Would you like to Shrink the Welfare State? The Opinions of European Citizens[✪]

Tito Boeri*, Axel Börsch-Supan, Guido Tabellini***

*Bocconi University, Milan, Italy, and IGIER
**University of Mannheim, Germany, and NBER, Cambridge, Massachusetts

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Abstract

The European welfare states have fundamental problems, in particular high unemployment and a mounting pressure on public pensions. Although these problems have been prominent topics of the political debate for years and years, we have seen little fundamental reform. Why this is so? One of the core hypotheses claims that the current state of affairs, as deplorable as it may be, is a political economy equilibrium that will only change if things get considerably worse.

In order to shed light on this question, we have conducted a survey which solicits the opinions of citizens in France, Germany, Italy and Spain on public pensions, unemployment insurance, and possible reforms in both areas. This paper reports and interprets the answers.

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1. Introduction

Economists often disagree and give conflicting policy advice. But there is one statement on which they are almost unanimous: The welfare state in Continental Europe needs to be reformed. The pay-as-you-go pension systems absorb too many resources, and their sustainability is threatened by population aging. The overall tax burden on labor has reached highly distorting levels, creating disincentives to work and reducing labor demand. Labor market regulations create allocative distortions, make it more difficult for Europe to benefit from the new wave of technological innovation, and may increase unemployment. At the same time, despite extensive government intervention and redistribution, there are groups systematically excluded from the benefits of the welfare state and from valuable job opportunities: the young unemployed, workers in the underground economy, a new rapidly growing cohort of temporary workers.

While the economic remedies to this situation are often evident and uncontroversial, the alleged reason why reforms are not undertaken is eminently political. What is the nature of these political constraints? Why did the European welfare state develop into its current form? Does it conform to what the majority of European citizens wants, or does it reflect the political influence of powerful and organized minorities? And how informed is the public at large about the costs and the unsustainability of the current system? More generally, what are the relevant conflicts of interest over the appropriate size and features of the welfare state? Which groups of citizens favor reforms, and who are the conservative supporters of the status quo? On which side are the trade unions? Do we still see a class struggle, pitting labor against capital and rich vs. poor, or has the conflict of interest become much more multidimensional? And finally, how can the proposals for reform be packaged so as to overcome the political constraints? Can they be bundled together to become more appealing to the most influential groups? Which issues need to be emphasized to convince public opinion at large?

Despite the rapid proliferation of a recent literature on political economics, the answers to these questions are still largely unknown. There is now a solid and detailed understanding that politics can affect policy decisions in a variety of ways, leading to inefficient outcomes and a bias towards the status quo – Persson and Tabellini (2000), Drazen (2000), Roland (2000) survey this recent literature. But most existing contributions are theoretical, and hence there is not always a good sense of which of the many theoretical models and insights best applies to the current European situation. Moreover, this existing literature is fairly abstract, and thus devoid of detailed institutional content and of sharp implications for politically viable but concrete reforms. As a result, the more applied policy debate on these controversial issues is often grounded on a detailed knowledge of the economic pros and cons of alternative reforms, but it is not guided by a sophisticated analysis of the political constraints and of the political incentives of the key decision makers. Policy advice is still often offered as if governments were benevolent social planners who only need to know what is in the best interest of society.

To make progress in answering these questions, in this paper we directly investigate the opinions of European citizens on the welfare state. We concentrate on the two most urgent policy areas: protection against unemployment risk and pension policy. We drafted our own questionnaire because we could not rely on publicly available opinion polls. The respondents are a representative sample of the entire population in the four biggest countries of Continental Europe: France, Germany, Italy and Spain. The same questions were asked in the four countries, during the same weeks end February/beginning March 2000.

These four countries were also chosen because their welfare states not only have some common features but also some important differences. All countries devote a very large fraction of transfers to pay for generous public pension programs. But they rely on very different forms of protection against unemployment risk. While Germany and France have generous systems of unemployment insurance, Italy and Spain have more stringent firing rules but only a small fraction of individuals is eligible for adequate unemployment insurance. Thus, the groups benefiting from these labor market programs differ across countries.

The questions were structured in four areas: (i) a general survey of household characteristics, including union affiliation and political opinions; (ii) a set of questions eliciting the demand for unemployment insurance; (iii) a set of questions eliciting the demand for public pensions as well as the citizens information about its current costs; and (iv) a set of normative questions about trade-offs in the welfare state.

The opinions of the respondents suggest the following four main conclusions:

First, despite a widespread perception of unsustainability, many respondents underestimate the true costs of the pension system. This misinformation matters: the better informed voters are more likely to favor reforms.

Second, the status quo size of the welfare state is a majoritarian outcome supported by public opinion at large, not just by a powerful minority. In all countries, however, a broad majority also opposes further increases of taxes and contributions. Under existing legislation population aging implies an automatic expansion of the welfare state. Hence, our results can also be interpreted as showing that a majority of the citizens favor reforms preventing further expansions, but not reforms that would shrink the current size of the welfare state.

Third, even though a majority opposes changing the overall *size* of the welfare state, large segments of the population would welcome changes in the *way* these benefits are provided or allocated. Specifically, a majority of the respondents would seem to be willing to opt out of the public pension system to replace it with private pensions, and, in Italy, a majority wants to shift transfers away from pensions towards unemployment benefits.

Fourth, conflicts of interests over the welfare state are generally aligned along three main dimensions: age, income, and the insider/outsider status in the labor market. From a theoretical point of view, this suggests that median voter models, where conflict is constrained to be one-dimensional, are overly simplistic. From a practical point of view, this result suggests that there is scope to package and bundle reforms strategically in order to build a large and mixed coalition of supporters.

The outline of the paper is as follows. In Section 2, we briefly sketch similarities and differences in the four welfare states. Section 3 describes our questionnaire and our sample. Section 4 is the core of the paper and reports in detail our results on unemployment protection, pension reform and the size and composition of the welfare state. Section 5 summarises our findings and concludes the paper with their implications for public policy.

2. The Status Quo: Four different welfare states

France, Germany, Italy and Spain are very similar in many respects. Overall, the social and economic differences among regions within each country are much more significant than the aggregate cross-country differences shown in Table 2.1 below. The four countries are at comparable levels of development, though Spain has a lower GDP per capita and a higher unemployment rate. Italy and Spain have slightly higher levels of inequality than France and Germany even after controlling for the redistribution operated by extended households (Bertola et al., 2000). Also the current demographic composition of the population as well as future demographic trends are about the same, although France has a somewhat more favourable demographic composition than the other three countries. Table 2.1 shows the two main challenges common to all four countries: high unemployment, especially among the young, and population ageing.

Table 2.1: Economic and Demographic Features

On closer inspection, however, there are important differences among these four welfare states. Spain has a considerably smaller size of government, both when looking at total government spending as well as when considering the overall tax burden on labour income. And in Italy social expenditures are much more concentrated on pensions and away from unemployment benefits. The asymmetry is even more striking when account is made of the higher incidence of unemployment in Italy than in France or Germany. Poverty relief programmes are significant in France, while they are almost negligible in Italy and Spain.

Table 2.2: Size of Government and Composition of Social Expenditures

Differences among the four welfare states continue when we examine the two policy areas, that will face the main challenges, in more detail: protection against unemployment and pension policy. We look at each in turn.

2.1 Protection against unemployment risk

France, Germany, Italy and Spain have chosen very different points in the trade off between the two main instruments to protect individuals against unemployment risk: (i) the provision of unemployment benefits (UB); (ii) the imposition of legal restrictions against firing in addition to those established by collective bargaining – the so called employment protection legislation (EPL). This is shown in Figure 2.1 below. The percentage of unemployed persons covered by unemployment benefits is displayed on the vertical axis, and the strictness of EPL on the horizontal axis of the left panel.

In France and Germany, but also in Denmark or Belgium, unemployment benefits are particularly generous – most notably, they are available for long durations and offer higher replacement rates to low-income earners[1] – while EPL has traditionally been close to the EU average.[2] Southern European countries like Italy, Spain and Greece, on the other hand, have

[1] The replacement rate offered to those earnings two thirds of the average wage is in France and Germany about 10 per cent higher than that offered to the average worker. In Italy and Spain, there are no differences in replkacement rates between those earning the average wage and two thirds of it.
[2] The EU-average of the index is 2.4. France is the only OECD country that has increased the strictness of EPL between the mid-1980s and the mid-1990s. See OECD (1999).

very strict employment protection regulations and a rather low coverage of unemployment benefits. Such a low coverage also reflects unemployment among the youngsters, who do not qualify for unemployment insurance. Youth unemployment is larger in countries with strict employment protection legislation (OECD, 1999).

Figure 2.1: Trade-offs in the Welfare State

Figure 2.1 also illustrates the trade-off between unemployment benefits and earliest retirement, that is, the earliest age at which it is possible to retire while drawing a full pension. While Italy has a low earliest retirement age and a low level of UB coverage, Germany took the other route with a higher earliest retirement age and a much broader UB coverage.

The differences between these systems of protection against the risk of job loss can be traced back to their origins. The Italian and Spanish social welfare system were historically designed to protect the heads of households, the breadwinners. Only employees in mainly large manufacturing firms were protected against the risk of job loss and were offered strong protection. To the extent that only the breadwinner is protected (by EPL) and insured (by UB covering only workers with long tenures), the provision of income support to the unemployed in the Southern European welfare states was ultimately assigned to the family.

Changes in the structure of employment have put these systems repeatedly under strain because new categories of workers were pushing to get more protection against the risk of job loss. The policy response has not been a change in the overall design of benefits, but simply a selective extension of the policy instruments used in the past to deal with redundancies, and the creation of new unemployment benefits schemes accessible to specific groups (see Box 1 for more details).

Employment protection regulations for workers with permanent contracts continue to be strict in Italy and Spain - see OECD (1999). The scope of fixed-term contracts has been significantly expanded, however. As a result, the share in employment of temporary jobs steadily increased. In Spain temporary work reached about one third of dependent employment in the early 1990s and has only mildly decreased in the second-half of the decade. In Italy it was about 10 per cent at the beginning of 2000, compared with 2 to 3 per cent at the beginning of the 1990s.

