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International Experience with Alternative Forms of Social Protection: Lessons for the Reform Process in Russia

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International Experience with Alternative Forms of Social Protection: Lessons for the Reform Process in Russia

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Report

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1. Introduction

Since more than three decades the systems of social protection and social security have to face serious problems.[1] In most of the industrialised countries decreasing fertility and increasing longevity have led to a strongly aging population; within the European social security systems the decline in economic growth connected with the demographic changes caused a trend to permanently increasing deficits, independent from the fact that the systems are more insurance or more aid orientated. Due to the demographic changes many of the existing systems are still not sustainable and have to be subjected to serious political reform processes.

Most of the existing systems date back more than a century and were originally orientated to guarantee a minimum social protection especially to the poor and the working classes. Especially after World War II the social security programs have begun to include more and more groups of the population and in the 60s of the last century they grew to cover almost the whole societies based on pay-as-you-go financing (PAYGO) rather than on actuarial funding. Under the influence of growing population and a comparatively positive growth performance even the benefits from the social security systems steadily increased until the early 70s of the last century. While PAYGO systems might be quiet appropriate for risk management if the costs of the insured events can be distributed on the assured within one period, in case of intertemporal insurance problems connected with pension as well as health risks the PAYGO procedures creates serious financial problems if changes in the assured cohort sizes occur. An aging population then means on the one hand a decline in the number of actively assured whereas the number of beneficiaries is increasing.[2] On the other hand costs strongly arise within the retirement as well as health care or insurance systems, respectively. If such a process is accompanied by growth retardation in income and wages, PAYGO systems run into structural deficits.

1 Compare, e.g., Boskin (1977) and the early publication of Jean-Jacques Rosa on “The World Crisis in Social Security”; see Rosa (1982). A more recent perspective is developed in Giersch (1997).

2 For details see, e.g., Petersen (1981 and 1986).

The trend to an ever-increasing welfare state has led to an enormous burden on wages and profits, thus producing negative incentives on the supply of effort.[3] The growing shadow economies as well as the capital mobility towards countries with more favourable conditions for employment and capital investment have forced at least some European countries to implement some hard social reforms. The growth of social expenditure consequently has been mitigated or even reversed; since many redistributive measures were more directed to favour middle and higher income classes,[4] the concentration on the really poor and needy people meant a better targeted social protection as well as an increase in the efficiency of income redistribution. Hence, social reform is possible without any social dismantling.

The main features of social reform comprehend a shift from PAYGO systems to at least partially funded systems which are more actuarially sound connected with increased primary responsibility for the people, clear definitions of the personal entitlements within the different branches of the social security system as well as improved incentives for the beneficiaries to enter the official labour markets after periods of unemployment.[5] The international experiences with the traditional social security systems as well as the reform processes, which have already taken place, are of enormous value for the countries in transition that are currently in a catch up phase. If these experiences are taken seriously, many problems, which have created numerous obstacles against economic growth, can be avoided, thus growth would be strongly enhanced and the catch up period substantially shortened.

Financing of social protection can be organised within private insurance schemes by actuarially fair premiums, in state owned systems (e.g., social insurance) by social security contributions or payroll taxes or even within the state budget itself, thus using general tax revenue for the social expenditure. In all the existing systems there is a certain mix of premium, contribution and tax financing; consequently the whole income side of the budgets have to be taken into consideration. The survey therefore follows an integrative perspective of taxes and transfers to present the comprehensive burden of taxes as well as any form of contributions on wages and profits. Because the incentive effects are of utmost relevance, the marginal as well as the average burden of taxes and contributions are presented in detail.[6] In a modern sense the income and profit tax as well as the transfers (in sense of a negative income tax) have to be analysed simultaneously and to foster a controlled and efficient process of income redistribution. Every reform process within the social protection system therefore has to be brought into agreement with the existing direct tax system to avoid differences in tax and transfer basis as well as strong hikes in the marginal tax rates and transfer reduction rates.[7]

An integrated analysis of the highly complex tax and transfer schemes is a very bold venture. Therefore, in chapter 2 the basic issues of social protection – targets, measures, institutions, risks to be covered etc. – are presented.[8] Chapter 3 then concentrates on the social protection in selected

[3] See Petersen (1981a and 1982).

[4] See Persson (2000, p. 3).

[5] The problems for Germany are described in Petersen (2000).

[6] In a theoretical perspective using the income-leisure-model, the marginal tax rate influences the substitution effect, while the average tax rate the income effect; the dominating substitution effects (or excess burden) together with the shift into the underground economy then determine the negative incentives of direct taxation; for details see Petersen (1993, pp. 281).

[7] See, e.g., Petersen (1997).

[8] For a detailed presentation see Petersen (1989).

European countries (Germany, Austria, the Netherlands and the United Kingdom), whereas in chapter 4 the necessary reform processes will be discussed. Connected with the experiences as well as the shortcomings still existing in the contemporary systems the lessons for the Russian reform process are derived. The survey closes with a short summary (chapter 5).

2. Basic Issues of Social Protection

Before the different possible systems of social protection are described in detail, the target, means and benefits of social protection have to be defined (2.1.); dependent on the decision, which groups should be included into the social protection system, mandatory (compulsory) or voluntary systems can be differentiated (2.2.). From the three basic forms of social protection, many mixed forms can be distinguished (2.3.) which are to be detected in existing institutional settings analysed in chapter 3. The decision on the level of the benefits guaranteed by the social protection system also determines the extent of monetary or real transfers to the beneficiaries. As far as these transfers are due to direct taxation the net replacement income is also dependent on the tax burden (2.4.). In an efficient income tax system the lifetime income, consisting of all the annual incomes of a taxpayer during his lifetime, has to be taxed once and only once.[9] Therefore, our analysis have to take into consideration not only the benefits from but also the tax treatment of the contributions and premiums to the social protection scheme so that double burdening of income parts in a lifetime perspective is avoided.

2.1. Targets, Means and Benefits of Social Protection

The basis of state theory and the theory of economic thoughts in democratic market orientated societies is the paradigm of methodological individualism; this paradigm states that all collective targets have to be derived from individual preferences. Consequently all theories must reflect the decisions of the micro units. The development of societal target systems is an interdisciplinary task of philosophy, political science, economics and socio-biology.[10] Ethical reasoning is heavily dependent on economic considerations so that economics itself always has a certain normative foundation. If the model of the open society is taken as reference, the societal target systems contains of peace, freedom, justice and welfare. Social protection is closely connected with the target of peace (internal social peace), which may perhaps conflict with freedom (in case of compulsory membership in social institutions) but also secures justice as well as at least a minimum standard of welfare.[11] With regard to justice two components are to be mentioned (see chart 1): The justice of ability which is closely bound to the performance orientated remuneration of labour and capital in the approach of welfare economics (Pareto efficiency), and the justice of needs which cannot be easily defined in terms of monetary and real transfers. As a minimal approach to the justice of needs the physical minimum of subsistence could be defined, the maximal approach would be the equal distribution of real consumption to all members of the society – connected with serious negative incentives for the whole society. Equal distribution would mean a marginal tax burden of 100 % for each income above the average, while all beneficiaries below average income would get a full compensation by transfers until they reach the average income. This redistributive process would impair the supply of effort of the able taxpayers as well as of the transfer recipients, so that the welfare would strongly decrease.

The costs of social protection and redistribution are always connected with a trade-off between the ability of needs target and the welfare target; therefore, redistribution and social protection have to be organised in a form that the incentives of the contributors to the welfare state are not

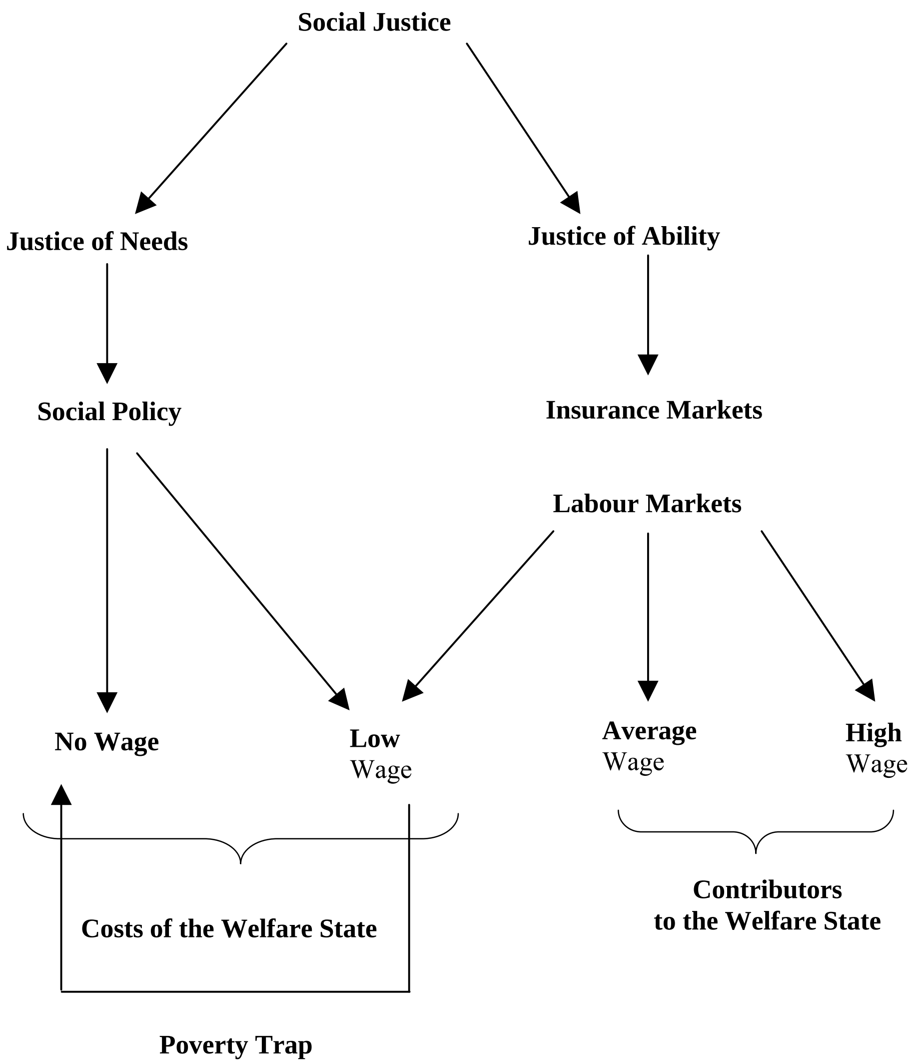
9 See Petersen/Rose (2003).

10 For details see Petersen (1993) and Petersen/Müller (1999).

11 An English version of the underlying details can be found in Petersen (1998).

overburdened while incentives remain for the beneficiaries to participate in the official labour markets. If we concentrate as in chart 1 on the productive factor labour, then the high and middle wage receivers are the contributors to the social security system (with their taxes and social security contributions). The costs of the welfare state are determined by the people who are unable to earn any income (due to age, sickness, disability, unemployment, occupational accident etc.) and people who are only able to earn an insufficient income (low wage), which is not high enough to reach a politically aspired consumption standard. If especially the transition from the transfer system to the official labour market is strongly burdened by a high marginal transfer reduction rates and strongly increasing marginal social contribution and wage tax rates, a poverty trap will become effective.

Chart 1: Elements of Social Justice



The poverty trap on the one hand means that unemployed people able to work will stay in the social security system because the net wage (after subtracted transfers, wage taxes and social security contributions) is not or not substantially higher then the transfers are. With other words, the social aid system defines a minimum wage without any job performance. On the other hand the low wage earners also having only little or no advantages compared with the transfer levels will switch into the social security system, too. Consequently the labour markets in the lower income brackets are heavily impaired, low qualified human capital is driven into unemployment and the shadow economy.[12] Thus the burden of the welfare state is increasing, impairing the incentive schemes for the high qualified, getting similar reactions on the supply of effort in these wage groups.

Beside the basic societal targets the predominating moral sentiments within the societies determine the character of the social protection schemes. In every economic setting people are acting under scarcity conditions; the benefit of one person often means the renouncement of another person. The readiness to disclaim heavily depends on attitudes as egoism, altruism or – the worst case – envy. In case of well-understood egoism or better altruism, the social sympathy would lead to positive sentiments for the fellow men so that the acceptance for redistribution and social protection is much higher than in case of envy.[13]

But the open society is not only described by the target system; as important as the targets is the set of instruments and the instrumental mix. In a historical sense the basic instrument is the family. Due to natural science and socio-biology the selection of relatives is an important support for social protection. The family – especially the extended family consisting of more than two generations – has been the core unit for social security in the societal development process.[14] The reciprocity is the intra-familiar form of altruism. Because of the positive sentiments between the generations still existing in modern societies the families, responsibility for the welfare of the families' members is often a basic pillar of social security. The principle of subsidiarity states that the primary responsibility for the personal welfare is with the person herself or with her closest relatives. Only in case that the micro unit fails or is unable to protect the own members, higher institutions (the neighbourhood, society or state, respectively) have to overtake the responsibility. In other words, if the subsidiarity principle malfunctions, the solidarity of the larger institutional group has to displace the family's responsibility. In the German legal setting the primary responsibility of the family is a core pillar of the Civil Law Code (BGB). The social aid system has only to overtake responsibility if a poverty (means, income and property) test has proofed the inability of the family.[15]

In addition to the family three other societal instruments play an important role. While morality and ethics determine the inter-familiar co-operation (neighbourhood) and collective solidarity, the law system regulates the general framework for individual and collective action, the supply of public goods as well as redistribution in favour of the incapable members of the society to prevent poverty within the society and to secure at least a basic security for all members. The market system as the fourth instrument guarantees the appropriate living standards by the system of relative prices (with ability orientated wages and interest rates) and allows for assurance as far as

12 The combination of benefits from the social protection scheme and income from illicit work in the shadow economy often leads to an higher net income than could be earned in the official labour markets. Obviously such behaviour means transfer fraud which overwhelmingly is taken as peccadillo.

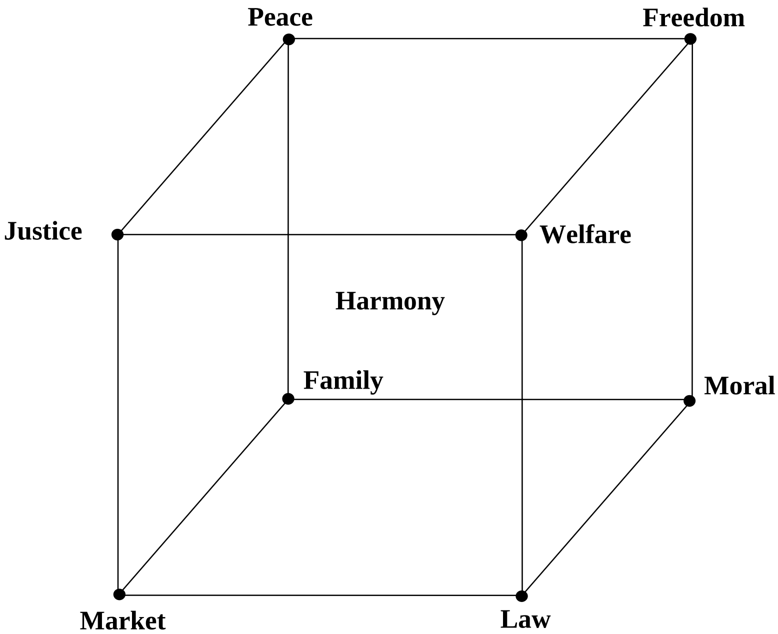
13 See Petersen (1997) und Petersen/Müller (1999).

14 See Petersen (1989, pp. 28.).

15 Such a maintenance obligation does not exist within the Anglo-Saxon civil law. Therefore in some states of the USA serious discussions on the former social aid system have taken place, blaming the lifetime guarantee for social aid benefits as main cause for destroying the fathers' responsibility for their own children. Especially in the slum districts of large cities most of the women are parenting their children alone because the male partner overwhelmingly have ended the partnership. The incentive to behave in such a way was seen in the benefit guarantee of the social aid system, convincing the male partner that the former female partners as well as his children at least were provided with a minimum standard of consumption goods. This was the main reason that in many states of the USA social aid has been restricted only to some (e.g., five) years of the life cycle.

private insurance system exists. If perfect market conditions are guaranteed, the justice of ability is in full accordance with the Pareto efficiency. Chart 2, that shows the target-instrument-cube of open societies, summarizes the results. The term of societal harmony characterises that dependent on differences in the value systems (norms) and traditions single targets and instruments are differently stressed, so that alternative constructions of the model of open society are possible.

Cart 2: Target and Instrument Cube of the Open Society



The description of the model of the open society already has made clear that social protection can be produced by private means (family protection and assurance in private insurance markets) as well as by state intervention. And state intervention is necessary if failures within the family or the market system occur. Dependent on the intensity of failures state regulation (e.g., of private insurance markets) can mitigate the market failures (for instance by competitive law) or – as in case of stronger market failure – the state itself has to organise the supply of social protection. Especially in case of poverty private provision of countermeasures often fail so that the state has to overtake the role as redistributive agent. But one has to be aware that redistributive interventions are always connected with the trade-off mentioned above.

In view of the argumentation presented above, social protection has at least two important aspects: 1. Fighting poverty is one important obligation in open societies because the vast majority of people (voters) agree that at least a physical minimum of subsistence should be guaranteed to every (incapable or disabled) member of the society. In so far social protection necessitates income redistribution from the rich to the poor. 2. People who live beyond some minimum income standards are able to self-responsible behaviour and to organise their own social protection using the family or the insurance markets. If the family is not large or not capable enough to organise a sufficient risk sharing between the family members, the insurance markets supply differentiated insurance contracts to insure for almost every standard risk where the risk consequences are distributed on a large number of assured members. Therefore, social protection always consists of two elements: the economics of income distribution (grants economics[16]) and insurance economics connected with risk sharing.

2.2. Standard Risks and Possible Institutional Settings for Social Protection

The definition of social risks is very closely connected with the development of the social security systems and the welfare state. Because of differences in norms and opinions there is no international agreement on a precise catalogue of risks and the level of security (e.g. replacement income in case of loss of income) striven for. But the International Labour Organisation (ILO) has formulated a list of minimum standards with regard to the following risks:

i. Sickness,
ii. unemployment,
iii. retirement,
iv. occupational accidents and diseases,
v. family burdens,
vi. motherhood,
vii. disability,
viii. death of the breadwinner.

In the following we will concentrate on the retirement (pension), sickness (health), unemployment and accident problems; hence, the argumentation is limited to institutions, which have the task to organise social protection in the fields of pensions, health, unemployment and occupational accidents. Due to our approach of methodological individualism we start with the possible market structures for the two main problems: pension and health insurance.

2.2.1. Market Structure for Pension and Health Insurance

In a purely private setting and sufficiently developed market systems there is an insurance market (◊) in which the citizen can buy life insurance contracts in different forms as shown in chart 3. The market Structure is comparatively simple while some serious information problems exist for the assured connected with the long termed contract as well as the intertemporal aspect of life insurance.

[16] For details see Boulding (1973).

Chart 3: Market Structure for Pension Insurance

assured members —— ◊ —— life insurances

↓

market for life insurances:

- capital insurance
- risk insurance
- pension insurance
- fund models

Under the same conditions also sufficient health insurance markets could exist. Whereas the life insurance market has just one demand and supply side, the health insurance problem is much more complex because of the much larger number of engaged actors. As in the case of pension insurance we have a health insurance market (◊) in which the assured can sign contracts to secure against loss of income in case of sickness and the additional expenses connected with the sickness (see chart 4).

Chart 4: Market Structures for Health Protection

assured persons	—— ◊ ——	health insurances
patients (a. p.)	—— ◊ ——	medical practitioners or consultants
patients (a. p.)	—— ◊ ——	pharmacies
patients (a. p.)	—— ◊ ——	hospitals
pharmacies	—— ◊ ——	pharmaceutical industries

In addition to the pension problem at least four more markets (◊) do exist in which different health goods and services are traded which leads to a certain intransparency for the patients as well as asymmetric information. Between health insurances, practitioners, consultants, pharmacists, hospitals, and the pharmaceutical industries complex networks of different relations do exist, which makes health protection to a multi dimensional organisational problem. The kind, number and intensity of relations are determined by the details of the single health protection system and often single or quasi markets as well as political negotiations substitute even all markets.[17] Especially with regard to the costs covered by the insurance contract often difficult ethical questions arise, which have to be decided by the individually assured person. In case of limited coverage the insurance premium is much less than for full coverage.

[17] For more detail see Scheffler (1997) and Petersen (1997a).

While unemployment insurance has been overwhelmingly taken as an insurance problem, which can only be solved within a social insurance system or aid program,[18] private accident insurances do exist on a broad scale. But due to different forms of market failure and the insecurity of the insurance funds in case of unregulated insurance markets, political decisions in the past were often made against markets and in favour of state intervention. A whole theory of private insurance failure has been developed, which consists of problems of relative poverty, adverse selection, moral hazard, risk infection, long term insecurity of private funds etc.[19] For decades it has been neglected in the traditional social policy that social insurance systems as well as care systems are confronted with just the same problems or even worse: the problems are more serious creating structural deficits which make the systems unsustainable.

