generally provide for pensions for those who become disabled during their working life, on similar terms to old-age pensions. If ability to obtain employment is one of the criteria for assessing disability, eligibility for disability pensions will increase during recessions. This has happened in a number of countries. In general, the reduction in the cost of leisure in old age through very high rates of earnings replacement raises the individuals' perceived lifetime income and can lead to a desire to "spend" some of this wealth earlier in life. It can and does also lead employers (and unions) to single out those who are eligible for income support when layoffs are necessary. As a result, average productive life in most OECD countries is falling, as individuals (both males and females) leave the labor force earlier.[10]

Public social protection systems thus suffer from some of the same risks of moral hazard as workplace employment protection legislation: by driving a wedge between income from employment and total labor costs, they can lead to a level of overall employment lower than that implicitly assumed in their design. Unless this issue is addressed with care, these systems can add to the imbalances they were established to correct.

However, it would be incorrect to conclude that the idea of social protection is therefore unviable. Systems which emphasize labor force participation as a condition for social protection are associated with low rates of poverty (however measured) *before* social transfers in a number of European countries (Förster 1994). Thus, the risk of reduction in labor force participation has to be set against the encouragement of participation in order to take part in the system. To the extent that lifetime wealth has been augmented as a result, use of part of that wealth to consume more leisure should be welcomed, not condemned.

9. France has started to address this bias by shifting some of the burdens of financing social protection expenditures from payroll taxes to a "general social contribution" (GSG) levied on all incomes—including those of social security beneficiaries.