France and Germany, two welfare states derived from the Bismarckian tradition of contributory social insurance, devote around 30 per cent of GDP to social protection expenditures, almost 10 percentage points more than Spain. In these countries, wage determination is mostly centralised, legal minimum wages (or binding contractual minima) are relatively high, whilst the strictness of employment protection legislation and the weight of active labour market policies is close to the EU average. The UB system is fairly generous and provides an almost full coverage of those with previous work experience (see Box 1 for details). In addition to the Bismarckian unemployment insurance systems, they have comprehensive social assistance schemes of the last resort. These safety nets are fairly complex, especially in France, pointing again to the fragmented nature of the French safety net.

2.2 Public Pension Systems

The provision of retirement income in France, Germany, Italy and Spain also looks very much alike. It is dominated by the pay-as-you-go public pension pillar. This is shown in Table 2.3, depicting the distribution of retirement income by "pillar" defined as follows[3]: First and second pillar comprise public and occupational pensions, while all other income sources (mainly asset income including private pensions, earnings, and family transfers) are subsumed in the third pillar. Note that most of the second pillar in France are mandatory, state-governed and pay-as-you-go financed pensions, resembling the first pillar in France and other countries.

Table 2.3: Retirement Income by Source (%)

In all four countries, contribution rates are high, ranging from 19.3% of gross earnings in Germany to 32.7% in Italy. Nevertheless, these high rates do not suffice to pay for all pension expenditures and government subsidies (in the order of a third of the budget in Germany, France and Spain, about 25% in Italy) are needed to fill the financing gap.

The four countries also share strong incentive effects on the timing of retirement. As the country studies in Gruber and Wise (1999) have shown, these pension systems penalise workers who postpone their retirement past the earliest retirement age they are eligible for.

Again, there are important differences on closer inspection. An important design feature for our analysis of policy reform feasibility is the fragmentation of the pension system. Fragmentation is likely to make pension reform more difficult since there are more possibilities of coalitions against a reform, particularly if fragmentation hides the special interests that are preserved in the various subsystems. Germany has a very monolithical system in which more than 90 percent of all workers are covered by a single system (GRV).[4] Only civil servants

[3] This deviates slightly from the World Bank definition, see World Bank (1994).
[4] Börsch-Supan and Schnabel (1999) provide a detailed description of the German pension system. A critical

and the self-employed workers are not covered by it. Italy and Spain have more fragmented systems but in both countries the largest "general regime" (INPS in Italy and RGSS in Spain) covers about two thirds of the work force.[5] France, on the other hand, has a very complex and fragmented system.[6] It consists of a base pension which covers about 40% of the average pension. On top of this, mandatory supplemental pensions are added which are strongly fragmented by occupation and socio-professional groups. Such fragmented occupational pensions play a very small role in Germany and Spain, and they are negligible as part of current retirement income in Italy, although this may change as younger workers become increasingly covered by occupational pensions at least in some industries.[7] Italy's high share of the third pillar is mainly attributable to the early retirement age and the labour income associated with it, mainly self-employment and income off the books.

Another important dimension of differences among the four countries' pension systems is the nature of the reform debate. In Germany and Italy, pension reform is one of the hottest political issues that is permanently in the press and substantially influences elections.[8] In both countries, a sequence of major reforms has taken place, creating awareness and information about pension issues. This is less true for France and Spain, although limited reforms haven taken place in these countries as well.

There is no simple ranking of the current generosity of the four pension systems. We refer to Box 2 for the details of the four pension systems. One dimension of generosity is the age from which full pensions benefits can be drawn. As already discussed in Section 2.1., Italy has the earliest retirement age, particular for workers who started their earnings history when very young, followed by Spain, France and Germany. The other important dimension is the replacement rate. Here we find again a strong difference between the Southern and the Bismarckian welfare state. Disney et al. (1998) have computed effective replacement rates, defined as the average net income of retired households aged around 67 years relative to the average disposable income of pre-retirement households aged around 55 years. These ratios range from 90% in France and Germany to 65% in Italy, similar in Spain. Note that the corresponding United States effective replacement rate is about 53%, reflecting the difference be-

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evaluation of the micro- and macroeconomic features of this system can be found in Börsch-Supan (2000).

[5] Brugiavini (1999) describes the Italian pension system. For the effects of recent reforms, see Brugiavini and Fornero (2000). Boldrin et al. (1999) provide a detailed description of the Spanish system.

[6] For a detailed description of the French system, see Blanchet (1999).

[7] Brugiavini and Fornero (2000).

[8] See Box 4.

tween the size of both types of the European welfare states on the one hand and the American welfare state on the other hand.

3. The Survey

How do the citizens assess their welfare states? Which aspects do they want to reform, and which do they want to keep? And how does this relate to the individual attributes of the respondents? In order to shed light on this, we conducted our own survey.

There were several reasons to do this rather than to rely on existing surveys. First, compared to existing surveys, we do not ask open questions ("Do you want more benefits?"), but we posed specific trade-offs among specific policy options ("Are you willing to pay x% higher contributions in order to obtain y% higher benefits"). These type of questions are in the tradition of "contingent valuation", and we use the "stated preference" questionnaire techniques described in Louviere, Hensher and Swait (2000). We combine this technique with a focus on two specific aspects of the welfare state, namely unemployment protection and pensions. Second, we seek to relate these rather specific answers to general attitudes towards the welfare state. Third, we tried to design survey instruments as similar as possible for the four countries in order to exploit the cross national institutional and historical differences that we have highlighted in the previous section and to identify how and why answers to our questions diverge across countries. Finally, we want to relate policy preferences to individual characteristics of the respondents, and this is generally not possible with other publicly available surveys.

3.1 Existing Surveys on the Welfare State: A Brief Review

We are not the first in gathering public sentiments towards the welfare state in Europe and in the U.S.. A comprehensive cross country study was conducted by Eurobarometer in 1992 (see Ferrera (1993)). The same questions were asked in all EU countries, trying to elicit general opinions about the welfare state. Like in our survey, by and large the majority wanted to preserve the current size of the welfare state. And like in our survey, Italy stands out as the country where the largest fraction is unhappy with the existing situation and demands reforms that would shrink the size of the welfare state.

A few other internationally comparable surveys relied on data from the International Social Survey Program (ISSP).[9] Using these data, Edlund (2000) studies attitudes towards redistri-

[9] See Toš, Mohler and Malnar (2000) for a selection of studies based on the ISSP, together with a set of methodological papers.

bution and taxes in three welfare states: Sweden, Great Britain, and the U.S.. Corneo and Grüner (2000) consider a sample of twelve countries in the ISSP sample to analyse individual attitudes towards redistribution. They find that these attitudes tend to be explained by ideology, the economic situation of the respondent, and variables measuring social status and social mobility, a finding common with Alesina and La Ferrara's (2000) study of the U.S.. Corneo and Grüner also find that citizens of former socialist countries tend to be more in favour of redistribution – this result will be echoed in our paper with regard to residents of East Germany.

There are also many national studies. Public pensions have received particular attention. The main message coming out of all such surveys is pessimism about the future sustainability of the pay-as-you-go system. A review of the results from national polls in four European countries (Germany, Netherlands, Switzerland and UK), the U.S. and Chile can be found in DIA (1999). In Germany, popular acceptance of the public pension system has declined considerably, particularly among younger persons. According to a poll by Allensbach (1996), 48 percent of all workers expect that they will experience a significantly lower standard of living than current retirees. A year later, Emnid (1997) puts this number at 34 percent. In 1998, a broad based poll by the Wirtschaftsjunioren (1998) reports 24%. Most recently, in January 1999, after the change in the government, 68 percent believed that additional private retirement income will be necessary to maintain a reasonable standard of living, while only 13 percent thought that the public pension will suffice (Bundesverband der deutschen Banken, 1999). We find a similarly low confidence in our own survey.

The deterioration of public sentiment to a rather pessimistic view is echoed in U.S. surveys, reviewed by Shoven (1999). He shows that the fraction of respondents in public opinion polls reporting that they are "not too confident" or "not at all confident" about the future of Social Security has risen from 38% in 1975 to 65% in 1983, the year of a major pension reform. Thereafter, this fraction declined to 60% and has since fluctuated around this value.

It is interesting to see that Spaniards, in spite of similar problems with their PAYG system as Germany and the U.S., do not share this pessimism. But at the same time they are not very well informed about their pension system (Perez-Diaz et al., 2000). We find the same result in our own survey. Moreover, we show that the correlation between weak information and high confidence also holds among the respondents in the other three countries of our own survey.

Boeri and Tabellini (1999) conducted a survey similar to this paper on a sample of 2000 Italians in the Spring of 1999. Their results were very similar to those described in this paper as far as the Italians are concerned.

An interesting contrast is provided by surveys that have been conducted in countries which have undergone systemic pension reform towards partially funded pension systems, e.g. Switzerland, the Netherlands and the UK. In all three countries, confidence rates in the pension system are much higher than in Germany and the U.S. (DIA, 1999). Specifically, about 60% of Dutch workers are satisfied with the balance between contributions and benefits both in their state base pension system and in their private occupational pension schemes (van der Heijden, 1996; de Vos et al., 1997). A similar satisfaction is voiced by the respondents to the British Social Attitudes Survey (BSAS), reviewed by Brooks et al. (1997). This survey also asked the respondents about their priorities for social security spending in general, an issue that we will take up in Section 4.3. Spending on pensions received top priority, together with spending on the disabled and on poor working families, while spending on the unemployed earned much less popular approval.

Finally Di Tella and MacCulloch (2000) used ISSP data to evaluate the relationship between the incidence of unemployment and preferences over the generosity of unemployment insurance. They found that above all individuals in high unemployment countries and regions would like to see more spending on unemployment benefits, a result which is echoed by our findings.