2.2.2. Systems of Social Protection and Security

Without doubt the problem of poverty and redistribution as part of social protection cannot be solved within private insurance markets and also not in social insurance systems if certain equivalence between the contribution and the benefits is striven for. Private insurance as well as social insurance schemes create serious security gaps in social protection, so that additional aid or care systems become necessary. If the basic institutional settings for social protections are taken into consideration, four systems are to be mentioned: 1. The private insurance system, 2. the social insurance system, 3. the social aid system, and 4. the social (health) care system. As practical means for social protection the citizen/private households can use their individual income and property, be engaged in existing insurance markets to secure against standard risks, pay transfers to relatives (maintenance obligation) to support them, or – in case of poverty or insufficient market income – rely upon transfers paid by public budget.

2.2.2.1. Purely Private Insurance System

As already mentioned in a purely private insurance setting the insurances of different branches are organising an individual risk sharing between the assured persons due to the insured volume or coverage within the insurance contracts. The contributions to the insurance are actuarially fair and equivalent to the single risks with higher risks paying higher premiums. The chosen coverage of the insurance contract reflects the individual risk preferences. The fair premium covers the costs of the insured events, the costs of administration as well as the profit of the insurance.

Because the insurances are in competition and the exclusion of bad risks (adverse selection) reduces the insurance costs, insurance companies often behave as risk averters. In case of high premiums for high-risk cases, the potentially assured people often behave as risk lovers so that they often not conclude any insurance contract. Both behavioural problems would led to a under coverage of the population which is often taken as sign of market failure. Moral hazard, in other words the fact that assured persons influence the insured event by own (illegal) action,[20] has especially in the past often created enormous additional costs thus jeopardising the existence of private insurances. Problems with risk infection regarding health care and the problem of a

[18] Despite the fact that in the recent year an increasing number of private unemployment insurances has been founded.

[19] For details see Schönbäck (1980) und Petersen (1989).

[20] For more detail see, e.g., Söderström (1997).

sufficient security of the actuarially correct insurance funds are also often mentioned as possible causes of market failure.

Summing up the problems, purely private insurance schemes were often connected with an insufficient coverage of risky events and a large number of uninsured people. The outcome was a high burden on the social aid system, which has to cover the costs of personal redistribution.

2.2.2.2. Social Insurance System

Because of the numerous problems with private insurance schemes in the late 19th, century the social insurance idea was seen as a practical alternative; the Bismarck-System – proposed with the Emperors message of 1881 – consisted of a broader risk sharing for the workers with compulsory social security contributions partly paid by the employees and the employers. The mandatory system prevents from risk lover behaviour as well as adverse selection and also distributes the costs of risk infection to a broadly defined group of assured persons. The contributions were exclusively bound to wages, independent from the individual risk position. Retirement age and the replacement income were following a modified equivalence principle and income redistribution (not necessarily in favour of the poor) was a built-in feature of that scheme. Family members (spouse and children) were assured on a contribution-free basis.

Actually the PAYGO system was implemented because only in such system pensions can be paid for the first generation without any own contributions, so to say the first generation made a remarkable windfall profit which has to be paid by all following generations. The retirement age, replacement rates and the catalogue of goods and services for health protection were politically defined, while the final responsibility for all regulations remained in spite of the autonomous social insurance companies with the Federal Parliament (Reichstag and later Bundestag).

In the course of the historical development more and more groups of the society fall under the social insurance schemes until a majority of the population was covered. Therefore, the solidarity principle, originally limited to the poor within the society, was extended almost to the whole society – a clear breach of the subsidiarity principle mentioned above, which has never come into the consciousness of the German social politicians. Because of very limited control mechanisms within the social insurance system and the total lack of important market incentive schemes, entitlement and moral hazard behaviour began to play an ever-increasing role so that costs explosions have become a frequent and permanently repeating characteristic. Beyond that increasing redistribution and related regulative interventions have seriously impaired the equivalence of contribution and benefits and so destroyed the insurance character, thus leading to additional behavioural adaptations. Already in the early 80s the worldwide erosion of the insurance myth was observed.[21] Because the replacement ratios as well as the provisional levels of the health protection systems are defined politically, since at least two decades in many countries the social politicians are hesitating to start with the necessary but very unpopular reform processes thus wasting the urgently needed time for stepwise adaptations. Instead of fundamental reforms they overwhelmingly undertake curing symptoms. Consequently the long-term perspective becomes more and more gloomy, especially if the demographic trends are taken into consideration.

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21 See Chickering/Rosa (1982, p. 215).

2.2.2.3. Social Aid System

In purely private and social insurance systems their remain serious gaps for social protection especially in the poor parts of the population where bad professional qualifications or health problems are often the most important causes of insufficient income from the official labour markets. If poverty is only measured as insufficient income from official labour markets, the extent of poverty is often strongly overestimated; aside the income from official labour markets at least a large part of that group has good chances to improve the actual consumption levels by working in the shadow economy or being engaged in different forms of household production.[22] Both income forms are in official statistics overwhelmingly neglected. Therefore, the actual consumption on the household level is a much better measure for poverty than market income because also inter-familiar transfers (between relatives) contribute to a more equal distribution of consumption than of (market) income.

Even if such important information on the actual consumption situations is taken into consideration, without doubt a serious poverty problem remains even in high developed industrial countries. Private protection via saving and capital formation as well as insurance based on the primary responsibility of the individuals in such cases cannot help to overcome the malaise because both implies sufficient market income or ownership of property. However, in every insurance setting protective measures against poverty are badly needed. Even in those countries, which were forerunners in the introduction of social protection, social aid programs have been developed to close the existing and often growing poverty gaps. Because the insurance schemes as well as the direct taxes (especially income tax systems) were separately and independently developed from the social aid system, in many countries the tax and transfer system is more or less uncoordinated. The tax and transfer basis are often defined totally differently and the marginal reduction rate of transfers together with the high marginal wage tax and social security contribution rates in the income brackets, where the switch from transfers to market income takes place, create a total marginal burden which is often clearly above 100 %.[23] Such an uncoordinated, even chaotic growth of the marginal burden especially in the low-income classes is the main reason for the poverty trap mentioned above (see chart 1).

This argumentation can be clarified by a German example, which is represented in chart 5. The scope of marginal tax and transfer rates is determined by the abolition of transfers with increasing market income (from wages and other sources) and the non-coordinated income limits within the tax and transfer system. For families receiving educational benefits, even marginal rates of above 100 % are possible.

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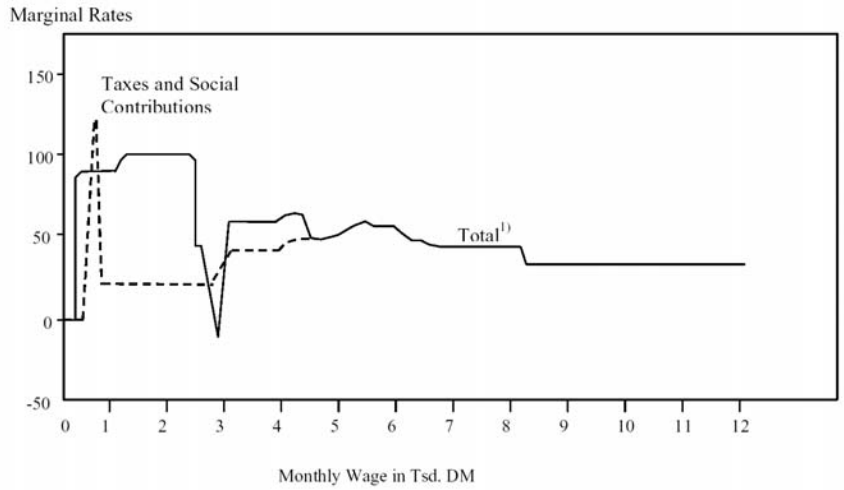
22 Market income is only one source within a total wealth concept; the other sources are income form illicit work and household production; see Petersen (1982, 1984).

23 The German example is presented in Fritsche/von Loeffelholz (1994) und Petersen (1997, pp. 65).

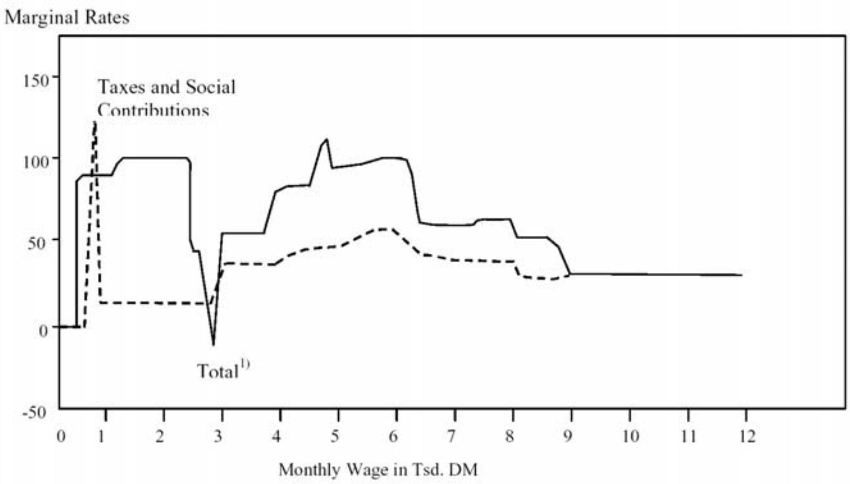
Chart 5: Marginal Tax and Transfer Rates in Germany

Tax and Transfer Rates for Spouses - One-Income-Earner, Two Children



[1)] Income Tax, Solidarity Surcharge, Employee Contributions to Social Insurance and Withdrawal of Income Dependent Social Benefits

Marginal Tax and Transfers Rates for Spouses - One Income Earner, Child-Care Benefit and Education Benefit



[1)] Income Tax, Solidarity Surcharge, Employee Contributions to Social Insurance and Withdrawal of Income Dependent Social Benefits

Source: Institut für Weltwirtschaft (1996, pp. 6).

If the subsidiarity principle is taken seriously, social aid is always a measure of the last resort when individual protection measures have failed. The lack of sufficient income and property has to be means tested[24] and only if a clearly defined minimum income level cannot be reached by an individual or household, under the solidarity of the whole society an aid level has to be defined

[24] The mean test in social aid corresponds to the tax assessment procedure in direct taxation; in many countries for long periods means tests were abolished because of their pretended discriminatory character for the poor people. This questionable, total arbitrary and asymmetric argumentation which lays high and efficient control on the taxpayers but just charity on the transfer recipients has led to transfer fraud and strongly increasing expenditure. In the last years a worldwide renaissance of mean tests can be observed while the control mechanisms for the aid recipients have been tightened up because transfer fraud became as frequent as tax evasion.

which corresponds to the countries development situation. Principally two poverty concepts can be distinguished: absolute and relative poverty. In case of the absolute poverty concept poverty is defined in terms of a minimum physical level of subsistence. Then a commodity basket has to be defined, which is necessary for the physical survival within the respective society. Such a basket must comprehend all necessary consumption goods (foodstuff, clothing and lodging) and also the necessary health goods and services. While the consumption standards are overwhelmingly clearly defined within the existing aid systems, clear rules for the minimum standard of health care are often badly missing because of the political fears that limitations with regard to certain health services might create serious ethical discussions in the public.[25]

The necessary commodity basket can be provided by the social welfare offices in real terms in form of vouchers or ration coupons; such real transfers mean a limitation of the consumers sovereignty, so that on the first glance a certain politically fixed consumption standard can be secured. This paternalistic approach of social aid might at least partially fail if such coupons are tradable and can be transformed in cash. The health protection can be secured in a way that social aid recipients get the individual insurance premium of a private health insurance paid by the welfare program or participate contribution-free in the social health insurance or care system. In more liberal approach cash transfers are directly paid to the social aid recipients. Consequently they have the full consumers sovereignty on that cash amount and determine their own consumption structure while the social aid offices overwhelmingly pay the rent and all connected costs directly to the renter. Often social aid payments are paid on the bank accounts of the social aid recipients, so that the contact between the social aid offices and the recipients is very infrequent. Because of an increasing anonymity the risk of transfer fraud is rising, so that additional control mechanisms are necessary.

In case of the relative poverty concept poverty is defined as a certain percentage of the average income of a typical individual or household within the most relevant social status group (workers, blue and white collar, government officials, pensioners, self-employed etc.). Individuals and households are defined as poor, if their income is less than 60 %, 50 %, 40 % etc. of the respective average income (poverty line). Relative poverty concepts were especially implemented in countries in which welfare state targets were striven for (e.g., Scandinavian countries, especially Sweden).[26] It is obvious that as higher the poverty line is as higher the costs of the welfare system (redistribution of income) are. On the one hand within a relative poverty concept poverty itself is a self-perpetuating fact. If people with income above the poverty line would in-migrate into a country, e.g. more well to do would live in that country, the number of poor people would also increase. Under such a scheme the social aid recipients fully participated in the real consumption growth process as long as the average wages were growing in real terms. On the other hand the relative poverty concept caused a permanent growing welfare state with such a high tax and contribution burdens that the resistance against that system strongly rose. Therefore, in many countries reform processes were implemented, which reduced the entitlements of the social aid receivers; in Germany, for instance, already in the early 70s of the last century the relative poverty concept was displaced by a socio-cultural minimum, which represents a certain fraction of a commodity basket, which could be consumed by similar household with a least one breadwinner in the family. This basket was at best been holding constant over time in adapting the commodity prices to the inflationary process.

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25 If clear decisions are avoided, social health insurance or care systems are under enormous cost pressures.

26 For the differences between the welfare state and the social state see Koslowski (1997, pp. 113).

2.2.2.4. Social (Health) Care System

Social care systems at least try to define a maintenance level (of income, health care etc.), which should be beyond a minimum level as, for instance, in an aid system, which should be guaranteed to every member of the society. The general tax revenue from the state's budget finances a care system. Due to the high system costs the still existing maintenance systems are limited to the health problem. While in private health insurance systems the patients are confronted with a complex of insurance and health service markets, in a purely social health insurance a monopoly exists in which all members of the society are compulsorily insured against the health risks. But the markets for health goods and services at least partially remain private or are substituted by so-called quasi-markets. In a health care system all market elements on the supply side are abolished and the practitioners, consultants, pharmacists, etc. are employees of the health care system itself (or the state). Such systems have been called Beveridgean, especially if they are connected with replacement ratios that fall if income levels are increasing.[27]

In a Beverigean health care system almost all market elements are abolished. Like in the Bismarckian health insurance system for generations the main target was to guarantee a high level of health care connected with high quality standards for all members of the society. For some decades this target could be reached more or less efficiently as long as the population as well as real incomes were growing. An increasing number of employees and assures was able to finance the every increasing health expenditure. Since the demographic changes and the slow down in real income growth have led to a strong limitation on the revenue side, the health care and insurance systems have run into structural deficits. While in the health insurance systems the contributions were strongly increasing, within the health care systems expenditure control was often organized in limiting the supply of cost intensive surgery. The results are increasing queues for complicated operations within the hospitals; as consequence the well to do are going abroad or buying the health services on private markets. Social politicians are still pointing to the fact that they try to guarantee one and the same level of health services, but since decades parallel private markets for health goods and services are flourishing. The one-class society for health care is a political illusion, like many other socialistic ideas that have not survived after the change. In all sectors of the economy the regulations have to have in mind the scarcity conditions, which are automatically met under pure market conditions. In social health insurance as well as health care systems the limitations within the supply of health goods and services have to be decided politically. The above-mentioned political fears are cause that often such decisions have never been made or the regulations are still too generous.

2.2.2.5. Mixed systems

Because all the discussed systems do have more or less serious shortcomings and failures, all real existing systems of social protection and security use a certain policy mix in which private insurance markets at least play a partial role beside the often dominating social insurance and aid systems. Due to bad historical experiences the private insurance markets have been more and more successfully regulated within the single countries. The insurance regulation comprehends the competition control, price control, and the control of the insurance funds as well as a reinsurance system. Due to the successful implementation especially after the World War II with

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27 See Casamatta/Cremer/Pestieau (2000, p. 504).

regard to old-age security, the private insurance system has become another important pillar beside the social pension insurances, often closely connected with corporation pension systems. Regarding the health protection in many countries only (some parts of) the employees are mandatory insured within the social health insurance scheme while individuals and households belonging to the upper income brackets and/or the self-employed are voluntarily insured in the social insurance or the private health insurances.

The private insurance system itself has been extremely successful in overcoming the limitations against individual assurance mentioned above. Especially the problem of moral hazard has been efficiently managed by different measures of risk and damage avoidance. The implementation of an own participation of the assured within the insurance contracts, the repayment of premiums in case of a risk and damage free insurance periods as well as a bonus on low risk cases and extra premiums (malus) for high risk cases together with effective investigation measures for insurance fraud are efficient countermeasures against moral hazard, so that expenditure control is often much more successful in private insurance than in social insurance schemes. On the contrary, in the social insurance schemes the discussions on the introduction of such countermeasures are highly on the agenda or have already been (partly) implemented.

Hence, most of the causes which have led to the introduction of social insurance or care systems are not any longer of relevance. In open economies the efficiently regulated private insurance systems themselves are as secure as the single states are. The still existing social insurance systems are more a historical reminiscence than an economic necessity. Almost all problems of adverse selection and even relative poverty can be solved by direct transfers to the poor and disabled so that both groups would be reimbursed for their premiums paid to the private insurance system. Even the social aid recipients then could profit from a premium reimbursement if they would use the health insurance carefully thus reducing the overall costs pressures on the system. A modern mixed system of social protection would consist of only two elements:[28] a basic security system which guarantees a minimum of subsistence to the poor (a physical or a social-cultural minimum, dependent on the development level of the single country) and a private insurance system for all citizen in which the poor and disabled are personally and directly subsidised for their private (extra) insurance premium. Such system is described in more detail in chapter 4.

2.2.3. Replacement Ratios and Income Taxation

As mentioned above, the existing social protection systems predominantly have been independently developed from the direct tax systems thus causing unintended hikes and declines in the marginal transfer reduction rates, marginal social insurance contribution and tax rates. Especially in the lower income brackets where transfers are reduced and the switch to wage tax and social security contributions takes place, these marginal rates or often close or even above 100 %. In a rationally planned social protection system, the income brackets as well as the marginal rates of the income tax system have to be well coordinated with the contribution and tax rates to avoid or at least reduce the negative incentives of the poverty trap. Additionally most income tax systems are based on a broad income definition and the tax schedule overwhelmingly shows a direct progression, which means that with increasing income the marginal tax rates are also rising. If transfers are paid as compensation for the loss of market income (wage) earned in the official

28 See Petersen/Raffelhüschen (2000).

labour markets, questions arise how the replacement income should be treated within the income tax system. In case of benefits in kind (e.g., from the social health insurance or the health care system) similar questions are to be answered.

2.2.3.1. Replacement Income Levels

The replacement income levels depend on the basic structure of the social protection system. Is the system care or aid orientated (Beveridegean system), the replacement income level is – in accordance with the justice of needs concept – defined as a minimum income, which is constant for people living in similar circumstances. In a private insurance system the replacement income in case of old age provision or sickness is dependent on the individually chosen coverage level, which corresponds with an actuarially fair insurance premium following the justice of ability concept. In case of social insurance systems (Bismarckian systems) the benefit principle (equivalence of contributions and benefits) also applies, but modified by certain redistribution in favour of the poor or other favoured groups (e.g., families with children). The social politicians within the parliaments make the decision on the precise replacement level.

The replacement income levels have to be defined for the different social insurance branches. Then political decisions have to be made for the pension level, the sick pay and the dole (unemployment benefit). It is obvious that the costs of the insurance schemes are heavily dependent on the replacement income ratios so that predominantly benefits are paid, which are clearly below the associated wage earned in the labour markets. With regard to the pension levels it is often argued that in the old age the need is more or less lower than in the employment period; consequently the pension is clearly below the last wage earned. Then some incentives remain for additional private life insurance or occupational pension insurance schemes that contribute to an increase of the individual replacement ratio. The effective replacement ratio is – independently from the political decisions on the single replacement ratios in the social protection branches – always determined by individual decisions because beside wages and pensions many individuals or households have additional capital income from property (interest, profits, dividends, rent, etc. or at least the use of freehold flats), which has got an increasing relevance due to the rising real incomes and saving capacities during the post war period.

The political decision on the replacement income ratios determines the costs of the transfer and social security system. Since all expenditures for the transfers and social protection systems have to be borne by the working generations being engaged in market activities, social expenditure beside the expenditure for public goods and services also determine the burden of taxes and social security contributions. In a PAYGO setting especially direct taxes and social security contributions are overwhelmingly financed by the working generations. In case of a high marginal tax and contribution burden, the likelihood of negative incentives is strongly increasing. Therefore, political decisions on the replacement levels and the extent of income distribution between the generations have always to be made in view of the consequences for the working generations. A fair intergenerational contract has to be aspired, which creates a well balanced burden sharing thus giving the future generations a similar chance to benefit from the social protection system under the same benefit rules as the current beneficiaries do.[29]

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[29] Most of the existing systems are – as mentioned above – currently not sustainable; future generations are much more burdened than the generation of the current pensioners are; see, e.g., Petersen/Raffelhüschen (2000).