10. See OECD (1992b, 1994) for a further discussion of this trend and its causes.

Appendix

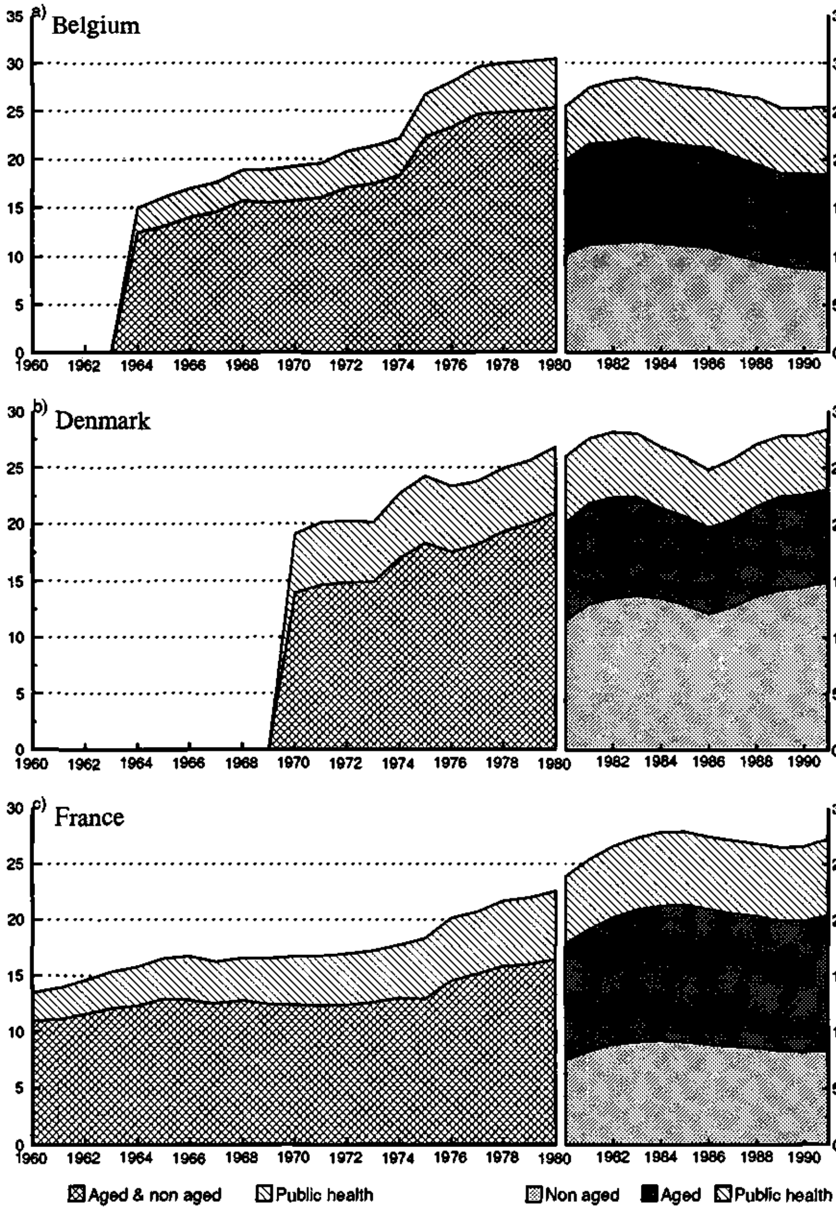
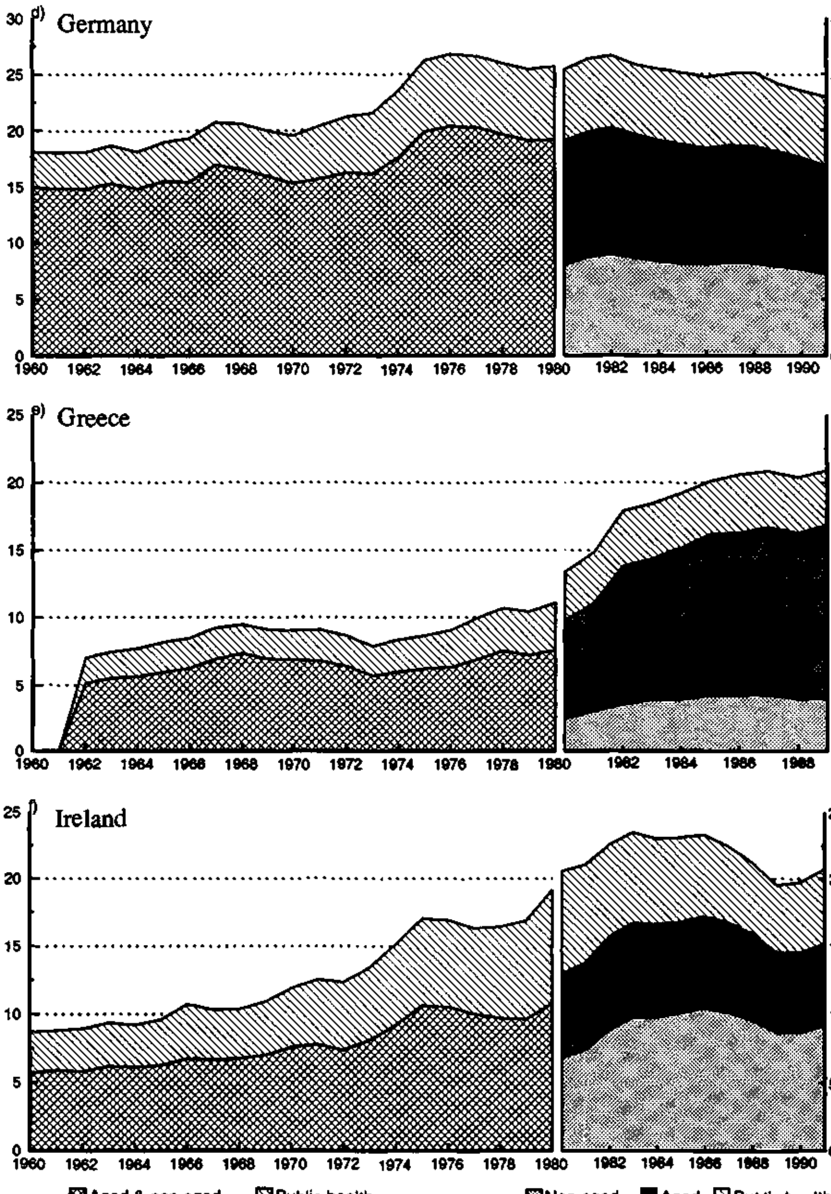


Fig. 2A.1 Public Expenditure on Social Protection as a Percentage of GDP in Other OECD Countries

Source: OECD 1994.

Note: OECD countries for which graphs are based on a mixture of old and new data from Eurostat. For reasons for differentiation, see cited source.