An important difference between most of these studies and our own is that these existing surveys pose open questions rather than specific trade-offs. We instead try to elicit individual demand curves based on willingness to pay for specific programs, and then relate these individual demands to general policy opinions, as well as to the attributes of the respondent.

3.2 Questionnaire and Sample Design

The questionnaire is divided in four parts. Part 1 collects information on the individual respondent, such as age, family situation, employment status, sector of occupation and so on. In Germany and Italy, these questions were part of an omnibus survey. We augmented this general background information by information on general political opinions and whether or not the workers are affiliated to a trade union. These latter and more sensitive questions were asked at the end of the interview.

The other parts assess the respondents' opinions on three aspects of the welfare state. In part 2 we ask the respondents whether they would be prepared to pay for unemployment insurance and how much. In part 3 we assess how informed the respondents are about the costs and sustainability of the public pension system, and whether they would like to opt out of it (eventually at some cost). The questions are designed to obtain information about the respondents' preferences on these programs: we try to elicit their demand for unemployment insurance and for a pay-as-you-go public pension system. Finally, in part 4 we solicit their general opinions on possible directions of reforms. The questions in this part are formulated to assess the respondents' political opinion on the desirability of reforms in general, not just for their own personal situations.

The interviews were carried out in all countries by the means of Computer Assisted Telephone Interview (CATI) techniques in the last week of February and the first week of March 2000. Co-ordination among the four agencies carrying out the survey (ASP in Spain, Demoskopea in Italy, Infas in Germany, CREP in France) was provided by Fondazione RODOLFO DEBENEDETTI. The survey universe is the population aged 16 to 80 living in households with telephone connections. In each country we sampled 1000 households. In Germany, where we had a larger budget, we choose to sample 1500 households in the West and 1000 households in the East to accommodate separate analyses for both parts of the country. The random sample design is described in Appendix 2. This appendix also provides the distribution of our sample by gender and age, compares it to the national labour force surveys, and shows that the weighted samples represent the main socio-demographic population characteristics very well. There is a slight under-representation of the population aged 55 or more, notably in Spain. Comparisons with census data also suggest that all surveys, except the German one, tend to under-represent the population of rural areas.

3.3 Are the answers reliable?

Economists are used to revealed preference data and many mistrust data based on stated preferences. Should we take the respondents' answers seriously? We think so, for several reasons. First, our results largely confirm similar findings of earlier surveys, at least in those questions where there is overlap (see in particular the ISSP project, Eurobarometer, and Boeri and Tabellini (1999). Second, we checked the answers for internal consistency, e.g., by ascertaining that a respondent did not say "no" to an offer if he had already accepted a less generous version of it, and the results were satisfactory – we report on some consistency checks in section 4.4. Third, we regressed stated choices on socio-economic characteristics, looking for the correlation patterns that we expected from theoretical priors or from revealed preference data. Inconsistencies were rare and the agreement with the expected correlation patterns was strong. We report on the results of these checks in more detail along with the discussion of the substantive findings, see especially Sections 4.2 and 4.4.

A common difficulty faced in any opinion polls is that they are particularly prone to framing biases. For this reason, we tried to avoid suggestive formulations. We want to ascertain the individual's answer on what is good for her or him, not some answer on what she or he thinks is good for society at large. Hence, we took great care in describing the applicable situation for the respondent and the corresponding offers in detail.

Another source of bias is the hypothetical situation which might be unrealistic. We tried to avoid this by anchoring the answers around realistic country-specific numbers, e.g., unemployment benefit levels, and by varying potential answers by socio-economic situation, e.g., between employed and unemployed. Non-response rates were minimised by outlining to respondents an entire array of options, e.g., potential levels of willingness to pay.

The survey is a cross section at a specific point in time. This has several limitations and potential biases. If we had observations at a different point in the business cycle, we could shed light on whether our results are influenced by the boom that prevailed in Spring of 2000. Moreover, with multiple observations of the same individual we could purge some of the large heterogeneity in the responses that is not related to measurable attributes. This is left to future work.

Our contingent valuation method allows to identify just one point along the demand curve for unemployment insurance or pension benefits, namely the willingness to pay for the particular scheme being proposed. We could have varied these schemes to map out the entire demand curve, however, this had required a much longer survey and larger samples.

4. Results

This section describes our findings. We first look at three specific issues: the demand for unemployment insurance (Section 4.1), the demand for public pensions (Section 4.2), and the preferences about the size and the composition of the welfare state (Section 4.3). We then synthesise our results and try to resolve apparent puzzles (Section 4.4).

4.1 How much would you like to pay for unemployment insurance?

Government policy can protect against unemployment risk in two ways: by providing unemployment benefits (UB), or through legislative firing restrictions – the so called "employment protection legislation" (EPL). The general question motivating this subsection is what explains the observed mix of UB and EPL in these four European countries. In particular, is a majority of those affected happy with the status quo? And if not, which is the desired direction of change? Finally, as already noted, these four countries have enacted very different combinations of EPL and UB. Can we explain these differences as reflecting different preferences of the citizens?

A second question concerns the nature of the political conflict over these alternative policies. EPL concentrate risk among the "outsiders" – the unemployed and those without stable and protected jobs, while they cost little to the "insiders". UB, on the other hand, provide insurance to the population at large. This conflict between "outsiders" and "insiders" has been studied theoretically in several papers – in particular by Saint-Paul (1997). Is this conflict apparent in our data, or is it obfuscated by other possible cleavages in society, related to income or education?

Finally, we would like to know what reforms are politically feasible. In Spain and Italy, in particular, the strict EPL and the small coverage of UB entail some obvious distortions: large fractions o the population are uninsured, while other sectors are too rigid and unable to adapt to changing economic circumstances. Reforms that reduce EPL and extend the coverage of UB are often advocated by economists in these two countries. How can political opposition to such reforms be overcome? Does strict EPL induce concentration of unemployment risk on a minority group of the labour force so that there is not a majority willing to change the status quo? Are there complementarities in reform that can be exploited? Which individuals demand more unemployment insurance, and why? Being able to answer some of these questions might suggest how to package reforms so as to make them politically more palatable.

Part 2 of the questionnaire addresses these issues. We focus exclusively on UB, where we can use contingent valuations and inquire about willingness to buy insurance. No tradeoff can be formulated in the case of EPL at the individual level, and for this reason we did not elicit individual preferences about such policy instrument.

In order to be realistic, we followed a two-pronged strategy. First we distinguished between the unemployed and the employees, and among the employees between those who are currently covered by UB and those who are not. Mainly because of their shorter employment history. Second, we outlined to these three groups replacement rates which are broadly in line with those offered in France and Germany, the countries with the most generous UB in place[10].

The interviewers were instructed to outline an insurance scheme offering 70% of the last salary for at most one year *to the unemployed* without imposing any minimum contribution record. This represents an extension of the coverage of unemployment insurance insofar as in all countries surveyed the workers need to have contributed to the system for a given period in order to qualify for UB (e.g., one year of insured work in the last three in Germany). The insurance offered *to the employees not covered by UB* was 50% of the last wage for the first year of unemployment and 30% for the second year. Then individuals were asked which fraction of their wage they were willing to allocate to contributions for such an insurance scheme. *Employees already covered by UB* were asked instead whether or not they wanted to increase existing benefits and contributions. In case of a positive answer, we elicited their willingness to pay for extending by one extra month the maximum duration of the benefits that they were already eligible for.

In all three cases, *all* brackets of potential willingness to pay were read first, starting at 10% and ending at 1%. The range was chosen such that the maximum exceeds the contribution rate known in an OECD country on one side, while the centre is close to the rates in France and Germany. The respondents could decide to decline an answer, reject the offer, or, if accepted, state a willingness to pay. Refusals ranged from 8% in Italy to 13% in Spain. Because Germany offers UB coverage to almost everyone in the labour force, only the third case is considered.

Table 4.1 summarises three pieces of information for each of these three groups: the precise question asked to that group, the fraction of our respondents belonging to this group, and how many of them accepted the proposal to buy, or to extend their, unemployment insurance.

Table 4.1: Coverage of Unemployment Insurance and Willingness to Subscribe the Proposed Unemployment Benefit Scheme

[10] Such schemes offer shorter benefit *durations* to individuals with a shorter working record (i.e., the unemployed) and replacement rates which are declining with the length of the unemployment spell The *replacement rate also depends on* the age, and the family situation of individuals. Higher replacement rates are typically offered to the individuals employed at the lower end of the wage distribution. As the organisation of the survey did not allow to adjust the proposed insurance scheme on the basis of the characteristics and wages of the respondents, proposed benefits are adjusted to reflect the terms offered to the average worker in each group of

We stress four results in Table 4.1. First, as described in Section 2, Italy has a much larger number of uncovered workers than any of the other three countries, including Spain. Second, the respondents most willing to subscribe to an unemployment insurance are the currently unemployed. Third, in Italy and Spain a majority also among those employees who are not currently covered wishes to subscribe to the proposed UB scheme. Fourth, those already covered are in favour of the status quo: at most one third of the respondents would like to increase benefits and contributions.

Overall, a majority of the surveyed labour force (we did not ask the questions on UB to the self-employed) is in favour of the status quo coverage of unemployment benefits in all countries except Italy, where respondents are split in two equally-sized groups: half of the labour force is happy with the current coverage of UB, and half of it would like to extend the coverage of unemployment insurance. Also in Spain a large fraction of the surveyed labour force (roughly 40 per cent) is in favour of an extended coverage of UB and is ready to pay for it. This suggests that in countries offering more EPL and less UB the fraction of the relevant population dissatisfied with the status quo is larger than in countries offering more unemployment insurance and less employment protection.

In order to understand better who wants to buy ex novo or additional unemployment insurance and how much he is ready to pay for it, we now turn to a separate analysis of the demand for unemployment insurance within each of these three groups of respondents.

