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НА АКАДЕМИК КСЕНТЕ БОГОЕВ
ПО ПОВОД 100 ГОДИНИ ОД НЕГОВОТО РАЃАЊЕ**

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SOCIAL EXPENDITURE IN THE EUROPEAN COUNTRIES

Introduction

Since the end of the Second World War, especially since the 1960s, the political economy of Europe has been defined by the development of a comprehensive and generous welfare model. European countries developed their welfare systems during a period when the region's benign demographic profile could support extensive social spending and when solid economic growth made it affordable. It reflected the aim of the state to help mitigate social risks encountered by the citizens, providing them with a range of social benefits and services, including pensions, poverty relief, unemployment insurance, sickness and accident insurance social housing, healthcare, education.[1] As Czech and Tusinska (2016) noted, these benefits and services have become a permanent component of the socioeconomic landscape in Europe and other developed countries and have heavily influenced economic processes and outcomes.

The expanding role of the welfare state and the population ageing in Europe have led to a continuous rise in social expenditures. Despite the rise of retrenchment narrative in the 1990s, in many countries welfare outlays have actually increased since then. However, the welfare states in the European Union countries undeniably face a range of demographic, fiscal and other pressures, exacerbated by weak economic growth or recession in the aftermath of the 2008–09 financial and economic crisis. Pressures on public finances, and the burden that social spending imposes on the 'productive' parts of economies, raise questions about whether European countries can still afford their welfare states. Social expenditure could crowd-out other productive expenditures, thus undermining growth potentials, a term known as 'social dominance' (Schuknecht and Zemanek, 2018). The debt crisis provided a particularly solid ground for criticism of welfare spending, being blamed as responsible for the rise in government expenditures and public debts in advanced economies. One of the most complex challenges currently facing European governments and societies is to reconcile the commitments to welfare provision with pressures that may make them unsustainable economically. Changing work patterns and competition from emerging economies with lower labour and social welfare costs pose additional economic and social challenges to European countries (Begg et al., 2015).

This paper focuses on the social expenditure in Europe, particularly in the European Union. Its main purpose is to provide an overview of the social expenditure in the European countries and its components, the dynamics of social expenditure in the 21st century and the differences across countries. Additionally, the paper notes some of the challenges that lie ahead in the future for the welfare states in Europe.

Social spending in Europe

European countries are recognised by their generous social systems. This, however, entails larger public expenditures on providing social protection, as well as on healthcare and education. Figure 1 shows public social spending as percentage of GDP for the EU and other OECD countries, reflecting the involvement of the state and its role in providing social security to the citizens.

There has been a steady upward trend of social expenditure in most of the countries (except in some cases in the 1990s, a period of tighter fiscal policy, resulting in a lower spending ratio in 2000 compared to 1990). The average social spending in the EU is among the highest. Other developed countries with social expenditure above 20% of GDP are Norway and Japan, followed by the English-speaking countries (New Zealand, USA and Australia). On the other end, within the OECD group, lower social spending is recorded in the South American countries – Chile and Mexico, in

[1] Social spending is aimed at relieving poverty and inequality and insuring people against risks. Looking at sub-categories, Castles (2009) found that cash benefits to the working-age population is most strongly associated with redistribution. On the other hand, health expenditure and old-age expenditure do not impact the vertical redistribution.

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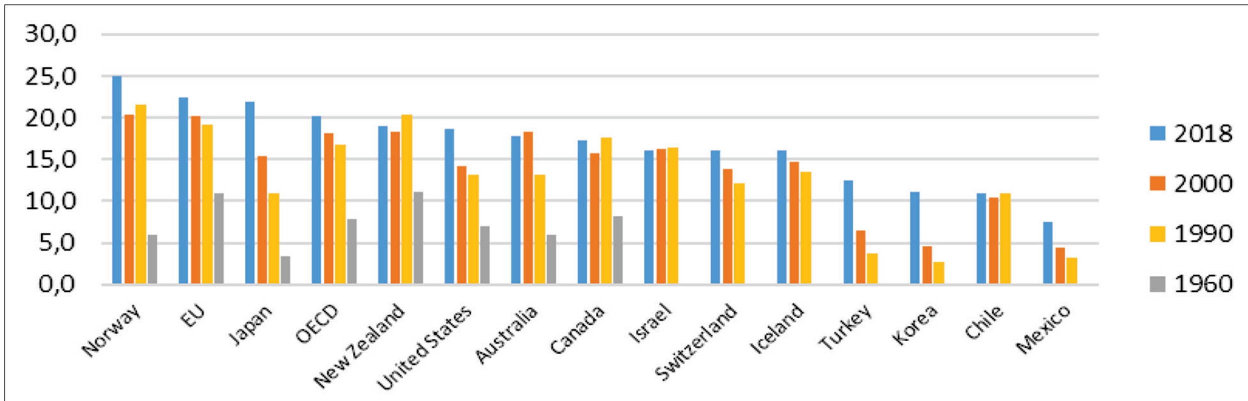
Figure 1. PUBLIC SOCIAL EXPENDITURE (% OF GDP)