Fig. 2A.1 (continued)



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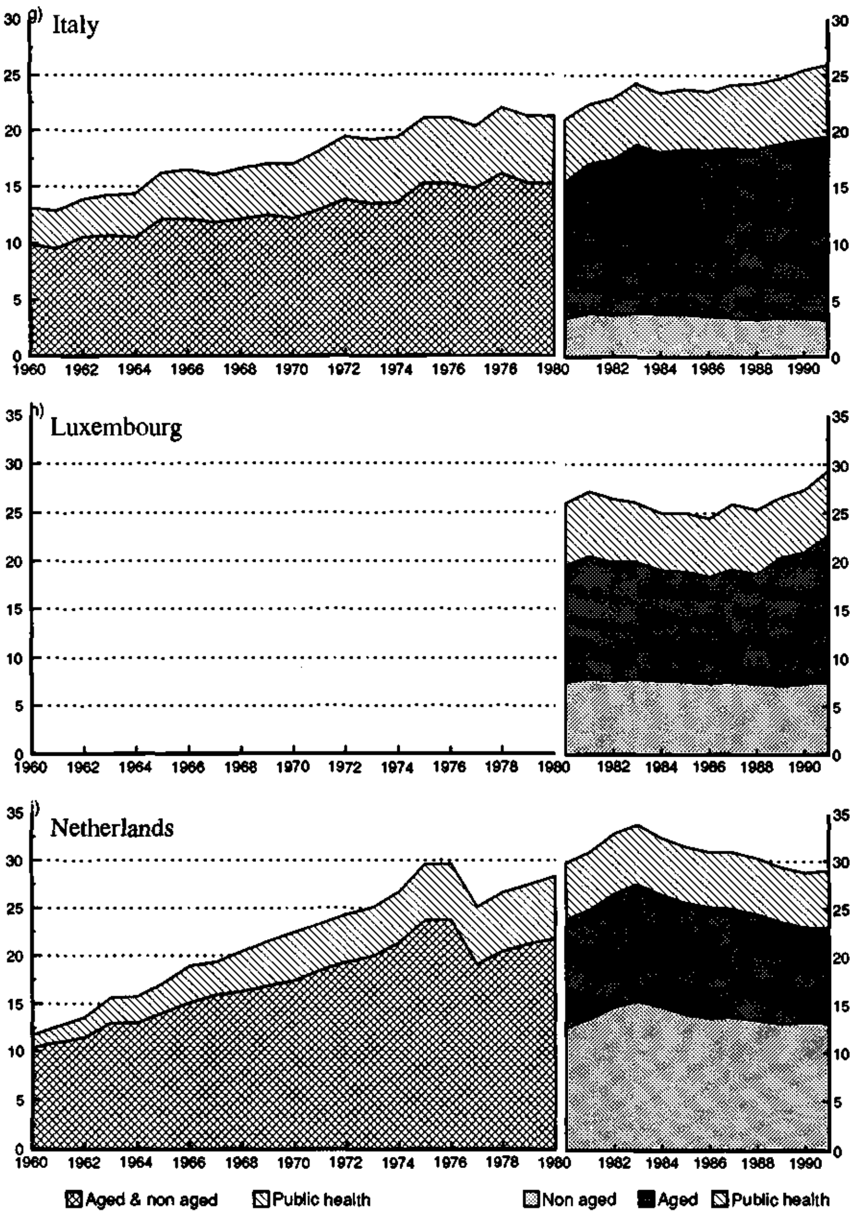