4.1.1 Currently unemployed

As we have seen from Table 4.1, a large majority of unemployed respondents wants to subscribe to unemployment insurance. The average willingness to pay (expressed as a fraction of the gross wage) is 5.7% in France, 6.3% in Italy and 6.4% in Spain. This is significantly more than the cost of an insurance of the type outlined to the unemployed respondents when account is made of job loss and job finding probabilities of the average worker in the different countries (Box 3). Why do unemployed individuals wish to pay more than a "fair" contribution rate, that is, a contribution level such that the expected income *with* the insurance equals the expected income *without* the insurance? In Box 3 we offer two explanations for this result. First, unemployed individuals are particularly exposed to the risk of experiencing new unemployment spells in the future. This is either because they have personal characteristics making them less "marketable", (e.g., low educational attainments) and because new jobs involve

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potential beneficiaries.

significantly less employment protection than existing jobs: unemployed individuals typically have access mainly to temporary (fixed-term or temporary-work-agency) contracts in France, Italy and Spain. Thus, the "fair" contribution rate for the unemployed is higher than for the average worker. Second, respondents are risk adverse and hence they are willing to pay more than a "fair" insurance.

Judging from the willingness to pay stated by the respondents, these unemployed individuals seem to be ready to accept reductions of up to 10 per cent of their wage if the entry job proposed to them is covered by an unemployment insurance. That is, providing unemployment insurance to new jobs (meaning not overly long vesting periods) could significantly reduce the reservation wage of individuals, even if such an insurance only provides a maximum duration of twelve months.

Who are the unemployed respondents who are more willing to buy unemployment insurance? The first two columns of Table 4.2 show logit estimates of the probability to subscribe to the proposed UB scheme, based on the pooled data from France, Italy and Spain. We ran a number of alternative specifications, including ordinary least squares, ordered logit and probit (taking the stated contribution rate as an ordinal measure of the willingness to pay), and binomial logit and probit. Results were broadly consistent across the various specifications. We display ordered logit estimates as this specification minimises the effect of imprecise answers vis-à-vis ordinary least squares and uses more information than the binary logit specifications. All variables are dummy variables. A list of variables with detailed explanations and a description of the reference individual is contained in Appendix 3.

Table 4.2: Willingness to Pay for Unemployment Benefits

Given the total sample of 1000 respondents in each of the three countries, the total number of valid responses among the unemployed is relatively small. We are therefore cautious with our interpretations. For the same reason, it is not surprising that only few variables turn out to be significant. They are marked by asterisks.

Two results stand out. Young unemployed demand more insurance, while unemployed persons with the lowest levels of education (compulsory education only) demand less of it. The latter effect is a bit surprising, since we expect human capital to provide some self-insurance, but it is consistent with other findings in this survey. The role of age may be explained by the effects of partial labour market reforms carried out in all countries in the 1990s, implying that the dominant form of hiring of young people is on temporary contracts, that is, unstable jobs.

This interpretation is supported by the fact that the effect of age on the demand for UB vanishes in the regressions for the employees already covered by UB, who for the most part have permanent contracts.

Political opinions and union membership (in this case non-active members) do not seem to affect the demand for unemployment insurance. We also find no effect of unemployment duration on the willingness to pay for unemployment insurance. However, those who have been unemployed for more than 12 months are, on average, willing to pay more for UB than those with shorter unemployment spells. This suggests that unemployment duration could increase the demand for insurance just because of sample selection: long spells of joblessness hit disproportionally those who have personal characteristics making them more prone to buy insurance.

4.1.2 Uncovered employees

We now turn to those employees who are currently not covered by UB. Mainly, these are workers with temporary jobs. Reflecting their chances to obtain a longer term job and higher wage relative to the unemployed in the previous subsection, the offer is slightly more generous in terms of the UB duration, but less generous with respect to the level of UB.

Among those wishing to buy insurance, the average stated contribution rate is fairly high: about 5% of gross earnings. As in the case of unemployed individuals, this is higher than actually fair (the latter would be less than 3% of gross earnings in all countries for the average worker).

To gain a better understanding of who demands insurance in this group of employees, we again turn to a multivariate analysis, controlling for factors which are likely to affect the degree of individual risk aversion as well as the entitlement to other forms of protection against unemployment risk. Results for uncovered employees are displayed in the middle panel of Table 4.2. The sample size is somewhat larger than in the previous group but still relatively small. Note that the sample is dominated by Italy where most workers are not covered by UB.

Like for the unemployed, younger workers are willing to pay more. So do workers deeming that pensions are bound to become less generous over time (the variable "crisis" further discussed in section 4.2.2 below). This points to some degree of substitutability between UB and public pensions: all four countries have made a widespread use of early retirement and have often granted a rather liberal access to invalidity pensions to deal with redundancies.

Moreover, we have further indications that the cross-country differences in the coverage of UB are not in line with the preferences of the outsiders: other things equal, the demand for UB protection is higher in Italy and Spain than in France.

Workers facing a high risk of job loss are more willing to buy UB protection. This confirms our discussion in Section 2 about the substitutability between EPL and UB.

4.1.3 Employees covered by UB

As emphasised at the outset of this section, only a minority of respondents in this group deems that the current system is not sufficiently generous and is thus willing to pay for extending unemployment insurance. In order to understand, who these respondents are, we use the same regression analysis as in the previous subsection, displayed in the rightmost panel of Table 4.2.

Two results stand out. First, the degree of employment insecurity is once more found to increase the demand for insurance. Second, country effects remain very important even after adding individual controls. The sign of the coefficients (positive in Spain and negative in France, while the reference group are German workers) are in line with the incidence of long-term unemployment in the various countries. Differences in the statutory maximum duration of UB – the other dimension likely to matter in this context – are indeed of a second order of magnitude across France, Germany and Spain as documented by Boeri, Layard and Nickell (2000). Italy is a peculiar case as the incidence of long term unemployment duration is large but falls to a large extent on those who are not covered by UB.

Local labour demand conditions are also important. They once again associate high and long-duration unemployment with the demand for extended benefits: the dummy variable capturing high unemployment regions is positive and statistically significant (for a precise definition, see Appendix 3). Finally, poor and less educated individuals demand more UB. This may have to do with the fact that the German unemployment benefit system redistributes more in favour of low-wage earners than in Italy and Spain, and German workers were not represented in the other regressions.

Overall, the survey hints at a two-fold relationship between demand for unemployment insurance and employment protection. On the one hand, those covered by EPL demand less UB: this is the trade-off that we observe also at the aggregate level. On the other hand, in the countries offering stricter EPL and less coverage of UB, there are larger coalitions of workers demanding extended coverage of unemployment insurance. Such a larger coverage could be self-financed insofar as potential beneficiaries are willing to pay more than a fair contribution rate. Governments of Southern European countries could take these trade-off into account and try to exploit them in reducing EPL and increasing UB. Reforms of UB systems requiring, on the one hand, shorter contribution records to qualify for benefits and, on the other hand, reducing the maximum duration of benefits for those already covered, would also seem to be politically feasible in the light of our results.

4.2 Pensions

In this section, we discuss our main findings on the demand for a pay-as-you-go pension system, on the level of information about the current cost of in terms of social security contributions, and on pension reform.

The first thing we want to find out is how informed individuals are about the cost of public pensions, about their sustainability and the likelihood of future reforms. As discussed in section 2, the cost of public pension has become extremely high, and, at current legislation, is projected to rise even further. How aware are individuals of these costs and future trends?

Next, we want to relate individual policy preferences to personal attributes, to the level of information available, and to other policy and political opinions. The exercise is similar to that of the previous subsection. Is the status quo a majoritarian outcome, or is there a majority of respondents in favor of abandoning or changing the system? What are the relevant cleavages and sources of disagreement? Are they in line with the predictions of economic theory, or do they reflect other non-economic (sociological, ideological) factors?

Finally, based on our findings, we would like to know how to package and present reforms in order to make them politically more attractive, either by bundling reforms together, or by increasing the level of awareness and information, or by insisting on some specific reform aspects. We are particularly interested in the political viability of proposals that attempt to scale down the size of the PAYG system, by allowing workers to partially opt out and rely on private savings or fully funded private pension plans.

All questions here are directed at employees. In the next subsection we document how informed the respondents are. Then we assess their perception of how sustainable is the pension system. Next we turn to policy preferences, by asking individuals whether they would like to opt out, and if so at what price. Then we consider policy preferences on a few simple reform alternatives.

4.2.1 Do you know how much you are paying?

We asked two questions, to employees only, in all four countries: one on the contribution rate and another on the balance of the PAYG system.

We first asked whether respondents know how much employers' and employees' contribute into the public pension system. We listed several brackets of possible answers, which were completely read to the respondents before they made their choice. The brackets were large and located to fit each country's correct value. We then sorted the answers in three categories: too low, correct and too high. In all countries but Germany there were only three brackets of possible values to choose from. In Germany there were several brackets, which we recoded in three groups only; we chose a smaller width than for the other three countries, because Germany has the least fragmented system and the system which experienced the smallest changes in the past. The three intervals for re-coding were as follows: France: 0-20, 20-(24.5)-45, 45+; Germany: 0-16, 16-(19.3)-25; 25+; Italy: 0-20, 20-(32.7)-45, 45+; Spain: 0-21, 21-(28.3)-35, 35+. The center interval has the correct value enclosed in parentheses.

Table 4.3 shows the distribution of the answers. About a third of the respondents did not know how to answer this question, more than a half in Spain but only a fifth in Germany. Of those who responded, generally less than a half got it right. Of those who got it wrong, almost all underestimated the true contribution rate. In Spain in particular, underestimation is huge: about 70% of those who answer pick the interval 0-21%, rather than the correct middle interval 20-45%. Among German employees the absolute size of the mistake is smaller, but it remains an underestimate: the average estimated contribution rate was 16.4%, which is about 3% below the correct value of 19.3% (as of 1.1.2000; the contribution rate in 1998 and 1999 was 19.5%). Only the Italians appear to be better informed about their pension system.

Table 4.3: Contribution Rate

What determines whether an individual is informed or not? The answer is contained in Table 4.4 which estimates the probability of providing a correct answer by binary logit. Don't knows are classified as providing the wrong answer.

