The Decline of the Welfare State: Can the European Union Harmonize Pension Policy?

Stephen West
The Decline of the Welfare State: Can the European Union Harmonize Pension Policy?

Stephen West, 2009

The European Union is a fascinating organization that continues to evolve and deepen integration between its member states. Starting with the Common Market, the E.U. has blurred the lines between state and supranational sovereignty so much that soon it will be difficult to determine when legislation originates in particular countries or throughout the continent. One of these issues is social welfare policy. This paper delves into the intricacies and problems of individual welfare systems and evaluates the possibility of having a E.U. Common Social Policy. While it is possible for the E.U. to develop procedures and standards for these systems, I argue that it is difficult to create a cohesive system because of a lack of norm convergence at a European-wide level. People simply trust their own nations to provide for them, and until a common European identity can coalesce, social policy will remain a national priority. I enjoyed writing this paper because of the deeper issues regarding social policy; people are so dependent on the welfare state not because of demographic strains or low funding, but rather because social policy is intrinsic to one's own national identity.

Since the end of World War II, European states have turned to the welfare state model to provide institutions that will help those citizens that are marginalized within society. Until recently, these systems were well-funded and sustainable. However, with increasingly aging populations, encouragement of earlier retirement, and unsustainable replacement rates, welfare systems across the European Union have strained budgets as more people wish to receive benefits. Moreover, labor shifts and internal migration within the European Union are favoring more skilled-labor jobs, which disadvantage those that had previously been integral parts of Europe’s reconstruction after World War II. Additionally, the E.U. Common Market makes it possible for people across Europe are able to vie for the jobs that only nationals of a particular nation had access to previously. With all of these problems facing traditional European nations, how can the welfare state survive demographic strain and an increasingly competitive E.U.-wide labor market? Can the European Union absorb some of the traditional functions of pension planning in the welfare state to provide a baseline social policy that affects all Europeans? I would argue that even though European Common Market policies are straining nations’ welfare programs, particularly in regards to pensions, individual countries will still be able to provide better
programs for their citizens. Because European integration has yet to develop shared norms and produce real results, people trust their national system more than a European one.

The problems that traditional welfare systems in the European Union community face are a result of demographic shifts in the population. The first demographic problem is an aging population. 1 After World War II, Europe had a baby boom that sustained their labor force through much of the 1960s, 1970s, and 1980s. Although the influx of labor resulted in increased prosperity for these nations, this generation is moving through the age structure. Consequently, fewer workers are paying into the system for more people that are retired. This problem is compounded by the increases in life expectancy brought about by better nutrition, public health, education, less strenuous jobs, and better overall healthcare across Europe. 2 In the EU-15, life expectancy at birth is 76.0 years for men and 81.2 for women. 3

In addition to people living longer on average, workers are retiring earlier than in the past. As people get older, they are less likely to continue working. The rate of employment for persons age 50-54 is 74.8%, with the rates decreasing for ages 55-59 at 42% and 60-64 at 11.8%. 4 The trend towards retiring earlier is explained by two factors. First, as a result of increased personal prosperity, there is an increased demand for leisure time, and retiring earlier maximizes an individuals’ leisure time. Second, more nations are reducing incentives to work longer. Many European Union nations are providing more generous pension plans. Moreover, they are reducing annual accrual of pensions, which decreases the opportunity costs for those who might work longer if these accrual rates were higher. 5

These statistics show that not only are there more people that are retiring, but the length of an average person’s retirement is longer, which means that nations must pay more to sustain each retired person. Since the state’s ability to pay rests on the ability of taxpayers to sustain these welfare benefits, more people would therefore be needed to continuing sustaining the system. However, there are increasingly fewer workers per retired person. If one looks at the aged dependency ratios of each of these nations, there are fewer workers supporting each retiree. In 1998, the average ratio for most developed nations was between 15% and 25%. With the baby boom workers retiring however, these ratios are becoming more strained. In Italy, the ratio is expected to be at 65% around 2050. In France and Germany, the numbers are better because of