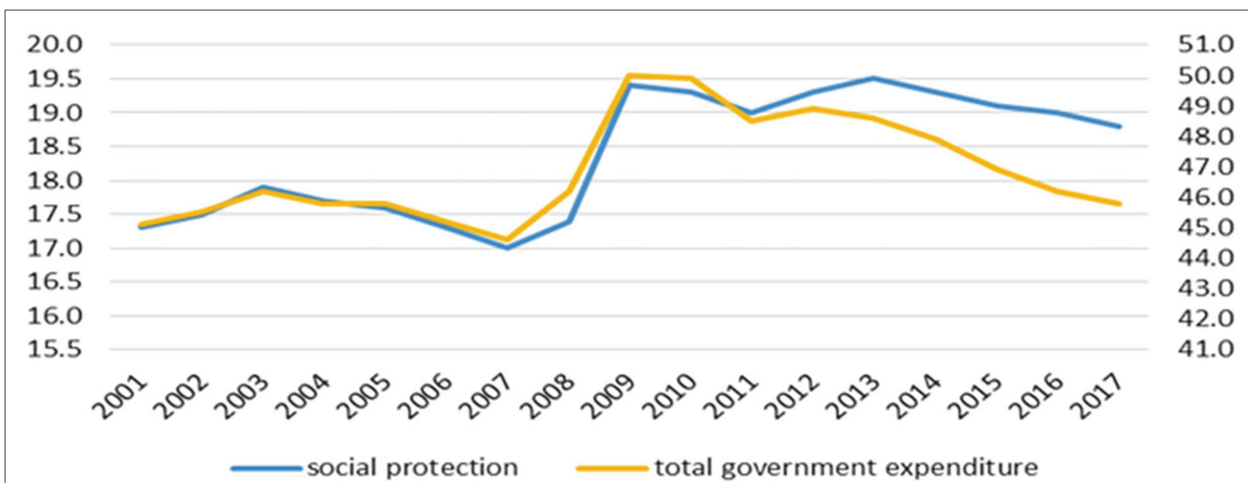
Source: OECD (2019) OECD Social Expenditure database (www.oecd.org/social/expenditure.htm).

Korea and Turkey. The real gap occurs between the 'old' industrial economies and the emerging markets – China, India, Korea, where social spending is a smaller share of GDP, but is likely to rise. As countries develop, social expenditure usually rises, tending to enhance the support for the wellbeing of their citizens.

In the pre-crisis period GDP showed a rising trend and then fell sharply with the crisis. Social expenditure, on the other hand, continued to grow. Hence, the ratio of social and of total public expenditure to GDP had a downward trend in the wake of the crisis (see Figure 2). The figure shows the rapid rise of public expenditure with the emergence of the Global recession. The economic recession has greatly amplified the financial pressure on the welfare state, both by multiplying the number of people on benefits and by decreasing the financial contributions for social policy. The increase in the ratio of social protection expenditure to GDP in the EU in 2009 by 2.8 p.p. resulted from a 4.3% increase in the social protection expenditure and a fall of 5.8% in the value of GDP (Eurostat, 2018a). After a double peak trend until 2014, public expenditure started to gradually decline in the last few years, partly due to reduction of spending, partly because of the resumed growth, but is still above the pre-crisis level. The total government expenditure had a steeper drop than the social expenditure after the financial crisis (whether because the latter played its automatic stabilizing function or in order to protect particular segments of the population for political reasons), implying that the rising social expenditures had crowded out other public expenditures, and all of this occurred despite the 'austerity' narrative (Begg et al., 2015). The welfare state thus has proved to be more immune to fiscal retrenchment than other public policy areas such as defense, education, economic affairs, cutting public investments.[2] This however does not mean that there

[2] It is argued that social expenditure has a high political, at least in the short-term, cost and it is hard to cut or even restructure social benefits for political economy reasons.

Figure 2. SOCIAL PROTECTION EXPENDITURE AND TOTAL GOVERNMENT EXPENDITURE (% OF GDP)

