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Financing social security in the EU: Business as usual?

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Abstract. *This article assesses how well welfare models with different financing mechanisms cope with a major financial crisis. It focuses on five EU countries, which represent different welfare models. It also analyses how the crisis and the associated stimulus or austerity measures changed financing, revealing a regressive impact. It demonstrates that, in the short- or medium-term, contribution-based social systems have more stable public finances during a recession than tax-based systems. That said, the corporatist/continental welfare model seems most likely to remain stable in the long run, in so far as it focuses on keeping employment – the system's main source of revenue – stable.*

Since 2000 it has become increasingly difficult to finance social security systems. In a world of globalized competition, industrialized countries face increased pressure to reduce wage and tax levels to prevent the flight of capital to countries with more favourable business environments. Social security funding has also been strained by population ageing, tighter public budgets and the spread of non-standard forms of work that generate less social security contributions.[1] Countries that depend on labour market participation as their main source of social security financing have found it especially difficult to maintain adequate funding (Schmähl, 2009, p. 390).

To make matters worse, a consequence of the financial and economic crisis, both GDP and employment have declined significantly throughout Europe since 2008. Dependence on social benefits has markedly increased, while public revenue has fallen, leading to rapidly expanding budget deficits. Many EU

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[1] From 2.4 per cent in the period 1995–2000, the EU's average public deficit declined to 1.7 per cent in the period 2000–07 (see Annual macro-economic database, available at: http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm [accessed 14 August 2012], hereinafter cited as AMECO). And even though employment rose by more than 7.5 per cent in the EU between 2000 and 2007, the increase in full-time equivalent employment was only 4.9 per cent, while part-time jobs grew by 17.7 per cent (European Commission, 2008, p. 29).

countries have changed their tax or social security systems, initially through stimulus packages and then through austerity measures. While such measures have varied across the EU, all of them are likely to have long-term consequences for social security financing.

There have been several recent contributions on the topic of social security financing (e.g. Bäcker, 2005; Püss, Viies and Kerem, 2005; Ganßmann and Himmelreicher, 2009; Schmähl, 2006 and 2009; Seils, 2009). This article, however, looks specifically at how financing has changed during the current crisis, either directly – through changes to tax or contribution rates – or indirectly through changes in revenue resulting from wage agreements, the introduction or extension of short-time working schemes, increased unemployment and reduced profits or consumption.

The main purpose of this article is to assess the ability of variously financed welfare systems to cope with a major financial crisis and find out whether the crisis that began in 2008 has changed the structure of financing systems (through stimulus or austerity packages). The article's hypothesis is that systems funded primarily through contributions are more likely to enjoy stable public financing during a recession than those funded through taxes: governments under the former system will focus on keeping employment stable, because it is their main source of revenue. While this article focuses on the period 2007–11, it also tries to offer insight into likely future developments.

In order to illustrate patterns of change in the EU, this article will compare five countries with different approaches to social security financing, drawing on distinctions made within the welfare state literature (e.g. Esping Andersen, 1990). The United Kingdom will serve as an example of tax-based financing, with its liberal, Beveridge-style welfare model that demands comparatively low levels of contribution and provides only basic social security (Seils, 2009). Sweden will represent the universal/social democratic welfare model, which also relies mainly on taxes but, unlike the United Kingdom, sets higher tax rates and provides a higher level of social security. Austria and Germany will exemplify the corporatist/continental welfare model that provides a rather high level of social security and depends mainly on employment for revenue (through social security contributions and direct taxes). Finally, Hungary will serve as an example of a central eastern European welfare model, with a comparatively well-developed system of social protection but no long-term history of stable tax rates or social security contributions.

The remainder of this article is organized into four sections. The first section reviews some advantages and disadvantages of contribution- and tax-based financing and examines factors that affect social security financing directly and indirectly. The second section looks at the impact of the economic crisis and the countermeasures taken, while the third section examines the consequences for social security financing more closely and considers probable long-term effects. The fourth section concludes with a short summary of the article's major findings.

Means of financing social security

Generally speaking, there are three main sources of public revenue: direct taxes, indirect taxes and social security contributions. Since different methods of financing have different consequences for income distribution and revenue generation, any discussion of social security financing must give special attention to the extent to which a system relies on taxes or social security contributions.

Contribution- and tax-based financing

While most OECD countries rely on both taxes and contributions, the relative importance of each of these sources of revenue varies widely. In the corporatist/continental welfare model of central and western Europe, contribution-based financing is especially important. In these systems, the fiscal equivalence principle dictates that contribution and benefit levels should be closely related. As a consequence, tighter budgets are less likely to result in cuts to benefit levels than they are under tax-based systems (Bäcker, 2005, p. 359). Also, as the connection between social benefits and contributions is fairly clear and as payment levels are often capped, public resistance to the tax wedge is likely to be lower.

