Financing social security – business as usual?

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Abstract

As a consequence of the financial and economic crisis both GDP and employment have dropped substantially throughout Europe since 2008. Dependence on social benefits has, accordingly, increased markedly, while public revenue has fallen, leading to quickly expanding budget deficits. Changes in tax and/or social security systems have been made throughout the EU, first by way of stimulus measures and subsequently through austerity packages.

This working paper assesses the impact on, and challenges to, the ability of welfare systems with different financing mechanisms to cope with the crisis. Additionally, it analyses how the crisis (stimulus measures, austerity packages) contributes to changing the structure of financing systems. It shows that social systems that rely primarily on contribution-based financing are more conducive to the achievement of stable public finances throughout a recession than tax-based systems, insofar as the former focus on keeping employment stable because it is their main source of public revenue.
Introduction

As a consequence of the financial and economic crisis both GDP and employment have dropped significantly throughout Europe since 2008. Dependence on social benefits has increased markedly while public revenue has fallen, leading to quickly expanding budget deficits. Numerous EU countries have made changes in their tax and/or social security systems, first by way of stimulus measures and subsequently through austerity packages. While these measures varied in their emphasis from one EU country to another, all are likely to have long-term consequences for social security financing.

The main goal of this working paper, therefore, is to assess the impact upon, and challenges to, the ability of welfare systems with different financing mechanisms to cope with the crisis. Additionally, it analyses whether the crisis (stimulus measures, austerity packages) contributes to changing the structure of financing systems. Our hypothesis is that social systems that rely primarily on contribution-based financing are more likely to allow for stable public finances throughout a recession than are tax-based systems, as the former will focus on keeping employment stable insofar as it is their main source of public revenue.

While there have been several contributions to the topic of social security financing in the last couple of years (e.g. Bäcker 2005; Püss et al. 2005; Ganßmann and Himmelreicher 2009; Schmähl 2006 and 2009; Seils 2009), this paper will focus on the changes that were brought about by the recent crisis – directly, through changes in tax and contribution rates and indirectly, through changes to income resulting from wage agreements, rising unemployment, the introduction or extension of short-time working schemes, or the slowdown of profits and consumption.

At the time of writing, the availability of data concerning the economic crisis was limited. While labour market data is usually available in a timely manner, data on social spending or government revenue is much less likely to be promptly available. In most cases, EU-wide comparable data – primarily from Eurostat- and Ameco-databases – offered empirical data up to only 2008 or 2009. Data for 2010 is thus based mostly on forecasts and should be viewed with the appropriate caution.

The financing of social security has experienced increasing difficulties since the start of the millennium. The international division of labour in a globalized world exerts increasing pressure on wage and tax levels as
industrialized countries seek to prevent the flight of capital in the direction of more favourable conditions. Combined with the continuous ageing of the European population, an ever increasing number of people working and living under precarious conditions and making scant contribution to social security, as well as tighter public budgets than in the past, put a strain on social security funding. Countries depending on labour market participation as the main source of social security financing have found it especially difficult to retain an adequate level of funding (Schmähl 2009, 390).

This article will start by looking at some of the advantages and disadvantages of contribution and tax financing. Section 2 will show the impact of the economic crisis and the countermeasures taken, while the last section will offer a deeper look into the consequences for social security financing, including probable long-run effects. The findings will be illustrated with examples from five EU countries with different social and economic structures.

In order to illustrate the developments in the European Union, this paper will compare countries with different approaches to the financing of social security, in line with the welfare regimes emerging from the welfare state literature (e.g. Esping-Andersen 1990). An example of a tax-based financing model will be the United Kingdom, with its liberal Beveridge-model social system with comparatively low levels of contributions and a correspondingly basic level of social security (Seils 2009). Sweden will represent the universal or social-democratic welfare system based, like the former model, mainly on taxes but with a high level of tax ratios (and high social standards). Austria and Germany will be examples of the corporatist/continental social system with rather high levels of social security and a high dependence on employment for the generation of revenue (through social security contributions and direct taxes), while Hungary will serve as the example of a Central/Eastern European country with a comparatively developed social system but with no long-term history of stable tax or contribution rates.