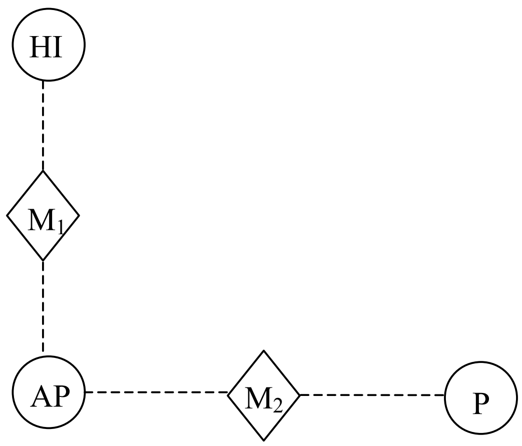
2.2.3.2. Transfers in Kind

The minimum income as well as the replacement income can be easily defined in monetary terms if a political decision on the particular neediness has been achieved. Especially with regard to the health protection system not only precautions for a possible income loss have to be made but also additional expenses for health goods and services have to be financed. In a private health insurance setting an individual health insurance contract would determine the possible reimbursement of the assured person for such health expenses. Then the individual person has chosen a certain coverage (full or partial) that is in accordance with an equivalent actuarially fair insurance premium. The level of the benefit in kind corresponds to the individual preferences.

In social health insurance and care systems the level of the benefits in kind secured by the social health protection system has to be determined by political decisions, too. While in the first phases of the social health protection systems a full coverage on an optimal level was striven for, the misconstructions within the systems as well as the permanent expenditure pressure have forced social politicians to several reforms in which the full coverage was stepwise reduced. These reductions have often met the resistance of the beneficiaries as well as of the interest groups being involved (associations of physicians, pharmacist, pharmaceutical industry etc.). Therefore, the necessary reform process is getting along only in a very draggling way.

What are the main misconstructions within the health protection system? The comparison of a private health insurance with the basics of the German social health insurance can shed some light on the main problems. Chart 6 and 7 contrast cum grano salis a private health insurance as a market system with the current regulatory mechanism in place for social health insurance, whereby, for the sake of simplicity, the above mentioned interrelated markets (see chart 4) are neglected.[30]

Chart 6: Private Health Insurance as a Market System



(Source: Herder-Dorneich (1980, p. 37).

[30] The most important source for such presentations is Herder-Dorneich (1980).

In the model of private health insurance we have three bargainers: the assured person (or patient), AP, as demander of health goods and services (here: out-patient physicians' services[31]), the physicians (or practitioner), P, as supplier of health goods and the health insurance companies, HI, as supplier of health insurance policies (cost coverage). Two markets connect these bargainers: market 1, M_1, for insurance services, and market 2, M_2, for health services. Without going into detail[32], it should be noted that the assured person, AP, directly demands health services from the physician, P, and pays in real market prices. The receipts, which the assured person obtains from the physician, comprise the quantity and quality of health services as well is the single prices. Consequently the assured person has full information on the services and the connected costs. The assured person then passes on the receipt to his health insurance, HI, which reimburses the assured. Hence, the assured persons have the full sovereignty of consumption with regard to the choice of insurances and the physicians, and they have full information on prices and services, so that a clear cost consciousness does exist.

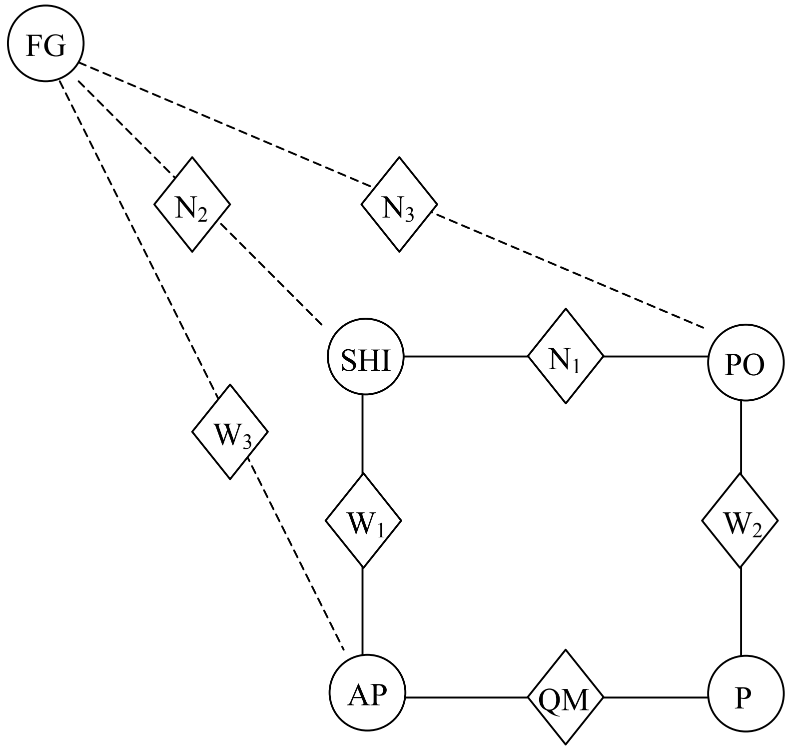
In comparison with the model of social health insurance (see chart 7), two other (groups of) bargainers are added: First, the physicians' organisation (or association), PO, is an institution, which is responsible for the distribution of the total amount of insurance revenue[33] provided by the social health insurance, SHI, for physicians' services to the individual physician. Second, the federal government social politicians, FG, who have the main responsibility for the insurance coverage as well as the budgets. In addition, the market relations within the private insurance model are replaced by electoral systems, $V_1 – V_3$, and a medical card (or voucher) system (often called quasi market, QM), which is the entrance key to the health services. The term quasi market is somewhat misleading because neither information on medical services nor on the costs of services are given to the assured persons. It is rather a voucher or purchase permit system which on the part of the assured creates the illusion that health services are zero priced – with all the well-known negative consequences for allocation. Furthermore the assured persons do not get any information about the quantity and quality of health services generated by the physicians, so that a real control mechanism of the physicians' supply is badly missing. Consequently the billing fraud is becoming a frequent problem. In case of such a misconstruction the differences between a Bismarckian insurance scheme and the Beveridgean health care system diminish in the course of time and both systems become more and more inefficient.

[31] In private health insurances the insurance contracts are predominantly separated in four kinds of health goods and services: 1. Outpatient physicians' services, 2. dental treatment, 3. hospital expenses, and 4. the replacement income in case of sickness. In these entire contract details different levels of coverage can be agreed upon dependent on the individual risk preferences of the assured person.

[32] See Petersen (1989, pp. 142).

[33] Simply expressed the total revenue results as average social health insurance contribution multiplied with the number of assured persons within the single insurance.

Chart 7: Steering Mechanism of a Social Health Insurance



(Source: Herder-Dorneich (1980, p. 35).

As consequence of the increased number of bargainers, the network of relationships between them becomes much more complex. The insurance market, M_1, is replaced by the election of membership representatives[34] to the health insurance, V_1, and an electoral process, V_2, is also implemented between the physicians, P, and the physicians' organisation, PO. The relation between the social health insurance, SHI, and the physicians' organisation, PO, is regulated by group negotiations, N_1, and corresponding group negotiations, N_2, take place between the federal government, FG, and the social health insurance, SHI. The general elections for the federal parliament, V_3, are an expression of the relation between the federal government, FG, and the assured persons (or voters), AP. Last but not least the group negotiations, N_3, between the federal government, FG, and the physicians' organisation, PO, have to be mentioned.

With regard to public choice theory, all bargainers have massive self-interests, which impair, at least partially, the overall efficiency of a market economy. Because the assured continue, as a result of their strategy to maximize individual utility, to obtain high-quality medical services at the most favourable insurance premium, and because there is a lack of information on the services supplied by the physicians and the corresponding costs, cost consciousness is inevitably reduced. Since the medical card system creates false information and illusions, the propensity to moral hazard behaviour is increased. In comparison with a private insurance system that consists of several competing private health insurances perhaps in an oligopolistic structure, a mandatory health insurance system covers a much larger membership. Because the costs of moral hazard are

[34] The employees (via the trade unions) and the employers both have 50 % of the representatives within the social insurance system.

distributed among all members, at least in the beginning, the per capita costs of moral hazard for the individual member in the social insurance system is lower than in a smaller private health insurance. Hence, the possible individual profit is high; the individual cost-benefit analysis demonstrates that moral hazard is profitable as long as it does not become a general phenomenon.

Therefore, to rely solely on quasi markets or on the introduction of some market elements into the social insurance system might currently be the only feasible strategy, but it remains a strategy of curing symptoms. It is quiet obvious that political group negotiations are instruments which may be popular with social scientists, but what is created instead of the alleged market failures of private insurance markets are political failures, governmental failures, electoral paradoxes, bureaucratic failures, etc. Causal therapy would involve strengthening the insurance markets by providing efficient regulation and by subsidising the insured individuals who would otherwise be hit by adverse selection because of a bad personal risk structure. The latter problem is an important task of a socially orientated market economy that directs its support to the really poor within the societies.

Since the health protection is more a problem where cost coverage can predominantly be organised within one period, the PAYGO approach is even appropriate for private insurance schemes. But because the health expenditures heavily depend on the age of the assured persons, also in the health insurance an intertemporal problem of risk sharing does exist. In a private insurance scheme the increasing costs for the older assured are reflected in a special fund financed from the premiums, which have been paid during the active phases of live. The private health protection is then at least partially protected against increases in live expectancy as long as such increases are projected correctly. In the social health protection systems such an intertemporal mechanism is badly missing, so that the demographic changes will also have gloomy consequences for social health insurance as well as care systems. Already in the last two decades in the German example the expenses for retired persons have been increased more than double as strong as the expenses for the general health insurance.[35]

Fundamental changes within the social health protection systems are in the discussion; on the one hand the financing by wage-related contributions has been substituted by per capita premiums (as in the case of Switzerland). Consequently such a reform would mitigate the problem of the ancillary wage costs (non-wage labour costs). But without a reform of the expenditure side on the other hand, no clear reduction of the ancillary wage costs can be reached. A catalogue of basic health services must be defined in which the coverage is limited to the really necessary sickness expenses.[36] This catalogue has to be guaranteed to every member of the society. In case of poverty the catalogue has to be supplied in form of transfers in kind, or alternatively, this catalogue is supplied by private health insurances. Then the social aid recipients would get their risk orientated personal insurance premium paid by the social aid system. In case of cost free insurance periods they also would profit from the repayment of premiums, so that even in this group a better cost control and incentives for decreasing health expenses are given. For all employed persons the insurance premiums for that basic health care would be income tax-free, so that all groups of the society would have the same minimum health care. Additional health services then have to be insured by insurance contracts guaranteeing higher coverage levels.

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[35] See Institut der deutschen Wirtschaft (2003, p. 5).

[36] See, e.g., Sowada (2000).

2.2.3.3. Gross or Net Orientated Replacement Ratios and Income Taxation

For the effective replacement level it is decisive if the replacement income from the pension, health and unemployment insurance is gross or net income (wage) oriented. As mentioned above, the income tax system and the social insurance branches were developed independently. Therefore, often no rational choice of one of the mentioned methods has been made but methods were arbitrarily introduced. If the income tax system follows the target of a consequent taxation of the total income of the individual or household, only a gross orientation would be a reasonable strategy. An ideal tax base for an efficient income tax system would be the whole lifetime income.[37] Due to a workable income tax system the annual taxation is a necessary feature, but within the annual taxation all parts of lifetime income should be taxed one time and only once. This correspondence principle can be reached by two different measures: first the contributions (premiums) to social protection institutions can be taxed during the gainful employment periods (preliminary taxation); second the replacement income paid by the social protection institution can be taxed (downstream taxation). Both methods are not fully compatible; because in the periods of gainful employment the wages are principally higher than the replacement income, (directly or indirectly) progressive tax schedules cause a higher taxation of lifetime income if the preliminary taxation is applied. Downstream taxation distributes the taxable income on more years, consequently more equal over the life span, and prevents from the progression effect. Because the working generations are already overburdened by the PAYGO social protection systems and the public debt, any measure should be used, which reduces the burden on the working generations to prevent increasing disincentives. Therefore the downstream taxation of replacement income is highly recommendable.

A rationally integrated tax and transfer system therefore would put all the contributions (within given legal limitations) to social protection institutions as well as corresponding premiums to private insurance systems tax-free (deductible from the tax base). Any replacement income should be gross orientated, e.g., pension entitlements should be formulated as a certain percentage of gross wages if the social protection scheme is wage oriented. Then all parts of taxable incomes are added on a gross base, the standard deductions (e.g., basic exemption to guarantee a tax-free consumption minimum at the amount of the physical or social-cultural minimum of the social aid system) are subtracted and the income tax schedule is applied. The resulting net replacement ratio then depends on the individual gross income situation of the taxpayer or household.

Precautionary measures within private insurance schemes are principally connected with capital formation and capital income. If a standard (traditional) income tax system is applied, this system exclusively depends on annual incomes. The previous history of the backgrounds of capital formation does not play any role. Therefore, capital formation is usually made from taxed income. In the following periods this capital itself forms a new tax base and the interest payments (or profits, dividends, rent, etc.) on that capital are taxed again. Capital itself and capital income is consequently several fold burdened.[38] Chart 7 demonstrates this so-called avalanche effect of capital income taxation in a simple example.

A wage tax rate of 25 % (e.g., flat-rate) is assumed; an employee is saving 1,000 Euro and invests that amount profitably at an interest rate of 5 % for 40 years on the capital market. Without any taxation his interest earnings would grow to 6,040 Euro (see chart 8) and be to the disposal for his

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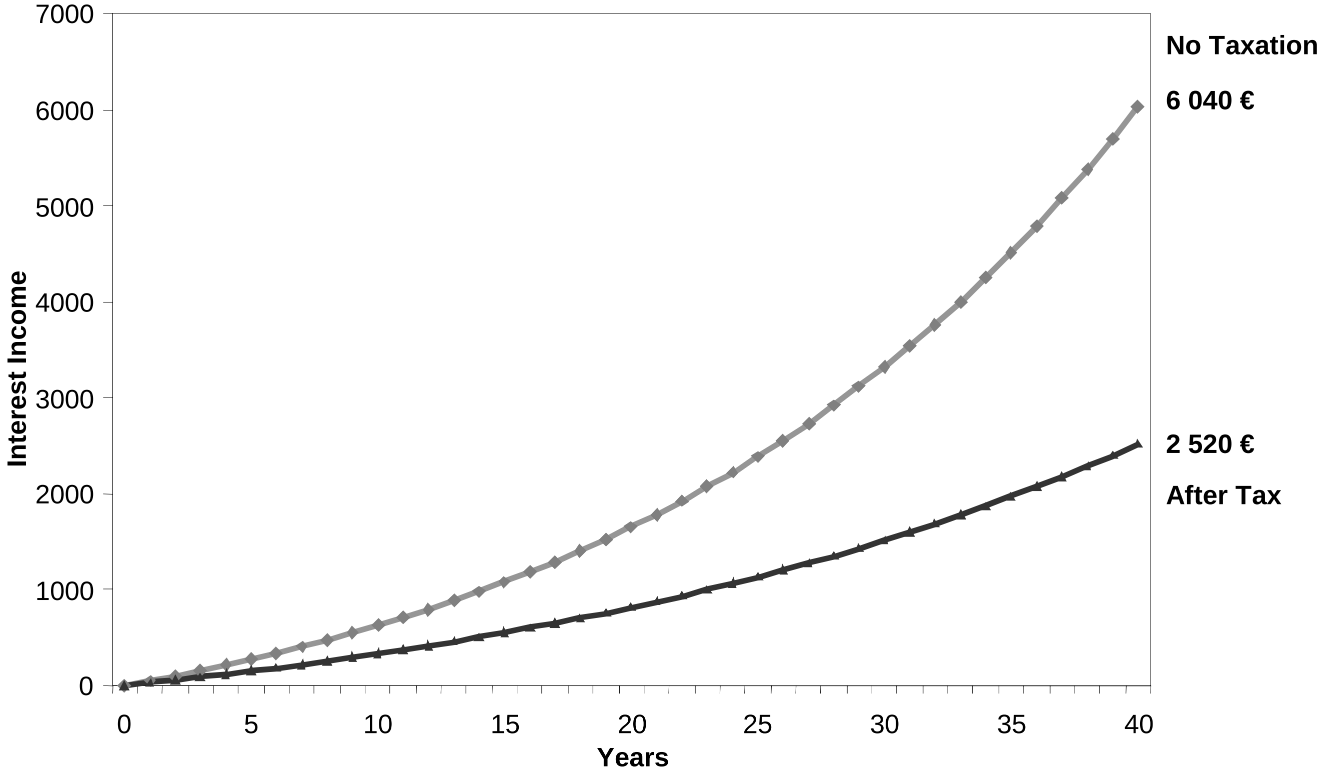
37 See Petersen/Rose (2003).

38 See for more details Petersen/Rose (2003).

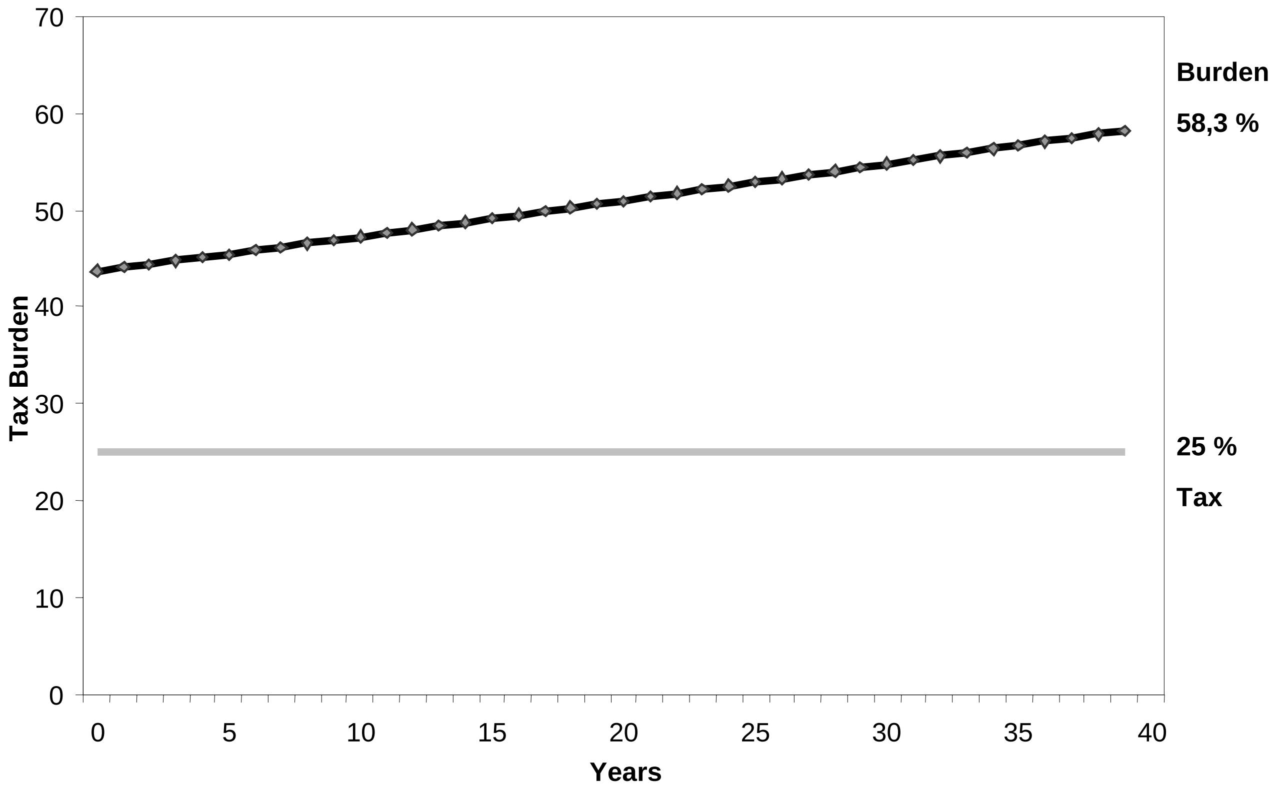
old-age consumption. In case of a traditional income tax saving is accumulated from taxed income, so that at the assumed wage tax rate of 25 % only 750 Euro can be invested for that 40 years period.

Chart 8: Income Tax Burden of Interest Income in an Traditional Income Tax System (Flat Rate 25 %)



Due to the tax reduced investment amount, the interest payment for the first year is not any longer 50.00 Euro but only 37.50 Euro. In spite of that original 25 %-burden the gross interest payment of 37.50 Euro is taxed again by the 25 % flat-rate mentioned above; consequently his saving account is only growing by 28.13 Euro. The effective tax burden including the originally already paid amount is then after the first year 43,7 %. In all the following 39 years income tax has to be paid on the annual interest income as well, so that his disposable amount for his old-age consumption is reduced to 2,520 Euro. Compared to the 6,040 Euro in the situation without any income tax, the effective lifetime tax burden on the interest income is 58,3 % (see chart 9), which is more than twice as much as the annual 25 % flat-rate.