Nonetheless, several challenges to contribution-based systems have emerged over recent decades. A primary concern is the inadequate financing of social benefits. Changes in the labour market have placed considerable pressure on these systems, as wages liable to contribution have steadily decreased.[2] Another concern arises when services, such as active labour market policies, are financed through social contributions but do not target contributors specifically. In this case, they are likely to have a negative economic impact by increasing the cost of labour relative to capital and thus making it more likely that capital-intensive forms of production will be adopted to reduce labour costs. Furthermore, by undermining the fiscal equivalence principle, they also reduce public acceptance of social security contributions (Schmähl, 2006). In such cases, tax-based financing offers a possible alternative.

Tax-based social security systems are more likely to be based on the ability-to-pay principle, with higher incomes taxed at a higher rate. They thus avoid the constraint to revenues presented by contribution ceilings.[3] As there are lower expectations of equivalence in these systems, redistribution is usually easier to achieve. This is especially true in systems based on direct taxation, which are generally more progressive, precisely because they tax higher incomes at a higher tax rate.

[2] Between 2000 and 2007, the adjusted wage share decreased from 58.5 to 56.4 per cent of the GDP in the EU27 (see AMECO).

[3] Though there are cases where no ceilings exist, as is the case, for example, with the public health insurance contributions in Hungary. See Mutual Information System on Social Protection (MISSOC), European Commission Directorate General for Employment, Social Affairs and Inclusion. Available at: http://ec.europa.eu/employment_social/missoc/db/public/compareTables.do?lang=en [accessed 14 August 2012].

By contrast, indirect taxes, such as value added tax (VAT), tend to be regressive, but they offer a comparatively easy means of generating a steady flow of revenue, because tax rates are easy to change and small changes in the VAT rate (e.g. 1 percentage point) can have a large impact on public finances. For a more detailed comparison of tax- and contribution-based financing, see Bäcker (2005) and Schmähl (2006).

Factors influencing social security financing

The financing of social security is influenced by several direct and indirect factors. Direct factors include changes to tax or contribution rates or the introduction of new forms of revenue generation. The effects of such changes must be carefully evaluated, taking into account the elasticity of demand and the target of taxation (e.g. consumption, wages, etc.). For example, if VAT rates are increased to compensate for lower direct taxes, this will likely change the impact of taxation, by reducing redistribution or altering consumption levels. Cutting taxes or contributions obviously reduces public revenues and thus poses a challenge for social security financing. However, depending on the exact measures taken, there may be positive effects on consumption or employment that will eventually generate higher revenues. Likewise, raising taxes and contributions is likely to increase public revenues. But again, if the measures taken alter prices or labour costs, they could reduce consumption or employment and therefore reduce revenue in the long run. Finally, new forms of revenue generation can be introduced, such as the taxation of wealth or financial transactions, or a broadening of the range of income eligible for social security contributions, as seen in France's 1991 introduction of the "Generalized Social Contribution" (CSG).[4]

Indirect factors may also influence social security financing, and these too must be evaluated with care. For instance, reduced employment or increased unemployment will strain social security financing, as fewer people will be able to pay taxes and contributions on their wages. Employment-stabilizing measures, such as the short-time working schemes that allow companies to reduce wage costs and avoid lay-offs, are also likely to affect public revenues: on the one hand, they maintain wages and therefore social security contributions, while, on the other, government subsidization of wages places a burden on the budget. Another important indirect factor results from wage agreements. For example, in 2009, negative GDP growth and moderately rising wages led to an increase in the wage share in several countries. As a consequence, consumption levels helped stabilize the struggling economies (Schulten, 2010).

[4] For most forms of income, the CSG tax rate was set at 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 per cent tax on all forms of income was introduced as a special "Contribution for the Reimbursement of the Social Security Debt" (MISSOC; OECD, 2010a).

