

The welfare state in the US and Europe: why so different?

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Question:

Why there is less redistribution of income from the rich to the poor in the US than in Europe?

The question is NOT why the size of government is larger in Europe than in the US.

The question is NOT whether redistributive effort is successful or not and at what costs.

Data:

- Size and composition of government spending
- Pension systems
- Taxation
- Labor market regulation

Table 1. Composition of General Government Expenditure, 2000

Percent of GDP

<i>Country</i>	<i>Total^a</i>	<i>Consumption</i>		<i>Subsidies</i>	<i>Social benefits and other transfers^b</i>	<i>Gross investment</i>
		<i>Goods and Services</i>	<i>Wages and salaries</i>			
United States	29.9	5.3	9.2	0.4	10.6	3.3
Continental Europe ^c	44.9	8.3	12.4	1.5	17.6	2.5
France	48.7	9.7	13.5	1.3	19.6	3.2
Germany	43.3	10.9	8.1	1.7	20.5	1.8
Sweden	52.2	9.8	16.4	1.5	20.2	2.2
United Kingdom	37.3	11.4	7.5	0.4	15.6	1.1

Source: Authors' calculations based on data from OECD Economic Outlook Database (No. 71, Vol. 2002, Release 01), June 2002.

a. Totals also include interest payments and some categories of capital outlays.

b. Includes social security.

c. Simple average for Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Netherlands, Norway, Portugal, Spain and Sweden.

Table 2. Government Expenditure on Social Programs, 1998

Percent of GDP

<i>Country</i>	<i>Total</i>	<i>Old-age, disability and survivors</i>	<i>Family^a</i>	<i>Unemployment and labor market programs</i>	<i>Health^b</i>	<i>Other^c</i>
United States	14.6	7.0	0.5	0.4	5.9	0.9
Continental Europe ^d	25.5	12.7	2.3	2.7	6.1	1.7
France	28.8	13.7	2.7	3.1	7.3	2.1
Germany	27.3	12.8	2.7	2.6	7.8	1.5
Sweden	31.0	14.0	3.3	3.9	6.6	3.2
United Kingdom	24.7	14.2	2.2	0.6	5.6	2.0

Source: Authors' calculations based on data from OECD Social Expenditure Database 1980-1998 (3rd Edition), 2001.

a. Includes cash benefits and in kind services.

b. Includes, among other things, inpatient care, ambulatory medical services and pharmaceutical goods.

c. Includes occupational injury and disease benefits, sickness benefits, housing benefits and expenditure on other contingencies (both in cash or in kind), including benefits to low-income households.

d. Simple average for Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Netherlands, Norway, Portugal, Spain and Sweden.

Pension systems imply a redistribution from young to old.

However “poor” old get proportionally much more than the rich and this effect is stronger in Europe than in the US

**Figure 1: Difference in marginal tax rates, in %, between the US and EU15
(excluding Denmark)**

**The difference equals the US marginal tax rate minus the unweighted average
European marginal rate for each income class.**