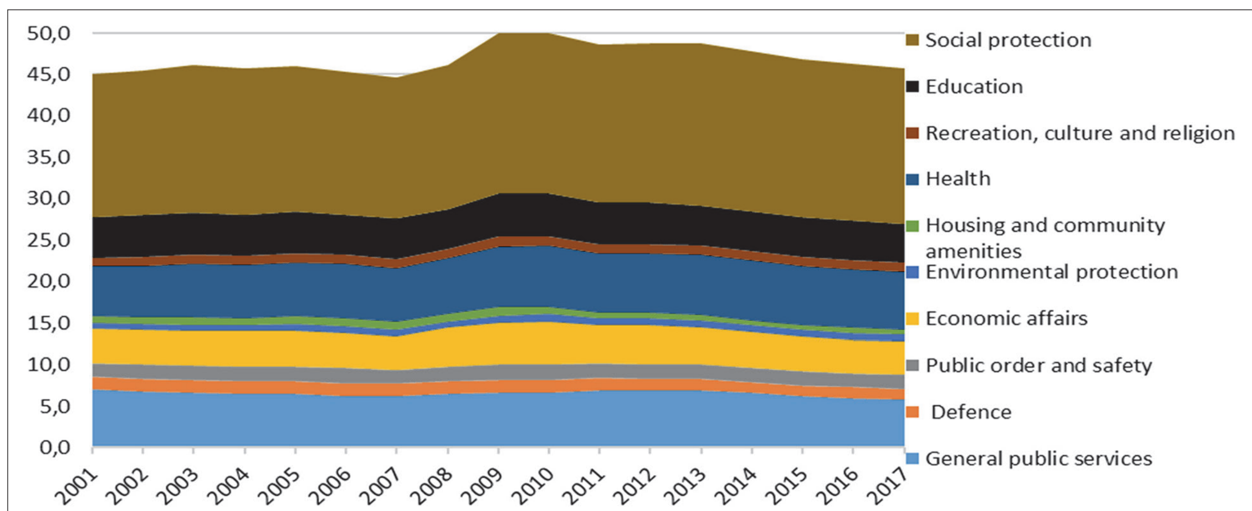


Source: Eurostat database.

have not been any cutbacks in social benefits as part of the fiscal austerity measures so as to help rebalance the national budget.

Spending on welfare presents the largest part of the general government expenditures in the European Union. Figure 3 shows the structure of expenditure by function of government. The largest share of total expenditure in 2017 is dedicated to social protection - 41.1%, followed by health expenditure with 15.3% (see Figure 3). The share of government expenditure dedicated to social protection and health increased from 38.3% and 13.4% in 2001, respectively. In terms of ratios to GDP, social protection accounts for 18.8% of the GDP, while health accounts for 7% of the GDP (increased from 17.3% and 6% in 2001). This means that while social and health expenditure increased by 2.5 p.p., the total government expenditure increased by 0.7 p.p (from 45.1% to 45.8% of the GDP). However, social spending has varied less than might be expected, only jumping in 2009 when the GDP, the denominator of the ratio, fell sharply. The share of education on the other hand, which is a social investment especially important for strengthening the human capital and for the future welfare of the people, has slightly fallen, from 10.8% to 10.2% of the GDP.

Figure 3. STRUCTURE OF THE GENERAL GOVERNMENT EXPENDITURE IN THE EU-28

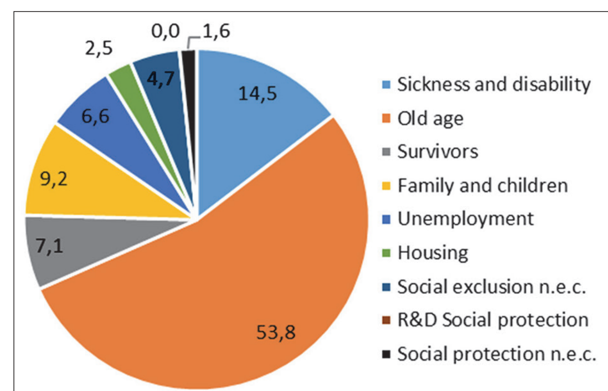


Source: Eurostat database.

Components of social protection spending in the European Union

When we look at the structure of the social protection spending in the EU, the largest part is dedicated to old-age expenditures (where the main category is old-age pensions) and the second largest share is dedicated to sickness and disability. Old-age and sickness together accounted for 68.3% of the total social protection expenditure in 2017. Begg et al. (2015) highlight that it is striking just how stable the shares of old-age outlays were up to the crisis and that they have actually increased since 2008, as has healthcare. With population ageing it is expected that these expenditures are going to take up more of the government finances in the future. This is one of the primary challenges for governments if they want to maintain the quality of life of their citizens while not endangering the sustainability of public finance. Family and children allowances are the third largest part, accounting for 9.2% of the total expenditure. The share going to unemployment benefit jumped after 2007 as the number of unemployed people rose and is now 6.6%.

Figure 4. STRUCTURE OF THE SOCIAL PROTECTION IN THE EU IN 2017E (%)



Source: OECD (2019) OECD Social Expenditure database (www.oecd.org/social/expenditure.htm).

Pension outlays[3] are an extremely important part of government social policy. They are on the rise and yet all governments seem reluctant to cut the old-age benefits. Despite the fact that pension systems have undergone some major reconstructions and reforms in a number of countries, from increasing the retirement age to introducing occupational and voluntary pension pillars, pension expenditure still is a significant share of the total expenditure. In 2016, pensions accounted for 12.6% of the GDP in the EU-28. The relative importance of expenditure on pensions varied considerably between the EU Member States. Greece had the highest share if its GDP dedicated to pensions (17.5%), followed by Italy, France, Portugal and Austria, which all had a ratio above 14%. On the other end, pensions comprised less than 8% of GDP in Romania, Latvia, Malta, Lithuania and Ireland (5.7%). In PPS terms, on the other hand, Austria recorded the highest average expenditure per pension beneficiary, at 19,893 PPS (followed by Luxembourg, Netherlands, Belgium, Ireland). This was 4.7 times as high as the lowest level of expenditure, as recorded in Bulgaria (4,275 PPS), followed by Lithuania, Latvia, Romania. Expenditure on pensions across the EU-28 rose in 2009 (in constant terms) by 6.3 % for old-age pensions, 1.9 % for disability pensions and 5.6 % for survivors' pensions. Between 2009 and 2015, expenditure on old-age pensions in the EU-28 continued to rise, but with a slower pace (Eurostat, 2018b).