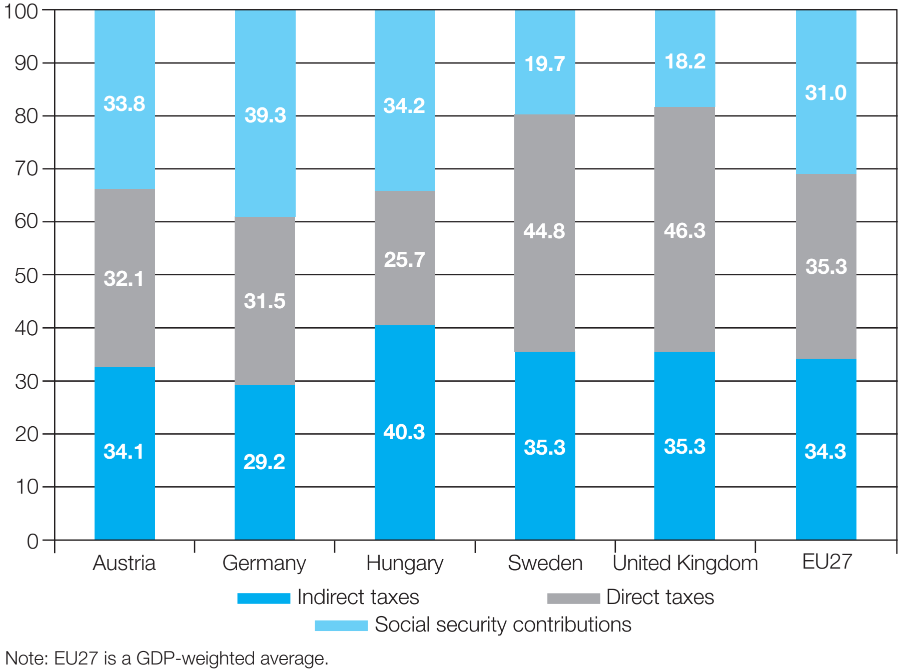
The impact of the crisis on social security financing

Public revenue before the crisis

In 2007, 34.3 per cent of government revenues in the EU27 came from indirect taxes, 35.3 per cent from direct taxes and 31.0 per cent from social security contributions (see figure 1). A cross-country comparison of these sources of revenue shows rather similar levels of reliance on indirect taxes, ranging from 29.2 per cent of total revenue in Germany to 40.3 per cent in Hungary. The relative importance of direct taxes varied more widely (between 25.7 per cent in Hungary and 46.3 per cent in the United Kingdom), as did that of social security contributions (between 18.2 per cent in the United Kingdom and 39.3 per cent in Germany).

Of the countries compared, the United Kingdom and Sweden are those that relied most heavily on taxes as opposed to contributions, with direct taxes making up a particularly large percentage of their government revenues. Austria and Germany's relatively strong reliance on social security contributions shows that these countries were comparatively more dependent on labour force participation.

Figure 1. Structure of government revenues before the crisis, 2007 (percentages)



Note: EU27 is a GDP-weighted average.
Source: Author's calculations based on EU Commission (2012).

Initial countermeasures to the economic crisis

The current economic crisis led to a deep recession between 2008 and 2009 with severe negative effects on public finances and unemployment as real GDP contracted by 4.2 per cent in the EU27 (AMECO). In response, economic stimulus packages totalled between 1.79 and 2 per cent of the EU's GDP or roughly 210 to 235 billion euros.[5] The size and design of stimulus packages varied considerably, with estimated fiscal effects ranging from approximately zero in Hungary to 4.6 per cent of GDP in Spain. On average, the countermeasures adopted across the EU were divided almost evenly between increased expenditure and decreased revenue (for more detail, see Watt, 2009; OECD, 2009).

Many European countries – Hungary, Sweden and the United Kingdom among them – introduced a mixed bag of measures. On the one hand, they lowered tax rates and social security contributions, mainly to stimulate business and reduce the cost of labour. On the other hand, they increased excise taxes to secure revenue inflow, especially in countries hit hard by the crisis (European Commission, 2010).

Increased public spending

Periods of economic downturn are regularly accompanied by falling employment and rising unemployment. Unemployment benefits act as automatic stabilizers by preventing excessively sharp reductions in workers' income and consumption levels.[6] As the International Social Security Association pointed out, countries with comprehensive social security systems in place were able to use them as a social buffer and stabilizer (ISSA, 2010, p. 40).

Several of the measures that were implemented increased public spending, with labour market packages the most prominent stabilizer relevant to social policy. For a more detailed examination of stimulus measures, see Stiglitz (2009) and Torres (2010).

Reduced public revenues

As the crisis unfolded, rising unemployment coupled with declining demand for goods and services eroded the personal and corporate income tax base and led to a decline in social security contributions. As a result, public revenues decreased significantly between 2008 and 2009.

Germany and, to a lesser extent, Austria stabilized employment by using short-time working schemes to avoid massive lay-offs (Eurofound, 2009; Bock-Schappelwein, Mahringer and Rückert, 2011).[7] This was especially important

[5] Author's calculations using 2009 GDP from AMECO and including a number of measures that were decided upon before the crisis began, such as tax reforms in Austria, Denmark and Luxembourg. See also, Watt (2009, p. 11) and European Commission (2009b, p. 43).

[6] However, it should be noted that not everyone who loses their job is eligible for unemployment benefits.

[7] Belgium and the Netherlands also used such schemes to stabilize employment.