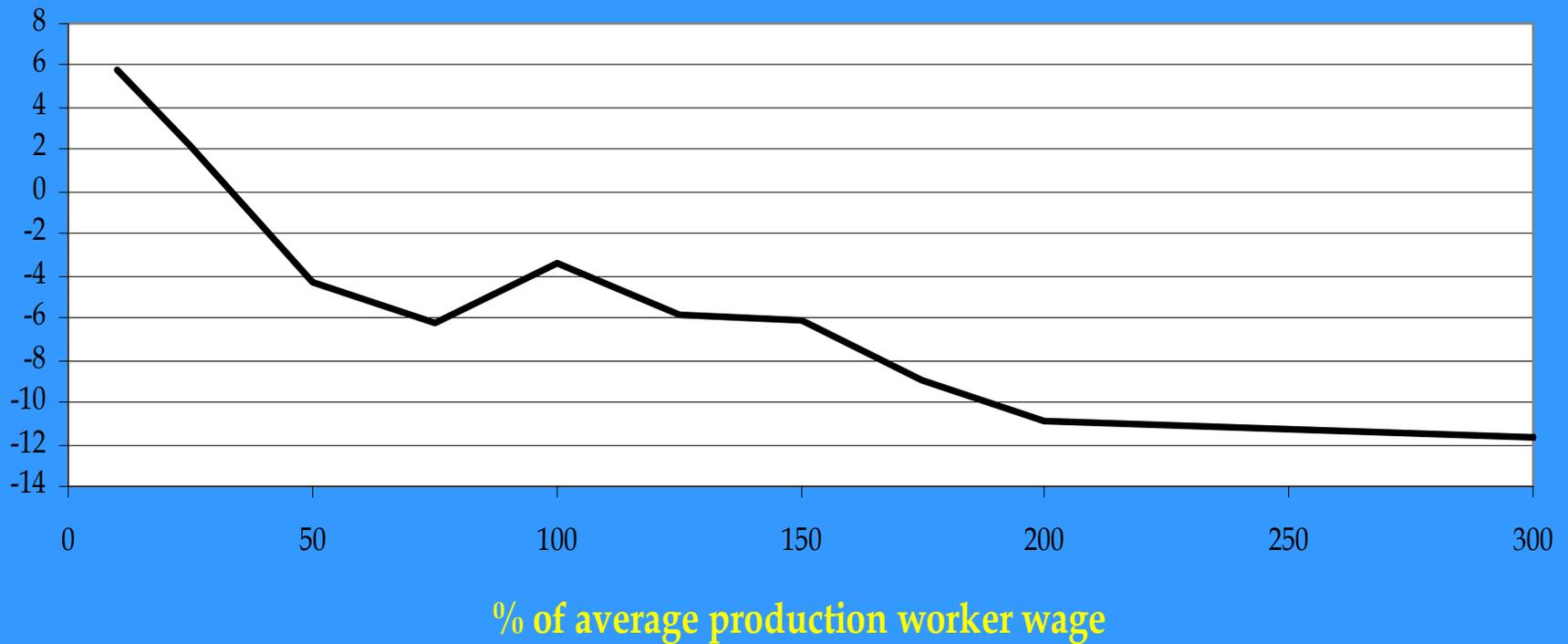


Table3

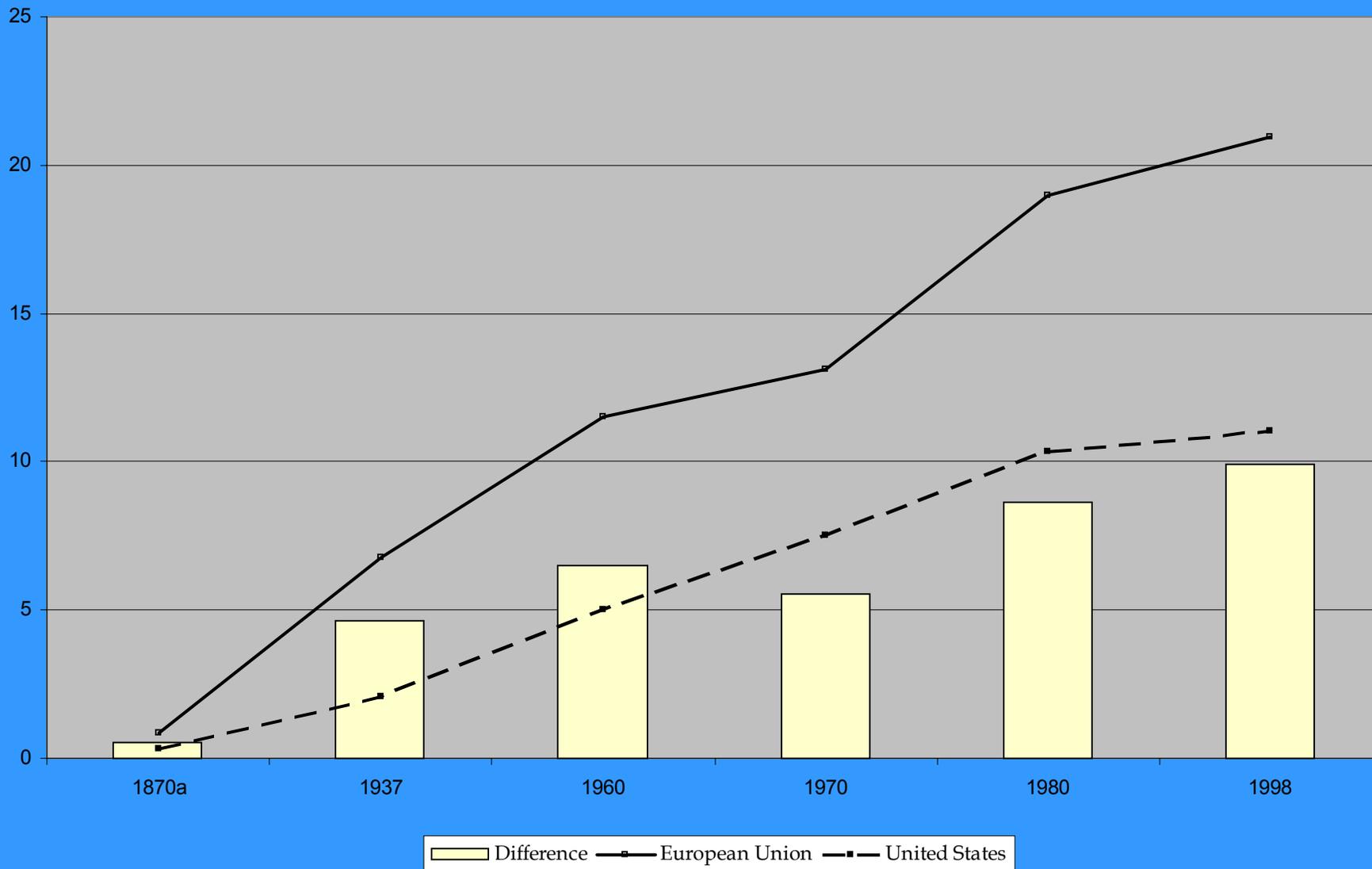
Labor markets in the US and in Europe

	Labor standards 1985-93	Employment Protection 1990	Minimum annual leave (weeks) 1992	Benefit replacement ratio (%) 1989-94	Benefit duration (years) 1989-94
France	6	14	5	57	3
Germany	6	15	3	63	4
Sweden	7	13	5	80	1.2
UK	0	7	0	38	4
European Union (1)	4.8	13.5	3.8	58.7	2.6
US	0	1	0	50	0.5

Source: Nickell and Layard (1999) and Nickell (1997)

1. Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Netherlands, Portugal, Spain, Sweden and UK.

Figure 2.2: Government expenditure on subsidies and transfers (% of GDP) 1870-1998
(obtained from Table 2.4)



Summary

- * Redistribution from the rich to the poor is much more extensive in Europe.
- * Some disadvantaged categories (sick, elderly, large families) also have protection in the US (although less than Europe), very few transfers to the “poor” per se in the US.

Private charity

Charity contributions are much larger in the US than in Europe:
charity per capita in the US in 2000 is \$ 691 per capita, against 141 for UK and 57 for Europe as a whole.

Explanations:

*Charity as partial substitute for public welfare

*You can choose to whom you give charity, but not how your taxes are spent

Why Europe redistribute more?

Possible explanations

- “economic” explanations
- political explanations
- behavioral, sociological explanations

Economic Explanations

- 1) The pre tax distribution of income:
more pre tax inequality, more demand
for redistribution in a democracy.

It does not work: pre tax inequality much higher in the US than in Europe.

Gini coefficient is 38.5 in the US, 29.1 in Europe. In the US top 20 per cent gets 43.5 of pre tax income, in Europe 37.1 per cent.

2) Variability of income and openness

More open economies have more variability of income and therefore government transfers are needed to stabilize.

It does not work: very weak cross country evidence. The US GDP is much more volatile than European countries GDP.

Table 4 Economic variability in the US and Europe (Standard deviations)

Series	Sample Range	US	EU15
GDP growth	1960-1997	0.020	0.017
Total manufacturing labor productivity	1980-1996	0.026	0.016
Unemployment rate (1)	1970-2000	0.414	0.220

3) Efficiency of the tax system

Tax system is more efficient in Europe, costs of collecting taxes lower. Easier it is for the government to levy high taxes to redistribute.

Very weak evidence of this effect.
European tax systems are very different
from each other.

Tax evasion is probably lower in the US
than in continental Europe.