1. Even though employment rose by more than 7.5 percent in the EU between 2000 and 2007, the rise in full-time equivalents was only 4.9 percent while part-time jobs grew by 17.7 percent (EU Commission 2008, 29).

2. On average the public deficit in the EU was 2.4 percent in the period between 1995 and 2000, subsequently declining to 1.7 percent between 2000 and 2007 (Ameco-database).
1. Means of financing social security

Generally speaking, there exist three main sources of public revenue, namely, direct taxes, indirect taxes and social security contributions. Since different methods of financing have dissimilar consequences for income distribution and the generation of revenue, among other things, it is necessary, in any discussion of social security financing, to pay special attention to the extent to which a system is financed through taxes or through contributions.

1.1 Contribution- and tax-based financing

While the financing structure in most OECD countries is based on both taxes and contributions\(^3\), the emphasis differs widely. In contribution-based systems the fiscal equivalence principle is rather important, as there is a close connection between contributions and benefits received. As a consequence, it is less likely than in tax-financed systems that benefit levels will be cut back because of tight budgets (Bäcker 2005, 359). Also the resistance towards the tax wedge is likely to be less as it is easier for people to see the connection between social benefits and contributions, which in most cases include a ceiling on payment levels. Contribution-based financing is especially important in the corporatist/continental social systems of Central and Western Europe.

As the changes in the working environment throughout the last decades have placed considerable pressure on contribution-based financing, wages liable to contribution have been decreasing steadily\(^4\). Another concern with contribution-based financing is the inadequate financing of social benefits. Tasks that are not especially directed at contributors but still financed through social contributions, e.g. active labour market policies, are likely to have a negative economic impact, as the costs of labour increase in comparison to those of capital, increasing the likelihood of a substitution of these factors towards a more capital intensive form of output production, while also decreasing the acceptance of social security payments (Schmähl 2006). In such cases, tax-based financing offers a possible alternative.

Social systems built mainly upon tax contributions are in general more likely to be based on an ability-to-pay principle, insofar as higher income

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3. With the exceptions of Australia and New Zealand.
4. Between 2000 and 2007 alone the adjusted wage rate in the EU 27 has decreased from 58.5% to 56.4% (Ameco-database).
will be subject to higher tax deductions, while also avoiding the constraint represented by the ceilings normally present in contribution-based systems. As expectations of equivalence are smaller in tax-based systems, redistributional tasks can usually be achieved more easily. This is especially the case in systems based on direct taxes, which are, in general, progressive in nature, characterised by increases in tax rates as the tax base rises.

Unlike direct taxes, indirect taxes, most prominently the value added tax (VAT), tend to be regressive, but they do offer a comparatively easy means of generating a steady flow of revenue, as tax rates are easy to change and small changes in the VAT rate (e.g. one percentage point) can have a large impact on the state of public finances. For a more detailed look at tax-based versus contribution-based financing of social security see Bäcker (2005) and Schmähl (2006).

1.2 Factors influencing social security financing

The financing of social security is influenced by various direct and indirect factors.

As concerns direct effects, cutting taxes and contributions has obvious negative effects on social security financing as less money is likely to be available to fund public tasks. Depending on the method of the reduction, however, there may be positive effects on consumption or employment that will lead to higher revenues. Raising tax and contributions will in most cases have the opposite effect of cuts. After increasing revenue in the short run, rising price and labour-cost levels might lead to a decrease in the demand for both, probably leading to lower revenue in the long run, depending on the practical measure. A third option is the introduction of new forms of revenue, e.g. taxation of wealth or financial transactions, or a broadening of income eligible for social security contribution, as in France, through the Generalized Social Contribution.

Depending on the elasticity of demand and the target of taxation (e.g. consumption, wages, etc.), effects have to be evaluated carefully. For example, an increase in VAT rates to compensate for a decrease in direct taxes is likely to change the impact of taxation.

As economic correlations in general depend on various factors, the indirect effects on social security financing have to be evaluated with care.