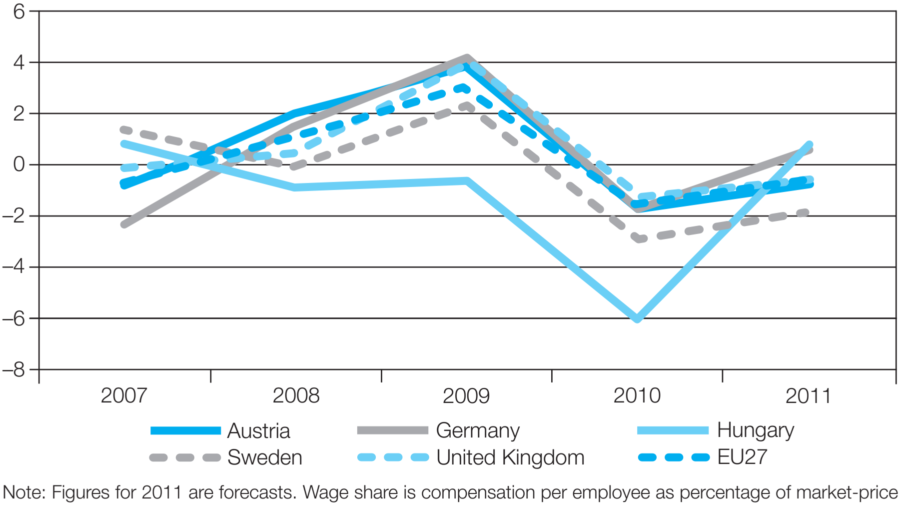
for social security financing because it mitigated the impact of the crisis on social security contributions and helped to sustain public revenues (Ganßmann and Himmelreicher, 2009).

Wage developments

Between 2008 and 2009, the inflation rate in the EU fell from 3.7 to 1.0 per cent, largely because of weak consumption and falling energy and commodity prices. Labour productivity also dropped because of the falling number of hours worked (on account of short-time working schemes, the use of working time accounts, reduced demand, etc.). Thus, the sum growth in inflation and labour productivity was actually negative, falling by 1.1 per cent in the EU27 (Schulten, 2010, p. 198). This resulted in a considerable increase in agreed wage levels in 2009 in all EU countries except Hungary (see also de Beer in this special issue). As Schulten points out, because wage policy is tied to medium-term, not short-term, trends in productivity and inflation, it acts countercyclically; the increase observed in 2009 is typical of an economic crisis and will usually later give way to a decrease, as it did in 2010 (see figure 2).

Actual earnings can differ considerably from collectively agreed wages because of wide variation in wage-scale commitments, the expansion of short-time work schemes and a decrease in overtime hours due to lowered demand (Schulten, 2010). Nonetheless, the high level of real wages collectively agreed in 2009 led to earnings growth that exceeded that of labour productivity in all of the countries considered here except Hungary. This trend favoured countries such as Austria and Germany, which are dependent on wages for social

Figure 2. Annual changes in the wage share, 2007–11 (percentages)



Note: Figures for 2011 are forecasts. Wage share is compensation per employee as percentage of market-price GDP per person employed.

Source: Author's calculations based on AMECO.

security financing. Towards 2010, however, inflation-adjusted wage increases slowed as the focus of collective bargaining shifted to measures to secure employment (ibid.). A further slowdown was expected for 2011; such a decrease in real wages will likely have a negative impact on social security financing and the economic recovery (Schulten, 2011).

Widening deficits and fiscal consolidation

In 2010, following the huge stimulus packages, re-establishing financial order and balance became a focal point of European governments. Because of rising budget deficits, the OECD advised countries to prepare for fiscal consolidation by 2011 at the latest (OECD, 2010b).[8] Many EU countries responded by announcing and implementing austerity measures as early as Spring 2010. While several measures targeted public spending cuts, others sought increased revenues.

Austria's fiscal consolidation plan aimed to decrease the general government deficit from 4.6 to 1.9 per cent of GDP between 2010 and 2013, and forecast a balanced budget for 2016 (Austria, 2012). Of Austria's overall fiscal consolidation target of 26.5 billion euros between 2012 and 2016, 40 per cent was to come from additional revenues, including tax increases on foundations and capital gains. A hiring freeze for parts of civil service was also agreed (Austrian Federal Chancellery, 2011).

Germany's fiscal consolidation plans featured deficit cuts totalling 81.6 billion euros by 2014 (or 3.3 per cent of Germany's 2009 GDP) and forecast a balanced budget by 2016 at the latest (German Federal Ministry of Finance, 2012). There was little emphasis on increasing revenue, with a few exceptions including a bank levy and an aviation fuel tax, which were to produce a total of 10 billion euros (Germany, 2010). Meanwhile, spending cuts targeted the armed forces budget and the public sector, including a pay cut of 2.5 per cent in 2011. Some 37 per cent (or 30.3 billion euros) of overall savings was to come from reduced social spending. In particular, the Federal Employment Agency was expected to reduce expenses by 10 billion euros by 2014, while central government contributions to social security were to be cut by a total of 6 billion euros.