Chart 9: Lifetime Burden on Interest Income of a Traditional Income Tax (Flat Rate 25 %)



In fact in most of the current traditional income tax systems small saving amounts are protected by special saving allowances or other tax privileges, but for savings beyond the exemptions much higher income tax rates are applied, so that the avalanche effects are even more severe. Similar effects are connected with profit taxation (within the traditional income and corporation tax systems), while in the German case the cumulative burdens were avoided by several loopholes that were currently abolished by the income and corporation tax reforms of the red-green government.[39] But capital income is not only burdened by income and corporation tax; property and wealth taxes, capital gains taxes and inheritance taxes create additional burdens, which in a lifetime perspective again show elements of the avalanche effects.[40] If in addition to the above-mentioned flat-rate of 25 % a 1 % property tax on total property is levied, the annual burden on capital income is increasing by 20 percentage points. The avalanche effect then produces a lifetime burden of both taxes, which is clearly above 70 %; in case of an additionally levied capital gains tax and in consideration of the burdens of inheritance taxes the total lifetime burden of all income and property taxes often reaches more than 90 %.[41] Hence, in many contemporary tax systems capital income would be obviously overburdened if the numerous existing loopholes would be abolished. It also becomes obvious that the frequently made proposal to broaden the tax base is a very dangerous advice, because the long-term burden of capital income taxation is heavily increased even if the annual tax rates are strongly decreased. The avalanche effects over compensate short-term tax rate cuts as longer as the investment period is. Therefore, one should not wonder that in countries with an extreme long-term burden on capital income, saving and

[39] For details see Petersen/Rose (2003).

[40] Not to forget the specific property taxes like the land taxes, motor vehicle taxes, etc.

[41] See, e.g., Anton/Petersen (2003) und Petersen (2003a).

capital formation is increasingly impaired. If in such countries (like Germany) there are still comparatively high saving ratios, this overwhelmingly depends on the fears of the working generations that the social pension system in view of the demographic development has a very gloomy perspective and a sufficient level of retirement income can only be secured by own capital formation. While capital formation at least in the short run might still be satisfactory, especially long term investment is avoided, so that the number of jobs is decreasing, thus creating an ever increasing number of unemployed people.

Deficiencies in capital formation and investment are the most important obstacles against a successful transformation and development process. Therefore, the efficient taxation of profits and other forms of capital incomes is of utmost relevance. While the downstream taxation of pensions and other forms of precautionary investments for the old age is an efficient method,[42] the avalanche effects within the traditional income tax systems are to be avoided by the introduction of the interest adjustment method for profits and other kinds of capital income. If a so-called protective interest rate (like it has existed in Croatia and will be implemented in Bosnia and Herzegovina) is subtracted from profits and the other forms of capital income in question, only profits and capital incomes beyond a standard interest rate of, e.g., 3 % to 5 % (or the current yield) are taxed and the avalanche effects are stopped. The combination of saving adjustment and interest adjustment is the most effective method to promote capital formation and investment in the own country. Most of the location disadvantages, which are to be faced by many highly developed industrial countries, are due to the facts that on the one hand capital income is overburdened in a lifetime perspective while on the other hand wages are overburdened by the payroll taxes and social security contributions, which are necessary to finance an inefficient welfare state. Therefore, tax and transfer reforms are both sides of one coin and only integrated reforms and adaptations will overcome the current malaise in many formerly successful countries.

[42] The downstream taxation of pensions corresponds with the saving adjustment method, because the contributions to social protection systems as well as the insurance premiums stay untaxed (that means that, e.g., saving for the old-age is subtracted from the traditional income tax base as mentioned above).

3. Social Protection in Selected European Countries

The case studies for Germany, Austria, the Netherlands, and the UK are presented in this chapter. The single subchapters have a uniform structure, beginning with some general remarks. Then the pension system and health system as well as the unemployment insurance and accident insurance – as far as they exist in the single countries – are described, followed by a concise overview on the basic security systems, respectively. The country studies are completed by a short overview on the taxation of wages and profits. Within the different branches the basic structures, the membership, the financing, and the benefits are described.

3.1. Germany

The German social protection system is one of the oldest if not the oldest social protection system in the world. The basic pillars have been proposed by the Emperors' Message of 1881. The draft laws were all following the social insurance approach, later called the Bismarckian system, which was intensively discussed in the "Reichstag". Aftermath the social health insurance was implemented in 1883, the social accident insurance in 1884, and the invalid and old age protection (later called social pension system) in 1889. Unemployment insurance was not part of the bill on social law. Unemployed persons were supported with a minimum aid by welfare institutions. The social unemployment insurance was introduced not until 1927, followed by the social aid system in the same year. The most fundamental tax reform was the Erzberger reform of 1920, which still determines the basic lines of the German tax system.

3.1.1. Pension System

The social pension insurance is an independent legal entity with a separate budget.[43] Employees and employers delegate representatives to the control body (two-thirds to one third), determined by the already above mentioned social elections. The self-administrative entities can decide on personal questions and the administration of assets. All other important problems of revenue and expenditures are in the competence of the Federal Parliament (Bundestag). The social pension system is a mandatory insurance in which all employees are compulsory insured against old age and disability.[44] Consequently the pension is wage related. The group of government officials is excluded and has an own mandatory system.[45] By the allowance of periods for child education, mothers or fathers acquire pension entitlements against the social pension insurance. Self-employed can become members by application.[46]

43 The social pension system comprehends the pension systems for blue and white collar workers as well as the mine-employees under one roof while a compensation scheme between the single insurances exists. Principally one national insurance scheme exists.

44 In case of enduring negligible employment (up to 325 Euro per month) and less then 15 hours work per week employees are principally not assured.

45 For details see chart 19 and the comments.

46 In former time a large number of the self-employed people were member of the social pensions system. Since as consequence of the demographic changes the rate of return from the social pension system is dramatically declining, many self-employed have switched to private systems.

Due to the compulsory membership of all employees, only excluded the self-employed (about 4,1 million people in 2000) and government officials (about 2,3 million people in 2001), about 43,1 million employees are assured in 2000 (see table 1).[47] The social pension insurance is financed by contributions and a grant from the Federal budget, which currently is about 30 % of total expenditure.[48] The PAYGO system is applied with a small reserve below the expenses for one month.[49] The contributions are related to the monthly wage (employees contribution), subtracted from the gross sum together with the wage tax by the employer, who transfers the social security contribution together with the corresponding employers contribution to the local or regional social health insurance on a pay as you earn basis.[50] Contributions are levied until the contribution assessment limit, which also determines the maximum pension payment.[51] The actual contribution rate and assessment limit is presented together with some other information in table 2. The contribution rate of 19.5 % is paid up to a limit of 61,200 Euro in the old (51,000 Euro in the new) states, so that the maximum contribution is 11,934 Euro (9,945 Euro) per year (50 % paid by the employee and the employer, respectively).[52]

Table 1: Social Pension Insurance

Specification	Unit	1998	1999	2000
Persons insured in the blue-collar workers' pension insurance [1]	1 000	20 680	20 741	20 199
Number of pensions paid on 1 July	1 000	12 695	12 862	13 130
Receipts	EUR mn	106 646	109 701	112 262
Expenditure	EUR mn	106 642	109 301	112 211
Persons insured in the white-collar workers' pension insurance [1]	1 000	22 173	22 218	22 529
Number of pensions paid on 1 July	1 000	8 328	8 547	8 830
Receipts	EUR mn	99 062	103 367	105 914
Expenditure	EUR mn	97 332	98 887	105 385
Persons insured in the miners' pension insurance [1]	1 000	434	396	371
Number of pensions paid on 1 July	1 000	1 002	999	997
Receipts	EUR mn	14 209	14 329	14 390
Expenditure	EUR mn	14 209	14 329	14 390

[1] Results of the micro census, April or May 2000; coverage of the characteristic "branch of social pension insurance" has been discontinued for the years 2001 to 2004.

Source: Statistisches Bundesamt (2002)

47 The active population in Germany was 40,5 million people in 2001, so that also inactive people are latently assured. All figures are to be found under http://www.destatis.de/basis/e/solei/soleitxe.htm.

48 The grant from the Federal budget was recently strongly increased, financed partly by a VAT rate hike of 1 percentage point in 2000 and partly by the revenue from eco taxation. The intension was the reduction of the contribution rates, an intention that failed because of the current recession that again has reduced the revenue and increased the expenditures of the social insurance scheme. For details see Bundesministerium für Arbeit und Sozialordnung (2002, p. 122).

49 Formerly a fluctuation reserve of above the expenses for one year existed, which was permanently reduced because of the increasing structural deficits.

50 The wage tax is transferred to the tax administration accounts also on a pay as you earn basis. The social health insurances then transfer the social pension contributions to the accounts of the social pension system.

51 Details on the pension systems are to be found in several languages under http://www.bma.bund.de/de/neuerente/frame.asp?cont=lexikon/lexikon.asp&bild=lexikon/lexikonbild.htm.

52 The social security contributions are in certain limits deductible from the income tax base; because these limits have been hold constant for longer periods, currently often less than 50 % are deductible dependent on the family status and the income, respectively.

The benefits from the social pension system are pension payments to the assured in case of disability and old age or to the surviving dependants (widow/widower and the dependant children[53]); a second task are measures for the maintenance of employment for the assured (e.g., rehabilitation), beside expenditures for education and information. From the pension, the pensioners have to pay a compulsory contribution to the social health insurance (7.5 % on pensions and other similar income). While formerly a flexible retirement age was applied (for women starting with 60 and men with 63), since 2001 a uniform retirement age of 65 is effective.[54] Beside that general age limit there are several models of part-time employment and early retirement overwhelmingly agreed between employers, trade unions and the social pension system, so that often the effective retirement age is much less.

Table 2: Overview on the Basic Parameters of the Social Insurance Scheme 2003

<u>Income limit for the legal obligation to insure</u>

Health insurance	Old States	New States
Year	45,900.00 Euro	45,900.00 Euro
Month	3,825.00 Euro	3,825.00 Euro
Day	127.50 Euro	127.50 Euro

<u>Contribution assessment limit</u>

Health and old age care insurance	Old States	New States
Year	41,400.00 Euro	41,400.00 Euro
Month	3,450.00 Euro	3,450.00 Euro
Day	115.00 Euro	115.00 Euro

Pension and unemployment insurance	Old States	New States
ar	61,200.00 Euro	51,000.00 Euro
Month	5,100.00 Euro	4,250.00 Euro
Day	170.00 Euro	141.67 Euro

<u>Contribution rates</u>

	Old States	New States
Branches of social insurance		
Pension insurance	19.5 %	19.5 %
Health insurance	11.9 % to 15.7 %	11.9 % to 15.3 %
Old age care insurance	1.7 %	1.7 %
Unemployment insurance	6.5 %	6.5 %
Students contributions		
Health insurance	45.67 Euro	45.67 Euro
Old age care insurance	7.92 Euro	7.92 Euro

<u>Wage limit for negligible part-time employment</u>

Month	325.00 Euro	325.00 Euro

Source: Bundesministerium für Wirtschaft und Soziales (2003).

53 Non-employed dependants are contribution-free insured with the breadwinner in all branches of the German social insurance scheme (household principle). In former time this redistribution overwhelmingly met the public acceptance. With the changing role of the family this measure is heavily criticised.

54 Pre-condition is a contribution period of at least five years.

The mode of pension calculation for new pensioners follows a complex pension formula; decisive for the annuity volume is the wage earned in every month to the average wage of all assured in the social pension insurance in that month, the length of the insurance period and the kind of pension, which is predominately dependent on the retirement age. With other words, the whole lifetime earnings determine the individual pension entitlement. A very rough figure is given by the standard pensioner ("Eckrentner") with 45 assurance years who in each month had earned the average wage. Currently such a pensioner would reach a net replacement income level of about 70 % (of the last wage before retirement); the Riester reform will reduce that level to about 67 to 68 % within the coming 30 years. This level is just a fictitious estimation, because the effective net replacement ratio is determined by many other individual variables (especially other incomes than from pension). The current pension payments are usually dynamically adapted to the net wage development. For pensioners with monthly wages above the contribution assessment limit the replacement income ratio is progressively diminishing (provision gap). In 2001 about 23,0 million pensions were paid by the social pension insurance (see table 1).

Especially this provision gap for higher income earners has been the reason for the introduction of the company pension systems especially after World War II, which in the following decades especially due to connected tax privileges were expanded also to the employees with lower wages. After the legal regulation and the stepwise abolishment of tax privileges, the enterprises often reduced their pension programs, so that – after a peak of about 40 % in the 70s of the last century – now the coverage is less than one-third of the employees in the private sector. Obviously, such voluntary pension systems contribute to higher replacement ratios that also are provided by the public pension systems (see chart 19 below). Formerly especially the self-employed and today the vast majority of all household types have in addition to their social pension and companies pension entitlements life insurance contracts, overwhelmingly in form of capital insurance (see 2.2.1. above) which usually has the highest rate of return. Consequently for a majority of the German households old age protection is organised from different pillars as shown in chart 22 below. Beyond that capital income (from interest, dividends, rent, etc.) and part-time employment contribute to further increases of the replacement income ratio. In total, the current pensioners generation is the wealthiest in the German history, privileged by numerous tax concessions. Up to now the demographic burdens have been overwhelmingly distributed by debiting the active and the future generations, so that today poverty is a phenomenon which could more frequently be found in family with children while the formerly domination of old age poverty has been almost totally overcome.[55]

3.1.2. Health System

The social health insurance system is not a unitary institution but consists of local, companies, guilds, agricultural, professional, etc. insurances and the so-called compensation cashes, which are self-administrative entities of public law (like all the social insurances). Since some years the number of the existing insurances decreased to 420 in the year 2000 (see table 3). The membership is compulsory for all blue-collar workers and for white-collar workers with a wage below the income limit for the legal obligation to insure (see table 2). Above that limit employees are free to choose self-coverage of health risks or to assure within private health insurances. Self-employed and employees above the income limit can be voluntarily insured in one of the above

[55] See Petersen/Raffelhüschen (2000).

mentioned insurance types while some special prerequisites apply. Since recently the compulsory members are free to choose their preferred insurance from the basket of the existing mandatory health insurances, so that a certain competition between the mandatory health insurances has been introduced.

Table 3: Social Health Insurance

Specification	Unit	1998	1999	2000
Single insurances	Number	483	459	420
Members (incl. pensioners) [1]	1 000	50 686	50 927	51 036
Receipts [2]	EUR mn	127 750	131 203	133 808
Expenditure [2]	EUR mn	127 473	130 918	133 740

[1] Average of 12 monthly values.
[2] Excl. risk structure compensation scheme.

Source: Statistisches Bundesamt (2002)

Compared to the social pension insurance, the large number of much smaller social health insurances creates an adverse selection problem for the single insurances because in some of them bad risk case are concentrated. With the purpose to avoid negative consequences for single insurances, risk sharing or equalisation schemes have been implemented (risk structure compensation scheme).

The single social health insurances have due to their different risk structure different costs, which are also expressed in different contribution rates. The actual contribution rates are in the range from 11.9 % for the most favourable and 15.7 % in the most expensive insurance (see table 2).[56] These contribution rates are applied until the contribution assessment limit is reached, which is 75 % of the above mentioned social pension insurance contribution assessment limit. The maximum contribution is then between 4,926.60 Euro in the most favourable and 6,499,80 Euro in the most expensive social health insurance. Non-working family members (spouse and children) are contribution-free insured.[57] As in case of the social pension insurance contribution, the employee and employer pay half of the contribution, respectively. Principally the single insurances have to balance their budgets by contribution adaptations in due time. Therefore contribution revenue (receipts) and expenditure are almost balanced (see table 3).

The benefits from the social health insurance are mainly medical services (transfers in kind) and sickness benefits (see chart 19 below as well as the surrounding text). Law independently from the actually paid contribution defines about 95 % of all medical services. The comprehensive catalogue comprises all necessary medical treatment from ambulant treatment of physicians and dentists to hospital treatment on a comparatively high level.[58] With different cost abatement laws co-payments for the assured were introduced. For pharmaceuticals, hospital treatment and especially for dental treatment (dental prosthesis) as well as eyeglasses the co-payments are partly defined in absolute and partly in relative terms.[59] But generally the patients do not get any

[56] The actual contribution rates are to be found under http://www.abc-der-krankenkassen.de/template.php3?page=alphabetinc.php3&id=1.

[57] The income dependency (instead of a risk orientation as in private insurance schemes) and the contribution-free co-insurance of family members are re-distributive measures, which currently are seriously discussed.

[58] For details see http://www.abc-der-krankenkassen.de/gesetzlicheLeistungen.htm.

[59] See http://www.abc-der-krankenkassen.de/zuzahlungen.htm.

information about the quantity and quality of medical treatment they have demanded, abstained from any price or cost information (see chart 7 and the surrounding text above).

People in old age who were in need of care were only very limited assured in the social health insurance and often got into the social aid system due to the high care costs. Therefore in 1995 old age care insurance was invented and implemented as a mandatory system for all citizen older than 18 years. Even the self-employed and government officials are compulsory members. Therefore, this social insurance scheme has with 71,3 million members in 2000 the largest number of persons insured of all existing social insurance systems (see table 4). Citizen with income above the limit for the legal obligation to insure have to procure an old age care insurance contract with their private health insurance.

Table 4: Social Old Age Care Insurance

Specification	**Unit**	**1998**	**1999**	**2000**
Number of persons insured	1 000	71 458	71 545	71 319
Recipients of benefits	1 000	1 738	1 819	1 822
- domiciliary care	1 000	1 227	1 275	1 261
- residential care	1 000	511	544	561
Receipts	EUR mn	16 083	16 318	16 543
Expenditure	EUR mn	15 823	16 352	16 674

Source: Statistisches Bundesamt (2002)

The contribution rate in the old age care insurance is constant since 1996 with 1.7 % up to the contribution assessment limit of the social health insurance (see table 2). The maximum annual contribution is 703.80 Euro, again divided between employee and employer. While in the first years the old age care insurance has made a surplus, until recently deficits have been run, so that contribution rate increases as in the social health insurances are likely.

The need of care is defined in detail by the law; different grades of care are differentiated. In the first grade daily care is supported by transfers in kind up to 383.50 Euro or in cash to assisting relatives up to 204.50 Euro per month. In the highest third grade the amounts are 1,431.60 Euro and 664.70 Euro, respectively. Due to the high monthly costs of old age care in nursing homes of often much more than 3,000 Euro per month, even in case of an average pension payment both, the transfer in kind and the pension are not high enough to pay for the nursing costs. Then the maintenance obligation of the relatives becomes effective or in case of poverty the social aid system has to come into effect.

Because a large part of the German population is compulsory assured in the social health insurance system (clearly about 90 %), the assured persons in the private health insurance system are overwhelmingly self-employed and government officials. The latter do have an own health care system, which principally pays for 50 % of the medical expenses; usually the other 50 % are assured by quota-contracts within the private health insurance system.[60] Naturally the private health insurances have risk-orientated premiums for the individual members (differentiated for male and female, age, individual risk situation, age at inception date, etc.) including lifetime individual accounts for the old age accruals. In spite of the regulations in other European countries, in case of insurance change the accruals are expired. This regulation interferes the

60 Both can by application also become members of the social health insurance as far as their income is below the limit for the legal obligation to be assured or before they have been employees with mandatory membership.

competition between the single health insurances. However, discussions on possible changes in the regulation have begun. The private health insurance market has an oligopolistic structure. The opening with regard to the common European market has strengthened the competition and additionally improved the risk structure within single insurances. The contract usually consists of four parts: ambulant treatment of physicians, dental treatment, hospital treatment, and replacement income. All measures to avoid moral hazard are used. In each part of the contract a certain retained amount can be arranged that reduce the insurance premium. Moreover, premium reimbursement is implemented, which also reduces the premium dependent on the length of the period (number of month or years, partly with progressive reimbursement) in which no benefits have been claimed. In case of high risks additional premiums are applied. The in former times possible debarment in case of high risks is today overwhelmingly avoided because such practices have undermined the trust of the assured into the private insurance scheme.

In Germany the private health insurance is bound to the price system of the social health system, thus reflecting the problems and inefficiencies involved in that scheme. The medical services are systematically higher priced as in the social health insurance by a multiplier system, which is dependent on the complicacy of the single medical treatment. In the coming reform of insurance regulation also separate price negotiations between the private insurances and the physicians (or physicians' association) have to be reconsidered.

3.1.3. Unemployment Insurance

The unemployment insurance has the main target to guarantee a replacement income in case of unemployment. Because unemployment was taken as a societal mass risk, traditionally the opinion was prevailing that unemployment could not be insured via private insurance markets. Recently some private unemployment insurances have been successfully founded, so that principally also regulated private unemployment insurances are a reasonable alternative. Beside the guarantee of a replacement income, the unemployment administration of the social unemployment insurance has the important task of employment promotion and placement service. Because of enormous failure especially with regard to the placement service, private service units have been implied and the whole unemployment institution is facing a fundamental change, which has the purpose to increase efficiency and reduce the enormous costs.

The unemployment insurance has only compulsory assured members, namely all blue and white collar workers, excluded the self-employed and the government officials, the latter mainly employed on a lifetime basis. Retired people and pensioners are also not assured. The expenditures are financed by contributions of the employees and employers (50 % each); a possible deficit is financed from the federal budget (see table 5 for revenue and expenditures). The current contribution rate is 6.5 % up to the contribution assessment limits (61,200 Euro in the old and 51,000 Euro in the new states, see table 2). A benefit entitlement is acquired if the assured has worked 12 month within the last three years. For employees younger then 45 the maximum benefit period is 12 month (24 month worked within the last three years); employees older than 57 can get the benefit up to 32 month (in the past often followed by an early retirement scheme).[61]

61 For details see Bundesanstalt für Arbeit (2003) and http://www.arbeitsamt.de/hst/services/merkblatt/pdf/mb01_alo.pdf.

Table 5: Unemployment Insurance

Specification	Unit	1998	1999	2000
Unemployment benefit[1]				
Recipients [2]	1 000	3 491	3 324	3 152
Expenditure	EUR mn	42 573	40 443	36 772
Unemployment assistance (aid)				
Recipients [2]	1 000	331	331	325
Expenditure	EUR mn	3 973	4 045	4 127
Short-time allowance				
Recipients [2]	1 000	115	119	86
Expenditure	EUR mn	335	314	335
Federal Institute for Employment				
Receipts	EUR mn	46 573	47 954	49 606
Expenditure	EUR mn	50 542	51 694	50 473

[1] Federal Ministry of Labour and Social Affairs, Bonn.
[2] Average of 12 monthly values.