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5. There are cases in which no ceilings exist, e.g. in Hungary for public health insurance contributions (Missoc-database).
6. In 1991 France introduced the Generalized Social Contribution (contribution sociale généralisée, CSG) as a means of diversifying the forms of income contributing to social security. The rate for most forms of income is 7.5 per cent, with reduced rates for the unemployed and pensioners and higher rates for some forms of capital gains. In addition, a 0.5 tax on all forms of income (contribution pour le remboursement de la dette sociale, CRDS) has to be paid as a special means of financing the social security debt (Missoc-database, OECD 2010a).
Changes in employment, e.g. a rise in the unemployment rate, are likely to have negative consequences on social security financing, as public revenue will fall because there are fewer people in a position to pay taxes and contributions on their wages. Employment-stabilizing measures, like short-time working schemes, which allow companies to reduce wage costs while refraining from lay-offs, are also likely to be relevant for public revenue: On one hand, they maintain wages and therefore social security contributions; on the other hand, subsidising wages places a burden on public budgets. Another important factor is the result of wage agreements, as evidenced by the fact that decreasing GDP rates and moderately rising wages led to an increase in the wage share in numerous countries in 2009. As a consequence of this development, consumption levels exerted a stabilizing effect on the struggling economies (Schulten 2010).
2 The impact of the crisis on social security financing

2.1 Public revenue before the crisis

On (weighted) European average government revenues in 2007 consisted of 38.0 per cent indirect taxes, 32.9 per cent direct taxes and 29.1 per cent social security contributions. A comparison of government revenue forms shows, because of VAT harmonisation in the EU, rather similar levels of indirect tax quotas. These range between 32.7 per cent in Germany and 40.3 per cent in Hungary. The range between levels of direct taxes is wider (between 25.7 per cent in Hungary and 46.3 per cent in the UK) and levels of social contributions likewise differ quite considerably (between 18.4 per cent in the UK and 38.6 per cent in Germany).

Figure 1 shows the greater relative importance of taxes over contributions in the UK and in Sweden, compared to Austria, Germany and Hungary, as the two former countries have a higher rate of direct taxes among their government revenues. Austria and Germany are more dependent on workforce participation than other countries as social security contribution levels are comparably high.

Figure 1 Distribution of government revenues in 2007

Source: EU Commission (2010b)
2.2 Countermeasures to the economic crisis

The current economic crisis has led into a deep recession, with severe negative effects on GDP growth, public finances and a steep rise in unemployment. Between 2008 and 2009 real GDP in the EU 27 decreased by 4.2 per cent (Ameco-database).

Since the start of the crisis economic stimulus packages adding up to between 1.79 per cent (Watt 2009, 11) and 2 per cent (EU Commission 2009b, 43) of EU GDP, amounting to somewhere between 210 and 235 billion euros, have been raised (including a number of measures already decided upon before the start of the crisis, like the tax reforms in Austria, Denmark and Luxembourg). Stimulus packages vary considerably in their size and design, ranging from an estimated fiscal effect of approximately zero in Hungary to 4.6 per cent of GDP in Spain. On an EU average, the measures were divided almost evenly between expenditure increases and revenue decreases. For more detailed information on this topic see Watt (2009) and OECD (2009).

Many European countries – Hungary, Sweden and the UK among them – introduced a mixed bag of measures. On the one hand, they lowered tax rates and social security contributions, mainly to stimulate (corporate) business and make labour cheaper. On the other hand, they increased the level of excise taxes to secure the inflow of revenues, especially in countries hit hard by the crisis (EU Commission 2009b).

2.2.1 Increase of public spending

Periods of economic downturn are regularly accompanied by falling employment and rising unemployment. Unemployment benefits act as an automatic stabilizer by preventing any sharp or substantial decrease in the income (and therefore consumption) levels of the work force. As the International Social Security Association (ISSA) has pointed out, countries with comprehensive social security systems in place were able to use them as a social buffer and stabilizer (ISSA 2010, 40).

Several of the discretionary measures that were implemented increased public spending, with labour market packages the most prominent of the stabilisers with social policy relevance.

Since 2008 Austria has adopted two labour market policy packages. They were aimed at keeping employment high by facilitating access to (already existing) short-time working schemes. In Germany too, among other measures targeting the labour market, existing short-time working schemes were modified to fit the new situation. Eligibility criteria, for example, were relaxed.
and the maximum duration was increased to 24 months. A large number of measures intended to increase labour market integration were approved in Sweden, including raised subsidies for employers hiring people with reduced work capacity. The United Kingdom invested a total of 1.5 billion € in support for the increasing number of unemployed. The crisis management of the Hungarian government, meanwhile, foresaw no increased public spending measures (Council of the EU 2009, 20).