---

5 Visco, 7.
immigration, but they still are expected to have a ratio of around 40% by 2050.\textsuperscript{6} Since the aged dependency ratio takes into account both higher life expectancy and increasing population, Europe needs to find a way to pay for all of these benefits, or change the way their welfare systems function. Europe is already straining, as the level of debt as a percentage of GDP continues to rise significantly due to increased payouts for pensions. In 1993, general government debt figures as a percentage of GDP in France and Germany were 45.3% and 46.9%, respectively. In 2004, this figure had risen to 65.1% and 66.4%. Considering that the European Monetary Union requires debts to be under 60% of GDP, France and Germany need to reform quickly to be in compliance with Common Market standards.\textsuperscript{7} Indeed, many European citizens also agree that some reform is needed, with 59% of the E.U. population responding that their national pension systems will go bankrupt if they do not reform.\textsuperscript{8} Although European citizens understand the need for reform, national governments are slow to implement change.

Another demographic problem that the European Union is facing is decreasing fertility rates. The population replacement rate is 2.1 children per family. No E.U. state has a fertility rate that matches the population replacement rate.\textsuperscript{9} This trend towards having fewer children is a result of different labor force requirements and changing social norms. Before a majority of the European Union had developed into a post-industrial, services-oriented economy, more children were required to provide an adequate means of living for a family. Often, families would have many children to have more labor on farmland. Due to urbanization, people are increasingly moving to cities and suburbs where land is more expensive; thus, having more children is costlier in urban areas than in the country. Nowadays, since per capita income is high enough to provide most every employed person a suitable standard of living, families are choosing to have fewer children. This choice is a result of changing social norms within Europe. More women are seeking higher education, which allows them to enter the workforce and delay marriage, and hence childbirth. Moreover, the feminist movement has empowered women to make their own choices regarding childbirth by increased access to contraception and abortion. Women view childbirth as not a primary social duty, and consequently, there are fewer births in the European Union.

With the combination of strain on the individual welfare systems and the lack of popular support for joint E.U.

\textsuperscript{6} Ibid., 4. \\
\textsuperscript{7} Mika Vidlund, “Old-age pension reforms in the EU-15 countries at a time of retrenchment,” Finnish Center for Pensions Working Papers 1 (2006), 8. \\
social policy, the question remains whether the current problems indicate a collapse of the welfare state. However, while there have been positive gains made by European bureaucrats that the public is less informed about; these gains towards solidifying a common European Union Social Policy have been minimal. I will be arguing that although both norm and policy convergence is happening in European Union social policy, citizens still trust their own states to make policies that help them rather than E.U. citizens as a whole. These citizens’ decisions have all been made on the individual level as a result of past successes and failures on the part of the European Union.

The underlying desire to integrate a social policy in Europe depends on whether European citizens share the same norms and beliefs towards social policy convergence. In all capitalist economies, it is difficult for governments to balance economic progress and social welfare. It is posited by many theoretical economists that capitalism is the result of risk-taking entrepreneurs that innovate and invest with little government intervention. However, the rapid growth that results destroys the human and social fabric of society. This destruction of social frameworks then requires government intervention to intervene to protect human and social rights.\textsuperscript{10} Without government intervention, capitalism can theoretically change social behaviors and norms through innovation and economic success, but these successes usually come at the expense of those who work in the system. In Marxist theory, the workers would rise up to control the means of production, and the resulting state would then guarantee social rights for the proletariat at the expense of the bourgeois. European welfare states are different, in the sense that proletarian welfare is guaranteed in addition to protecting bourgeois social rights. These states provide a foundational level of welfare for all as opposed to certain socioeconomic groups (although these groups are given additional help). Since these rights have been guaranteed in the European Union states since its formation, social norms have developed in the populations that might want to scale back their welfare programs. People are averse to placing additional restrictions on welfare programs; while being able to continue to provide social programs is widely considered a social good, many people are socially dependent on the breadth of welfare that these countries provide.\textsuperscript{11}