Source: Statistisches Bundesamt (2002)

The unemployed person has to be willing to work and to be available for the labour markets. That includes the disposition to accept a reasonable job offer. However, a reasonable job offer is already given if within certain limitations the new job is connected with a lower qualification and wage. The unemployment benefit is dependent on the families' status; transfer base is the net wage (after wage tax and social security contributions), which has been earned during the last 52 weeks before unemployment. The replacement income ratio is 60 % for a single, or 67 % for a married unemployed with at least one child. The unemployment benefit is defined as assurance benefit and therefore not means tested. Beside the unemployment benefit a short-time allowance is paid for employees who have to work short time due to economic reasons. This partial compensation follows the same replacement ratios as the unemployment benefit.

If no benefit entitlement does exist, unemployed can come under the unemployment assistance (or aid). The assistance is similar to social aid and consequently means tested. The replacement income ratio is 53 % or 57 %, respectively. As opposed to the unemployment benefit, the unemployment assistance is permanently paid and financed by a grant from the federal budget. Due to the planned labour market reforms, the unemployment assistance is fundamentally criticised. As in some other OECD countries, which also had a combined system of unemployment benefit and assistance,[62] the proposal has been made to unify the social aid with the unemployment assistance on the replacement level of the social aid system while the job placement should also be done in a unique institution.

[62] For details on unemployment compensation schemes see Burda (1997).

3.1.4. Accidents Insurance

Between the accidents insurance and the health insurance there are some similarities that in some countries have been taken as reasons to combine both systems within the health insurance. In Germany the social accidents insurance scheme was developed from the former firms liability for the own employees. But the definition of assured persons was extended to all persons in work or education. The German social accident insurance consists of three entities: the general, the agricultural, and the maritime accidents insurance, which are organised in form of occupation co-operatives. The co-operatives are self-administered legal entities. The representatives within these entities are elected by the assured and employers (one-half each).

Table 6: Social Accidents Insurance

Specification	**Unit**	**1998**	**1999**	**2000**
Social accident insurance [1]				
Number of persons insured [2]	1 000	56 341	58 072	57 960
Number of pensions paid [2,3]	1 000	1 157	1 152	1 143
Receipts [4]	EUR mn	13 474	13 420	13 544
Expenditure [4]	EUR mn	13 269	13 279	13 384

[1] Federal Ministry of Labour and Social Affairs, Bonn.
[2] Excl. accident insurance for pupils.
[3] At the end of the year.
[4] Incl. accident insurance for pupils.

Source: Statistisches Bundesamt (2002).

The number of persons insured is clearly higher than in the social pension and health insurance because the pupils and the younger children in kindergarten are included. The social accidents insurance is exclusively financed by contributions of the employers. Pupils and students are insured in public accidents insurance. The employer’s contributions are fixed to the expenditures of the preceding year and the PAYGO system is applied. The contribution depends on the payroll in the single company and the risk situation with regard to occupational accidents. The insured events are accidents at work and occupational diseases.

The main tasks of the accidence insurance are accident prevention, rehabilitation, and replacement income in case of shortened income (accident pension). Prevention is organised by the occupation co-operatives, which have to implement corresponding regulations, which are also controlled by their technical staff. The current contribution ratio was in the year 2000 1.31 % of the payroll of all companies. This social insurance branch is the only one with a decrease in the contribution rate compared to the 60s of the last century.[63]

Because the social accident insurance is concentrated on occupational and educational accidents, there are private accidents, which are not insured within the public system. Private accident insurances complement the social insurance; partly substitute them (possible in case of voluntary assured, e.g., physicians, pharmacists). Insured are the consequences of disability, temporarily affections in the ability to work, death, and hospital costs. The agreed contract volume determines the premium while specific risks (for instance risky sports) are taken into consideration.

[63] For details see http://www.hvbg.de/d/pages/kosten.htm.

3.1.5. Basic Security System

The German social aid system has the main task to close the protection gaps that are left by the social insurance system. The justification of social aid has at least two reasons: On the one hand there are individuals or groups who are not able to earn a sufficient income on labour markets because of physical, mental or psychic diseases or disabilities. Consequently they are also unable to acquire entitlements from the social insurance system. On the other hand grinding poverty for larger groups of the society is unacceptable in social orientated market economies because such situation could jeopardise the future peaceful existence of the market system itself. Therefore, the justice of needs concept is one basic pillar for open societies (see chart 1 and 2 above).

The social aid payments are motivated to allow the recipients a sufficient life in human dignity and a certain participation in the public life. Because of its character as individual assistance in case of needs, applicants are to be subjected to a means test that controls the income and property status. As a basic security instrument, social aid is financed by general tax revenue following the PAYGO procedure (for details see 2.2.2.3. above and 4.1.2. below). The continuous subsistence payments are defined as a standard rate, which is discretionary adapted to the development of a certain commodity basket and the price level. Additionally the costs of housing are fully covered as well as single payments in specific situations of need are made (for instance for clothing and residence contents).

Assistance in special situations especially is paid to persons living in nursing homes and several other cases (see table 7). In the former case the full costs or the missing part is paid if the pension or other income is insufficient to pay for the full costs. Persons in nursing homes then get a small pocket money from the social aid system.

The housing costs including all extra costs are fully paid if the flat corresponds to a standard that seems to be appropriate; often the social aid offices take on even higher rents if then the families can stay in their accustomed ambience. Such partly more generous regulations have prevented the country from having large slums in which poverty and criminal activities often play a disastrous role.

The standard rate is a cash amount, which is fixed as a specific commodity basket consumed by an adult. The number of family members determines the aid. The head of the household gets the full aid payment, which was 292 Euro in 2002; the spouse gets 80 % of that standard transfer, whereas for the children the multiplier is in the range of 50 % to 90 % dependent on the age.[64] For certain groups, especially old age people, additional requirements are accepted, which is 20 % of the standard transfer.

Social aid recipients are indebted to accept reasonable jobs, for instance working for local public companies. Is such a job refused, the social aid offices have the possibility to shorten the transfer up to 20 %. This rule is only rarely applied but more and more intensively discussed in the public (see 4.1.2. below)

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[64] For children younger than seven years the multiplier is 50 % (in case of a single parent 55 %), between 7 and 13 it is 65 %, and between 13 and 17 years 90 %; for older children who are able to work the amount is reduced to 80 %.

Table 7: Social Aid System

Specification	Unit	1999	2000	2001
Social Aid				
Recipients of continuous subsistence payments	1 000	2 812	2 694	2 715
Incl.:				
Outside institutions	1 000	2 792	2 677	2 699
Recipients of assistance in special situations	1 000	1 402	1 459	1 498
Incl.:				
Assistance for nursing care	1 000	310	324	332
Assistance during sickness (incl. assistance regarding sterilisation and family planning)	1 000	548	581	576
Integration assistance for handicapped persons	1 000	503	525	555
Gross expenditure on public assistance	EUR mn	22 978	23 319	23 942
Of which:				
Subsistence payments	EUR mn	10 044	9 777	9 669
Incl.:				
Outside institutions	EUR mn	9 746	9 518	9 434
Assistance in special situations	EUR mn	12 934	13 542	14 273
Incl.:				
Assistance for nursing care	EUR mn	2 901	2 876	2 905
Assistance during sickness (incl. assistance regarding sterilisation and family planning)	EUR mn	1 206	1 234	1 279
Integration assistance for handicapped persons	EUR mn	8 522	9 113	9 764
Benefits for asylum-seekers				
Recipients of normal benefits	1 000	436	352	314
Gross expenditure	EUR mn	2 114	1 945	1 710

Source: Statistisches Bundesamt (2002).

With the begin of 2003 a needs orientated basic security for old age and disabled people has been introduced which is similar to the social aid system but should prevent the so-called bashful poverty. The transfer will approximately reflect the standard transfer from the social aid system; while a means test is only applied if relative have an annual income, which is over 100,000 Euro. Connected with this basic security scheme is the possible draw of an accommodation allowance, which can also be drawn by other people with wages in the lower wage brackets.[65]

With increasing market income the social aid payment is stepwise reduced. The problem of the high marginal transfer reduction rate is discussed below (see 4.1.2.).

3.1.6. Taxation of Wages and Profits

It is impossible to give a complete overview on the complex German direct tax system within such a survey, so that one has to concentrate just on the very fundamentals. The personal income tax is the tax on physical persons and personal companies and the corporation tax the

65 For details see http://www.bmgs.bund.de/downloads/sozialhilfe_wohngeld.pdf.

corresponding tax on legal entities. The income and profit definition in both laws are almost identical. The income notion does not consist of a synthetic definition but enumerates the different kinds of income that belong to the taxable base. Seven income kinds do exist, from which the first three (income from farming and forestry, income from personal lead companies, income from self-employment) are following the Schanz-Haig-Simon (S-H-S) type of income definition (comprehensive income tax base). The remaining four income kinds (income from employment, income from capital property[66], income from rents and leasing, as well as miscellaneous (especially pensions) are defined in accordance with the source principle (Fuisting). On the level of the single income kinds, different specific exemptions are possible.[67] Then the amounts are added and further personal allowances are deductible until the taxable base is derived. On the taxable base the income tax schedule is applied, which is a directly progressive tax tariff with increasing marginal rates for the rising income brackets.

The personal income tax consists of three different sub-categories: the wage tax and the withholding tax on dividends, raised following the pay as you earn approach, and the assessed income tax following a complex assessment procedure. The corporation tax is levied on the legal entities and also based on the assessment procedure, while the distributed dividends are taxed at the source. Half of the gross dividends then are taxed as capital income within the personal income tax. For dividends a reduced form of double taxation has been implemented until the tax credit method was abolished.

In the personal income tax the above-mentioned progressive tax schedule is applied. In case of spouses the splitting procedure is adopted. Within the tax schedule a basic exemption makes sure that the replacement income that is set by the social aid system principally remains tax-free. The basic exemption for a single person (basic income tax schedule) is currently 7,205.64 Euro (for spouses: 14,411.28 Euro). The first tariff zone until a taxable income of 8,945.05 Euro (17,890.10 Euro) starts with a marginal tax rate of 19.9 %. For taxable incomes beyond that limit until 54,998.13 Euro (109,996.26 Euro) the marginal rate increases linearly from 23 % to 48.5 %. Above that limit the marginal tax rate is hold constant. For the years 2004 and 2005 further reductions of the marginal rates are planned, so that the initial rate in 2005 will be reduced to 15 %, while the highest marginal rate will decline to 42 %. Connected with the tax reform 2000 the taxable base was defined in a more comprehensive way, abolishing several tax concessions especially directed to companies. Whereas the short-term tax burden was reduced by marginal rate decreases, the long-term burden is rising because of the higher tax base and the avalanche effects described above (see 2.2.3.3. and 4.3.1. below). Chart 10 represents the marginal and average tax rates of 1998 and 2005.

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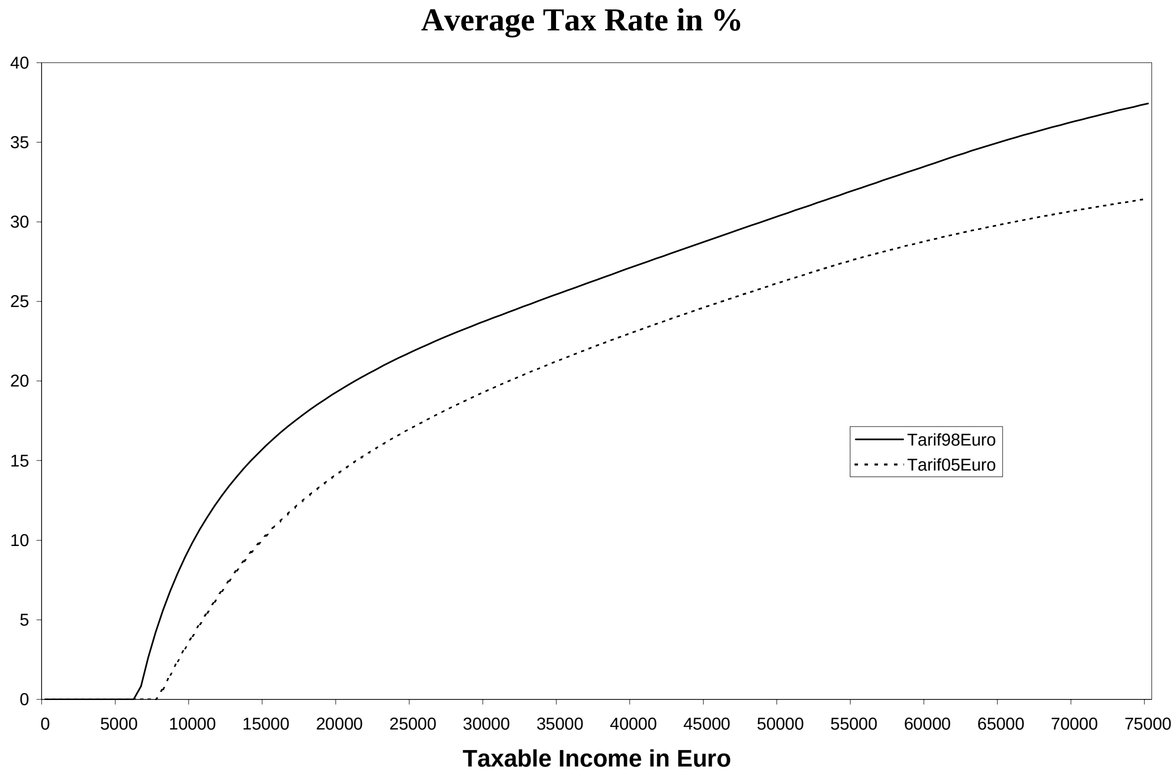
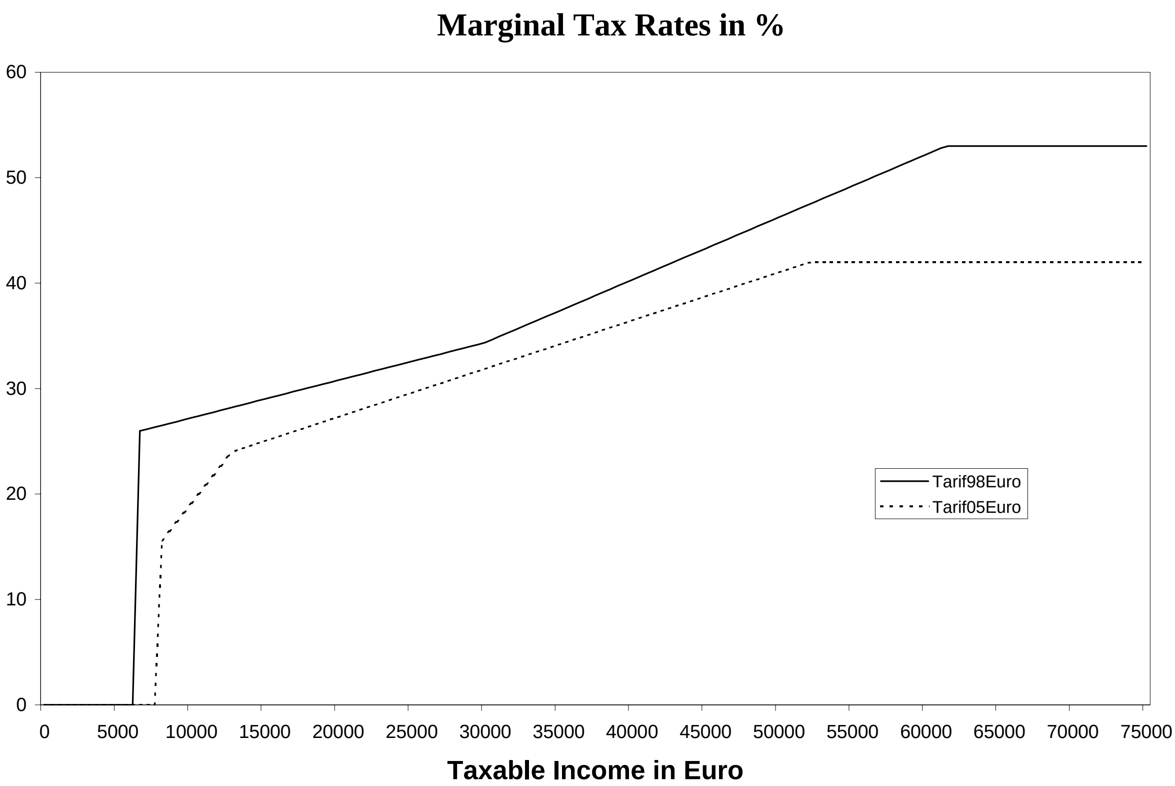
[66] Here a saving exemption is applied which is 1,585 Euro (for couples 3,170 Euro) per year. Only interest payments, dividends etc. beyond that amount are taxed.

[67] For details see Petersen (1988). The recent figures for exemptions and the tax schedule are to be found under http://www.bundesfinanzministerium.de/Steuern-und-Zoelle/Lexikon-Steuern-A-Z-.701.htm.

Chart 10: Marginal and Average Tax Rates of the Income Tax Schedule 1998 and 2005





Source: Own Calculations.

While formerly the tax rate of the corporation tax has always been close to the maximum rate of the personal income tax, since the mid 90s in Germany like in many other countries the corporation tax rate and even the marginal tax rate for personal companies within the personal income tax has been reduced stepwise. This relatively high tax burden on the legal entities was justified by the alleged higher ability to pay, which stock corporations would have in comparison with personal lead companies. In combination with other taxes on profits and property (in Germany the business tax, capital gains taxation within the income and corporation tax, and the property tax) the total average tax burden was clearly above 70 % for profits, which has led to increasing tax avoidance and capital exports (see 4.1.1. and 4.1.3. below) due to the growing capital mobility in a globalised world. The current proportional corporation tax rate is 25 % on retained and distributed profits as well. Additionally the business tax applies with an approximate average tax burden of 13 % on profits and the solidarity surcharge with 5.5 % so that the total average tax burden is about 43.5 %.[68] The property tax was abolished in 1997 due to a verdict of the German Constitutional Court. For personal companies the business tax yield is now credited within the personal income tax, so that another reduction of tax rates has taken place. The long-term development of the effective tax burden is now determined by rate decreases, but tax base increases (including the inflationary increases called cold progression). The overall effect of such a tax reform is then determined by the details of the future investment policy within the companies and corporations.

Not only the tax burden but also the ancillary wage costs are of utmost relevance for the future perspectives of employers as well as employees. The wage tax and the social security contribution are finally borne by the employees but also increase the total wage costs. For the employers those elements are ancillary wage costs, which increase the price of labour compared to capital. Therefore, often rationalisation investments are induced, which further decrease the number of jobs within the companies. Increasing unemployment is the result that again contributes to rising social expenses. The employees on the other hand are suffering from the increasing negative incentives due to the necessary social contribution increases, so that additional activities are shifted into the shadow economy.

Before the 2000 income tax reform, which brought a slight reduction of average and marginal tax rates, we have estimated the marginal and average burden of wage tax and social security contributions for an average single taxpayer in Germany (figures of 1998 in DM, see chart 11).[69] At an annual gross wage of 55,052 DM the employers social security are added because these contributions reflect the individual entitlements of the employee against the social security system and in an economic sense are part of the employers wage.[70] From the gross wage the personal allowances are subtracted, so that the taxable base of 48,978 DM results. The connected tax yield due to the 1998 basic income tax schedule is 10,179 DM, the solidarity surcharge is 560 DM and the church tax (which is about 9 % auf the income tax yield) is 916 DM (principally the membership in the churches, which levy the church tax, is voluntarily). If the social security contributions are added, the total burden is 34,227 DM compared to the total gross income of 66,338 DM.

The average tax rate, which demonstrates the average burden of wage tax of each earned Deutschmark, is 15.3 %. The marginal tax rate, which represents the wage tax burden of the last earned and the next additionally earned Deutschmark, is with 38,2 % substantially higher. The

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68 The official figure is 43,65 % at a business tax multiplier of 428 %, see Bundesfinanzministerium (2003) and http://www.bundesfinanzministerium.de/Bild/original_13761/Steuerpolitische-Fakten-fuer-Deutschland.jpg.

69 See Petersen/Raffelhüschen (2000).

70 The differentiation in employees and employers contribution is purely historical and does not have any economic rationality.

average social security contribution rate results with 34 %, while the corresponding marginal rate is 41 %. If both, the tax and social contribution rates are added, the total average rate is derived with 51.6 % (more than half of the gross income) and the corresponding marginal rate with 79.2 %. While the 2000 income tax reform has brought a slight decrease of perhaps 1 to 2 percentage points with regard to the wage tax, the social security contribution rates were slightly increased. The total burden remained almost the same.