2.2.2 Decrease of public revenues

The rise of unemployment throughout the crisis and the negative developments in the orders situation in the business sector led to a decline in social contributions and the erosion of personal and corporate income tax bases. As a result, public revenues decreased significantly between 2008 and 2009 (see below).

Employment too saw a steep drop between 2008 and 2009 in all the countries examined here, with the exceptions of Germany and Austria (Figure 2). Germany experienced the least negative impact of the countries under consideration as the unemployment rate rose only very slightly, and it was the only one of these countries that simultaneously experienced an increase in employment. Austria too saw its employment rate remain rather stable despite a (comparatively small) increase in the unemployment rate. A large increase in unemployment occurred in Hungary, the UK and Sweden, which also saw the most severe decrease in employment. The fact that the fall in employment rates appears not to correlate with the increase in unemployment rates is attributable to the fact that they depend on different assessment bases.

Figure 2 Change in employment and unemployment rates 2008 to 2009

![Figure 2](image-url)

Source: Eurostat, own calculations
Germany (as well as, for example, Belgium and the Netherlands) (Dublin Foundation 2009) and to a lesser extent Austria (Bock-Schappelwein et al. 2011) successfully employed short-time working schemes to avoid massive layoffs. This was especially important for social security financing as social contributions did not suffer (as much) as in other countries, thus keeping public revenue afloat (Ganßmann et al. 2009).

As can be seen in Figure 3, social contributions fell only slightly in 2009 in Austria and Germany, while decreasing by more than 10 per cent in Sweden and the UK. Hungary’s negative development can also be partly traced towards the social VAT reform (see below).

To turn now to **discretionary measures adopted** as a consequence of the crisis, tax cuts and business-friendly depreciation rules were approved all over the EU, in some cases for a temporary period only. The Austrian tax reform of 2009 included a tax reduction for high income earners as well as a lowering of the marginal tax rates applicable to personal income tax from 42.6 per cent to 42.2 per cent and from 38.3 per cent to 36.5 per cent. The 2009 German tax reform followed a few of the same paths as the Austrian reform, while also including improved depreciation of health- and long-term care insurance contributions, as well as an increase of child benefits and child tax allowances.\(^9\) Tax reform in Hungary included a reduction of the employer’s social security contributions (5 percentage points), various tax relief measures, such as a decrease of marginal personal income tax rates from 18 per cent to 17 per cent and from 36 per cent to 32 per cent, putting an end to the 4 per cent solidarity tax on high personal

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9. The German tax reform of 2008 that focused on improving the economic prospects of businesses was agreed on in 2007 and will therefore not be regarded as part of the anti-crisis steering measures.
(and also corporate) income. While reducing the cost of labour, Hungary simultaneously increased its excise taxes and the general VAT rate from 20 to 25 per cent. In introducing a so-called “social VAT reform”, it cancelled out any short-run growth-enhancing effects of the income tax cut (OECD 2010b, 27).

In Sweden social security contributions for employees and the self-employed were reduced by one percentage point, while the lower income tax bracket for taxation by the central government was widened and the in-work tax credit was increased. In the United Kingdom the standard VAT rate was temporarily cut from 17.5 per cent to 15 per cent (from 1 December 2008 to the end of 2009), while the personal tax allowance was increased for persons under 65 with an annual income of less than 100,000 GBP (EU Commission 2009a).

2.3 Wage developments

As inflation was down in 2009 because of the price development of raw materials and energy as well as a generally weak economy leading to weak consumption, the EU-wide inflation rate sank from 3.7% in 2008 to 1.0% in 2009. Together with a drop in productivity per worker, as a consequence of a reduction of hours worked (use of working time accounts, short-time working schemes, orders situation, etc.), the margin for distribution for collectively agreed wages decreased by 1.1 per cent in the EU 27 (Schulten 2010, 198). This resulted in a considerable increase in inflation-adjusted official wages, leading to a remarkable rise in the wage rate in 2009 in all countries examined here with the single exception of Hungary. As Schulten points out, a rise of this magnitude is typical for times of economic crisis, as it is anti-cyclical and will give way to a decrease as early as 2010, as can be seen in Figure 4.