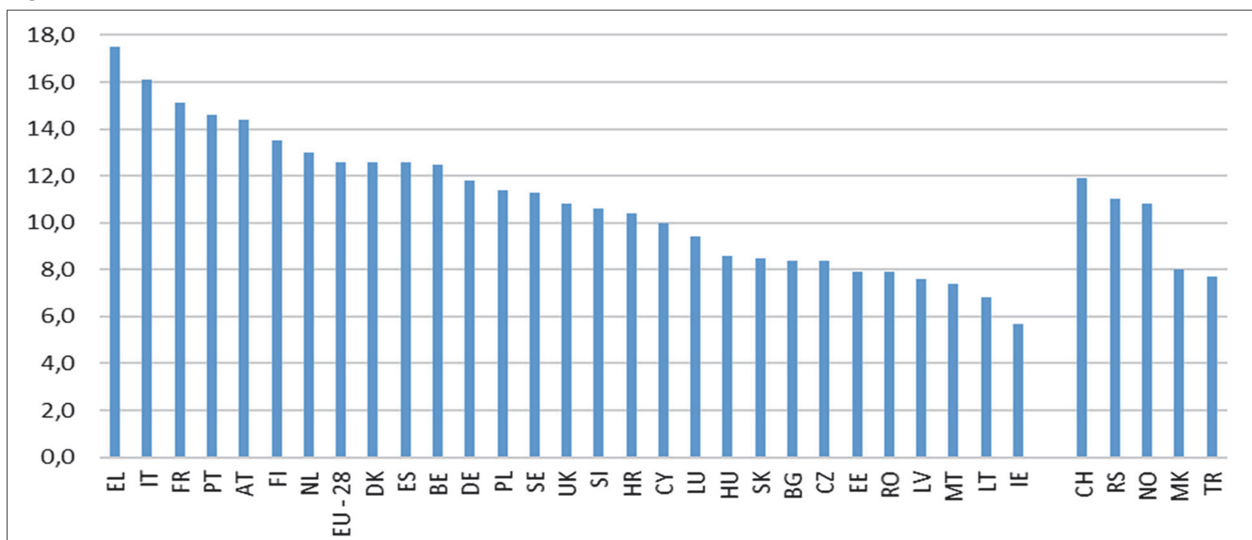
Welfare state models and social expenditure in the EU

The Member States of the European Union have comprehensive social protection systems in place, typically comprised of well-established social insurance systems and tax-financed universal social assistance schemes (European Commission, 2017). Despite the similarities in the welfare models of the European countries and the common goals and principles, especially in the member countries of the EU, that emphasize the role of the state in providing social protection for its citizens, the policy solutions differ among countries in terms of universality, generosity, eligibility and types of welfare benefits and reflect the individual historical, political, economic and cultural experiences of each country.

Universal (Beveridge) coverage is usually related to tax-financed provisions. Figure 6 presents the welfare receipts by type for the European countries. A distinctive feature of Scandinavian countries is their much bigger reliance on government contributions than the rest of the countries, followed by liberal and Southern countries. However, this is also the case for several CEE countries (for example, Bulgaria, Hungary). By contrast, continental European countries generally have fragmented social protection schemes along occupational lines, related to contributory (Bizmarckian) social insurance.

Many authors don't recognize a universal European social model, but point to several distinct welfare models. The seminal work by Esping-Andersen[4] (1990), who

Figure 5. EXPENDITURE ON PENSIONS IN EUROPE IN 2016 (% OF GDP)