Chart 11 : Marginal burden of an average taxpayer (1998)

Gross wage	55.052
Employers Social Contribution ESC	11.286
Gross wage (including ESC)	**66.338**
Taxable income	48.978
Tax yield	**10.179**
Solidarity surcharge	560
Church tax	916
Social security contribution (employee)	22.572
Total burden	34.227

Average tax rate	15,3 %
Marginal tax rate (ESt, Soli, KiSt)	38,2 %
Average social contribution rate	34,0 %
Marginal social contribution rate	41,0 %
Total average burden	51,6 %
Total marginal burden	**79,2 %**

Demographic change	
Increase of marginal burden until 2030/2040	
Social pension insurance:	8-10 percentage points
Social health insurance (incl. old age care):	4-6 percentage points
In total	12-16 percentage points

Example:	12 percentage points	16 percentage points
Gross income	69.641	70.742
Social security contributions	29.178	31.380
Wage tax	10.179	10.179
Average tax rate	14,6 %	14,4 %
Marginal tax rate (ESt, Soli, KiSt)	38,2 %	38,2 %
Average social contribution rate	41,9 %	44,4 %
Marginal social contribution rate	53,0 %	57,0 %
Total average burden	56,5 %	58,7 %
Total marginal burden	**91,2 %**	**95,2 %**

Source: Own Calculations.

If the future demographic changes are taken into consideration, and the additional burdens are only distributed to the burden of the working generations, within the coming 25 to 35 years another increase of all social security contributions from 12 to 16 percentage points seems to be likely.[71] Then the marginal rate would exceed 90 %, a burden, which obviously would lead to serious disincentive effects. There is no doubt about that such a tax and social policy does not

71 See Raffelhüschen (2000).

yield a sustainable perspective. Instead of a permanent increase of the burden on the working generations, a well-balanced reform strategy has to be implemented, which would secure a fair burden sharing between the generations. Otherwise the future generations would press to cancel the generational treaty. The reform elements are discussed below (chapter 4).

With regard to companies' taxation the 2000 income and corporation tax reform has reduced the scheduled tax rates, whereas the tax base was made more comprehensive; dependent on the single companies situation the short term tax burden might be slightly reduced, while the long term burden on the effective tax burden is determined by the avalanche effect. The reduction of tax rates for corporations and personally lead companies does also mean a slight shift in the direction of a dual income tax system. As mentioned above the legal entities are burdened with a scheduled tax rate of about 43.5 % (including solidarity surcharge and business tax). The maximum marginal rate for personal companies is currently 51.2 % (marginal income tax rate 48.5 % and solidarity surcharge 5.5 % on the tax yield, which means another 2.7 percentage points as additional marginal rate), reduced in 2005 to 44.7 %. At least personal companies with larger profits have a higher tax burden than legal entities. Theses differences are even aggravated if the distribution of tax concessions and subsidies is taken into consideration. While multinational enterprises do have a comparatively high capital mobility, they are able by tax optimising, e.g. in using appropriate clearing prices, to minimise their German tax burden, and at the same time they are profiting from remarkable subsidies. Very easily examples are to be found that the largest German enterprises often have a zero tax burden and some subsidised firms are net profiting. The total outcome of such an unequal distribution of burdens within the firm sector is that small and medium sized companies are fully hit by the income tax burdens, while the large are able to avoid high tax burdens. The increasing cases of bankruptcy since years are alarming and have substantially contributed to the bad labour market performance in Germany. Therefore a fundamental reform of business taxation, which details are presented below (see 4.4.), is the main prerequisite for a recovery in Germany.[72]

3.2. Austria

The Austrian social security system has a tradition, which is almost as old as in the German example. The implementation started in 1889 with the introduction of the social health insurance system, which was constructed as a self-administering legal entity.[73] After World War second a basic reform was undertaken in which the social pension, health, and accident insurance were integrated. The basic structure has some similarities with the German system, whereas in principle the compulsory membership is broader defined. The following description concentrates on the very essentials because of the numerous details, which would go beyond the scope of this presentation.

[72] With regard to the value added tax (VAT) the opinion is prevailing that this tax is shifted forward on the consumers. Even if such assumption seems to be a bit optimistic for the firms sector (or to pessimistic for the consumers), the VAT burdens are neglected. For information only the German usual tax rate is 16 %, the reduced rate is 7 %; some transactions are VAT-free; for more details see 4.3.2. below.

[73] For details see http://www.sozialversicherung.at/esvapps/page/page.jsp?p_pageid=110&p_menuid=961&p_id=6.

3.2.1. Pension System

The Austrian pension system consists of three pillars: the social pension insurance, the companies pension system, and the private old age protection. Within the social pension system the whole working population, including the self-employed and government officials, is compulsory insured. The system is financed following the PAYGO approach. Blue and white-collar workers have to pay a social pension contribution rate of 22.8 %, which consists of an 18.5 % basic rate and a 4.3 % additional rate. While the basic rate is equally distributed on employees and employers, the employers pay 3.3 % of the additional rate, so that employees pay 10.25 % and employers 12.55 % of the total rate. For farmers the mandatory contribution rate is 15 % (possibly expanded to 22.8 %) and for self-employed people 20 %.[74] These contribution rates are applied within different contribution assessment limits. For blue and white collar workers this limit is 47,040 Euro annually. For self-employed persons there are lower and upper ceilings, while the upper limit is again 47,070 Euro per year. As in Germany a limit for negligible employment exists, which is 309.38 Euro per month.

The Austrian social pension system guarantees a minimum pension payment, which is 630.92 Euro per month for a single pensioner and 900.13 Euro per month for a couple.[75] Within the higher income brackets the pension payment has the target to secure the level of living dependent on the last income earned, but it also depends on the periods of contribution payment (Period of employment). Opposite to the German system the best 15 insurance year determine the pension entitlement, which are extended to a maximum period of 40 years.[76] This might lead to a maximum net replacement ratio of about 87 %.[77] Such a pension formula favours people with unequal distributed lifetime income and often redistributes pension entitlements in the direction of well to do.

Pensions are paid to disabled, old aged, and surviving dependants. As in Germany the dependants are contribution-free insured if there is only one breadwinner in the family. The retirement age is 65 for men and 60 for women.[78] The employee’s contributions are fully deductible from the income tax base, while the employers’ contributions are business expenses. The pension payments stemming from employers contributions are fully taxed, while the payments based on the employees are only taxed by 25 %. Compared to the German procedures, the Austrian method is much more rational and comes very close to the downstream taxation described above (2.2.3.3.).

While the social pension system comprises roughly 94 % of the total old age protection, the companies pension system and the private old age protection contribute about 3 % each.[79] Qualified for a companies pension are about 10 % of the Austrian employees, while no figures could be found for the extent of private protection measures. The rules for the companies systems depend on single arrangements and the systems are generally funded. A government subsidy of 4.5 % of the contributions is paid up to 44.98 Euro per month.[80] Employees contributions are tax

74 See Hauptversicherungsverband der österreichischen Soziaversicherungsträger (2003, pp. 13).

75 See Schmid (2002, p. 45).

76 See Europäische Kommission (2002), http://europa.eu.int/comm/employment social/missoc/index de.html.

77 See Bundesministerium für soziale Sicherheit und Generationen (2003), http://www.sozialversicherung.bmsg.gv.at/.

78 See Schmid (2002, pp. 49).

79 See Wöss (2002, p. 96).

80 See Holzmann/Heitzmann (2002).

deductible until an annual amount of 654 Euro. The assurance benefit is dependent on the single contract. The same holds true for private measures, which overwhelmingly consist in life insurance contracts. Naturally, other private property, especially dwelling property, plays an important role for people in old age.

3.2.2. Health System

As in case of the pension system, the Austrian social health insurance system comprehends the whole working population, e.g., almost 99 % of the Austrian population.[81] Contribution base is as in the social pension system the gross earned income and the social pension. Self-employed are at least due to a minimum monthly contribution. Otherwise the contribution assessment limits apply as in the case of the pension insurance, including the limit for negligible employment.

The contribution structure is more complex than in the German case. A remarkable difference can be seen in the fact that the Austrian non-employed dependants are not contribution free insured like in Germany, but have to pay an own additional contribution. The contribution rates differ for the different type of employment. For blue-collar workers the rate is 7.6 %, which is partly paid by the employee (3.95 %) and the employer (3.65 %). The white-collar workers rate is 6.9 % (employees: 3.4 %, employers 3,5 %); the rate for government officials is 7.1 (employee: 3.95 %, federal budget: 3.15 %). Pensioners are contributing 3.75 % of their pension payment and self-employed 8.9 % of their gross income. The additional contribution of dependants is 3.4 %, which was introduced in 2001. Children and grandchildren are still contribution-free assured.[82] In comparison to Germany the Austrian contribution rates are substantially less, which cannot be only explained by the additional contributions for dependants.

The insurance benefits comprehend obligatory benefits and transfers in kind as well as voluntary benefits, on which single decisions are made by the insurances. The insurances consist of regional and occupational health insurances (8 and 9 insurances, respectively).[83] The sickness benefit is 50 % of the earned income[84] and fully taxable, while the insurance contributions are fully deductible. Like in Germany an extensive catalogue of cost sharing exists, which comprises participation in the costs for consultations, hospital costs, and rehabilitation. In total, the medical system is more controlled by the family doctors, and with regard to the average income the cost sharing seems to be more severe than in Germany. Both obviously have a positive impact on the total costs of the medical system.[85] On the other hand, the private health insurance does play only a very limited role. It is relevant just as an additional insurance scheme, in which about one-third of the population is complementarily assured. The old age care is organised within the social insurance system, so that no separate insurance does exist.[86]

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81 See Europäische Kommission (2002), http://europa.eu.int/comm/employment social/missoc/index de.html.

82 See Europäische Kommission – Beschäftigung und Soziales – Österreich (2002, p. 1).

83 See http://www.sozialversicherung.at/media/33855.PDF, p. 28.

84 Bundesministerium für Soziales und Generationen (2002, pp. 91).

85 In 2001 83 % of all medical expenses have been financed by contributions and the remaining 17 % by other sources; see Bundesministerium für soziale Sicherheit und Generationen (2002a).

86 For details on old age care see http://www.bmsg.gv.at/bmsg/relaunch/behinderung/content/downloads/pfleged.pdf.

3.2.3. Unemployment Insurance

In the Austrian unemployment insurance all employees are compulsorily assured. The contribution base is the gross wage. The currently applied contribution rate is 6 %, which is half paid by the employees and employers, respectively. The same contribution assessment limits are operating as in the other social insurances.[87] The whole system is financed by contributions and grants from the federal budget. The unemployment benefit depends on the qualifying period. After a one-year period of employment, an unemployed has a benefit entitlement for the next 20 weeks. Only after a qualifying period of 9 years, the dole is paid for a full year; the maximum entitlement is reached after 15 years; then the dole is paid for 18 month.[88]

The reference wage is the net wage within the last twelve month before the unemployment. The replacement income ratio for a single is 55 %, while family allowances exist. The dole itself is net orientated and therefore income tax-free. The employees' contribution is not tax deductible.

Similar to the German unemployment assistance (aid), an emergency aid ("Notstandshilfe") does exist. The monthly aid also depends on the period of unemployment. In case of unemployed having received unemployment benefits for 20 weeks, the fixed monthly amount is 630.92 Euro, after 30 weeks 736.00 Euro, and after 52 weeks 90 % of the unemployment benefit. However, the emergency aid is insofar means tested, as income limits do exist for the dependants of the unemployed person.[89] These amounts are clearly above the aid payments from the Austrian social aid system (see 3.2.5. below). Compared to the benefits from the German unemployment insurance, the replacement ratios remarkably lower, the qualifying period much longer, and the period of dole payment much shorter.

3.2.4. Accidents Insurance

In the social accidents insurance the whole working population as well as the pupils and students are insured.[90] The system is PAYGO financed by contributions, which for the employees are exclusively paid by the employers, namely 1.4 % of the payroll. Self-employed persons have to pay a lump sum amount of 81.37 Euro per year, while farmers are contributing 1.9 % of their respective income.[91] However, for employees and farmers the same assessment limits are applied than in the other social insurance braches.

The insurance benefits comprise treatment of sicknesses connected with the assured accidents, rehabilitation, and recoupments in case of occupational accidents, replacement income payments, and accident provisions. The employers' contributions are as business expenses tax deductible. Pension payments on the other hand are fully taxed, so that in this case downstream taxation is applied.

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87 See Hauptverband der österreichischen Sozialversicherungsträger (2003, p. 3).

88 See Schmid (2002, p. 57) and Europäische Kommission (2002, pp. 34 and pp. 103).

89 One dependant person is only allowed to earn 435.00 Euro per month, the second up to 217.00 Euro. For unemployed above the age of 50 the limits are doubled, above 55 tripled.

90 About 3 million employees, 1.4 million self-employed, and 1.2 million pupils und students are compulsory insured; see http://www.sozialversicherung.bmsg.gv.at/.

91 See Hauptverband der österreichischen Versicherungsträger (2003, pp. 4).

3.2.5. Basic Security System

The Austrian social aid system is organised in accordance with the subsidiarity principle, which also determines the German approach. If neither income from labour market participation can be earned nor other sources from institutions or the family can guarantee the personal subsistence, then a legal claim exists for payments and in kind transfers from the social aid system. That comprises cash payments, medical services, as well as care services in old age care and nursing homes. As in Germany the maintenance obligation of the family and means tests are applied. In contrary to the German solution, there is no federal law on social aid; the social aid is regulated in single state laws.[92]

Consequently the minimum level of subsistence is not uniformly defined for the whole federation but within the states. The basic targets and benefits are principally the same as in the German law, so that we can concentrate on the standard rates. For singles the standard rate is between 382.10 Euro per month (Burgenland) and 496.50 Euro per month (Oberösterreich). An increased standard rate is paid by some states especially in case of inability to work. Dependants get a reduced standard rate of about 60 % of the amounts mentioned before. In addition to the cash payments the costs for housing are paid as well as single payments in specific situations of need are made (for instance for clothing and residence contents).

Compared to the German situation the number of unemployed and social aid beneficiaries is much less. Especially with regard to the social aid, in 1999 the number of social aid recipients was 62,922 people, while 57,889 people were living in old age care and nursing homes. Therefore, the social aid payments are substantially higher without having the negative incentives as are to be observed in Germany. Perhaps the more intimate social control in smaller communities and the countryside prevents people from demonstrating moral hazard behaviour, so that the more generous regulations are much less exploited.

3.2.6. Taxation of Wages and Profits

With regard to the Austrian personal income and corporation tax, both also follow many of the basic features of the German income tax system. Within the income tax seven types of income exist which are identically defined as in Germany. In contrary to the German system the tax exemption are more rationally defined: almost all social insurance contributions are tax deductible within the single type of income (from the gross wages or as business expenses). After business expenses and similar expenses in case of the other types of income are subtracted, the sum of income is derived, which is reduced by the personal allowances. Then the taxable income results, on which the income tax schedule is applied. The structure of the tax schedule is a directly progressive tariff, which shows a stepwise increasing marginal rate.

The basic exemption is currently 3,640 Euro; for an annual income between 3,641 Euro and 7,270 Euro the marginal rate is 21 %, between 7,271 Euro and 21,800 Euro 31 %, between 21,801 Euro and 50,870 Euro 41 %, and above 50,871 Euro 50 %. The individual taxation is applied, and different tax credits are disposed (general tax credit, which is reduced with increasing income, a

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92 For details see http://www.bmsg.gv.at/bmsg/relaunch/portal/content/berichte/downloads/sozialschutzsysteme.pdf, pp. 95.

tax credit for employees and for commuting between home and place of employment, single earner tax credit, child allowance, pensioners allowance, etc.).[93]

Specific tax rate are applied in case of capital gains for companies (halt the average tax rate) and the 13th and 14th monthly wage ("Felix Austria"). For interest and capital income taxpayers have the choice between the usual assessment procedure and the final taxation of capital income at the source at a tax rate of 25 % (source tax). Obviously the latter method is more favourable for those taxpayers with a higher individual marginal rate. The source tax on the one hand sets incentives for well to do to stay with their capital within the country and on the other hand attracts capital from abroad, where the well to do have to pay higher individual tax rates. Hence, since Austria has introduced the source tax, much foreign capital was attracted, which especially found severe criticism in Germany and the other EU countries (belonging to the high-tax countries).

The Austrian enterprise sector is burdened by the personal company tax within the personal income tax, the corporation tax, and the communal tax. The profits of natural persons are taxed by the marginal rates as described above (from 21 % to 50 %), while personal deductions apply. The tax rate on profits from legal entities (stock companies, etc.) is 34 %, which is clearly below the highest marginal rate in the personal income tax. Additionally both, personal led companies and stock corporations, have to pay the communal tax, which is a tax on the payroll of the single company at a proportional rate of 3 %.[94] Also the Austrian income and profit tax system shows a certain dual character. Interest payments (final source tax) and retained profits (34 %) are less burdened than at least the higher incomes (and wages) within the personal income tax. Additionally many legal entities are less burdened then a large number of small and medium enterprises.

Compared to Germany the corporation tax rate is 9 percentage points higher; but the communal tax yields a burden on the profits, which is slightly below the German business tax. If the solidarity surcharge is included, the total tax burden on Austrian profits is about 4 to 5 percentage points less than the German profits if special concessions with regard to the tax base are neglected. The same holds true for a comparison of the average wage earners. If just the white collar workers are taken into consideration, the marginal wage tax rates in Austria and Germany are quite similar but the total social security contribution in Austria are 33.7 %, while at an average social health insurance contribution rate of 14 % the burden on a German white collar worker is 41.7 %. At the same time the ancillary wage costs for Austrian enterprises are also about 8 percentage points less than for the Germans, so that the competition advantage for Austrian enterprises is further increased. This advantage is also expressed in the Austrian growth performance and in the labour markets, where unemployment is much below the German levels.

3.3. The Netherlands

While the German and the Austrian social insurance scheme are obviously of the Bismarckian type, at least some authors classify the social protection system of the Netherlands more in the

93 See Hoereth/Zipfel (2002, pp. 9) and Bundesministerium für Finanzen (2002) under http://www.bmf.gv.at/service/publikationen/download/broschueren/steuerbu.pdf.

94 The VAT rates are also differentiated in Austria. The standard rate is 20 %, whereas two reduced rates are applied: the 12 % rate (for sales by winegrowers, rents for office space, etc.) and the 10 % rate (books, newspaper, foodstuff, rents for housing, etc.).

direction of the Beveridgean type.[95] Especially the replacement income is orientated in the direction of a basic security approach or the replacement income ratios are decreasing with increasing income. Due to the Waasenaar-agreement between trade-unions and employers the Dutch have been able to come to realignments of the welfare state, which permanent growth before had mainly caused what in the economic literature was called the Dutch Disease.[96] Numerous new instruments have been implemented to reduce the number of the assured within the social insurance scheme, to support the exit, and to improve the chances for low qualified employees and long term unemployed for the re-integration into the official labour markets.[97] The Dutch ministry for economic affairs (Ministerie van Economische Zaken, EZ) just resumed such a policy in its dedication to a free market: "EZ is permanently open to the needs of the private sector, since an efficiently operating 'market' is one of the main prerequisites for economic growth. The Ministry encourages the free market in two ways. Firstly through competition policy, designed to create maximum scope for competition between companies. Secondly by keeping superfluous and unnecessary regulations at a minimum."[98] It is not surprising that under such a motto economic and social policy has been comparatively successful, while the big countries in the EU (namely France and Germany) have not jet made their homework. The Dutch experience are therefore of utmost relevance and an appropriate benchmark for future reform processes.[99]

3.3.1. Pension system

Despite the above-mentioned tendencies in the Beveridgean direction the legal organisational structure of the Dutch social protection system follows the social insurance approach.[100] In the social pension system (Allgemene Ouderdomswet, AOW) all persons with a residence in the Netherlands are compulsorily assured.[101] Instead of the household principle as in Austria and Germany the individual principle is applied. As in most European countries the social pension insurance follows the PAYGO financing.[102] The system is exclusively financed by employees' contribution and the total contribution rate is 19.15 %.[103] This total contribution is divided into 17.9 % for the AOW and 1.25 % for the dependants insurance (Allgemene Nabestaandenwet, ANW). The contribution assessment limit is 27,009 Euro per year,[104] while an amount of 3,995 Euro is contribution-free for wages from negligible employment.[105]

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95 See Casamatta/Cremer/Pestieau (2000a, p. 504).

96 See Broersmar/Koeman/Teulings (2000, p. 96).

97 See Europäische Kommission (2000, pp. 47).

98 http://www.minez.nl/Homepages/ext_eng_frame.asp?site=/Homepages/english_home.htm.

99 For details see Ministry of Economic Affairs (2000) under http://www.ez.nl/publicaties/pdfs/03B102.pdf.

100 See, e.g., See Europäische Kommission – Beschäftigung und Soziales – Gesundheitsversorgung in Europa (2002, p. 13) under http://europa.eu.int/comm/employment_social/missoc/2002/03/intro_de.pdf.

101 See Weber/Leienbach (2000, p. 86).

102 See Vinken (2001, p. 255).

103 In the German example above (chart 11) we have added the employers contribution to the gross wage of the employee, so that the figures are comparable with the Dutch rates.

104 See Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part1_de.htm.

105 See Europäische Kommission – Beschäftigung und Soziales – Missoc (2001) under http://europa.eu.int/comm/employment_social/missoc/2001/nl_0201_de.pdf.