Figure 4 Yearly changes in the wage rate in percent

![Figure 4](image_url)

Source: Ameco, own calculations.

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10. The term “social VAT reform” refers to the fact that cuts in social security contributions were financed by increasing the VAT rate. (OECD 2010b, 28).
The development of actual wages can differ considerably from collectively agreed wages\textsuperscript{11}. Despite this, the above-mentioned high collectively agreed rates of pay led to increases in actual wages that exceeded the margin of productivity in all of the examined countries except Hungary in 2009, thus favouring countries like Austria and Germany that are dependent on wages to step up the financing of their social systems. Towards 2010 inflation-adjusted wage raises slowed down, however, with social partners concentrating instead on measures to secure employment (Schulten 2010).

### 2.4 Deficit development and the need for consolidation

Re-establishing financial order and balance after spending a huge amount of resources to stabilize the economy throughout the crisis became the focal point of governments in Europe in 2010. While numerous financial measures were directed at a reduction of public expenditure, several changes targeted consolidation through an increase in revenue.

As a consequence of rising budget deficits\textsuperscript{12} in the aftermath of the efforts to rescue the economy, the OECD advised countries to prepare for fiscal consolidation in 2011 at the latest (OECD 2010c). Many EU countries responded by announcing and implementing austerity measures as early as spring 2010.

Austria did not present its consolidation plans until October 2010, which allowed it to go for a scaled-down austerity package, as by that time global economic conditions were already showing improvement. The total volume of Austrian consolidation is forecast to be 0.6 per cent of GDP in 2011, rising to 1.1 per cent in 2014, with 40 per cent of it agreed to come from additional revenues, including tax increases on foundations, capital gains, tobacco and petroleum. (AK Wien 2010)

Germany’s consolidation plans feature deficit cuts totalling 81.6 billion Euros (3.3 per cent of German GDP 2009) until 2014 but with few plans for additional revenue. While cuts include contributions from corporations, the armed forces and spending reductions in the public sector, including pay cuts of 2.5 per cent in 2011, 30.3 billion euros (37 per cent) of the total of the auxiliary programme were to be contributed by the social sector. The Federal Employment Agency is expected to reduce expenses by 10 billion euros by 2014, while central government contributions to social security are to be cut by 6 billion euros in total. Among the tax-raising measures it is worth mentioning a bank levy and an aviation fuel tax (10 billion euros in total) (German Federal Government 2010).

\textsuperscript{11} Among the reasons for the difference are widely varying tariff commitments, the expansion of short-time working schemes and a decrease in overtime hours because of the orders situation during the crisis (Schulten 2010).

\textsuperscript{12} Public deficits rose between 0.7 per cent in Hungary and 6.4 per cent in the UK in 2009 (source: Ameco-database).
After electing a right-of-centre government in 2010, cash-strapped Hungary deleted the higher income tax bracket of 32 per cent while introducing a flat-rate tax of 16 per cent for all personal income, reducing the corporate income tax rate for small and medium-sized enterprises from 19 to 10 per cent and cutting wages in the public sector by 15 per cent. Furthermore, a bank levy was introduced, scheduled as a temporary measure (for three years) and expected to raise 700 billion euros in 2010 (Financial Times, 8 July 2010). In October 2010 a so-called “crisis-tax” on the retail, energy and telecom sectors was introduced. Later that year the government resolved to seize the mandatory private pension system and add the funds (approximately 10 billion Euros) to the budget to retain financial flexibility despite the tax cuts (Financial Times, 14 December 2010).

Sweden did not issue an austerity package to finance the consequences of the crisis, as the economic recovery was stronger than expected in Sweden in early 2010, according to the Swedish National Debt Offices forecast (Riksgälden 2010, 2). In the end, GDP grew by 5.5 per cent in 2010, the highest rate in the EU. As a consequence, the central government deficit was 0.5 per cent in 2010, with a surplus of 0.1 per cent projected for 2011 despite a rather severe drop in public revenue (see above). Because of this privileged situation Sweden was able to issue a budget for 2011 that includes offensive measures to increase employment, while raising the in-work tax credit. At the same time, a one-percentage-point reduction of social security contributions for employers and the self-employed was introduced. Income tax reductions for pensioners and people below 26 were also decided (EU Commission 2010a).