Table 4.4: Who is Informed About the Correct Contribution Rate? (Logit Estimates)

As expected, more informed individuals are middle aged, males, richer and more educated (the variable "Compulsory Education" takes a value of 1, if the individual's education had ended at the compulsory level, and "University Degree", if the respondent has a college or university degree). Workers with a permanent contract are more informed, union members less informed. Individuals to the right of the political spectrum answered more often incorrectly.

Spain, and to a lesser extent France, are less informed than Italy and Germany. As pointed out, this may be an effect of two factors: the intensity of the public debate and the fragmentation of the pension system. In Germany, a single contribution rate applies to all workers. Moreover, this single rate features prominently in newspapers articles on the future of the German pension system. In contrast, every French sector has a different contribution rate. And while the Italian system is more fragmented than the German one, the pension debate is much more in the news than in France and Spain, which, in addition, are even more fragmented. Box 4 displays the number of times that the word pension appears in major newspapers in these four countries during 1999. As can be seen, pension reform is in the news much more often in Germany and Italy than in the other two countries.

The better information of Italian respondents also shows up in our second question on how the pension system works, namely whether the contributions to the PAYG system are sufficient to finance it expenditures, see Table 4.5. Slightly less than a half of the contributors to the system were aware that additional government resources have to flow into the pension system to finance pensions. In Spain, almost a third even believed that the PAYG system runs a surplus – in fact, government subsidies are about a third of the PAYG budget (cf. Section 2).

Table 4.5: Pension System's Balance, Deficit, or Surplus

Those who are informed about the system's balance are also likely to know the correct contribution rate and to believe that a crisis of the public pension system is likely (see Table 4.6 below). This follows from a similar regression as the one in Table 4.4 (not reported). The high frequency of "Don't know/no answer" follows the same pattern.

In Germany, the questionnaire also asked how the pension system works, i.e., pays-as-you-go (financing exclusively current retirees) or funded (financing the own pension). Results are shown in Box 5. Only 47% of the respondents realise that all of their contributions are used to finance current pensioners and nothing goes toward their own retirement. So they confuse the current German pay-as-you-go system with elements of a funded pension system. Surprisingly, respondents with at least a high school degree have a lower level of knowledge than those with lesser formal education.

4.2.2 Do you expect a pension crisis?

Although most respondents underestimate the financing burden, most of them also think that there will be a financing crisis of the public pension system. Being asked if they think that in 10 to 15 years their public pension system will not be able to keep the pensions on today's level, more than 80% of the respondents in France and Germany think so, and almost three quarters in Italy. Only the Spanish respondents were more optimistic; here, a majority does not agree with the crisis statement as it was formulated in Table 4.6:

Table 4.6: Pension Crisis

The question in Table 4.6 was asked to all survey respondents, including people not in the work force. A detailed analysis of the German data (not reported) shows that blue-collar and white-collar workers – i.e., those respondents that are enrolled in the German GRV system – are even more pessimistic than the general population. 91% of the contributors expect an impending crisis, rather than 81% of all respondents. Older individuals and today's pensioners are more optimistic, and so are civil servants – those who are the least affected. The higher is the level of education, the more pessimistic was the assessment of the situation. There are no substantial differences between men and women, nor between East and West Germans in the evaluation of this matter.

The pessimism in the ability of the public pension systems to cope with the future is reflected in the respondents assessment of whether there will be an incisive pension reform – see Table 4.7 below. More than 70% of the respondents in France, Germany and Italy anticipate a reform which will decrease their pension levels significantly. Consequently, only one-third of the young respondents in Germany (aged under 45) expect the public pension to be the main source of their income in old age. As with the previous question, Spain is different from Germany, France and Italy: not even half of the respondents expect a pension reform in the medium-run future.

Table 4.7: Likelihood of Pension Reform

4.2.3 Would you like to opt out?

How many respondents want to opt out of the current public pension system, who are they, and what are they willing to pay for it? These questions are the main focus of this section. All working respondents were asked if they would like to partially opt out of the public pension system. We formulated this question so as to mean that they and their employer would only pay half the contributions in the future, but they would also receive only half of the pension rights once they opt out. Past contribution would be valued at their old benefit levels.

The opting-out proposal was presented in several versions. In the first version, the amount saved by the reduced contributions was simply added to net income. In this case, the employee had the free choice of how to dispose of this money. In a follow up question, the employee was constrained to invest the amount rebated in an old-age fund of his own choice, either private or employer-based. A third version, asked to those who agreed to the first opting-out proposal, imposed a transition burden in the form of a lower valuation of future pension rights. In the German version of the questionnaire we also experimented with a different framing of the question by adding a bit of moral suasion in the form of the phrase "if this would help so that the generation of our children and grandchildren does not have to pay still higher contributions". This increased the willingness to opt-out quite considerably, see Box 5.

Version 1: Unconditional Opting Out. Table 4.8 shows the results concerning the first version. In all four countries only a small fraction does not know or refuses to answer, but nowhere there is an absolute majority willing to opt out. In Germany and Italy, about 47% of those who give a valid answer would like to opt out of the public pension systems, while some 48% would prefer to remain in it. In France and in Spain, the approval of an opting-out deal is much lower.

Table 4.8: Opting Out Unconditionally

Who wants to opt out of the pay as you go system? To shed light on our findings, it may be useful to formulate our theoretical priors explicitly. Suppose that individuals are rational, have the same expectations about returns in financial markets and the same degree of risk aversion. Since the rate of return in financial markets is likely to dominate the rate of return on the pay as you go system, a rational worker with average income should want to opt out, at least partially, unless he is very risk averse. But there is another relevant dimension: all pay as you go systems de facto entail some degree of intra-generational redistribution, from rich to poor. Hence, workers with below average income face a tradeoff: opting out leads to higher expected returns, but entails the loss of some intra-generational redistribution. This tradeoff is affected by age and by expected survival after retirement: for younger workers, giving up on the higher expected returns is more costly, because such returns cumulate for more periods. Hence, for the same level of income, opting out is more attractive the more distant is retirement age. Conversely, a longer expected life after retirement should discourage opting out, as the pay as you go pension is likely to be enjoyed for more years. We are thus led to an intuitive prediction: opting out should be more popular among younger and richer individuals, and among those with a shorter expected life time (typically males). What about education? Since education reduces the transaction costs of investing in financial markets and it is likely to be positively correlated with future income, opting out should also be more popular among better educated workers.

Table 4.9 estimates the probability of accepting the opting out proposal. The results are remarkably consistent with our priors. The rate of acceptance decreases with age and rises with income and education. Males are more likely to accept. More informed individuals (those that answered correctly to the previous question about the size of social security contributions) also are more likely to accept the proposal. This correspondence between theoretical priors and our estimates is reassuring, because it suggests that respondents understood what they were saying despite the difficulty of the question. After controlling for these individual attributes, however, there remain significant country effects, with acceptance much more likely in Germany and Italy as compared to France and Spain. In East Germany, workers are less willing to opt out than in the West.

In columns 3 and 4 we also included a dummy variable ("crisis") taking a value of 1 for those individuals who expected a crisis in the PAYG system in the future. Not surprisingly, this dummy variable is highly significant and has the expected (positive) sign. Now, Spain is no longer different from France, suggesting that the Spanish effect detected in the columns 1 and 2 is due to the optimistic perspective of Spanish respondents about the future of the pay-as-you go system. Finally, the political opinion of the respondents does not affect the willingness to opt out, nor does union membership (in both specifications).

Overall, these regressions confirm that the willingness to opt out responds as expected to economic and informational variables, while it does not seem to reflect the political or ideological opinions of the respondents.

Table 4.9: Who wants to opt out?(logit estimates)

Finally, one may ask whether the individuals who want to opt out of public pensions also want less unemployment insurance, or vice versa, reflecting another dimension of the trade-off depicted in Figure 2.1. A rigorous answer would entail the joint estimation of two choice models, one for pensions and one for unemployment insurance. As a rough approximation, we added to the regressors in Table 4.9 an additional dummy variable, that takes the value of 1 if the individual wants to buy more unemployment insurance then he currently has, and zero otherwise (results not reported). This new variable is statistically significant and has a negative sign, suggesting that individuals who do not have enough unemployment insurance are less willing to opt out, perhaps because they perceive that the pay-as-you-go system also performs a function of insurance against bad labor market outcomes (as already noted, early retirements have traditionally been a way to provide implicit insurance to middle aged workers in these countries). If correct, this finding suggests a potential complementarity in reforms. Providing more unemployment insurance in some countries could make some workers feel more secure, and through this channel it could induce more willingness to opt out. We are not too confident of this inference, however, since it is contradicted by the finding in Table 4.9 that permanent workers appear less likely to want to opt out.

Version 2: Opting Out Under Mandatory Savings Plan. The second version of the opting-out proposal constrains individuals to invest the rebated contributions. One might expect that this would reduce the willingness to opt out relative to the previous question. But we find the opposite: If the money saved has to be invested into a private old-age provision of one's own choice, the acceptance rate of the proposal *rises* from 47% to 67-71% in Italy and Germany, from 19% to 63% in Spain, and from 24% to 50% in France - see Table 4.10. A mandatory private pillar has more supporters than a voluntary supplemental provision.

Table 4.10: Opting Out with Mandatory Private Pensions

This is all the more surprising as most respondents who would accept the unconditional opting out proposal, would anyway invest in old-age provision, as Table 4.11 shows:

Table 4.11: Use of Rebate After Opting Out

Table 4.12 displays the percentage of respondents who switch opinion between the unconditional opting out proposal and the opting-out proposal with mandatory savings. The main puzzle lies with the 36% of respondents (emphasised in Table 4.12) who say no to the unconditional opting out question, but nevertheless want to opt out if they are forced to invest the rebate.