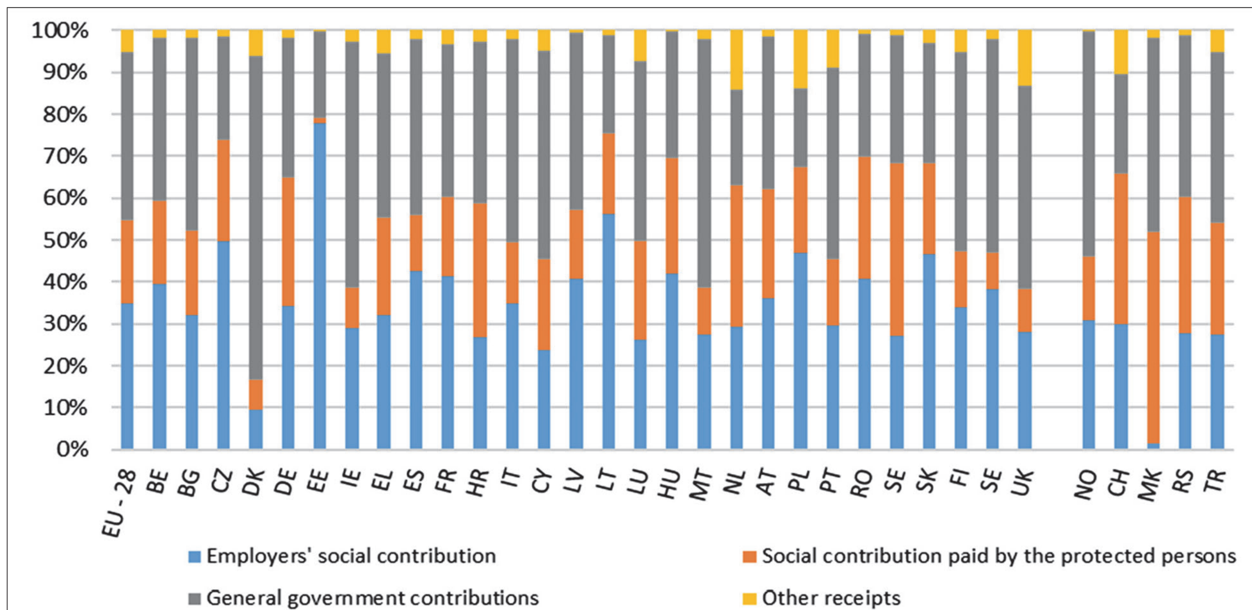


Source: Eurostat database.

[3] Expenditure on pensions comprises: disability pension, early retirement due to reduced capacity to work, old-age pension, anticipated old-age pension, partial pension, survivors' pension and early retirement due for labour market reasons.

[4] Esping-Andersen identified 3 types of welfare in OECD, considering the principles that regulate the relationships between state, family and market: Liberal regime (Anglo-Saxon countries: United States, Canada, Australia and United Kingdom); Social Democratic regime (Scandinavian countries: Sweden, Norway, Finland and Denmark) and Conservative-corporate regime (continental

Figure 6. WELFARE RECEIPTS BY TYPE (% OF GDP)



Source: Eurostat database.

distinguished between liberal, conservative-corporatist and social-democratic welfare states, has been a starting point of most of the subsequent research in the field. The rich European social model literature recognizes the following groups of countries (see Sapir, 2006; Obinger and Wagschal, 2012; Hemerijck et al., 2013; Kostadinova, 2014; ILO, 2017): Nordic (Social-democratic); Continental (Conservative-corporatist); Anglo-Saxon (Liberal); Mediterranean (Southern European); Central-Eastern European – in more recent studies.

The *Nordic (Scandinavian)* or *Social-democratic model* is typical of the northern European countries: Norway, Sweden, Finland, Denmark. Their social model is known for the universal aspect of its welfare supply, drawn on the principles of equality (such as equal access to social and health services, education and culture), solidarity and security for everyone (Holm, Liss and Norheim, 1999; Ferrera and Rhodes, 2013). The generous universal and highly redistributive benefits are based on the principle of citizenship and financed through general taxation and are particularly effective in combating poverty.

The *Continental* or *Conservative welfare regime* includes Austria, France, Germany, Belgium, and Luxembourg. Governments provide generous unemployment benefits, within contribution-based social insurance schemes. The welfare is aimed at income maintenance of the worker and their family through a strong social insurance system based on contributions, protecting them from risks such as illness, disability, unemployment and old age (Pena-Casas, 2015). A well-funded welfare state allows poverty reduction, high quality health care and disability pensions.

The *Anglo-Saxon* or *Liberal model* is implemented in the United Kingdom and Ireland. The market is the main agent in socializing risks, while there is a smaller role for the state. Liberal welfare states are characterized by means-tested assistance programs (non-contribution based), modest universal transfers, or modest social insurance plans (contribution based) and little redistribution. Private insurance is encouraged through tax reductions. The health system is a national universal public service, mainly funded from general taxation, while cash benefits are usually financed through social contributions.

The *Mediterranean* or *Southern European model* is present in Italy, Spain, Greece, Portugal. The model is based on the principle that the family has the main role in supporting its socially unprotected members (Popova and Kozhevnikova, 2013). This regime appears as a mix of characteristics from the continental regime and its strong family orientation and work-related social insurance base with universal public services (health), but weak state welfare support (notably in terms of services) and lower benefits than in other EU countries (Pena-Casas, 2005).

The *Central-Eastern European model* includes the New Member States. They seem to mix characteristics form both the conservative and the social-democratic