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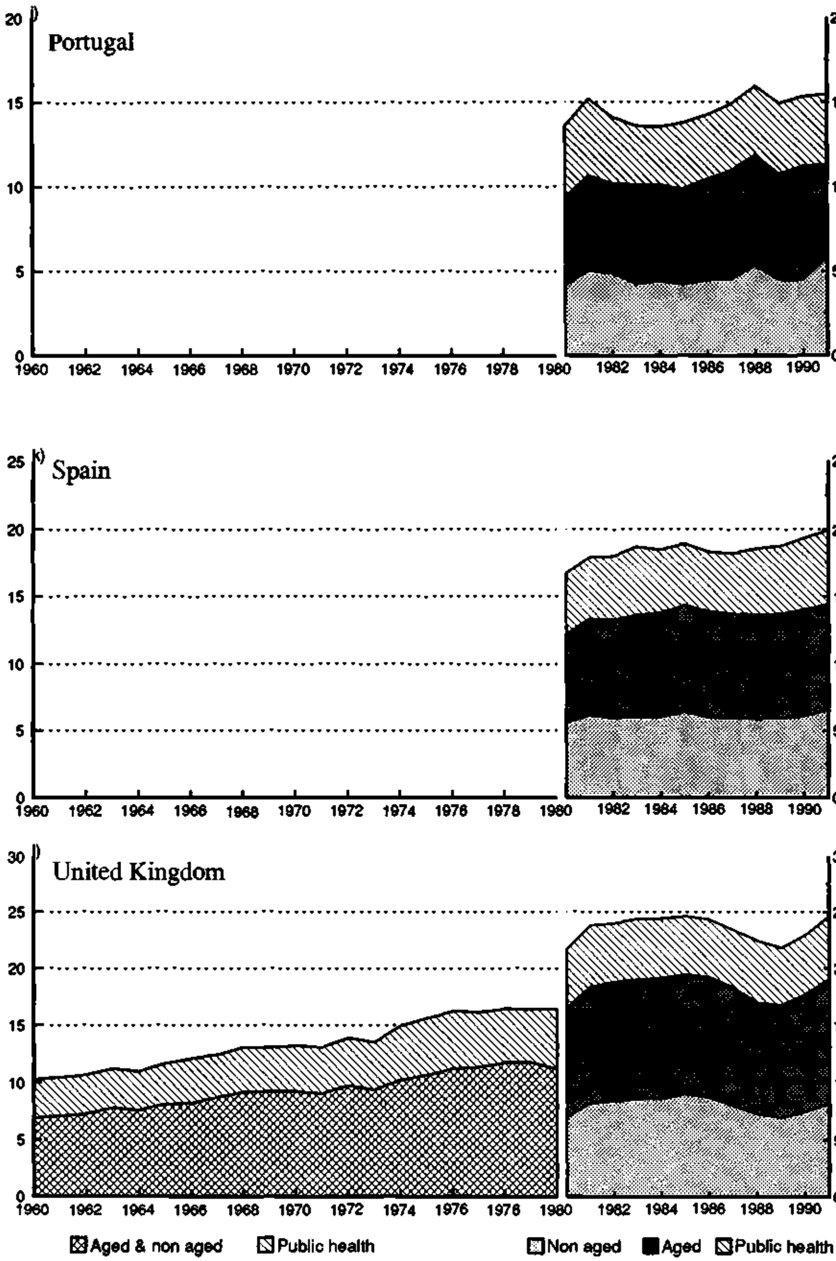