Table 4.12: Change of opinion between the two opting-out proposals

Who are these individuals, and why do they switch opinion? We can only speculate among a number of possible explanations. First, respondents may have simply misunderstood the second question with forced savings. Some evidence for this explanation stems from the fact that it is much harder to relate the responses to the second opting-out proposal to individual attributes. A regression similar to the one in Table 4.9 provides a similar pattern but a much worse fit with fewer significant results. A second explanation is that respondents are concerned with time inconsistency either at the personal level (they do not trust their own discipline to save and need the mandate in lieu of perceived lacking self control) or at the societal level (if other individuals do not save, some of them will have to be bailed out because they will end up too poor for society to tolerate, raising the tax burden). A third explanation is that respondents might expect that mandatory pensions are subsidised either through tax relief (as it is the case in most countries that already have a high share of private pensions) or through a government guarantee (e.g., by bailing out failing funds), although our question did not make any reference to such a possibility.

To shed further light on this puzzle, we estimated in Table 4.13 a logit model of the probability of saying no to the unconditional proposal and yes to the proposal with mandatory savings (i.e, belonging to the emphasised cell in Table 4.12). Very few variables are significant, and the fit is not very good. Thus, we cannot easily discriminate between alternative explanations. There is a pattern, however: Individuals who switch opinion in favour of the constrained opting-out proposal tend to be females, residents of France and East Germany, and individuals who want more unemployment insurance than they currently have. This last result suggests that time inconsistency may indeed play a role. We will again pick up this puzzle in Section 4.4.

Table 4.13: Who switches opinion? (logit estimates)

Version 3: Opting Out With Transition Burden. Opting out of the PAYG system is only feasible if someone bears the transition burden: those who have already retired need to be financed through the existing PAYG system, while at the same time future retirees have to save for themselves. This transition burden can be financed either by cutting existing pension benefits thereby lowering the PAYG contributions of current workers and making room for savings, or by adding savings to the current contributions. Both options are unattractive and are likely to reduce the political support for of a fully funded system. Conesa and Krueger (1999) argue that this political effect can be quantitatively important. Simulating an overlapping generations model with income heterogeneity calibrated to fit the US economy, they show that the transition burden induces a large status quo bias in favor of the PAYG system.

With this third version of our opting-out proposal, we want to find out to what extent individuals are willing to pay for the transition burden in order to get out of the pay as you go system. All those who had accepted the (unconditional) opting out proposal were asked whether they would still accept a less favorable proposal, offering the same tax rebate but a smaller future pension. Table 4.14 features the precise wording and our results. We chose to model the transition cost as a pension benefits reduction because the respondents were at this point of the interview used to thinking in dividing up pension levels between PAYG and funded pillars.

Not surprisingly, the acceptance rate is considerably lower than without a burden. But the extent to which opting out is rejected may surprise and suggests that perhaps the question was not well understood. In Germany and Italy, only a quarter of those who had accepted the previous proposal are still willing to opt out. In France and Spain, where fewer people accepted the unconditional opting out proposal, the decline is less pronounced: 40-50% still want to opt out even under a transition burden. Altogether, these numbers convey a similar negative result: in all four countries only little more than 10% of the respondents is willing to opt out if that entails bearing the transition burden envisaged in our question. [11]

[11] How does the average willingness to give up pension benefits from Table 4.14 compare to the transition burden in actual pension reform proposal? We have made some calculations for Germany. Using today's relation between payroll contribution rate and pension benefit level, we converted the average willingness to give up pension benefits from Table 4.14 into the corresponding contribution rate. Those who would accept an additional burden would be ready to pay on average 5.4% of their gross income on average as a price for opting out of the current public pension system. This is slightly higher than current reform proposals in Germany, though the opting out scheme we envisage is much more radical. For instance, in Germany, the planned "Pension Reform 2000" suggests a voluntary savings plan of 4% of gross earnings in order to keep payroll contributions stable. A similar calculation yields an average accepted additional burden of 5.2% of the gross wage in Italy among those who wanted to opt out with transition burden. This is more than what proposed by Castellino and Fornero (2000). Assuming higher rates of return, Birg and Börsch-Supan (1999) suggest that 2.5% of gross earnings suffice to finance this partial transition. Under both plans, the transition costs will be borne by only one generation.

Table 4.14: Opting Out with a Transition Burden

Perhaps these answers cannot be taken at face value, given the difficulty of the question. But they suggest that the transition towards a fully funded system could be politically difficult, unless the burden is spread across several generations and the benefits of reforms are carefully explained to public opinion.

4.3 Size and Tasks of the Welfare State

The third part of the questionnaire investigates the opinions of respondents on two general public policy issues. Is the size of the welfare state appropriate, is it too large, or too small? And should the composition of transfers (pensions vs. unemployment insurance) be reconsidered? While the questions discussed in the previous subsections were designed to solicit opinions on the individual demand for specific transfer programs, the questions discussed here relate to general political issues.

We expect that the responses will reflect general ideological and political opinions of the respondents, and not just the individual economic situation. We also expect that the answers in this part will be more fuzzy and harder to analyse than those to pensions and unemployment insurance. In order to minimise whimsical answers, we again always imposed a budget constraint. This distinguishes our approach from that in the so called “Eurobarometer”. For instance, we did not ask whether the welfare state should be made more generous, but we asked, whether the respondent is willing to pay more taxes for a bigger welfare state.

There are several motivations behind this part of the questionnaire. A first issue is how much congruence there is between these more general ideological opinions and the specific demands revealed in the earlier parts of the questionnaire. A related issue is whether and how much general political opinions are influenced by the economic interests of the individuals, and by his information. Do we find support for the view of much recent literature in political economics, that political opinions and behavior are dominated by selfish economic interest? More generally, what are the sources of the relevant political conflicts? Do we observe “class” and ideological conflicts around the welfare state, or do we see instead “neo-corporatist” conflicts that have nothing to do with ideology? And how do these conflicts over the welfare state relate to general political opinions on a left-to-right scale? What is the role of unions in this regard? Are trade unions just a lobby for the insiders and the retirees, as some observers have argued, or do they also reflect the opinions of unemployed and temporary workers?

A second interesting question is whether the status quo reflects a majoritarian outcome, or whether instead a majority of citizens is in favor of reforms. Knowing the answer to this question is important not only to predict the future of the welfare state, but also to understand how it came about: does the status quo reflect the influence of a powerful minority, or is it a "median voter optimum"?

Finally, by gaining a deeper understanding of the citizens opinions on these controversial issues, we hope to learn something about the design of reforms: how to make them politically more viable, by bundling together different reforms, by appealing to specific group of supporters, or by finding ways to compensate the opponents.

4.3.1 The size of the welfare state

We start by asking individual opinions about the appropriate size of the welfare state. The precise wording of the question is reported at the top of Table 4.15. Unlike in Sections 4.1 and 4.2, this question was posed to all respondents, whether employed or not.

Table 4.15: The size of the welfare state

Our central finding is that the status quo size is a majoritarian outcome. In Italy a relative majority is in favour of reducing taxes and transfers, but an absolute majority is against it. In all other countries there is both a relative and an absolute majority in favour of the status quo. Germans are most satisfied with the current size of the welfare state: Almost 59% are in favour of the status quo. Of those that are not content, two-thirds would like to reduce revenues and expenditures, and one-third would like to increase them. The pattern is very similar in France, with a bit less satisfaction and more support for a shrinking welfare state. In Spain, while a majority enjoys the status quo, a significant minority (almost a third) wants an expansion of the welfare state.

Who wants to expand, or shrink, the welfare state? We applied an ordered probit model to investigate the attributes of individual respondents. Table 4.16 reports our estimates. Higher values of the dependent variable correspond to preferences for a larger welfare state. "Don't know/no answer" is treated as a missing observation. We first look at the leftmost panel and then discuss two alternative specifications in order to check the robustness of our findings.

Table 4.16: Who wants to shrink the welfare state? (ordered probit estimates)

Table 4.16 reveals patterns broadly consistent with the findings of the previous subsections. Most importantly, disagreement is observed along the same three dimensions as in the previous questions, namely along *age*, *income,* and a variant of the *insider/outsider* conflict. Individuals who are more likely to oppose shrinking the welfare state are poor and old, while the young prefer a smaller welfare state. Education (captured by the "compulsory education" and "university degree" variables) does not seem to matter, though individuals employed in lower and medium skilled jobs are in favour of a bigger size of government (see Appendix 3 for a precise definition). The situation in the labour market matters in so far as workers (i.e., everyone who works) are in favour of bigger government compared to non-workers, and self employed workers are against bigger government. On the other hand, being unemployed, being in the public sector or having a permanent labour contract is not associated with significant preferences either way. Thus, here the conflict between insiders and outsiders is confined to the different preferences of self-employed individuals. Note that union members prefer bigger governments even after controlling for individual attributes – we discuss this finding in more detail in subsection 4.3.3 below.

Altogether, these results support the political economics viewpoint: Policy preferences are largely correlated with the individual economic situation. As that line of research would predict, a large welfare state is supported by those who benefit from it.

Cross-country differences remain significant even after controlling for individual attributes. Italy and France are confirmed to be in favour of smaller governments compared to Germany, while Spain is strongly in favour of bigger governments. Not surprisingly, East Germans prefer a larger welfare state than West Germans. These cross country differences confirm the earlier observation, that being exposed to different media and debates can shape policy preferences. The cross-country differences also reveal an interesting finding, namely there is some evidence of convergence towards a social model such as that currently present in France and Germany. We conclude this from observing that Spain, with a much smaller size of government, is also the country with most consensus in favour of a bigger welfare state. As we had pointed out in Section 2, Spain is also the country with the largest inequality even after controlling for the redistribution through extended families (Bertola et al., 2000).