However, while norm convergence is possible, it depends on individual member countries’ previous results with implementing E.U. decisions into their domestic policy. A common E.U. social policy can only be successful if member states can integrate these new directives into existing institutions without harming citizens’ benefits. Consequently, the E.U. cannot mandate too much, or states will simply refuse to implement the changes. Furthermore,


the diversity between types of welfare states (i.e. Bismarck, Beveridge systems) makes it so that only limited community social policies can be created by the European Union. As a result, the potential of creating a common social policy has been predicated on the previous success of the Common Market. The Common Market’s success has been a result of norm convergence, but states have also introduced their own particular social characteristics into the integration. These unique values and beliefs are all brought into the system; because of this, Europe is not converging, but rather introducing a diversity of norms that all can coexist within the same framework. Since each country has their own set of norms which affect policy, implementing European Union reforms depends on how close these community institutions resemble national institutions. Countries that have already introduced legislation similar to E.U. reform are more likely to implement community reforms quickly. On the other hand, if these national systems are different from proposed E.U. policy, change is slower. Once again, acceptance of European Union directives is predicated on the social norms of each particular nation; if a state does not have similar institutional norms, change is dependent on whether states can integrate these new policies effectively within the existing policy framework.

Finally, continued positive trends towards social policy convergence depend on how each member state views the European Union as a political entity. Since each nation views the E.U. differently, norm convergence depends on increasing political, economic, and social connections within the countries of the E.U. Every state has different opinions on the future of the European Union; some states want a federalist system, while others want to continue on a road of functionalism. With the Lisbon Treaty about to be ratified, a deeper political union is likely to be formed. However, under the Maastricht Treaty, the Social Protocol still requires voting unanimously for social policy objectives rather than through qualified majority voting. Consequently, agreements in social policy are likely to be slower than in other areas, even excluding implementation delays in each country. Without a more cohesive political union, national interests will still remain supreme. The Lisbon Treaty is essential to consolidating these political norms because each state will then view the European Union as a political entity that has the legitimacy to implement social policy. If political consolidation in the European Union continues to occur, states will then be able to view social policy directives not as overarching

proposals, but legitimate directives that can be integrated into national welfare systems. However, this integration is still theoretical, even if the Lisbon Treaty is passed. More than simply social convergence, member states would also have to coordinate policy in order to provide for a European model of social welfare.  

Policy convergence is the other improvement in social policy integration that needs to happen if a common social policy is to be consolidated in the European Union. When determining domestic policy, governments always have to weigh the economic and social concerns of their own citizens. Usually these judgments are made within the context of the domestic arena, which makes policy-making not only reflective of social norms but also generally easier because they do not have to think about other nations. Because the European Union has the Common Market however, new strains are placed on the policy-makers in each respective member nation. The European Central Bank is responsible for all fiscal decisions in the market, which weakens states’ individual abilities to change economic policy.  

Moreover, European Union social policy outcomes are increasingly dependent on the results of Common Market integration. By controlling fiscal policy centrally, states are relegated to more market-oriented reforms rather than interventionist reforms. This contradicts the welfare state’s expressed aims because the welfare state is supposed to manage the economy to help protect citizens from pitfalls in a volatile capitalist system. The Common Market so far has yet to affect the way that welfare states are structured and funded, which means that states have not had to intervene.  

Although the European Union has been successful in creating an integrated economic framework for twenty-seven countries, the implemented policies have had interesting ramifications; specifically, increased migration from less prosperous countries to more prosperous ones. Instituting a Common Social Policy has been both slow and haphazard, yet creation of a European Central Bank to control the Common Market has dictated that nations provide for the welfare of migrated E.U. citizens as well, which places an extra burden on member states. This means that in addition to providing for the welfare of a nation’s citizens, workers from another nation can receive the entire scope of benefits that a national citizen receives. For countries that receive many migrant workers, this influx of new dependents is a mixed blessing. On one hand, they have more workers that are paying into the system, which makes it easier for the state to continue providing generous welfare payments to increasing numbers of...

18 Ibid., 541.  
19 Bean et al., 13.
retirees. However, it also means that in the case of disability or retirement, the state has to provide for a worker that is not a citizen of that nation, but is a citizen of the European Union. Currently, these migrant workers are paying more into the systems of the countries than they are taking out. However, these statistics do not take into account the future burden that they will place on the system when they retire. Nevertheless, the consensus within the European Union is that continuing to welcome migrant workers in to their countries will increase economic output; therefore creating more money that can be used to pay for the receiving nation’s welfare system.