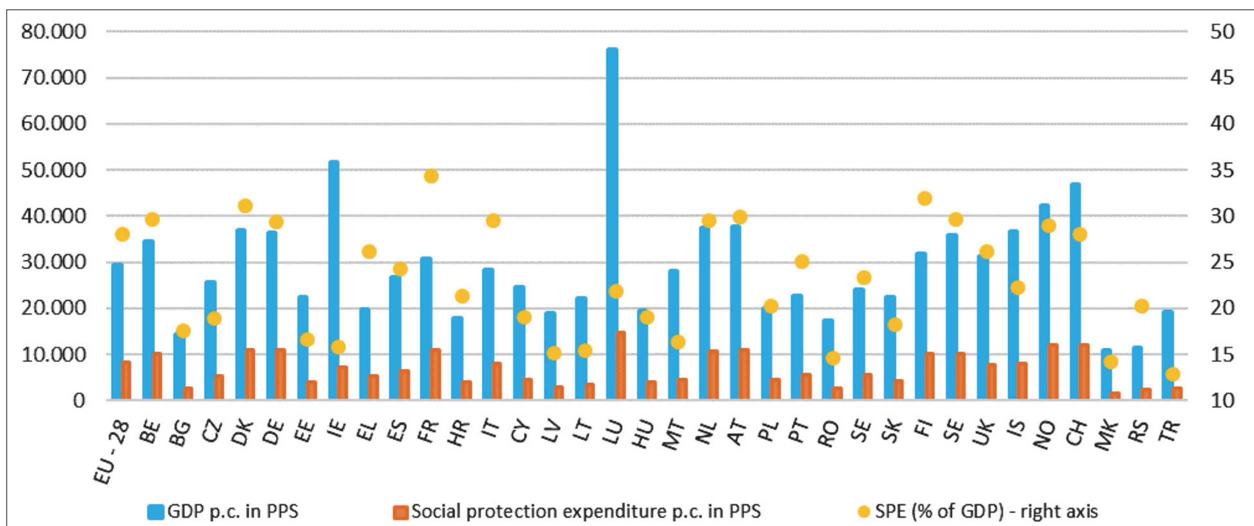
European countries, including Spain, Italy, France, Germany, and also Japan).

type. Most of them include contributory social insurance systems, combined PAYG and private funded pension systems, free basic public education. However, the labour markets are more restrictive than in other EU countries. According to Fenger (2007), in general the level of trust, the level of social programs and the social situation in the CEE countries are lower than in other, mostly Western countries. However, he notes that the Visegrad countries have better performances than the rest of the group, reflected in lower unemployment, poverty rates and inequality.

Per capita welfare spending is generally lower in the countries with lower GDP p.c. (see Figure 7). Additionally, it is also lower as a share of GDP in the lowest-income EU countries. An exception is Luxembourg, with the highest GDP p.c. and welfare spending p.c., but where social protection expenditure is a lower share of GDP than the EU average. France has the highest proportion of GDP dedicated to social protection, with astonishing 34.3% of the GDP in 2016. Finland and Denmark also have social protection expenditures above 30% of their GDP. In general, the 'old' member states dedicate more of their GDP to social protection than do the new member states and the candidate countries. The lowest share of the member countries was in Romania (14.6%), while candidate countries had the lowest social protection expenditures p.c. and, except for Serbia, the lowest ratios to GDP.

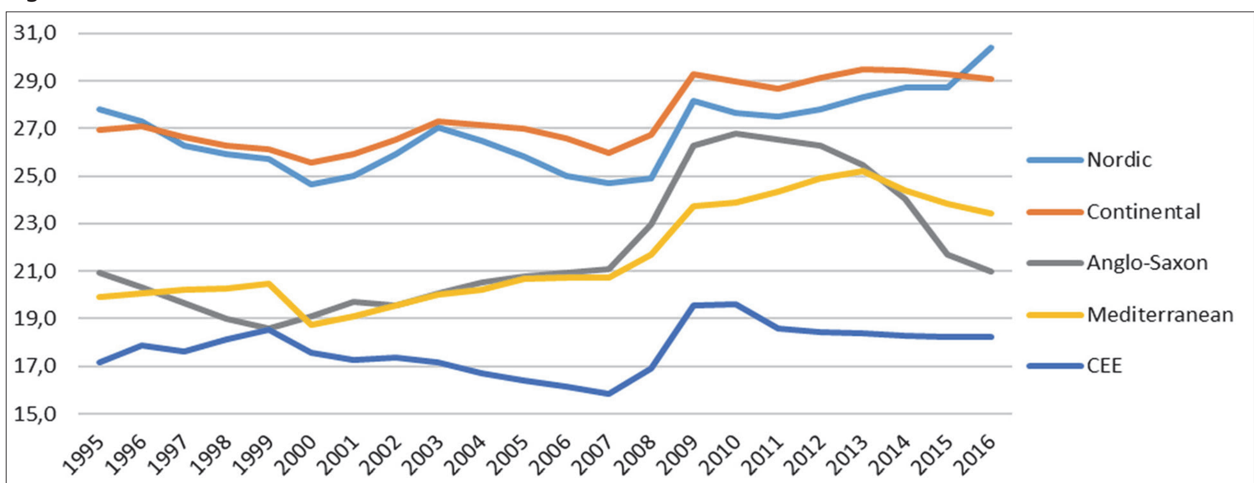
Social protection expenditure by country groups is presented in Figure 8. Despite the narrowing of cross-national differences in the last few decades, the division between larger spenders from the Nordic and

Figure 7. GDP AND SOCIAL PROTECTION SPENDING IN EUROPE (2016)



Source: Eurostat database.