After electing a right-of-centre government in 2010, cash-strapped Hungary[9] removed the higher income tax bracket (32 per cent) and introduced a flat-rate tax of 16 per cent for all personal income.[10] It also reduced corpor-

[8] In 2009, public deficits rose between 0.7 percentage points in Hungary and 6.4 percentage points in the United Kingdom (AMECO).

[9] In November 2008, the IMF approved a US$15.7 billion loan (then approximately 12 billion euros) for Hungary as part of a programme designed to ease financial market stress in the country (IMF, 2008). In early June 2010, the Hungarian Government accused its predecessor of falsifying budget numbers from previous years. This was thought to be an attempt to gain greater leeway from the IMF to increase the country's budget deficit in 2010 above 3.8 per cent, a condition that had been imposed by the Fund in 2008 (Menzel, 2010).

[10] The lower income tax bracket in Hungary had been 17 per cent.

ate income taxes for small and medium-sized enterprises from 19 to 10 per cent and cut wages in the public sector by 15 per cent. Furthermore, a bank levy was introduced as a temporary measure to last for three years; this was expected to raise 700 million euros in 2010, equivalent to about 0.77 per cent of the 2009 GDP (Bryant, 2010). In October 2010, a so-called “crisis tax” was introduced on the retail, energy and telecom industries. Later that year, the Government decided to seize assets held in the mandatory private pension funds (approximately 10 billion euros) and add them to the general budget to retain financial flexibility despite tax cuts (Bryant and Cienski, 2010). By late 2011, Hungary was (again) asking for financial aid from the IMF and the EU, as the abovementioned reforms did not appear to enhance economic growth as hoped (Reuters, 2011). Hungary’s fiscal convergence programme of 2011 aimed for a deficit reduction of 3.1 percentage points by 2015, down from 4.6 per cent in 2009 (Hungary, 2012).

Sweden did not have to adopt an austerity package, because its economic recovery was stronger than expected in early 2010. In 2010, its GDP grew by 5.5 per cent, the highest rate in the EU. As a consequence, despite the rather severe drop in revenues in 2009,[11] the country’s public finances were nearly balanced by 2010 and a budget surplus was achieved in 2011 (Sweden, 2012). Because of this privileged position, Sweden was able to include aggressive measures to increase employment in its 2011 budget and to increase the in-work tax credit. At the same time, social security contributions were reduced by 1 percentage point for employers and the self-employed, while income taxes were reduced for pensioners and people under the age of 26 (European Commission, 2010).

Of the five countries considered here, the drop in output and public revenue was by far the most severe in the United Kingdom, whose public deficit reached 11.5 per cent of GDP in 2009. In the United Kingdom, fiscal consolidation plans featured a deficit reduction of 7.1 percentage points by 2014 (HM Treasury, 2012). Early austerity measures included raising excise taxes on alcohol and tobacco and introducing an extra income tax bracket for annual income above GBP 150,000 (168,345 euros) to be taxed at 50 per cent starting in April 2010. In addition, from April 2011, employers, employees and the self-employed were to increase their national insurance contributions by 0.5 per cent (European Commission, 2009a). In 2010, an increase in the capital gains tax was implemented, up to a ceiling of 28 per cent, and in 2011 the standard VAT rate was increased to 20 per cent (European Commission, 2010). The United Kingdom was the only country considered here to announce major cuts in public sector employment, with a goal of shedding 490,000 jobs or roughly 10 per cent of the total (ETUC, 2010).[12]

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[11] Sweden ran a budget deficit of 0.7 per cent of GDP in 2009, after surpluses of 3.6 per cent in 2007 and 2.2 per cent in 2008.

[12] In its November 2011 forecast, the Office for Budget Responsibility argued that public-sector employment in the United Kingdom is likely to fall by up to 710,000 jobs by 2017, as further cuts were announced for the years 2016 and 2017 (OBR, 2011).

Consequences for social security financing

Government revenue trends

Between 2007 and 2011, real government revenue shrank by an average of 7.7 per cent in the EU27. Austria and Germany managed to increase real revenue slightly (+1.3 per cent each), while Sweden and Hungary experienced only slight drops of 0.8 and 2.0 per cent respectively, which in Hungary's case was the result of the abovementioned seizure of mandatory private pension funds.[13] In the United Kingdom, however, revenue declined by more than a quarter (–26.7 per cent), a figure far worse than the EU average.