Early austerity measures in the United Kingdom included raising excise duty (on alcohol and tobacco), in addition to an extra level of marginal income tax (50 per cent) for annual income of over 150,000 GBP (168,345 €), starting in April 2010. In addition, employers, employees and the self-employed have had their national insurance contributions raised by 0.5 percentage points since April 2011 (EU Commission 2009a). In 2010 an increase in the capital gains tax was implemented, up to a maximum of 28 per cent, while the standard VAT rate will increase to 20 per cent in 2011 (EU Commission 2010a). The UK is the only one of the countries considered here that announced major cuts in public sector employment, the goal being to shed 490,000 public servants, roughly 10 per cent of total employment in the public sector (ETUC 2010).

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13. In November 2008 the International Monetary Fund (IMF) approved a 15.7 billion USD (then approximately 12 billion Euro) loan for Hungary as part of a programme that was designed to ease financial market stress in Hungary (IMF 2008). In early June 2010 the Hungarian government accused its predecessor of falsifying previous years’ budget numbers. This was thought to be an attempt to gain greater leeway from the IMF to increase the country’s budget deficit in 2010 to more than 3.8 per cent, a condition that had been imposed by the Fund in 2008 (Handelsblatt, June 9th 2010).
14. The lower income tax bracket in Hungary was previously 17 per cent.
15. About 0.77 per cent of Hungarian GDP (2009).
3. Consequences for social security financing

3.1 Development of government revenue

Between 2008 and 2009 government revenue shrunk by 6.9 per cent in the EU27. While Austria and Germany experienced a rather slight drop of 2.0 and 2.1 per cent respectively, Hungary (10.7 per cent), Sweden (12.4 per cent) and particularly the UK (18.2 per cent) suffered decreases far more severe than the EU on average.

![Yearly changes in private consumption in percent](image)

Source: Ameco, own calculations.

The large differences in private consumption developments have to be highlighted when searching for further reasons for this development. In many countries taxes and contribution levels were reduced during the crisis to increase aggregate demand, leading to very different results. As can be seen in Figure 5, private consumption growth remained positive in Austria and fell only very slightly in Germany between 2008 and 2009. As a consequence, VAT revenue remained stable, as net disposable income dropped only slightly in those countries, probably not least because of the stable employment situation (see

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17. Net disposable household income dropped by 0.8 per cent in Austria in 2009, by 1.0 per cent in Germany and 1.6 per cent in the EU27 on average. In Sweden the drop was 6.6 per cent, in Hungary 11.6 per cent. At the time of writing no data was available for the UK for 2009. Already between 2008 and 2009, however, the United Kingdom saw net disposable household income decrease by 10.2 per cent (source: Ameco database).
above). Levels in Hungary and Sweden fell in 2009, while the UK saw a decrease as early as 2008. While all three countries managed to recover between 2009 and 2010 and returned to positive growth rates, only Sweden was able by then to reach and surpass the private consumption levels of 2008.

When comparing the – mainly crisis-related – changes in government revenue by contribution between 2008 and 2009 (Figure 6), a drop in direct tax revenue can be seen in all of the countries examined here, since personal and corporate income fell right across Europe. While the level of indirect taxes and social contributions stayed rather constant in Austria and Germany, Hungary and Sweden experienced decreases of more than 15 per cent and the UK a decrease of about 12 per cent in social contribution revenue. The UK also saw its income from indirect taxes shrink by as much as 16 per cent, by far the most severe decrease in the sample, with Sweden’s (-9 per cent) and Hungary’s drop (-8 per cent) also above the EU average of minus 7 per cent.

3.2 Short-run consequences of the economic crisis on social security financing

The economic crisis and the stimulus packages that followed had different consequences for social security financing in the countries considered in our sample. Germany and, to a lesser extent, Austria placed the main focus on employment-stabilizing measures, which helped to keep employment and therefore social contributions steady throughout the crisis. Since both these countries are examples of the corporatist/continental model that depends on
employment for social security financing, it would appear that this system performed better than other European social models. Sweden and the UK, both depending mainly on taxes for social security financing, did not do as well, experiencing severe drops in public revenue as consumption fell – not least because of a considerable drop in employment – reducing indirect tax revenue together with a general decrease in direct tax revenue that occurred in each of the countries in our sample as well as in the EU27 on average (see above). Despite its severe drop in revenue, the Swedish economy recovered quickly following the downturn, because of its steep GDP growth in 2010 (see above). The situation in Hungary is difficult to assess, as the changes that took place there seem to have been driven by the change of government rather than by the economic crisis.