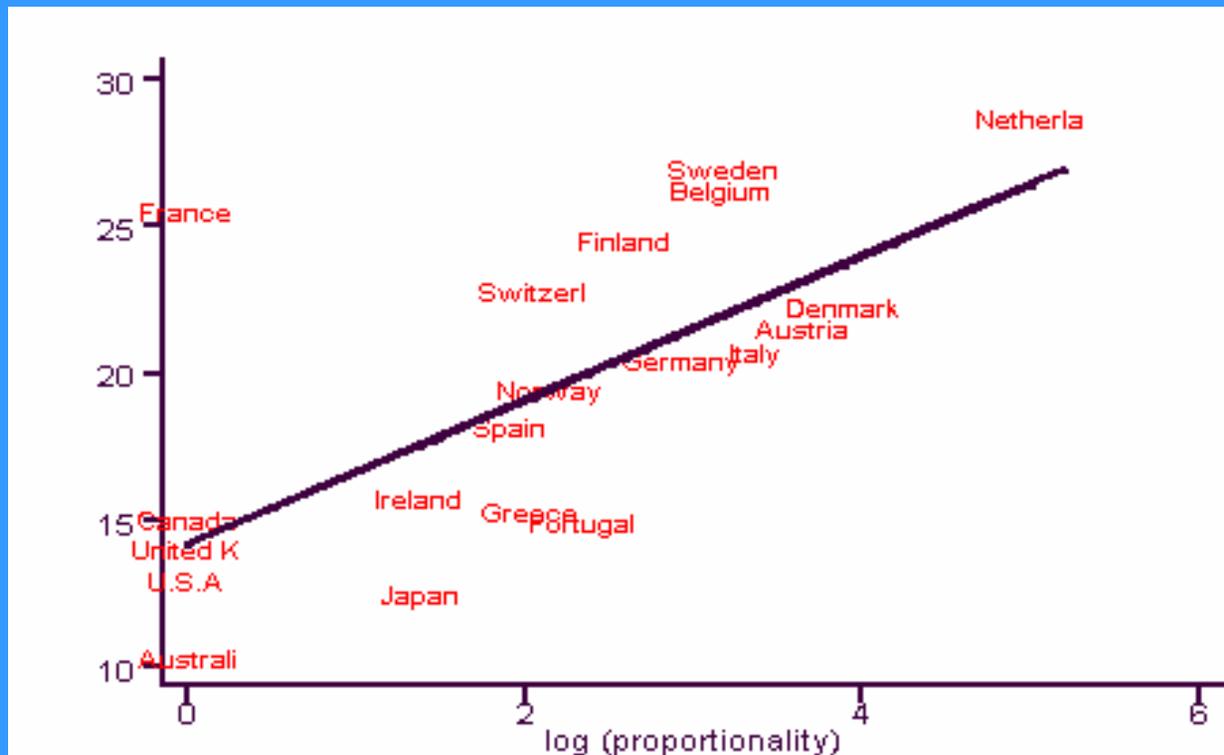
Political Explanations

1) The electoral systems

Proportional electoral systems are associated with larger transfer spending programs in OECD countries. The US and the UK have two of the least proportional electoral systems. Northern European countries have very proportional systems.

Figure 4

Transfers/GDP vs. Log (Proportionality) OECD countries



2) Lack of a strong socialist/communist party in US history

The strength of socialist parties is strongly associated with the expansion of the welfare state

3) Role of the judiciary system and the Supreme Court

Special role of US Supreme court. Throughout US history at least until the mid part of the past century, Supreme Court always rejected welfare legislation arguing that it would go against private property. A famous case was the rejection of a federal income tax in 1894.

FD Roosevelt had to win a battle over the Supreme Court in the nineteen thirties to pass welfare legislation (Court Stacking)

**Why the US and “Europe” have
chosen different institutions?**

1)The adoption of proportional electoral systems

When, why, and how proportional systems were chosen in many European countries

Proportional representation is recent :
a conversion to proportional representation
happened mainly between 1917 and 1920

Proportional representation reflected
the growing power of labour movement
and socialist parties.

The United States did not get proportional
representation because the socialist party
was much weaker.

Also, in the United States proportional representation was considered too favourable to minorities like Blacks and recent immigrants.

Conservative forces within the US were too powerful to allow a reform of that magnitude.

2) The lack of an American Socialist party: why?