Revenue from taxes and social security contributions also changed between 2007 and 2011 (see figure 3). Real revenue from direct taxes decreased in all countries in the sample, as well as in the EU as a whole. It decreased most severely in Hungary (–48.1 per cent) and the United Kingdom (–30.0 per cent). Real revenue from social security contributions also significantly declined in the United Kingdom (–23.5 per cent). In contrast, Austria, Germany and Sweden were able to increase their revenue from indirect taxes and, in the first two countries, from social security contributions as well.[14]

Employment and unemployment rates play a major role in explaining the changes in social security finances. Between 2007 and 2011, Germany, and to a lesser extent, Austria were the only countries in the sample to experience a decrease of unemployment and an increase in employment (see figure 4). This helped stabilize or, in Germany's case, even expand public revenues. Sweden saw rising unemployment (+1.4 percentage points) but relatively stable employment. The United Kingdom and, to a greater extent, Hungary faced significantly higher unemployment and lower employment in 2011 than they had in the pre-crisis period; these developments put additional pressure on these countries' already weakened public finances and will have to be compensated for.

Large cross-national differences in the evolution of private consumption also decisively affected government revenue. In many countries taxes and contribution rates were reduced during the crisis to increase aggregate demand, leading to varied outcomes. As shown in figure 5, private consumption did not contract in either Austria or Germany for the period 2007–11;[15] as a consequence, VAT revenue remained stable even though VAT rates were not increased (in contrast with countries that increased VAT rates as part of their austerity plans). Net disposable income dropped only slightly in these two countries, not least because of their stable employment situation.[16] In

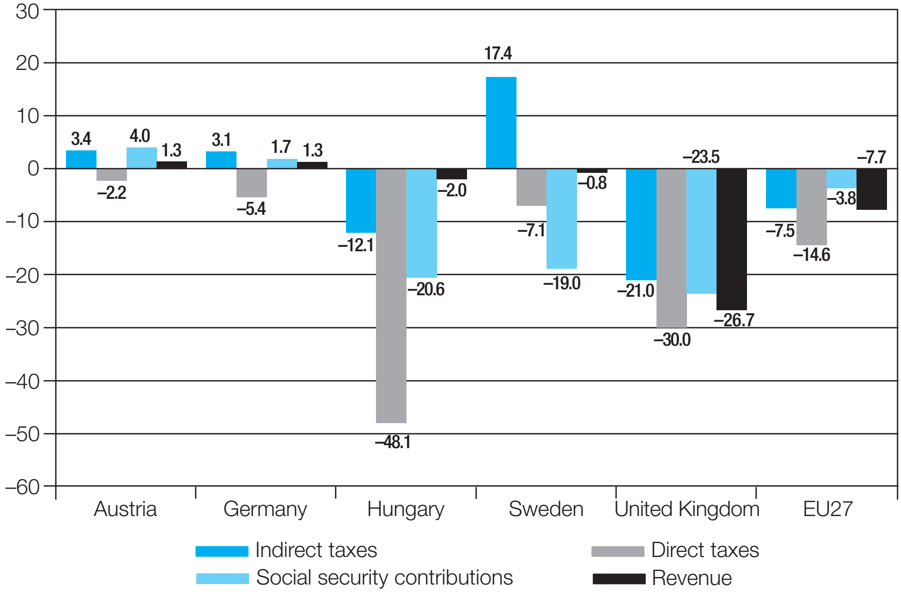
[13] Without the seized funds (roughly10 billion euros), real revenue in Hungary would have fallen by approximately 20 per cent between 2007 and 2011 (based on author's calculations).

[14] Author's calculations based on AMECO and Eurostat. See Eurostat, available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes [accessed 14 August 2012].

[15] However, private consumption did not grow in Germany in 2009.

[16] In 2009, net disposable household income dropped by 0.7 per cent in Germany, 1.1 per cent in Austria and 2.2 per cent in the EU27 on average. In Sweden the drop was 6.1 per cent; in the United Kingdom, 8.6 per cent; and in Hungary, 11.0 per cent (AMECO).

Figure 3. Total change in the structure of real government revenues, 2007–11 (percentages)

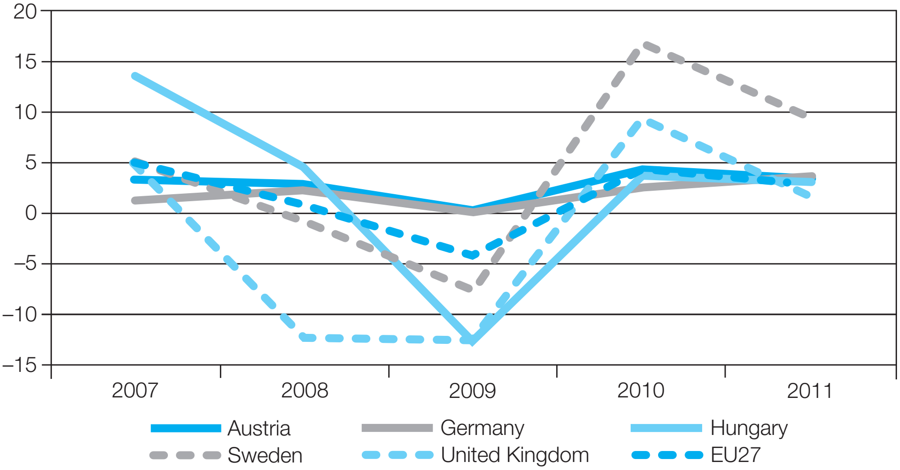


Note: Total revenue also takes into account other sources, such as loans in the case of Hungary.
Source: Author's calculations based on AMECO; Eurostat.