Opposite to the Austrian and German approach, the pension payments are not related to the individual lifetime income. In other words, the modified benefit principle, which at least points to the remaining insurance character in both countries, is in the Netherlands not applied. The pension payments are orientated to the gross minimum wage; therefore the pension has just a basic security character for people in old age. After an insurance period of 50 years a single pensioner gets 70 % of the Dutch minimum wage as monthly pension payments, which is 869.24 Euro. In case of a couple, each person gets 50 % of the minimum wage, which is a monthly amount of 598.07 Euro after 50 years of insurance.[106] For every missing year the pension payment is shortened by 2 %. The general retirement age is 65 years.[107] The pension payments are adapted to the average agreed gross wage. The social pension contributions are deductible from the tax base, while the pensions are fully taxed. Hence, the downstream taxation is applied. Additionally contributions for the social health insurance are subtracted.

Opposite to Germany and Austria the disabled pensions are financed by an own system: the social disability insurance (Wet op de arbeidsongeschiktheidsverzekering, WAO). The system is exclusively financed from employers' contributions. The basic premium is 5.85 %, and an additional premium on the payroll is levied which depends on the firm size (from 1.24 % for small to 8.08 for large enterprises). The contribution assessment limit is a daily wage of 159 Euro.[108] Additional mandatory systems exist for the self-employed (Wet arbeidsongeschiktheidsverzekering zelfstandigen, WAZ) and for young disabled persons (Wet arbeidsongeschiktheidsvoorziening jonggehandicapten, Wajong). The disabled pension payments are dependent on the degree of disability and related to the Dutch minimum wage.

As second pillar for old age security a companies pension system exists, which is a voluntary system introduced by negotiations between the employers and trade unions. The corresponding law regulates that the contributions, usually one third paid by the employees and two thirds by the employers, are to be invested into direct insurance (private life insurances) or in pension funds of the single branches. In 1996 92 % of the employees were assured in such a companies pension system.[109] Target of most systems is to assure a replacement income ratio of 70 % (including the minimum pension paid from the social pension system) of the last wage or at least the average wage earned in lifetime after a working period of about 40 years.[110] The contributions to the companies pension systems are deductible, while the pension payments are fully taxed. This pillar follows the funding approach. The third pillar, private old age protection in form of capital formation or life assurance, is also funded. The private life insurance system supplies the usual insurance contracts and forms, while the extent of coverage is not reported. The contributions are

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106 See Vinken (2001, p. 255) and Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part6_de.htm.

107 Since the 70s of the last century also some early retirement systems have been introduced (VUT). For details see Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part1_de.htm.

108 See Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part1_de.htm.

109 See Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part1_de.htm.

110 A same replacement income ratio is currently possible in the German social pension insurance after 45 years of working. But the difference is that this pension is only PAYGO financed and therefore this replacement rate is not sustainable.

in a certain limit tax deductible;[111] whereas the benefits form the life insurances are principally taxed. Again the downstream taxation applies.

3.3.2. Health System

The Dutch social health protection system consists of two pillars: the social health insurance for usual medical treatment (Ziekenfondswet, ZFW), and the system for extraordinary diseases (Algemene wet bijzondere ziektekosten, AWBZ). Within the ZFW all employees are compulsory assured up to an income limit for the legal obligation to assure, which is also the contribution assessment limit; in 2002 this amount was 30,700 Euro per year. Also compulsory insured are self-employed whose taxable income is less than 19,650 Euro per year and pensioners up to the same income limit. For employees the contribution base is the gross wage. The total contribution consists of a wage dependant amount of 7.95 %, from which 1.7 % is paid by the employee and 6.25 % by the employer, and an annual per capita amount of 181.39 Euro (average amount for an adult fixed by the single health insurance).[112] The dependants on a single breadwinner are contribution-free assured.

Grants from the public budget as well as a push across allocation form the private health insurances are another financial sources for the ZFW. The medical services are based on family doctors, who control the access to the system and decide on the referral to the consultants.[113] Co-payments are usual in case of dental prostheses, partly for pharmaceuticals, and transport of sick persons.[114] The sickness benefit is paid for 52 weeks by the employer at an extent of 70 % up to a ceiling of 159 Euro per day.[115] The benefit payment is taxable.

About 64 % of the Dutch population are assured in the ZFW; another 5 %, the public employees, are assured in an own health insurance system with comprehensive coverage,[116] while 31 % of the population – not compulsory insured in the ZFW – are insured in the private health insurance system (about 50 single insurances),[117] based on a legal obligation to insure. The average insurance premium for an adult in 2002 was about 136 Euro per month, while the premium is coverage dependent. The private health insurances are obliged to supply a standard insurance form, which premium is controlled and fixed by public authorities. The private assured are also bound to the co-financing of the ZFW with an annual contribution of 234.24 Euro per each adult, and 117.2 Euro for each person below the age of 20 years (push across allocation). The coverage of the medical service is contract dependent, but the private insurances are also bound to supply a standard insurance coverage like the ZFW for certain groups of persons.[118]

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111 In 1997 the exemption was 2,704 Euro; see Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part1_de.htm.

112 See Hamilton (2002, p. 27).

113 See Schmidt (2002, p. 192).

114 See Jakubowski/Busse (1998, p. 116).

115 See Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part3_de.htm.

116 See Jakubowski/Busse (1998, p. 96).

117 Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/03/netherlands_de.pdf.

118 See Hamilton (2002, pp. 27).

Within the system for extraordinary diseases (Algemene wet bijzondere ziektekosten, AWBZ), which is comparable to the German social old age care insurance (see 3.1.2. above), all residents of the Netherlands are compulsory insured. This system regulates the entitlement in case of cost-intensive and non-insurable diseases and need of care. The contribution rate is 10.25 % for all Dutch inhabitants with income in Box I up to a contribution assessment limit of 27,846.68 Euro, which coincides with the upper limit of the second income bracket of the income tax schedule for employees. This contribution is similar to an earmarked income tax and therefore neglected in table 8 below.[119]

3.3.3. Unemployment Insurance

The unemployment insurance is regulated by the law on the unemployment benefits (Werkloosheidswet, WW). The contribution to the WW consists of two separate components: one is paid into the general unemployment fund (Algemeen werkloosheidsfonds, Awf); the other into the social security agency's redundancy payment fund (Wachtgeldfonds, Wgf).The Awf contribution is 8.55 % in total, while 4.95 % are paid by the employee and 3.60 % by the employer. The employer only pays the Wgf contribution of 0.85 %. The ceiling for the WW-contributions is 159 Euro per day with a contribution-free allowance of 55 Euro per day. The above-mentioned Wgf contribution is an average; it may vary according to branch and industry.[120]

The amount of the unemployment benefit depends on the qualifying period. After at least 26 weeks of paid employment during 39 weeks before unemployment a short-term benefit is paid for six weeks, which is 70 % auf the Dutch minimum wage. A salary related benefit and a follow-up benefit are granted if the 26 weeks rule applies and additionally four years employment within the last five years are given with at least 52 days employment in every year. Then a salary related benefit is paid, which is 70 % of the last wage up to the ceiling of 159 Euro per day.[121] The duration of payment depends on the length of insured employment. After four years of employment the salary related benefit is paid for six month, after 10 to 15 years for 12 month up to five years for employment periods over 40 years. The follow-up benefit, which is 70 % of the minimum wage, is paid for another two years. All benefits paid are due to the income tax.

Compared to the other unemployment benefit systems, the Dutch is less generous in case of short-term employment, while the income related benefit has a much longer qualifying period and a 12 month entitlement is reached much later than in Germany. On the other hand in the Netherlands the duration of payment for unemployed persons with a comparatively long working career is longer than in Germany, where in such cases early retirement schemes are implemented. But in principle the Dutch approach is more basic security orientated than the Austrian and German systems are.

However, of utmost relevance is the active Dutch labour market policy. Many measures against diseases and disability have been implemented during the last years. The re-integration of sick people is an important task for the employee as well as his employer. Both have to report to the

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[119] Because this contribution also burdens the wages, this additional burden has to be reconsidered (as the NHS expenses in the UK case if the country systems are compared.

[120] See Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/missoc_16_en.htm.

[121] See Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part10_en.htm.

concerned social insurance system. If the report is negatively evaluated, the benefits from the disability insurance might be reduced. Beyond that 131 centre for work and income have been implemented, which are working for the job placement of unemployed and disabled persons.[122] It is worth to be mentioned that even investment orientated collective wage agreements are proposed and flexible wage structure are striven for. For 2002 a tax concession is planned if employees participate in the firms profits. In total the labour market policy has been extremely successful especially in comparison with the German deadlock.

3.3.4. Accidents Insurance

In the Netherlands there is no specific insurance against occupational accidents and diseases. Such risks are covered by the social health insurance, the social disability insurance, and the social insurance for dependants.

3.3.5. Basic Security System

The Dutch basic security system is regulated by the national social aid act (Algemene bijstandswet, Abw). The target is to provide financial assistance to every citizen resident in the Netherlands for the necessary costs of supporting himself or his family in situations of personal need. For younger recipients benefits can be reduced if the municipalities find that full benefits would make work less attractive. For people above 65 the aid payments are in accordance with the pension paid from the AOW system. Every recipient in the employment age must try to get work, accept a suitable employment and be registered at the employment office. Generally the subsidiarity principle is applied, which includes the maintenance obligation for parents; therefore the aid payment is a measure of the last resort.

As in case of the other benefits from the social protection scheme, the benefit is bound to the Dutch net minimum wage, which is 1,047.02 Euro (gross minimum wage: 1,180 Euro) in 2002. The guaranteed minimum is for married or unmarried couples aged 21 to 65 just 100 % of the net minimum wage. Lone parents receive 732.92 Euro and singles 523,51 Euro. Nonrecurring aid is given for incidental but necessary expenses. The first child gets a 14 % additional benefit, the second, third, etc. a 19 % benefit. The beneficiaries are compulsory assured in the ZFW. Principally housing and heating have to be paid from the basic benefit. The program is means and property tested.[123] The benefits are taxable within the income tax system; additionally the contributions for the social insurance schemes (Anw, AWBZ, AOW, and ZFW) are subtracted. In case of additional labour income a small part is not deducted from the transfer, but the marginal transfer reduction rates are similar to that in Germany and Austria.

Compared to the German benefits, the effective net benefit heavily depends on the rent, which is paid by the German social aid system. Especially for families with children in large cities, the German benefits seem to be substantially higher. But more generous are the Austrian benefit levels, because the cash benefit is higher than in Germany and the rent is also paid by the Austrian

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[122] For details see Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/socsot_netherlands_de.pdf.

[123] The property limit is 9,640 Euro for couples and 4,820 for singles; for more details see Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/nl_part11_en.htm.

aid system. Due to the tax and social contribution treatment in the Netherlands, the system is systematically designed to reduce the effects of the poverty trap and comes close to the solutions as proposed below (see 4.1.2.).

3.3.6. Taxation of Wages and Profits

The Dutch personal income tax system is a combination of tax credits (instead of tax exemptions as in Austria and Germany) and a progressive income tax schedule. Since 2001 the income tax base is defined in three boxes, while the single boxes are due to different tax schedules or tax rates, respectively. Box I comprises the incomes from work and home, which consists of firms profits, income from self-employment, wages, continuous income (child benefits, sickness benefits, etc.), imputed rent on owner-occupied dwelling[124], pensions, etc., which is progressively taxed up to a marginal rate of 52 %. The income tax is levied in one sum together with the social security contributions. Box II covers the income from substantial interest; a shareholding is substantial if a person, either alone or with the partner, holds more than 5 % of the shares in a limited company. Then a flat rate of 25 % is applied. Box III includes the income from savings and investment. Not the actual interest payments from capital is taxed but the deemed fixed return of 4 % of the total property (total net worth).[125] This “targeted” capital income (in German: Sollertrag and Sollertragsbesteuerung) is taxed by a 30 % flat-rate, while a tax exempt property amount of 18,146 Euro is applied.[126] For the wage tax, the social security contributions, and the dividends the pay as you earn procedure (withholding tax) is implemented. For the other taxpayers two advance payments per year are to be made.

For incomes in Box I numerous personal tax credits apply. Every taxpayer below 65 years has a “general tax credit” of 1,647 Euro per year; for pensioners above 65 this amount is reduced to 737 Euro, so that pensions are more severe burdened than wages and other incomes (apart from the reduced social security contributions). Every employee gets an additional “employment tax credit”, which is 949 Euro for persons below 57.[127] The child credit is under 65 years 40 Euro and above 19 Euro. For taxpayers below a taxable income of 28,096 Euro from Box I to III get a “supplementary childcare credit” which is 341 Euro under 65 and 154 Euro for taxpayers above 65. Lone parents get a “single parent tax credit”, which under 65 is 1,301 Euro and 582 Euro above 65. Last but not least people above 65 get an old age credit of 289 Euro if their income from the Boxes I to III is below 28,096 Euro.

The progressive tax schedule of Box I consists of four income brackets with increasing marginal rates. The first income bracket is from 0 to 15,331 Euro. In this bracket the marginal tax rate is 2.95 %, and the social security contribution rate is 29.4 %[128], so that the total marginal burden in this bracket is 32.35 %. In the second bracket from 15,332 Euro to 27,847 Euro the marginal tax rate is 8.45 %; consequently the total burden including the social security contribution rate is

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[124] The municipalities fix the property value of the owner-occupied dwelling; the taxable income is a percentage (maximum 0.8 %) of that value.

[125] The net worth is the property value (savings, rented housing, shares and other securities, etc.) minus debt (beyond 2,500 Euro).

[126] Additional a child exemption of 2,422 Euro per child exists; see Ministry of Finance (2002, p. 10) under http://www.minfin.nl/default.asp?CMS_TCP=tcpAsset&id=BD53672AB52F4A91BB98CBD7B50E09EB.

[127] At the age of 57, 58 and 59 it is 1,119 Euro, at 60, 61 it is 1,289 Euro, at 62, 63, 64 it is 1,460 Euro, and at 65 it is 654 Euro.

[128] Here the ambiguity remains as already mentioned in footnote 119 above.

37.85 %. In the third bracket from 27,848 Euro to 47,745 Euro the social contribution assessment limit is reached, so that the marginal social contribution rate is zero, while a marginal tax rate of 42 % is applied. The last bracket for income above 47,746 Euro is taxed with a marginal rate of 52 %.

As in Germany and Austria the profits from personally led companies are taxed within the personal income tax (Box I). Profits of legal entities are due to the corporate tax (in the Netherlands corporate income tax); two profit brackets exist. In the first bracket from zero to 22,689 Euro the marginal rate is 29 %; in the second bracket above 22,689 Euro a marginal rate of 34.5 % is applied, so that the corporation tax schedule is slightly progressive. With regard to distributed profits (dividends) the classical system of double taxation applies (if not a substantial shareholding is given). The distributed profits additionally are burdened by the dividend withholding tax with a rate of 25 %. A Dutch shareholder has to add the value of the shares to the property value in Box III and then includes 4 % of this value in his personal income. The dividend withholding tax, which is a source tax and transferred by the companies together with the corporation tax to the accounts of the fiscal administration, is then deductible from the yield of the personal income tax. For non-residents the dividend withholding tax is the final burden in the Netherlands, unless due to double taxation agreements lower tax rates are applied.[129]

There are pros and cons in the current Dutch system of direct taxation. A very positive feature is the integration of the personal income tax (Box I) with the social security contribution scheme. Consequently the initial marginal tax and contribution rate is 32.35 %.[130] The German initial rate is 40.75 % (initial marginal tax rate 19.9 % plus the employees contribution rates of 20.85 % at a an average social health insurance rate of 14 %). Considering that the employees' contributions in the Netherlands are much higher and the employers' contributions much less, the effective initial German rate is substantially higher (at least 10 percentage points, see the example in chart 11 above). If the contribution-free insurance of the non-working German dependants as well as the splitting procedure for married couples are taken into consideration, especially the marginal burden of the second earner in the family is dramatically higher than in the Netherlands.

Another convincing feature is the sufficient gap between the transfers of the social aid system, orientated to the minimum wage, and the minimum wage itself, so that incentives for a re-integration into the official labour markets still exists. That has been realised by a consequent gross orientation of all transfers and benefits from the social protection schemes, which are all included into the income tax base. Therefore, even social aid recipients are already used to pay for social insurance contributions, so that the negative incentives due to strongly hiking contribution rates in case of starting to work in the official labour markets are overwhelmingly avoided.

Beyond that the 2001 tax reform obviously followed the arguments that productive capital has to be treated more careful than in the past. A more moderate taxation of income from property, capital, and profits principally is another positive feature. But the price of that reform is a totally unequal treatment of capital income from different kinds of capital on the one hand, and the fatal perspective that earned income at least in the middle and higher income brackets is much more burdened than capital income. Capital, as mobile factor, is privileged, while labour as much less mobile factor is discriminated. The Box approach is an unsystematic one, which clashes with

[129] See Ministry of Finance (2002, p. 11).

[130] If the AWBZ contribution would have to be added, the Dutch burden would be 10.25 percentage points higher, see also the footnotes 119 and 128 above.

ability to pay arguments as well as the justice of ability, mentioned before. The marginal rate structure in Box I is still to progressive and in the long run might cause serious disincentives in the middle and higher income brackets.

The imputed rent in Box I as well as the targeted property taxation in Box III necessitate elaborate determination of property values, which again are often arbitrary and discriminating. Despite the decrease of the tax burden on some kinds of capital income[131] due to the Box-approach, the high lifetime burden of capital income taxation due to the avalanche effects still exists. However, compared to the other direct tax systems the positive features are dominating.

Regarding the companies taxation, beside the corporation income tax no other tax on profits does exist.[132] If just the scheduled marginal tax rates are taken into consideration, and the numerous possible tax concessions especially for foreign direct investments in the Netherlands are neglected, the comparison between the Dutch, German, and Austrian System shows clear advantages for the Netherlands. If the upper marginal rate is taken, the Dutch marginal rate on profits of legal entities is 34.5 %,[133] the Austrian (including the communal tax) about 38.5 % and the German 43.5 %. Additionally the employers social security contributions in the Netherlands are much less than in Austria and Germany, so that another competitive advantage has to be mentioned, which obviously has influenced the growth and labour market performance already in the past in a very positive way.

3.4. United Kingdom

The Beveridgean type of social protection has grown out of the poor relief, which was exemplified in the early pension legislation of Britain (1908).[134] Today a comprehensive state administered social protection system covers almost the entire population. While the care components are mainly tax financed, the social insurance components are financed from contributions, which partly allow for income-related benefits.[135] The National Insurance Fund (NIF) is the core institution of the social insurance system, which is financed by compulsory contributions based on current income and paid by most workers and employers.[136] The system covers the pension insurance, unemployment insurance, accidents insurance as well as sickness and maternity benefits. The contributions raised by the NIF are distributed on the single insurance branches. Additionally the NIF receives a public grant from the budget, which is about 10 to 15 % of the total expenses.[137]

The NIF contributions are paid as part of the income tax, following the pay as you earn approach (withdrawal or source tax). In case of the existence of occupational pension schemes, only

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131 If the rate of return on some kinds of property is below the deemed fixed return of 4 %, the targeted capital income taxation causes a loss of real assets and yields effects similar to a high property tax.

132 See Bach/Seidel/Teichmann (2002, p. 110).

133 Like in Germany and Austria the tax rates of the VAT system are differentiated. The standard rate is 19 % and the reduced rate (for foodstuff and pharmaceuticals) is 6 %.

134 Before similar models were introduced in Scandinavia, e.g., in Denmark 1891. See for more details Baldwin (1997, pp. 4).

135 See Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/org_de.pdf.

136 See Schmidt (2002, p. 166).

137 See Inland Revenue (2003, p. 48).

reduced contributions to the NIF are paid (so-called contracting-out). For private old age protection, the total NIF contributions apply. The NIF then transfers the contributions, which are above the reduced contributions to the private pension insurance. For the NIF contributions four different contribution classes exist (see chart 12).

Chart 12: Contribution Classes for the NIF

Contribution Class		Description
Class 1	-	Paid by people who work as employed earners and their employers
Class 2	-	Paid by people who are self-employed
Class 3	-	Voluntary contribution by people who wish to protect their entitlement to the state pension and do not pay enough national insurance contributions in another class
Class 4	-	Paid by those whose profits and gains are chargeable to income tax. These are normally paid by self-employed people in addition to Class 2 contributions

Source: Inland Revenue (2003, p. 2).

In class 1 the British "standard" employee is assured. Above the income threshold the employers' contribution rate is 12.8 % and the employees rate 11 % of the earned wage (see chart 13). For contracted-out workers the employers contribution is reduced to 9.3 %. Below the threshold no contributions are raised and the employer is not assured. For wages in the range of the lower limit (5,805.80 Euro)[138] and the threshold (6,691.75 Euro) contributions are still zero, but an assurance does exist; the contributions for the self-employed are also represented in chart 13.

Chart 13: NIF Contributions and Assessment Limits

Class	Contributions		Assessment Limits
	Employees	**Employers**	
Class 1	- Wage below threshold: no contributions - Wage above threshold: **12.8 %** (Contracted-out: **9.3 %**)	- Wage below lower limit: **no insurance** - Wage between lower limit and threshold: **0 %** (but assured) - Wage between threshold and upper limit: **11 %** (Contracted-out: **9.4 %**) - Wage above the upper limit: **1 %**	- Lower limit: **5,805.80** €/ year - Threshold: **6,691.75** €/ year - Upper limit**:** **44,863.00** € / year
Class 2	- Lump sum contribution (2002): **2.90 € / week**		Negligible income limit: 5,836.25 €/ year
Class 3	- Lump sum contribution (2002): **9.93 € / week**		No limit, volutary contribution
Class 4	- **8 % of profits** above the lower and below the upper limit - **1 % of profits** above upper limit		Lower limit: 6,691.75 €/ year Upper limit: 44,863.00 € /year

Source: Inland Revenue (2003, pp. 7 and 2003 a, pp.13) and Adams/Kaplan (2002, pp. 9).