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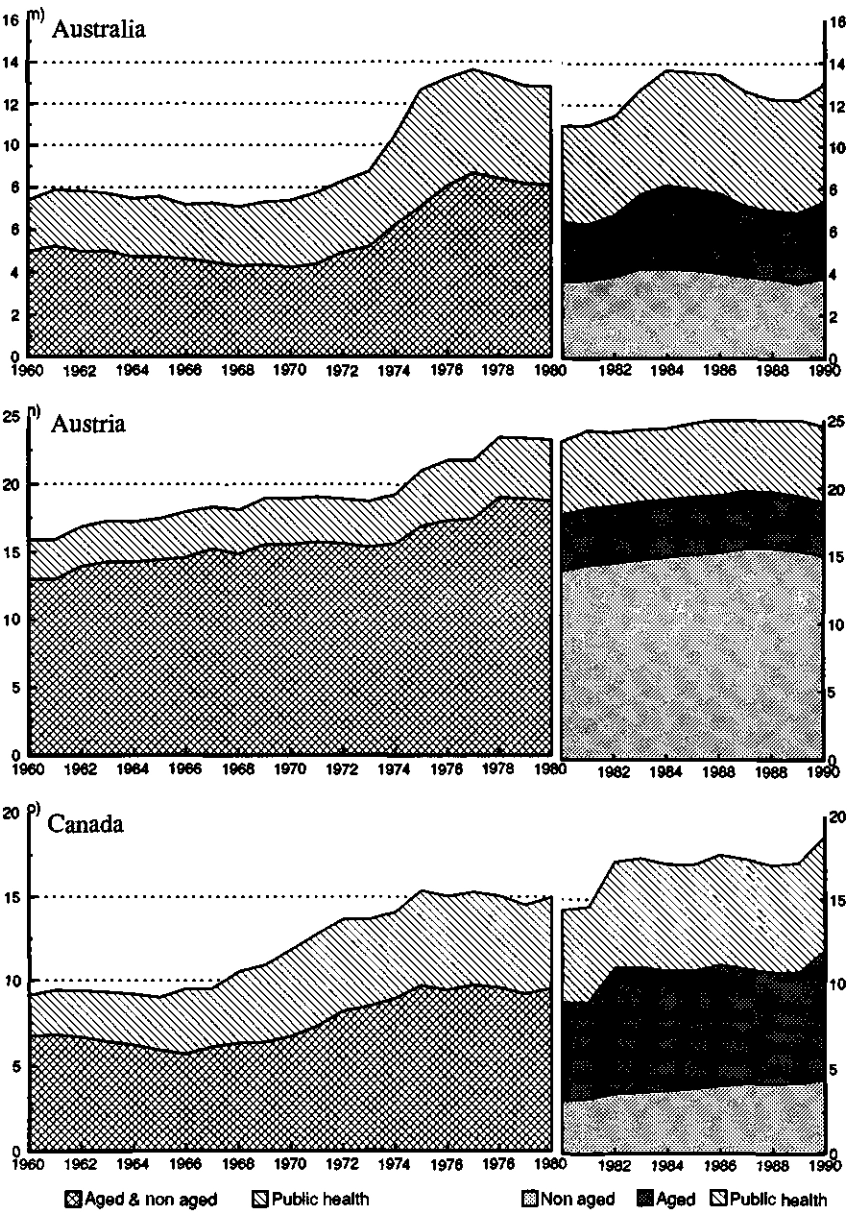

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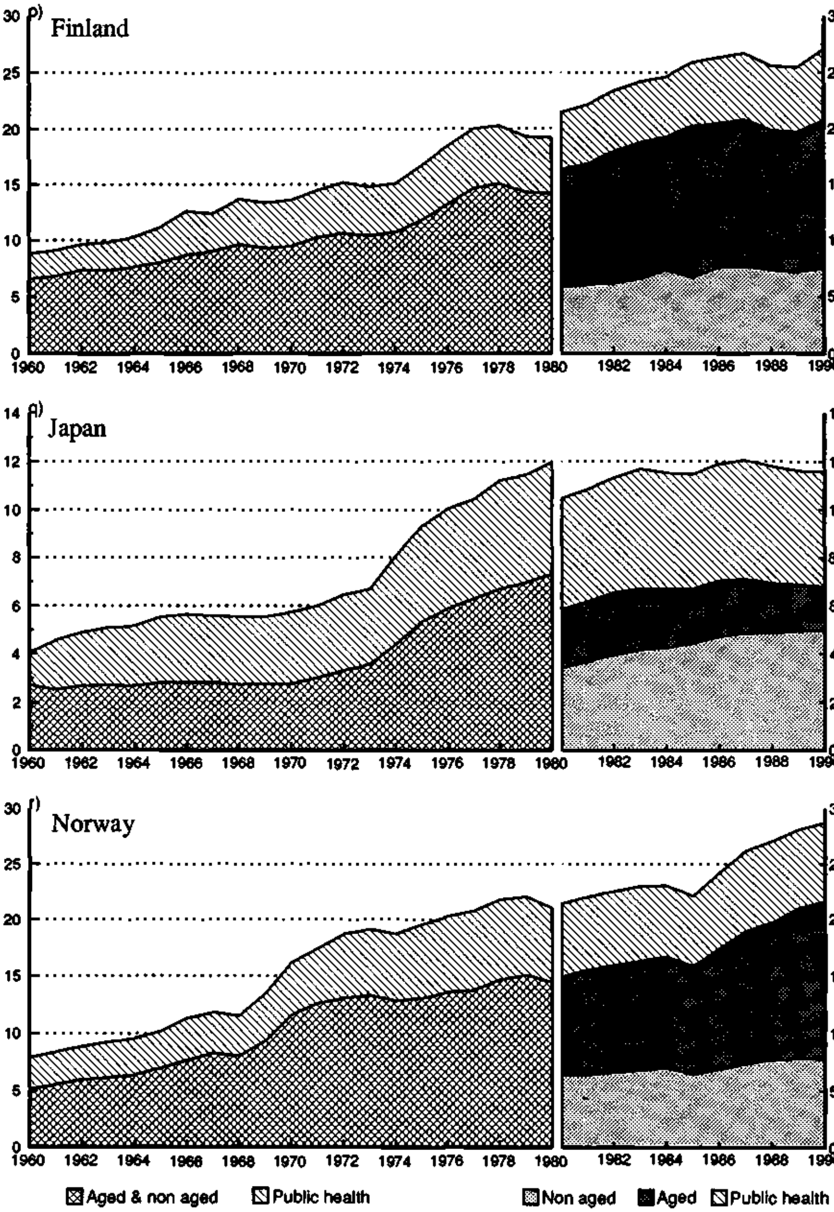