Figure 4. Total change in employment and unemployment rates, 2007–11 (percentage points)

Source: Author's calculations based on Eurostat.

Figure 5. Annual changes in private consumption, 2007–11 (percentages)



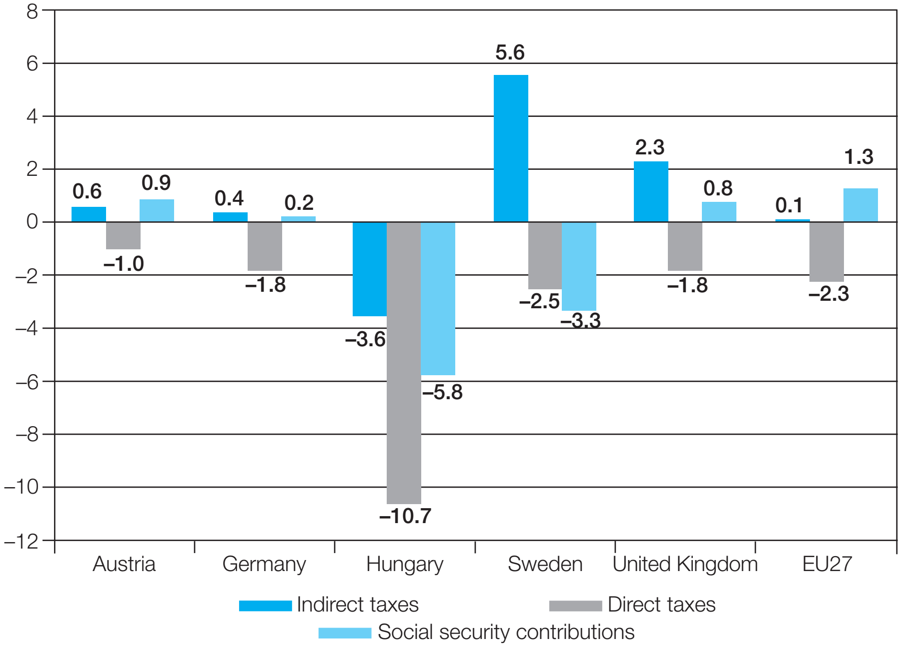
Note: Figures for 2011 are forecasts.
Source: Author's calculations based on AMECO.

Hungary and Sweden, private consumption fell in 2009; in the United Kingdom, it declined as early as 2008. In all three of these countries, private consumption recovered and returned to positive growth rates between 2009 and 2010 (seen most clearly in Sweden). However, in Hungary and the United Kingdom, it was not until 2011 that levels of private consumption surpassed the levels of 2007.

Short-term consequences of the economic crisis for social security financing

The economic crisis and the countermeasures that followed had different consequences for social security financing in the countries in the sample considered here. Germany and, to a lesser extent, Austria focused mainly on employment-stabilizing measures, which helped keep employment, and therefore social security contributions, stable throughout the period. Since both these countries are examples of the corporatist/continental model, which depends on employment for social security financing, it would appear that this model outperformed its European counterparts during the crisis. Sweden and the United Kingdom, both of which depended mainly on taxes for social security financing, did not do as well. They experienced a severe contraction of public revenue as consumption fell in 2009 – not least because of a considerable drop in employment that reduced revenue not only from social security contributions but also from direct taxes (see figure 6). Despite a severe drop in revenue, the Swedish economy quickly recovered, with strong GDP growth in 2010. 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 the economic crisis.

Figure 6. Total change in the structure of real government revenues, 2007–11 (percentage points)



Source: Author's calculations based on AMECO.

The distributional effects of crisis-related measures are clearly across the EU as a whole. In each of the five countries considered here indirect taxes and social security contributions made up a larger share of government revenues in 2011 than before the crisis.[17] All the while, the earlier cuts in personal and corporate taxes, made to counter the effects of the crisis in 2008 and 2009, led to a decrease in revenue from direct taxes that was not (fully) compensated by the austerity measures that followed (figures 3 and 6). Together, these changes led to a situation where social security financing resulted in lower levels of redistribution in 2011 than it had in 2007. Overall, countries were more likely to rely on expenditure reductions – including social benefit cuts – than to pursue revenue generation.