Figure 8. SOCIAL EXPENDITURE BY COUNTRY GROUPS (% OF GDP)



Source: Eurostat database.

continental group and smaller spenders from the other groups exist[5]. Low state budgets in the CEE countries, due to poor tax collection, reflect negatively on the social protection expenditure and they are the lowest in this country group. The pre-crisis period shows that social expenditure is not necessarily cyclical (Hemerijck et al., 2013). In times of economic growth, it was rather stable in some countries while it increased in countries with overall low expenditure levels, that is within the Southern and Anglo-Saxon group (CEE countries were adjusting their public finance due to the EU integration process). The cyclical component is evident after 2008 when social spending grew in almost all analysed countries. However, after the initial increase due to the response to the crisis, social spending has stabilized and even declined in some groups of countries, as part of the austerity measures aimed at improving the situation with their public finances.

Future challenges for the European welfare states

While Europe's governments have developed an elaborate system of social protections and incentives for their citizens, its welfare states face a number of long-term trends with implications for the design of the welfare state, the level and structure of social expenditures and the fiscal sustainability: demographic change, and in particular population ageing; pressures from economic globalization; intensified European integration and the increasingly explicit EU-level requirements for national budget discipline; technological change; changes in family structure labour market (Castles, 2004; Barr, 2012; Hemerijck et al., 2013). Since 2008, the economic crisis has put a greater financial pressure on the social protection systems, adding cyclical shorter-term challenges (Milotay, 2018).

In the era of globalization, it is more difficult for the European governments to run their welfare systems independently. It is argued that countries with expensive welfare states will lose competitive advantage to countries with less expensive welfare states (Barr, 2012). Due to capital and labour mobility, countries have to take account the foreign competition in attracting capital and workers and the risk of companies moving their operations abroad. For example, companies from European countries with relatively high welfare charges, are moving increasing proportions of their operations to locations with lower labour costs. Similarly, restrictions on firing workers to minimize social exclusion caused by unemployment can lead to companies taking employment offshore (Begg et al., 2015).

The EU countries are even more restrained in conducting their welfare policies due to the intensified EU integration. Given the integrated nature of the European economies through the single market, reducing government deficits and debt has become a central priority for the European governments and the EU as a whole, affecting the level of spending on social affairs. Although the mix of welfare expenditure in each EU member state is driven by national politics and policies, coordinated reform responses have been established at the EU level and national welfare states today are embedded in a complex multi-level system of the EU social and economic governance (Hemerijck et al., 2013). The European Union member countries have agreed upon the European Pillar of Social Rights ('Social pillar') in 2017, where one chapter is devoted to promoting social protection and inclusion and proposes several measures to support the implementation of the pillar (see Milotay, 2018) The social pillar combines the principles of social investment with social protection and stabilization and stresses the strong link between labour force activation and access to quality services (childcare, housing, healthcare).

In all EU countries, the share of service activities in the economy tends to grow and that of industry to decline, with implications for the types of jobs that are created or lost. The European welfare model is also challenged by polarization in the labour market, reflected in a core of high-skilled workers and a peripheral workforce (see Barr, 2012). An associated trend is the increasing number of part-time or other types of non-standard forms of employment, including short hours, temporary contracts and low pay, as well as the emergence of new forms of employment (such as platform work), which raises challenges for both coverage and benefit levels, particularly for states that base entitlements to various forms of welfare provision on full-time work. (ILO, 2017; Milotay, 2018).

Societal changes and changes in the family structure create demand for certain social services while also affecting the basis for welfare funding. In particular, the significant increase in the single-parent families and the participation rate of women in the labour force in large parts of Europe over the past few decades has increased the importance of some aspects of the welfare system, like the provision of publicly supported childcare or child benefit. Europe's overall

[5] Conversely, when considering private social spending, Anglo-Saxon countries are bigger spenders than the other groups. Obinger and Wagschal (2012) thus conclude that public spending has not been substituted by private spending, except in the Netherlands, but rising public spending has been complemented by a rise in private spending in English-speaking countries.

workforce is shrinking as the population ages, so this will gain importance as women are more encouraged to participate in the workforce.

Population ageing, due to increase in life expectancy and lower birth rates, is the biggest threat to all European countries and their welfare systems, although at different degrees and timelines. Overall, the proportion of the population aged 65 or over in the EU28 is projected to rise steadily from 19.8% in 2018 to 23.8% in 2030, 28.5 % in 2050 and 31.3% in 2100 (Eurostat, 2019). This will undoubtedly affect the labour market and the financial sustainability of each country's welfare state. More money will be needed for pensions (which is the largest segment of social expenditures), healthcare, sheltered housing, long-term care and other social services for the elderly. The technology advancement extends the medical possibilities, but drives higher spending on health care (Barr, 2012). The financial burden of the system and of the working population increases, unless countervailing action is taken. Hemerijck et al. (2013) point out that one of the biggest challenges to welfare states in Europe comes from the staying power of male breadwinner old social insurance, especially in the areas of old age pensions. Different countries have undertaken different reforms to their pension systems to deal with the problem of sustainability of the pensions systems, ranging from increasing the retirement age, reducing the pension replacement ratio, to establishing two or three pillar pension systems.