- * Racial fragmentation
- * Economic opportunities
- * Political institutions and electoral rules: the President, the Senate, the Supreme Court
 - * Density and size of the US
 - * The role of wars
- * Ideological “biases” of US Trade Unions

3) the stability of American Constitutionalism

Old versus new constitutions

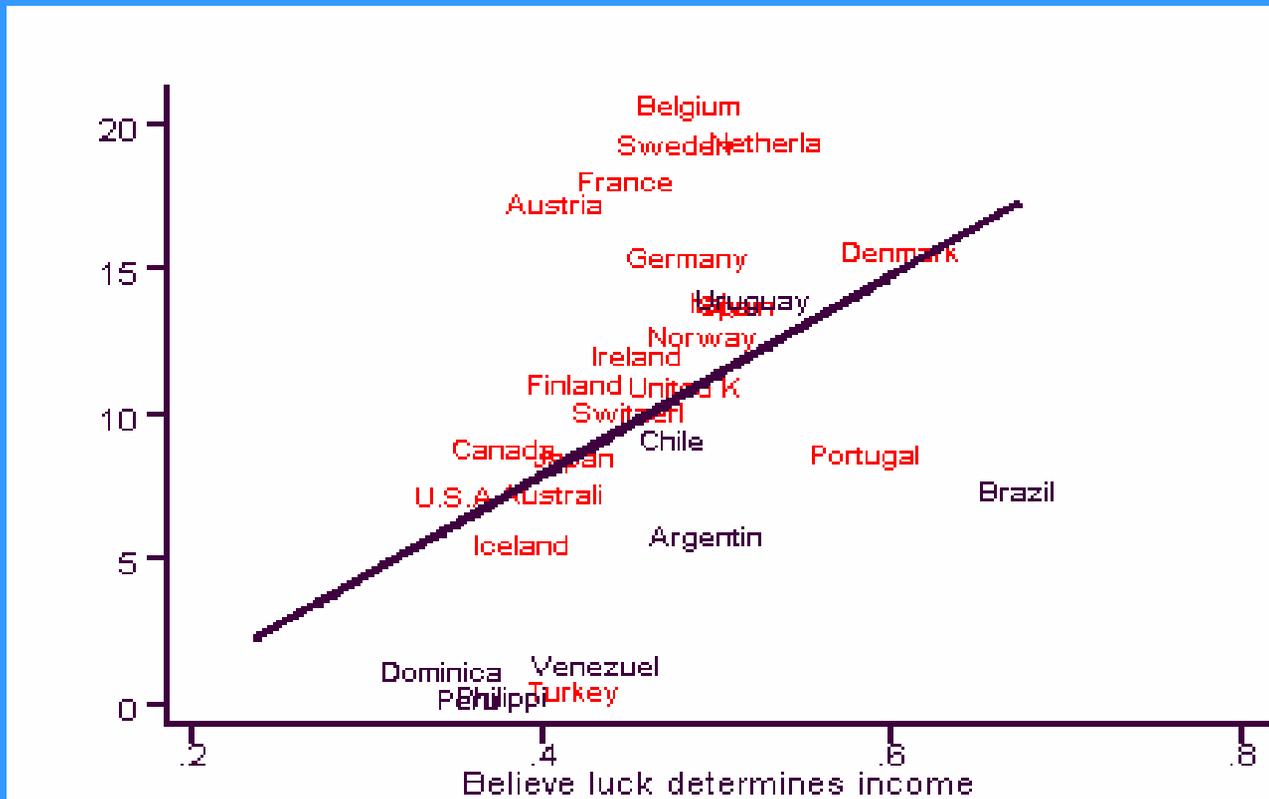
Behavioral and sociological explanations:

Perceptions of poverty

Americans believe that the poor are lazy;
Europeans believe that the poor are
unfortunate.

According to the World Value Survey, 71 per cent of Americans versus 40 per cent of Europeans believe that the poor could become rich if they tried hard enough

Social Spending/GDP vs. Mean Belief That Luck Determines Income



What explains this difference in beliefs?

Protestant Ethic

Racial fragmentation

Self selection of those who emigrated
from Europe to the US

Protestant Ethic

- *Culture based on wealth indicating your worthiness.
- *Frugality, working hard as way of showing your moral value.
- *Weberian view of protestant ethic as an engine to capitalism.