Possible long-term consequences

As the glaring problem of paying for the consequences of the crisis gained notice in 2009 and 2010, trade unions and civil society became increasingly vocal in expressing displeasure at the EU's lack of commitment to fairer wealth distribution and its continuing refusal to introduce a financial transaction tax to protect its population from the negative effects of financial capitalism

[17] Except in Sweden, where social security contributions fell more than direct tax revenue.

(e.g. ETUC, 2009). While it is still hard to say whether those initiatives will eventually succeed, they are certainly putting a great deal of pressure on policy-makers.

As Schulten (2010, p. 201) has pointed out, collectively agreed wages no longer exceeded inflation and productivity growth in 2010 (as they had in 2009). Early data for 2011 showed that collectively agreed wages would likely return to the pre-crisis norm of being below the productivity margin and would thus once again put pressure on the corporatist/continental welfare model. However, Austria and Germany's rather successful adaptations throughout the crisis seem to have slowed structural reform of their social security financing, though such reform may still be necessary in the long run because strong dependence on wage earners for public revenue places a heavy burden on labour costs (Seils, 2009). As mentioned above, public finances in Sweden recovered fairly quickly, reaching a budget surplus in 2011, and, consequently, the country did not need to implement an austerity package. After a moderate stimulus programme, the United Kingdom, suffering severely from the economic crisis, introduced very harsh austerity measures, increasing both tax and contribution rates, while cutting at least half a million jobs in the public sector. The effect of the changes introduced in Hungary will probably prove even more severe as its social financing system was almost completely restructured. In both cases, cuts are likely to reduce the funds available for social security, making any subsequent crisis all the more devastating.

Conclusions

The financing mechanisms of European welfare models have been weathering the economic crisis quite differently. Countries that followed the corporatist/continental model and that managed to maintain (or even increase) employment rates have been quite successful at stabilizing public revenues in the short run but might be headed for trouble in the long run as dependence on wage earners gives rise to high labour costs, placing a heavy burden on the economy.

Sweden – an example of the universal/social democratic model – experienced a steep drop in revenue, thereby supporting this article's hypothesis that steady employment takes pressure off social security financing by sustaining revenue. In the long run, however, the drop in revenue experienced in 2009 may not be much more than a "bump in the road", given that Sweden's economy quickly recovered, its public finances are again solid and employment levels are stable. However, the increase in unemployment will need to be addressed to ensure sustained social and economic development.

The immediate consequences of the crisis were more severe in the United Kingdom with its liberal, Beveridge-style model. High dependency on the financial service sector for growth and low levels of social protection did little to stabilize the country's economy. Consequently, the United Kingdom was hit the hardest of the five countries studied here and accordingly implemented a severe austerity programme, with major cuts in social benefits. It is likely that this will make the country even more vulnerable to any future crisis.

Despite being hit hard by the crisis, Hungary made substantial changes to its financing system that, in many instances, seem to have aggravated the negative effects of the crisis rather than mitigating them. The long-term consequences of these changes cannot yet be fully evaluated.

While it is still too early to pass a final judgement on how much social security financing will change as a result of the crisis, the adjustments made so far clearly have reduced its redistributive potential. Depending on the extent of further cuts, political leaders may face more pressure either to find new sources of public revenue or, in all likelihood, to cut benefit levels. Given the need to tackle increased public deficits, redistribution through social spending is likely to decrease further. A quick return to "business as usual" is certainly out of the question, especially in the wake of the economic downturn that, in 2012, had the EU on the brink of another recession.[18]

Despite the differences in economic performance during the crisis which suggest that social benefits play an important role in mitigating the consequences of a downturn, the new equilibrium level of social security benefits is likely to be lower than it was before 2008. Many European countries, such as the United Kingdom and Hungary, are facing huge public deficits and are trying to reduce them by cutting benefit levels, partly blaming excessive social spending before the crisis for the current situation.[19] Benefit levels in Sweden and Austria are relatively stable for the time being, whereas Germany plans to cut welfare benefits drastically, despite the fact that it weathered the initial impact of the crisis rather well.

Even as the consequences of the crisis are still resonating throughout Europe and fiscal consolidation plans are under way, another recession may already be around the corner. The changes made to social security financing – directly or indirectly – have lowered benefit levels in most cases, redirecting resources to deficit reduction and leaving social protection systems in a debilitated state to cope with what is likely to happen next.

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[18] Real GDP growth in the EU was forecast to be 0 per cent in 2012 (European Commission, 2012).

[19] "We need to address the areas where we have been living beyond our means", as David Cameron said, in a statement representative of the views of many other European politicians (Oliver, 2010).

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