It is natural to ask how these results are modified by also controlling for the political opinions of the respondents. This is done in a simple way in the middle panel of Table 4.16, where we include as an additional control a dummy variable for asserting to be on the left or on the right. Most estimates remain stable, providing further support to the view that ideology does not swamp individual economic self-interest. Political position, however, does not completely disappear: the variable “left” is statistically significant; left wingers tend to prefer a bigger welfare state.[12]

Recall that political position and union membership were never statistically significant in the unemployment insurance and opting out regressions. Those questions were formulated so as to induce respondents to reveal their perceived economic interests, i.e., their “demand” for unemployment insurance and for public pensions. Indeed, ideology seemed to play no role. Here instead we are investigating their view about what public policy ought to be. Economic self interest continues to play an important role. But now political position and union membership also matter. We conclude that ultimately policy opinions reflect a blend of economic self interest and ideological views about what is “right” or “wrong” for society as a whole. In this respect, left wing ideology seems to matter more than right wing views.

In our third specification, we investigate whether information matters. To do so, we include the dummy variable measuring whether respondents were correctly informed about the contribution rate to the public pension system (see Table 4.3). The sample of respondents is now much smaller because the information question was asked only to those who currently pay social security contributions.

Indeed, the rightmost panel of Table 4.16 shows that, once more, the citizens’ information matters. More informed individuals are also more likely to prefer a smaller welfare state. This is further support for the political economics view that economic self-interest shapes general opinions about the appropriate role of government intervention. Political positions now becomes even more significant while most other coefficients remain largely unaffected with two exceptions (the income variables are now statistically insignificant, and cross country differences vanish) probably due to the smaller sample size.

4.3.2 The composition of transfers

We have seen that a majority of respondents wants to maintain the current *size* of the welfare state. What about the *composition* of transfers? To find out, we asked whether individuals favor a reallocation between pensions and unemployment support. The question was asked to all those who, in the previous question, replied that the size of the welfare state is adequate. Precise question and answers are depicted in Table 4.17.

[12] Note that the estimates in the regressions including the “left” variable could be biased, if a latent omitted variable influences both the probability of having a left wing ideology and individual preferences over the size of government: in this case the variable “left” would be correlated with the error term of this equation.

Table 4.17: Pensions or unemployment benefits?

The results are quite similar to those of Table 4.15: Germans, French and Spaniards appear largely content, while in Italy there is a relative (but not absolute) majority in favor of change. In all four countries, if change at all, it is away from pensions towards unemployment benefits and other jobseeker support, most strongly so in Italy and Spain, confirming the results in Section 4.1. The results on Italy are in accord with the observation that the existing transfer system gives much more to pensions and much less to unemployment insurance compared to the rest of Europe. Thus, again, the opinions of European citizens seem to point to some kind of convergence towards a common European social model.[13]

Again, we regressed the answers to the question in Table 4.17 on individual attributes. Our regression specification is bit more involved, because the sample of respondents is not random. We applied a two stage procedure. In the first stage, the probability of answering "maintain the size of the welfare state" is specified similar to the regression in Table 4.16 (significant variables only). In the second stage, reported in Table 4.18, we estimate the probability that the respondent wants to give more to the unemployed. The dependent variable is dychotomous: 0 if the respondent wants to give more to the unemployed, 1 if the respondent wants to maintain the status quo or give more to pensions. Estimation is by joint maximum likelihood.

The results confirm our prior expectations and the results of the previous subsections. Individuals who oppose a reallocation of transfers towards unemployment insurance are older, less educated and have a permanent contract, while currently unemployed individuals want a reallocation towards unemployment insurance. Union members do not have significant preferences either way after controlling for individual attributes. Italy is confirmed to be different form the other countries. The second panel of Table 4.18 adds to the second stage specification a dummy variable for high unemployment regions (see Appendix 3). Not surprisingly, this new variable is significant and has a negative sign, but our previous conclusions remain largely unaffected; only some of the other variables now have a lower significance level.

Overall, we mainly see a conflict between insiders and outsiders on the one hand (or employed and unemployed), and between young and old on the other hand. Political position and

[13] The sample of respondents is confined to those that prefer to maintain the size of government as is. In the case of Italy, given the pattern of responses to the previous question, it is quite likely that, if the same question had been posed to all respondents, we would have obtained an absolute majority in favour of a reallocation away from pensions and towards unemployment insurance. This is what Boeri and Tabellini (1999) had found in a similar opinion poll just for Italy, conducted a year earlier.

income (specifications not reported) do not play a role in affecting preferences over the allocation of social expenditure.

Table 4.18: Who wants to shift resources from pensions to UB, given no change in the size of welfare state? (probit estimates with sample selectivity correction)

4.3.3 Are unions conservative?

The attitudes of union members towards these issues deserve special emphasis because any reform of the welfare state in France, Germany, Italy and Spain would have to be negotiated with the trade unions. Whose opinions do the unions reflect? Is it true, as it is often argued, that unions are mainly concerned about "insiders" and have a strong bias towards preserving the status quo?

Table 4.19 provides some answers. We adopt two alternative definitions of status quo bias. The first and broader definition associates status quo bias with being against any retrenchment of the welfare state (answering "maintain" or "increase the size of the welfare state" in Table 4.15). The second more restrictive definition includes only those individuals who want to maintain the current size of the welfare state *and* do not want to redistribute in favour of UB (answering "keep current situation" in Table 4.17).

Table 4.19: Status quo bias of unions

Table 4.19 clearly shows that union members are generally more prone to preserve the status quo than those who do not belong to a trade union. This holds for both definitions of status quo bias. Is this an effect of union membership *per se* which remains significant even after controlling for individual characteristics such as age, gender, and income? Or is it a selection effect that vanishes once we take the socio-economic characteristics of union members into account (among union members, insiders and older workers are over-represented while unemployed are underrepresented)?

To answer this question, we go back to the regressions in Table 4.16 where we controlled for personal characteristics. We see that union membership *per se* strongly affects opinions about the size of the welfare state. However, once we turn to more specific questions – see the many regressions in Sections 4.1 and 4.2 on UB and pensions, and also Table 4.18 on the composition of transfers – the effect of union membership *per se* vanishes, being swamped by other individual attributes. This finding may reflect how torn union members are in the current political and economic situation. On the one hand, there may still be the “great vision” of a large helping welfare state, generating a *per se* union effect on issues of broad scope. Once it boils down to specific issues, however, union members share the general view point that non-members have. If their attitudes are more “conservative”, as suggested by Table 4.19, this is because of the individual attributes of union members. Unions tend to represent economic and political interests that would be hurt by reforms to the welfare state. This suggests that different rules for union memberships could change the attitudes of unions towards these issues.

4.4 Reforming the welfare state – yes or no?

The responses discussed in subsection 4.3 do not offer an encouraging picture for those arguing in favour of a retrenchment of the European welfare state. In all countries over 50% of the respondents would answer with a resounding no to the question in the title of this paper: A retrenchment of the welfare state would not carry a majority among the voters in any of these countries.

Such a conservative picture comes a bit as a surprise in light of the results in Sections 4.1 and 4.2 on UB and pensions. However, these results indicated that large groups of respondents would welcome bold proposals such as privatizing as much as half of the public pension system (Table 4.10), and that a majority of the labour force in all countries but Italy did not want a more generous UB (Table 4.1). So why is there so much reluctance to shrink the welfare state in the last part of the questionnaire? Does this imply that reforming the welfare state is a politically impossible task? This subsection addresses these issues by comparing the answers to various parts of the questionnaire.

We concentrate our attention on pensions, since unemployment insurance is only a very small fraction of the government budget. Specifically, we consider the puzzle of why a majority appears unwilling to shrink the welfare state, despite the fact that a majority also wishes to opt out of the PAYG system once savings are mandatory. Table 4.20 below shows the pattern of responses to the opting out question with mandatory savings (see Table 4.10) and the question on the size of the welfare state (see table 4.15).

Table 4.20: Opting out and maintaining the size of the welfare state (% of respondents)

The puzzle lies with the one third of respondent who answered yes to the opting out question, and who also want to maintain or increase the size of the welfare state (cells emphasised in

Table 4.20). Why are they so reluctant to shrink the welfare state, given that they would be happy to opt out of the public pension system?

We first want to stress that this puzzle is not an artefact due to the different samples of respondents (all respondents were asked about the size of welfare state, while employees only were asked about opting out). In fact, the distribution of responses to the welfare state question is quite similar in both samples, and even among those who answered the opting-out question there is a majority in all countries against shrinking the welfare state.

We offer four (not mutually exclusive) explanations for this puzzle. First, generalising the insights about union membership in the previous subsection, ideology and political positions may play a different role in general compared to specific questions. Ideology appears to play a role when individuals are asked normative policy questions, but not when instead economic interests is been elicited. This explanation is suggested by the finding that political opinions (in particular left wing ideology) and union membership are significant variables in the regression of Table 4.16 but not in the regressions of Sections 4.1 and 4.2. By their own assessment, many voters find it advantageous to demand a smaller welfare state, nevertheless this conflicts with their view about the appropriate role for government policy.

A second explanation centres on "general equilibrium" calculations. They might play a role when the question is about general policy issues, but not when it is about individual behaviour. More precisely, voters are aware of the transition burden implied by privatising social security, and tend to underestimate the costs and the distortions associated with the existing generous welfare states. This explanation is suggested by the much lower acceptance rate of the opting out proposal when the transition burden is made explicit, and by the finding that most respondents vastly under-estimate the cost of the PAYG system (both the current contribution rate and the need to finance public pensions out of general revenue). Under-estimation of the distortions and inefficiencies associated with a given tax rate is also likely, though difficult to measure.

According to a third interpretation, individuals would accept important reforms to the welfare state but do not want to scale down overall government intervention. They want to retain the social insurance aspect of the welfare state, though they might be willing to scale down its redistributive role. This explanation is suggested by the two very different patterns of responses to the opting-out questions with and without mandatory savings: A majority wants to opt out of public pensions only if it is accompanied by mandatory savings. According to this explanation, the question on the size of government is interpreted loosely (and imprecisely) as referring to the scale of government intervention, and not to the particular form it takes. Results from the previous Eurobarometer survey also accord with this interpretation.

Finally, we offer a much more mundane explanation: Respondents have simply misunderstood the opting-out question, or they have not thought carefully about it – in particular, since this question is about the most complicated in our questionnaire. The few significant results in Table 4.13 may support this mundane explanation.