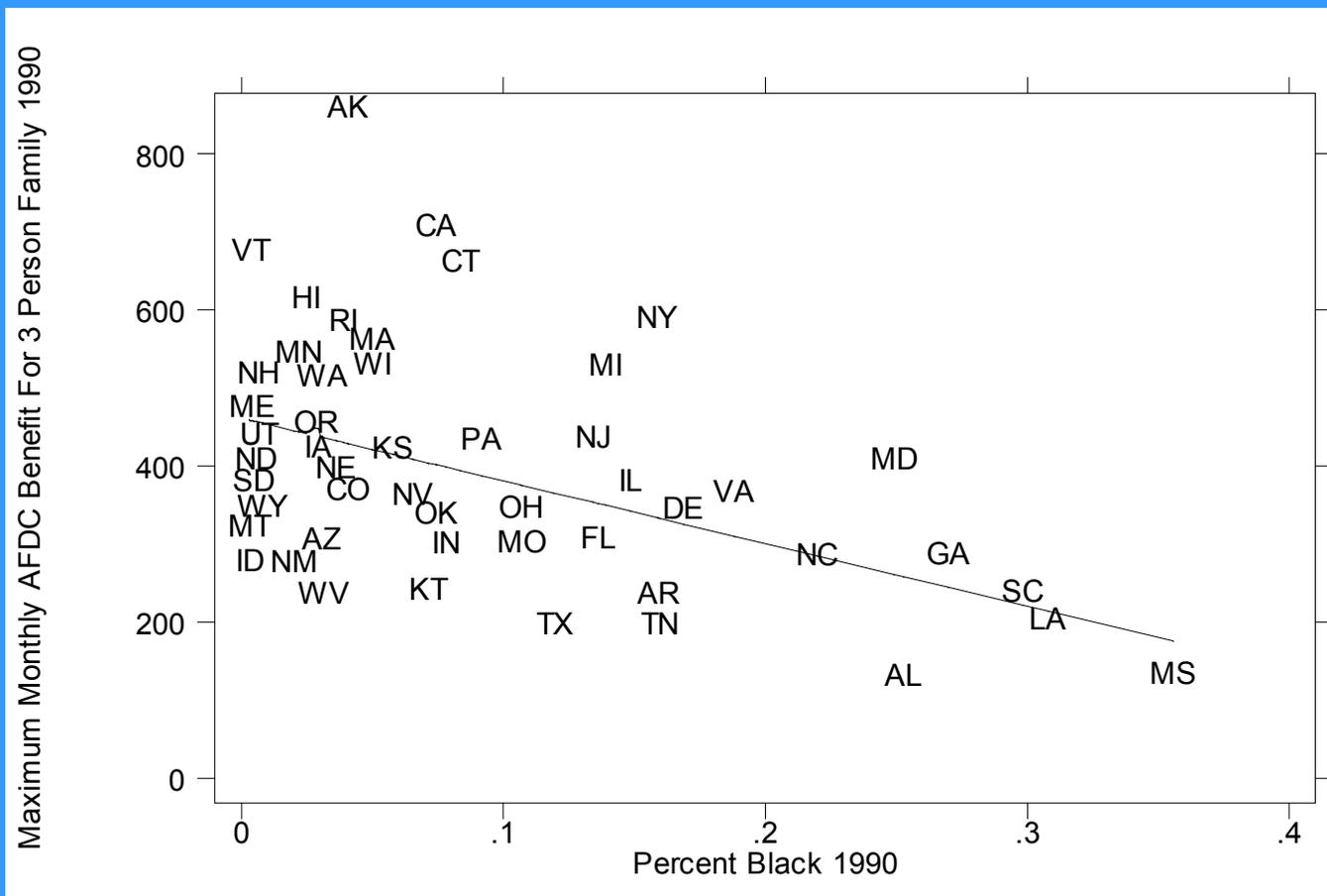
Racial fragmentation

Race relations are an extremely important determinant of US politics. Racial differences are often more important than income differences in explaining how people vote.