Overall, the dependency on social contributions was slightly reduced in favour of higher VAT rates, while countries were, in general, more likely to go for expenditure reductions than revenue generation.

3.3 Possible long-run consequences

With the exception of Hungary, where changes were due more to political strategy than to the crisis, modifications in the tax/contribution structure were small in the countries of our sample. As paying for the consequences of the crisis began to be a glaring issue in 2009 and 2010, however, trade unions and civil society became increasingly vocal in expressing their massive displeasure at the EU’s lack of commitment towards fairer wealth distribution or the continuing refusal to introduce a Financial Transaction tax to protect its population from the negative effects of financial capitalism (e.g. ETUC 2009). While it is hard to say whether those initiatives will eventually be successful, they are certainly placing policymakers under a great deal of pressure.

As Schulten (2010: 201) points out, wage agreements in excess of the margin of productivity as seen for 2009 came to a halt in 2010. It is therefore very likely that the trend of wage agreements below the productivity margin, that was the norm before the crisis, will continue, thus once again putting more pressure on the corporatist/continental social model. However, the rather successful adaptations throughout the crisis in Austria and Germany seem to have slowed structural reforms in social security financing that might still be necessary in the long run, as overly strong dependency on wage-earners for public revenue places a heavy burden on labour costs (Seils 2009). Despite experiencing a severe drop in public revenue in 2009, Sweden regained its financial stability pretty quickly. Consequently no austerity package was needed and a small budget surplus is already forecast for 2011. Direct changes in social security financing will probably not greatly affect public revenue. After a moderate stimulus programme the UK, suffering severely from the economic crisis, introduced very harsh austerity measures, increasing both tax and contribution rates, while cutting back on almost half a million jobs in the public sector. Changes in Hungary will probably be even sterner as its social financing system was almost completely restructured. In both cases cuts are likely to reduce the funds available for social security, making a possible subsequent new crisis all the more devastating.
Conclusions

In terms of how their social security financing mechanisms proved able to weather the economic crisis, European social models fared quite differently. While corporatist/continental-model countries that managed to maintain steady employment were quite successful at stabilizing public revenues, Sweden – an example of the universal model – experienced a steep drop in revenue, thereby supporting the hypothesis formulated in the introduction that steady employment takes pressure off social security financing by keeping revenue afloat. Even more severe were the consequences in the UK with its Beveridge model system. The new Hungarian government, despite being hit hard by the crisis, made substantial changes to its financing system that might in many instances have aggravated the negative impacts rather than reducing them. The long-term consequences of these changes cannot be fully judged at this time.

It is too early to judge how much social security financing is going to change as a result of the crisis. Adaptations have been made but, depending on the need for further cuts, pressure on political leaders to find new forms of public revenue or – more likely – to cut benefit levels are likely to increase. Given the need to fight increased public deficits, the means of redistribution through the social system are likely to decrease, as less money is now available for this task than before the crisis. A quick return to “business as usual” is certainly out of the question.

Despite the different economic performances during the crisis suggesting social benefits to be an important factor in combating the consequences of the downturn, a possible new equilibrium level of social security benefits seems likely to be lower than the current one. Many European countries such as the UK or Hungary are facing huge public deficits and are planning to reduce them by cutting benefit levels while blaming excessive social spending before the crisis for the current situation. Benefit levels in Sweden or Austria remain rather stable – for the time being, whereas Germany’s consolidation plans include a drastic cut in welfare benefits, despite rather successful recession busting.

As the consequences of the crisis are still distinctly being felt throughout Europe, consolidation is already on the way, endangering still weak economic recovery. The changes made to social security financing – directly or indirectly – have had weakening effects on benefit levels in most cases, as resources have been partly redirected towards deficit reduction, leaving social systems in a debilitated state to cope with future crises.

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18. “We need to address the areas where we have been living beyond our means”, as David Cameron said in the *Sunday Times* of 6 June 2010, representative of numerous other European politicians.
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