To discriminate between these alternatives and to gain more information about these puzzling individuals, we created a dummy variable that takes the value of one if the respondent answered “yes” to opting out with mandatory savings and “maintain” or “increase” to the size of the welfare state question. We then estimated a logit regression relating this dummy variable to individual attributes. The results, displayed in Table 4.21, suggest some interesting insights: Political ideology and union membership seem to play no role. However, education, information and crisis perception are statistically significant. Individuals who want to opt out but oppose a smaller welfare state are less educated and more uninformed about the true cost of social security, though they expect an imminent pension crisis. They are also concentrated among Germans, as revealed by the negative country fixed effects that are measured vis-à-vis Germany.

Table 4.21: Who wants to opt out without shrinking the welfare state? (logit estimates)

These results seem to rule out the first explanation about the role of ideology, while they are consistent with the explanation that “general equilibrium” effects are taken into account in general but not in specific questions. Among those willing to opt out, opposition to a smaller welfare is associated with a crisis perception and with less ability to process information. This is consistent with the idea that these respondents oppose shrinking the large European welfare states because they discount its burden and the associated general equilibrium distortions, while at the same time they wish to opt out because they do not trust is long-run sustainability. The significance of the variables “informed” and “university degree” are also consistent with our most mundane explanation, a misunderstanding of the opting-out question.

5. Summary and Policy Conclusions

Our survey has revealed a host of findings about the willingness to reform the systems of protection against the risk of job loss, the pension system and the welfare state in general. We summarise each in turn.

5.1 Labor market reform

A central theoretical result from the literature in political economics is that a majority of voters prefers to under-insure against unemployment risk. The reason is that such risk is concentrated in a minority of individuals. The unprotected minority of outsiders is unhappy, and would be prepared to pay for more insurance, but is politically powerless.

By and large, the results of our survey confirm these theoretical insights. In France, Germany and Spain, a majority does not want more insurance, while in Italy the respondents are split in half. The reason is that, with the exception of Italy, most individuals in the labor force are insiders who already enjoy adequate protection. In all these countries, nevertheless, the group of outsiders is large; these are individuals in unsecured jobs, with temporary contracts, or unemployed. Among them there is widespread demand for more extensive unemployment insurance than currently provided, especially in Spain and Italy. The survey therefore confirms the picture of dual labor markets, with some highly protected insiders and a large group of less protected and under-insured outsiders. This conflict between insiders and outsiders turns out to be one of the important and persistent sources of disagreements and political conflict in the survey.We also find evidence supporting the presence of a trade-off between UB and EPL, in line with recent theoretical results. The more influential workers find it more expedient to seek protection through EPL rather than by paying for UB.

These trade-offs suggest a possible direction of politically viable reforms. In Italy and Spain, a government willing to reduce firing restrictions would find it easier if it accompanies this with an extension of UB coverage. Such a bundle could receive the support of unemployed individuals and of temporary workers – those more willing to pay for unemployment insurance – and some workers already covered by UB. Furthermore the extended coverage could be self-financed as the workers benefiting from it seem willing to pay more than required to maintain the insurance scheme on balance. For countries like France and Germany, though, this strategy is less likely to pay off, given that a very generous UB system is already in place. In these countries reforms would seem to be politically viable which, on the one hand, extend the coverage of UB also to workers with relatively short contribution records, and, on the other hand, reduce the maximum duration of benefits for those already covered. Such reforms are likely to improve the efficiency of the UB systems, as empirical work suggests that long term unemployment is associated with a long maximum duration of unemployment benefits.

Finally, the demand for UB declines with age in some groups of respondents. This suggests that, old-age pensions can be regarded as a substitute for UI. If so, there is another important complementarity of reforms: opposition to smaller pension benefits could be dampened by a contemporaneous expansion of UB.

5.2 Pension reform

A central finding concerns the role of information in shaping policy preferences. Despite a widespread perception of unsustainability, many respondents underestimate the true cost of the PAYG pension systems. The majority of the working population in the four countries does not know or underestimates the magnitude of the contribution rates to their public pension systems, and almost every second employee incorrectly thinks that these systems are in balance or even make a surplus. This misinformation matters: the better informed voters are more likely to favour reforms.

Thus, informing public opinion about the costs of the system is an important aspect of any politically successful reform. Politicians, union leaders, or opinion makers who minimise the cost of the system and its future problems are making reforms less likely. Moreover, an important ingredient of successful reforms is their simplicity and transparency, since this helps the voters to recognise the cost of the PAYG system.

Despite their inadequate quantitative information, more than two thirds of the respondents in France, Germany and Italy expect a crisis of the pension system, particularly a reduction of the pension level and a significantly higher retirement age. Workers in Spain are more optimistic. Again, this more or less optimistic attitude is reflected in the policy preferences about the pension system: more pessimistic respondents are more willing to opt out of the PAYG system.

There are significant differences across countries in both the level of information and the degree of optimism about the future of the system. Italians are best informed and most pessimistic. Spaniards are at the opposite extreme: less informed and more optimistic. This is an indirect confirmation of the relevance of the pubic policy debate for both policy preferences and the accuracy of the citizens information: the pension system is a hotly debated policy issue in Italy, much less so in Spain.

These findings on the critical role of information also suggest promising directions for research in political economics. Voters' rationality and information are strong and unrealistic assumptions. More reasonable assumptions would allow the citizens opinions and policy preferences to be affected by campaign contributions, lobbying, media, etc.

A second central insight of this part of the survey concerns the schemes to opt out of the public PAYG pension pillar. The details of how the scheme is formulated seem crucial for its political viability. If opting out is accompanied by mandatory savings into a second or third-pillar for old-age provision, then it enjoys widespread support. But opting out seems less appreciated if the freed contributions can also be used for current consumption. It becomes even less popular if worker are asked to bear a large transition burden. The reform currently under way in Germany is in line with these findings: first it is presented as a necessary step to avoid future increases in the contribution rate to the PAYG system; second, the reform strongly encourages workers to invest contributions into a private pillar while curtailing future public pension benefits; third, in many cases this will be mandatory within occupational pension scheme.

Finally, individual policy preferences on opting out are systematically related to a few individual attributes. Public pensions are more popular among older, poorer, less educated and less informed workers, as expected. They are also more popular among individuals with a permanent and protected contract. Similar to UB, union membership and political position do not seem to matter after controlling for other attributes. We thus find three relevant cleavages or conflicts: between young and old, between rich and poor, and between insiders and outsiders in the labour market.

This also suggests that opting out proposals could be packaged so as to be more appealing to large groups of voters. If poor and old individuals are less willing to opt out, their vote could be bought by offering them a more favourable opting out deal. "Segmentation" of this kind could seem unfair, but it could prove essential to overcome political opposition, as illustrated by the 1995 pension reform in Italy.

5.3 General lessons: Are reforms politically feasible?

Our project was motivated by three general questions. First, what does a majority of the citizens want? Does the welfare state in its current size and form satisfy the preferences of a majority, or is it suited to fit the wishes of a powerful minority? The overall message is that a majority of the citizens does not want to change the status quo *size* of social expenditures, even in the light of high current taxes and contributions: retrenchment of the welfare state is unlikely to win a majority in Continental Europe. When we consider the *composition* of transfers and the details of the programs, however, the conclusions are not so clear and differ across countries. In Italy, in particular, there could be widespread support for reforms that modify various aspects of specific welfare programs.

From the point of view of political theory, the finding that the status quo is a majoritarian outcome can be interpreted in two ways. It could just be a manifestation of the "median voter" result. Political parties have adapted to the voters' preferences: electoral competition has forced them to offer the policies preferred by the majority of voters. The alternative interpretation is that the citizens preferences are endogenous, and adapted to the status quo. Voters suffer from a "negativity bias": once they get something, they don't want to give it up. If so, the voters' psychology induces status quo bias and path dependence in politics. This second interpretation has been studied by political scientists such as Pierson (1996), but has been neglected by economists. Our findings on the importance of information suggest that perhaps it ought to receive more attention.

Second, what are the relevant cleavages in the political debate over the welfare state? Here the picture is quite clear and similar in all countries, and supports the recent research in political economics. Political conflicts are firmly grounded on the economic interests of the citizens. Specifically, there are three dimensions of economic conflict: between young and old, rich and poor, and insiders and outsiders in the labour market. The intergenerational conflict is always present on all policy issues. The other two conflicts, linked to income and to the situation in the labour market, manifest themselves differently depending on the policy issue at hand. Political ideology also plays a role, particularly over the size of government, but not in the demand for specific welfare programs. Union members tend to be staunch supporters of the status quo. The main reason seems to be that among union members insiders and older workers are over-represented, while unemployed are underrepresented. Certainly, conflict over the welfare state is much more complex than suggested by the simplistic Marxian vision of a class struggle.

Our last motivating question concerned the political viability of reforms. All together these results suggest that, while shrinking the welfare state may be politically very difficult, there appears to be room for reforms that redesign its key connotations. In particular, reforms appear possible that aim to stabilise the costs of pension systems and to make them sustainable in the face of population ageing. While according to this survey citizens do not seem to want a smaller welfare state, they certainly would also oppose further hikes in taxes and contributions and they seem aware of the unsustainability of the status quo.

Moreover, reforms could be designed to exploit some complementarities. Two of these potential interactions are hinted by this survey, which both originate by an extension of the coverage of unemployment benefits. Such a reform, notably in Southern European countries, may increase support to reforms going in the direction of greater labour market flexibility. It may also help increasing the consensus for partial privatisations of pension systems.

Whether we like it or not, public opinion in Continental Europe seems to be strongly averse to the social model advocated by Mrs. Thatcher in the UK or by President Reagan in the US. By and large, continental Europeans do not want to get rid of government intervention in social affairs. We leave it to the reader to decide whether this is a positive or negative conclusion. In any event, a reform-minded politician could still exploit the widespread dissatisfaction and pessimism revealed in the survey to achieve a more efficient and sustainable welfare state.

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