The changing world of work and population ageing are placing greater pressure on the financial sustainability of the social protection systems, and on the sustainable development as a whole. Maintaining a comprehensive welfare state while ensuring fiscal sustainability is becoming an increasingly more challenging task. Government debt has increased significantly across the EU to a weighted average in a range around 87% of GDP in 2014, then contracted to 80% of GDP in 2018. The biggest rise in indebtedness appeared in 2009, when debt jumped from 61% to 73% of GDP (Eurostat database). Besides the bail out of parts of the financial sectors by governments in the lead-up to the financial and economic crisis, accompanied by increased government borrowing, sustaining welfare commitments at a time of declining economic competitiveness in an increasingly open world economy has also contributed to the rise (Begg et al., 2015). The falling output and higher unemployment rates added fuel to the long-term drivers of rising social expenditures. The crisis is a reminder of the vulnerability of social spending and public finance in general to such shocks in economic activity. The debt crisis provided a particularly solid ground for criticism of welfare spending, being blamed as responsible for the rise in government expenditures and public debts in advanced economies. However, other authors argue that even though the dynamics of debt and social spending do bear similarities, it is hard to conclude that the growth of the latter was the main cause of public debt growth. (Czech and Tusinska, 2016)

Conclusion

European countries have developed generous and comprehensive welfare systems, providing social security for their citizens. This undoubtedly has a positive influence on the quality of life, both through the provision of cash benefits and through high quality social services. The welfare benefits provided by the state necessarily induce costs and compared to most other countries and regions in the world, European countries spend a higher proportion of their income on social protection, which also constitutes the largest share of government expenditure by function. Among the different sub-categories, most of the social expenditure is devoted to pensions and health care.

There are of course differences in the scope and generosity of social expenditure in different countries, with Scandinavian and Continental countries having the highest social spending ratio to GDP, while the Central European countries dedicate the smallest share of their GDP for social protection. Despite the differences, all European welfare states face a range of demographic, fiscal and other pressures (coming from population ageing, globalization, EU integration, changing family structures and work patterns, competition from emerging economies with lower labour and social welfare costs etc.), driving social expenditures up in the long-run. The Global Recession showed the vulnerability of social systems to short-term pressures in addition to the long-term challenges, adding to the financial pressure on the welfare state both by multiplying the number of people on benefits and by decreasing the social contributions. Young generations are under particular pressure from demographic change and structural changes in the labour market, including the shift to non-standard forms of work. In the future, they are likely to receive lower pension entitlements than today's pensioners and pay higher contribution rates during their work lives in order to fund expenditures on the growing number of pensioners (European Commission, 2017; ILO, 2017)

One of the most complex challenges currently facing the European governments and societies is to

reconcile the commitments to welfare provision and rising social expenditures with pressures that may make them unsustainable economically. This have led governments to seek for solutions for the financing and sustainability of their welfare systems and many put an emphasis on combining social protection and social investment policies so as to achieve flexibility, stability and protection (Milotay, 2018). The European Commission (2017) argues that European countries need a higher percentage of potential workers entering employment, extended length of working lives, increased net immigration and higher fertility to sustain population growth and sustained investment in human capital, all in order to avoid additional challenges to the well-being of the present and future generations.

Everywhere, reforms have been introduced to make pension systems sustainable under conditions of low or declining fertility and increasing life expectancy, including increasing the retirement age, limiting early exit, introducing occupational and private pillars on top of the public schemes and redefining the actuarial links between contributions and benefits. Immigration can mitigate the impact of the demographic shift, particularly if migrants are predominantly younger working-age people who are motivated to work. However, if the migrant structure is such that most do not join the labour market, then they add to the burden of the welfare system and their role in countering the population ageing is questionable. Another general trend has been labour market deregulation, in order to make labour markets more flexible and to create opportunities for labour market outsiders. Retrenchment of the unemployment protection has been part of the flexibility venture almost everywhere, although minimum income schemes have been introduced or improved in a number of countries where these were lacking. The European Commission also recommends expanding the coverage of social security schemes to include non-standard workers. Many countries have also increased their efforts to assist people in their attempts to reconcile work and family, for example, by extending child care and preschool facilities and other services as well as parental leave provisions.

Various welfare policy reforms have been guided by the idea of social investment. Namely, promoting and strengthening human capital yields a double benefit: less money will be spent on cash benefits and more revenue will be collected from taxes and contributions, thus enhancing the long-term financial sustainability of the welfare state, while at the same time promoting economic growth. The European Commission has promoted social investment as the key policy framework to guide member states in their social policy reforms and to reach the goals of the Europe 2020 strategy for smart, sustainable and inclusive growth. However, Van Kersbergen (2015) reminds us that the austerity measures after the financial crisis included retrenchment on social entitlements so as to help rebalance the public budget and warns that social investment policies are particularly vulnerable to cuts in the short run, precisely because they yield returns only in the longer run.

European governments have indeed undertaken serious reforms to their welfare systems with the aim to make them financially sustainable, with as smaller implications as possible on the well-being of the present and future generations of citizens. This is becoming an increasingly difficult task and it remains to be seen whether the implemented measures will suffice or further adjustments will be needed in the future.

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