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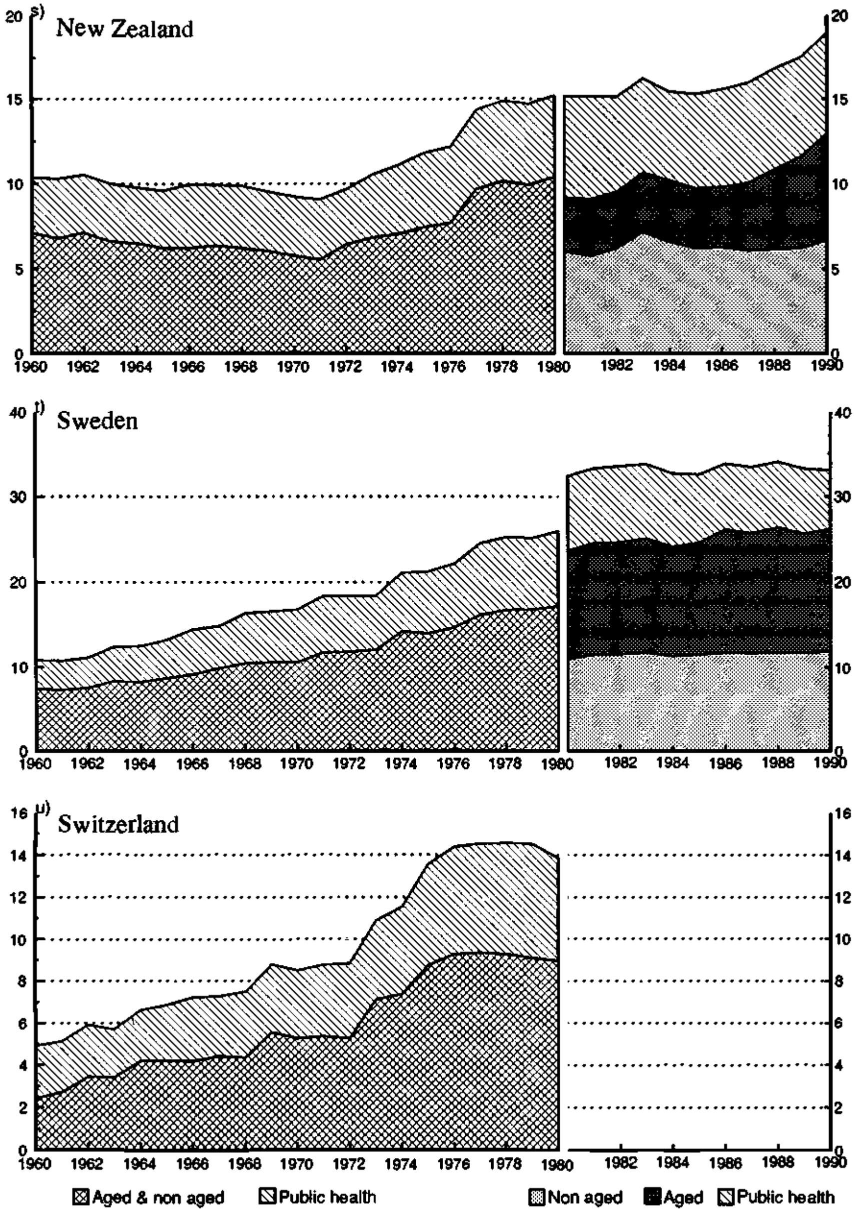

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