The European Union also continues to pass laws related to migrant workers’ social rights in order to maintain similar freedoms and benefits for migrants regardless of which country they choose to settle in. These laws, because they pertain to cross-border rights for citizens, are passed by the European Union, not the member states themselves. With the current strain on welfare systems, mandating that member states provide additional benefits to those who are not citizens is costly, both politically and economically. The European Union needs to change the way states view migrant labor. If a Polish citizen can be viewed in the same way as a German citizen, then states will be more willing to provide benefits in the future. In this particular case, support for providing migrant workers welfare protection depends on the entrenchment of European norms and standards in order to be successful. Without this norm convergence, states will continue to view migrant workers as expensive outsiders that they are mandated to help, rather than the boon to nations’ respective economies.

While all of the supranational directives that the European Union pass are implemented, “only a minority get implemented on time, and there is substantial variation in implementation delays.” This lag in passing these laws on a national level is due to individual states’ cost-benefit analysis of the potential benefits and consequences of implementing these laws. Moreover, member states are accountable to their citizens, and if the change is viewed as something that is more for Europe than for the nation, citizens lose trust in the E.U. Even if these benefits increase political legitimacy or economic success, if they do not integrate well with previous laws, change will be slow and populations will resent supranational intervention. Because many of these E.U. laws are focused on providing protections for workers that migrate from one country to another within the E.U., only 38% of Europeans think social welfare is better accounted for in joint European Union decisions than in national governments. This Euro-pessimism reflects the state of social policy in Europe- too much strain on the


21 Linos, 548.
22 Ibid., 550.
individual systems too soon, with no perceived help coming from the European Union.

Another problem with integrating many member states’ policies into a common social policy is a result of the different levels of national prosperity. As with all major international organizations, there are net givers and net receivers in the system. The European Union includes states that are some of the best economies in the world, but they also have states that are still developing. The integration of CEEC economies has placed a particular strain on the system, as these countries are still trying to successfully transition from command economies to market economies. In order to compete with the rest of these more highly developed nations, the less developed nations offer lower wages, but also require other labor costs to be lower as well. Consequently, these nations cannot burden their citizenry with increased welfare costs, otherwise they would not be competitive within the Common Market. In Portugal, 17.6% of GDP is allocated to the welfare budget. In Sweden, this figure is 40%. If E.U. policy dictates that each economy harmonizes at the lower level, the wealthier states’ welfare systems would collapse. If the harmonization was at the higher level, the poorer states would not be able to compete in the Common Market.25

Additionally, even if the effort to standardize welfare levels was successful, it would be difficult to create an intrinsically European type of welfare system. The problem arises in the different methods that welfare systems are structured and funded. Structurally, different nations divert different amounts of money to particular aspects of the welfare program. For example, Italy uses 50% of its welfare budget for old-age pensions, while Ireland only uses 25%. Moreover, to finance these systems, each nation uses different amounts of tax income. In Denmark, general tax revenues pay for 87% of the welfare budget, but in France, only 18% comes from general tax revenue.26 The European Union would have to create a standardized institutional and funding structure if it were to create a common welfare system. Although this is possible theoretically, member states would still maintain their sovereignty because the move might either harm the states or the citizens. At the bare minimum, there would be lengthy negotiations over the system, and for the states that lose, there would be a complete restructuring of large government bureaucracies. At the individual level, this means that the citizens might be responsible for higher taxes and the welfare bureaucracies will have to reorganize a system that millions of citizens depend on for pensions. At best, this change would take years and cost states billions of Euros; at worst, this reform could bankrupt entire states.

24 Roberts and Springer, 57.
26 Ibid.
In conclusion, European welfare states are finally reaching the limits on how many people they can support. With the baby boomers retiring earlier and living longer, states are obligated to pay much more in pensions than in the past. Moreover, the replacement birth rate is not being achieved, which means that migrant workers have to support the aging populations instead. Solving the problem will be difficult. The question is whether creating an integrated European Union social policy will be able to help these states reform their systems. Citizens of these member states are not fully supportive of consolidation; they tend to trust their national systems more. In order for the E.U. to create a social policy framework, it must achieve norm and policy convergence among E.U. citizens. So far, social norms have yet to converge because of the perceived weakness of E.U. political integration. Policy convergence is dependent on how citizens view the success of the Common Market reforms and whether states can harmonize welfare systems. As of now, very little has been done that can assuage citizens’ fears that the European Union can create a common social policy. Until it does, individual states will have to endure the strains on their own.
Bibliography