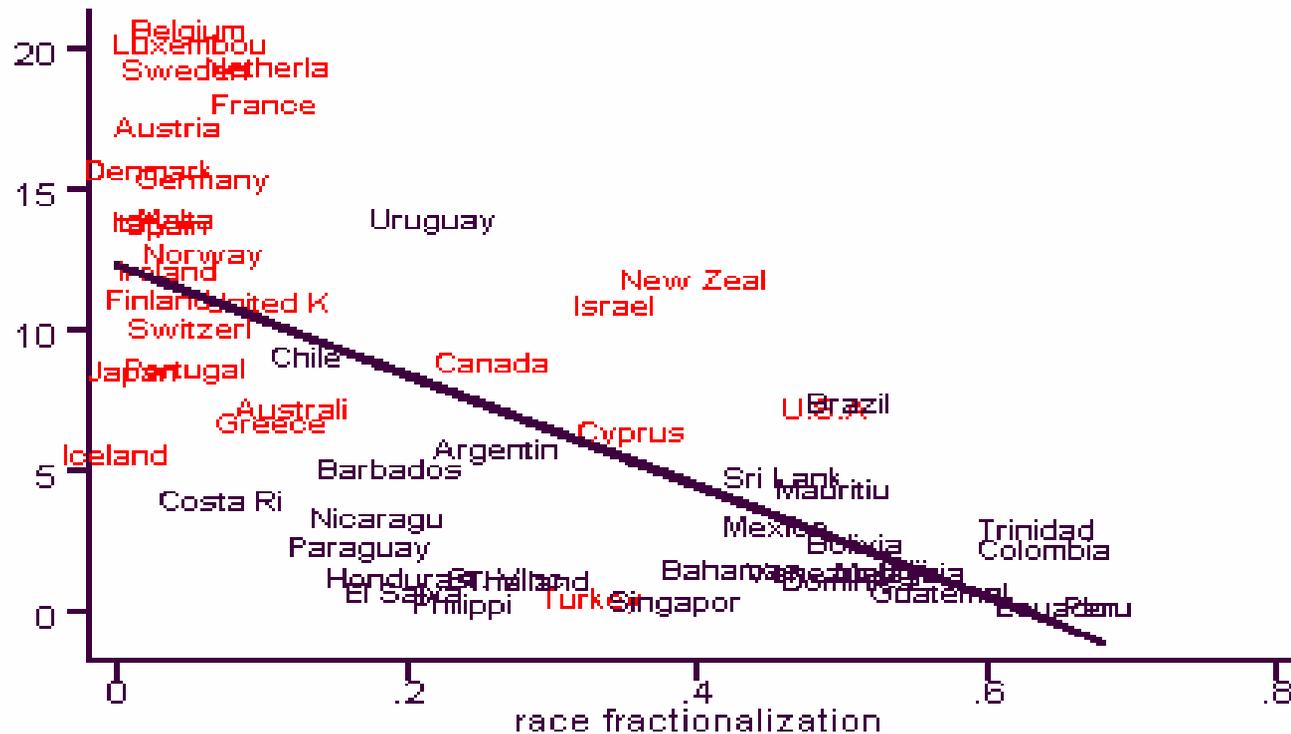
A large body of evidence shows that the white majority does not want to redistribute to the poor because the latter are perceived as “different” ethnically or racially.

Evidence confirmed by both individual level study (response to surveys) and aggregate studies.

AFDC Monthly Maximum vs. Percent Black By State



Social Spending/GDP vs. Race Fractionalization



Self selection of immigrants

The US is a nation of immigrants. those who chose to move from their own country may be those more likely to believe that one can escape poverty by taking risks.

What are the effects of these different beliefs?

“Sense of justice”: if you believe that luck (or inherited wealth) determines differences in income, you are more favourable to redistribution.

If you believe that individuals' effort and ability determines income, you are less favourable to redistribution

Individual survey evidence: those who believe that society is fair, that is people get what they deserve, they are less favourable to redistribution

Possibility of two equilibria

In Europe high taxes, disincentive to work and invest, a larger proportion of income is determined by inherited wealth and luck

In the US lower taxes higher investment, a larger proportion of income is determined by effort.

So both European and Americans may be right about what determines income, luck or effort.

The American self-made person:

Myth or reality?

Conclusions

The answer to the question of why the welfare states in the US and in Europe are different brings us back to long lasting historical and cultural differences between the two sides of the Atlantic.

- *Simple economic explanations fail.
- *Explanations based upon institutional differences go in the right direction but are incomplete because they do not tell us why institutions are different.

- * The investigation of why institutions are different has lead us to long lasting and many geographical and historical differences between the two sides of the Atlantic
- * Perception about the poor and different “ethical values” are also extremely important
- * The origin of these “ethical values” is associated, amongst many other things, to differences in history, to the self selection of those who crossed the Atlantic