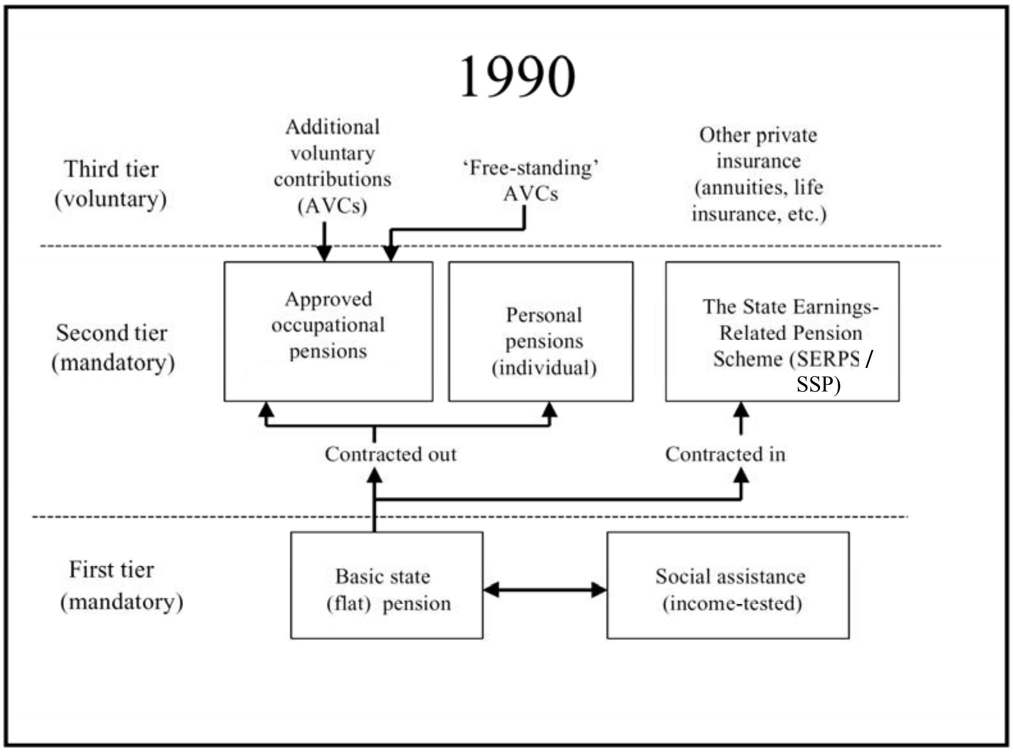
[138] The amounts have been converted from GBP to Euro with an exchange rate 1 GBP = 1.45 Euro.

Non-contributory benefits and transfers in kind are financed from the general tax revenue and dependent on specific personal circumstances. The National Health Service (NHS, see 3.4.2. below) provides universal health care, which are financed form tax revenue and the NIF. Because the whole social insurance (NIF) is financed by an overall contribution, a separation on the single branches is not possible.

3.4.1. Pension System

The pension system consists of a three-tier approach of state pensions, the occupational pension system and the private old age protection. The first tier is the basic pension, which is a lump sum transfer independently paid from the contributions paid during lifetime. The second mandatory tier was an income-related additional pension payment, the state earnings related pension (SERPS, see chart 14). This has been replaced in 2002 by the state second pension (SSP), which is partly income-related and partly non-income-related. The reform was made to improve the pension entitlements for earners of low wages in their old age.[139] In case of contracting-out instead of the pensions from SSP approved occupational pensions or private pensions are paid. The third voluntary tier creates pension entitlement from additional voluntary contributions to the approved occupational pension systems or to the private life insurances etc.

Chart 14: The UK Pension System



Source: Disney (1999, p. 17).

139 For contributions paid between 1961 to 1975 a graduated retirement benefit, which is income related, could be acquired. This pension type is loosing in importance.

The retirement age for male is 65 years and for female 60 years. From April 6, 2020 the state pension age for both men and women will be 65; the retirement age for women will be gradually changed over a 10-year period from 2010 to 2020. Male need 44 and female 39 qualifying years to be entitled to the full basic state pension, which is 5,692.70 Euro per year. Man with at least 11 qualifying years get the minimum pension of 1,367.00 Euro per year. In case of the full basic pension, supplements are paid for spouses (3,408.08 Euro), the first child (728.00 Euro) and each further child (855.92 Euro), all figures for the fiscal year 2002/2003.[140]

In the outbound state earnings related pension (SERPS) 14 % auf the full-employed men and 23 % of the full-employed women have earned pension entitlements.[141] At an identical retirement age as in the basic pension scheme the pension entitlements depend on the qualifying period as well as the on the contributions paid. Only the income between the lower and upper limit (see chart 13 above) are taken into account.[142] For the calculation of the pension entitlement the following formula is applied:

$$\text{SERPS (per year)} \quad = \quad \sum a_t (A_t - B_t)/N \ .$$

A_t is the amount of the extrapolated annual income (maximum the upper limit), B_t is the extrapolated lower income limit, a_t is a weighting factor[143] and N the qualifying period. The formula clarifies that SERPS is income-related and dependent on the lifetime earnings within the boundaries of the lower and upper income level.

The main target of the new state second pension is to pay that pension as flat transfer to low-income earners. The higher income earners should be motivated for contracting-out and private insurance. The SSP is paid as an additional pension payment to the basic pension. Pensioners with an active income between the lower limit (chart 13) and 13,050 Euro receive a flat pension payment of 5,220 Euro per year. For incomes, which exceed 13,050 Euro until 26,825 Euro, 10 % of the income part within this bracket is paid as additional amount. Between 26,826 Euro and the upper limit (chart 13) 20 % of the income part within this bracket further increases the pension entitlement.[144] The basic pensions as well as the second state pensions are fully taxable.

Due to the possible contracting-out from the SERPS/SSP the occupational pension scheme for the employees and the personal pensions for the self-employed are also mandatory systems (secondary tier in chart 13). The prerequisite for contracting-out is that the approved occupational pension system yields at least the same entitlement as the SERPS (reference scheme test). Three different types do exist: contracted-out-salary-related schemes (COSRS; with 8,3 million assured persons in 1996), contracted-out money purchase schemes (COMPS; with 0,6 million assured persons in 1996), and the contracted-out mixed benefit schemes (COMBS; new in 1996).[145] The occupational pension systems are funded systems with some exceptions for the pension schemes

140 Additional supplements are paid for people above 80 years, Christmas, case of death, etc., see Rechmann (2002, pp. 20), Disney et al. (1999, p. 21), Secretary of state for Work and Pensions (2002, p. 12), and Department for Work and Pensions (2002) under http://www.pensionguide.gov.uk/guides/pdf/pm2-nov02.pdf.

141 See Devetzi (1999, p. 45).

142 See Inland Revenue (2002, p. 29).

143 The weighting factor until the year 1998/99 was 0.25; for people who have retired in 1999/2000 for the period of 1978 to 1988 a_t remains constant and for the following years it declines stepwise by 0.005 until 0.2 is reached. See Rechmann (2001, p. 102).

144 See Disney (1999, pp. 26).

145 See Devetzi (1999, pp. 57).

of the public employees, while the first tier as well as the SERPS/SSP is PAYGO financed. The funds are legally separated from the business assets and in the COSRS employers and employees overwhelmingly pay the contributions dependent on the single contract. The pension entitlement is fixed at the conclusion of the contract. The pension entitlement is often defined as a certain percentage of the last income, which depends on the qualifying period (public sector: maximum 80 % of the last income; private sector: 60 % of the last income). The risk is with the employers' side, while surviving dependents (spouses) have at least a 50 % entitlement on the pension payment of the deceased.

The COMPS has an employer's contribution at least at the rebate rate by contracting-out. The contribution rates are fixed and the pension entitlements depend on the on the risk structure of the chosen assets and the rate of return, respectively. At least the amount of the nominal inpayment has to be assured. Surviving dependants have the same entitlements as in the COSRS. The COMBS, which combines the other two system approaches, exists since 1997. The employees' contributions are deductible from the tax base, while the employers' contributions are treated as business expenses. The pension funds themselves are tax-exempt from the income, corporation and capital gains tax. Like the basic and the second state pension, the occupational pensions of the three types are taxable income, so that the above-mentioned downstream taxation is applied. There is only one exception for tax-free once-only payments, which are limited to 25 % of the pension entitlement.

The private pension insurance is an extended system in which about 10 million persons are assured. 5.5 million persons do have an appropriate personal pension plan (PPP), which is acknowledged for contracting-out. Mainly self-employed are insured, but also employees from firms without own pension plan. Partly assured complement the occupational pension plans or SERPS/SSP. The private pension system is fully funded with actuarially fair insurance premiums. The contribution rates depend on the single contract coverage and volume; in case of contracting-out the contributions are paid via the Contribution Agency of the NIF to the private life insurances. The pension entitlements are similar to the COMPS (fixed contribution and risk-orientated entitlements) and accordingly taxed.

Summarising the results, the British pension system is a really complex one, which is heavily dependent on state regulations. The determination in how far the benefit principle is applied is almost impossible because any separation of the contributions from the other social insurance branches would be arbitrariness. Evaluating the last reform processes, it becomes obvious that even the second tier should be more strongly orientated for the lower income groups (shift from SERPS to SSP), while the well to do are motivated to switch over into the private insurance schemes. At the same time this is a tendency form PAYGO financing in the direction of the funding approach, which in view of the demographic changes is necessary and additional strengthen individual primary responsibility. But due to the enormous complexity, some de-regulative measures seem to be necessary.

3.4.2. Health System

The UK health protection system is a tax financed public health care system in which all the UK residence participate. Even the supply side (practitioners, consultants, pharmacists, hospitals, etc.)

is part of the public sector,[146] so that even the quasi-markets within the social health insurance approach (see chart 7 and the surrounding text above) are abolished. In contrary to the transfers in kind, which are covered by the National Health System (NHS), the cash benefits (sickness benefits, maternity benefits, and benefits in case of occupational diseases) are born by the NIF (see 3.4. above). The private health insurance system is limited to upgrade insurance (for details see 4.2.1. below). Because of increasing waiting times and queues especially for high quality medical treatment, private upgrade insurances have become more popular; in 1996 about 9 % of the UK population were assured in an private upgrade health insurance.[147]

The remunerations for the doctors are negotiated between the government and representatives from the doctors associations; the NHS administers the public hospitals. The expenses for medical services are financed by the general tax revenue (about 80 %); the remaining 20 % are mainly financed by the NIF. Parts of the social security contributions of class 1 (chart 13 above) are transferred from the NIF to the NHS (1.05 percentage points of the employees contributions and 0.9 % of the employers contributions).[148] Principally the choice of the home doctor is free but the doctor himself has to agree; like in the Dutch system the home doctor is the key-person who regulates the access to the consultants as well as to the hospitals. The medical treatment of doctors and within the hospitals is without any personal co-financing. For dental treatment of the General Dental Service a co-financing does exist. The NHS covers 80 % of a course of dental treatment expenses up to 522 Euro. For pharmaceuticals the co-financing is 8.85 Euro for each prescribed item.[149]

The sickness cash benefits are partly paid by the NIF; the contributions have already been mentioned above (see chart 13). The Short-term Incapacity Benefit (IB) applies for self-employed and unemployed people. For employees only the Statutory Sick Pay (SSP) applies if they have reached the lower earning limit of the NIF. Before sickness benefits are paid, there is a waiting period of three days. The SSP is paid by the employer in case of illness lasting at least 4 consecutive days up to a maximum of 28 weeks. The standard rate is 90.19 Euro per week (or about 390.83 Euro per month). The IB and family additions are financed by the NIF. The IB is paid in two rates: the lower rate of 76.26 Euro per week applies for first 28 weeks; the higher rate of 90.19 Euro applies thereafter. If the person is over pension age, the weekly amount is 101.14 Euro per week. For spouses over the age of 60 or adult caring for dependant children the additional benefit is 47.20 Euro per week, for the first child 14.07 Euro and for each other 15.89 Euro.[150] The sort-term IB applies for 52 weeks maximum; then it is replaced by a long-term incapacity benefit. All these benefits are due to the income tax.

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146 Since 1998 experiments with alternative models are made, in which personal medical services (PMS) are supplied on the base of local contracts between Local Health Authorities and licensed doctors. For details see Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/uk_part2_de.htm.

147 See Jakubowski/Busse (1999, p. 122).

148 See ibid. (pp. 120) and Britische Botschaft (2003, p. 2).

149 An annual (or 4 months) prescription prepayment certificate can be bought which offers considerable savings to those who need regular medication. The cost of the certificate is 46.26 Euro for 4 months and 127.02 Euro for one year. For further details see Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/uk_part2_de.htm.

150 See ibid.

Compared to the much more generous social health insurance cash benefits in Austria, Germany[151], and the Netherlands, the British system is obviously basic security orientated. Due to the high co-financing of pharmaceutical items, the waiting period of three days until the SSP und IB are paid, and the comparatively low sickness benefits, the UK population is obviously much less pampered by the social network and has therefore much stronger incentives for protection measures to be decided on in primary responsibility. In view of the poor protection levels and partly enormous queues for high quality medical treatment, the system still finds acceptance, obviously because from the very beginning it has promised less than many social insurance schemes did. However, discussions on the reform of the NHS are highly on the agenda.

3.4.3. Unemployment Insurance

Because the contribution problem has already been discussed above, here we concentrate on the unemployment benefits. The UK system also consists of an unemployment benefit (insurance orientated) and an unemployment assistance (aid orientated) as in the other countries under investigation.[152] The former is named the Contribution-based Jobseeker's Allowance (CJA), the latter the Income-based Jobseeker's Allowance (IJA). If the replacement income levels are taken into consideration, this distinction seems to have a more "academic character". Besides the usual main conditions (capable as well as available for work, actively seeking employment, etc.), the determining conditions for the CJA are: employment in the UK with an income above the lower income level of class 1, 25 weekly contributions of 111.65 Euro each, and a minimum amount of 5,582.50 Euro within the last two tax years.

The weekly CJA benefit is 76.92 Euro for persons above the age of 25, 60.90 Euro for persons from 18 to 24, and 46.32 Euro for persons from 16 to 17. After a waiting period of three days the duration of payment is limited to 182 days for each period of unemployment. The benefits are financed from the NIF and no means test applies. The benefit is included in the taxable base of the income tax. Contrary to the CJA the IJA is means-tested. Covered by the IJA are persons with their usual residence in the UK and the benefit levels are dependent on the family situation. The basic benefits for singles correspond to that of the CJA. Couples (both under 18) get 91.86 Euro per week, couples (both over 18) 120.71 Euro per week. Child supplements are possible. The duration of payment is unlimited as long as the conditions are met. Further constraints are that the property is below 11,600.00 Euro and the partner does not work for more than 24 hours a week. For persons fewer than 18 specific rules apply. Despite the CJA, the IJA is financed from general tax revenue. The IJA is included into the taxable base of the income tax but social security contributions are not raised.[153]

Compared to the other unemployment benefit schemes the British system is the least generous one (the ranking for generosity would be Austria, Germany, the Netherlands, the UK) and even more basic security orientated than the Dutch one. The gross minimum wage, which is 5.22 Euro per hour for persons from 18 to 21 and 6.09 Euro for persons over 21 (which means a weekly gross

151 The German sickness benefit, paid for the first six weeks by the employers, is 100 % of the last wage before sickness; the expenses of the employers are 4 to 6 % of the payroll. For more details see chart 19 and the surrounding text.

152 Naturally, other systems do exist: Australia and New Zealand, e.g., do only have unemployment assistance, while several other OECD countries do only have unemployment insurance; see Burda (1997, p. 269).

153 For more details see Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/uk_part10_en.htm.

wage of 208.80 Euro/ 243.60 Euro or monthly wage of 904.79 Euro/1,055.59 Euro for a fulltime job of 40 hours a week), is therefore substantially higher (even for part-time employment), so that after the subtracted wage tax and social security contribution a remarkable gap between the net wage and the unemployment benefit remains at least for singles.

3.4.4. Accidents Insurance

The accidents insurance is not a single branch of the social insurance system but also part of the NIF and regulated by the Social Security Contributions and Benefits Act 1992. The system includes all employees and is as state non-contributory system tax-financed. The system covers employment injuries and occupational diseases. Travel from home to work is not covered. The benefits are in form of medical services and lump sum transfers in case of the risk incidence. Cash benefits connected with occupational accidents are income tax-free.

3.4.5. Basic Security System

The British basic security system is called Income Support and a tax financed scheme providing financial help for people who are not in full time work (16 hours or more a week for the claimant, 24 hours or more for claimant's partner), who are not required to register as unemployed and whose income from all sources is below a set minimum level. The aid is paid as a differential amount. Claims to other benefits must be exhausted but if need still exists, Income Support can be paid to bring income up to a set limit. The same property limit as in the other means-tested programs applies. The guaranteed minimum is set nationwide by the government. The unit to be supported is the claimant and his family (partner and any dependant children). Most income resources, most social security benefits and pension are taken fully into account. Benefits generally ignored include: Housing Benefit, Council Tax Benefit and non-contributory disability benefit.

With regard to the aid payments a whole catalogue of personal allowances and premiums does exist.[154] The weekly amount of benefit for a single aged over 25 (personal allowance) is 79.92 Euro. The second adult gets 56 % and each child under 16 years 59 % of that personal allowance. The monthly amounts (including family benefit where appropriate, full Housing Benefit and Council Tax Benefit) are in the example of a single over 25 years 660.69 Euro, for a couple, no children, 912.02 Euro, for a couple, child of 10, 1,200.75 Euro, and for a couple, two children 8 and 12, 1,398.35 Euro. The Income support is non-taxable.

Compared to the other benefits the social aid payments seem to be relatively generous. If the Housing Benefit and all other supplements are neglected, the monthly personal allowance for a single is 346.32 Euro. The basic state pension is 474.39 Euro per month, the statutory sick pay 390.83 Euro, and the Contribution-based Jobseeker’s Allowance 333.31 Euro, the latter clearly below the above mentioned personal allowance of Income Support. Especially in case of families with children but only a single breadwinner the gap between social aid payments and the minimum wage is obviously very small. Because of the low incentives for low qualified persons to be re-integrated into the official labour markets, a Family Credit system was introduced as

[154] For details see Europäische Kommission – Beschäftigung und Soziales – Missoc (2002) under http://europa.eu.int/comm/employment_social/missoc/2002/uk_part11_en.htm.

measure stimulating social and professional integration, which in 1997 was substituted by the Working Families' Tax Credit (WFTC). Under the old schedule an adult at least working for 16 hours a week got an additional Family Credit, dependent on a standard rate for the adult and supplements for the children. At a working time of 30 hours weekly another supplement was paid. In combination with the reduction with other transfers this system was connected with a marginal transfer reduction rate of 80 % what has led to serious disincentives to work for more hours, a typical feature of the above mentioned poverty trap.[155]

With the introduction of the WFTC two decisive changes were made:[156] On the one hand the administration was shifted from the Income Support offices to the tax administration (revenue service), so that now the way via the social aid system is avoided. On the other hand the regulations have been made much more attractive. The standard rates have been substantially increased and the marginal transfer reduction rate was reduced to 55 %.[157] The labour supply effects of the WFTC as well as of the American Earned Income Tax Credit (EITC)[158] are overwhelmingly positive.[159]

3.4.6. Taxation of Wages and Profits

The British income and corporation tax system has the oldest tradition, is highly complicated and would have a good chance to win a contest of complexity even compared to the German system. Therefore, a concentration on the main issues is inevitable. The income tax is levied for a fiscal year, e.g., 2002/2003 (from April 6 to April 5). The residence principle as well as the worldwide income concept applies. The so-called schedules of income are the defined income sources, which are taxable. The schedules are as follows: Schedule A taxes income from land ownership,[160] Schedule D taxes business profits and similar income components,[161] Schedule E taxes the income from employment, and Schedule F dividends and other distributions received form UK companies. Many of the social security payments mentioned above are tax-exempt (e.g., disability living allowance, invalidity benefit, attendance allowance, maternity allowance, WFTC, etc.). Also certain payments on interest are exempt, namely interest payments on government bonds.[162]

As in Germany the income tax is collected by two methods: first the deduction of income at source and second direct assessment. Deduction at source is done for interest payments, dividends and in the pay as you earn (PAYE) system for Schedule E (income from employment). Since

155 See Duncan/Giles (1996, p. 143).

156 For details see HM Treasury: Budget 98 (1998) under http://www.hm-treasury.gov.uk/media//1D41C/wftc.pdf.

157 For more details see Ochel (2002, p. 15).

158 The United States has also introduced measures against the poverty trap. The "Welfare to Work"-Program of the US consists of two elements: the EITC (introduced as early as in 1975) and the "Wisconsin Works" approach introduced in Wisconsin in 1997 and then extended to the whole US. For more details see Feist (1999) and Ochel (2001).

159 For a German proposal see Sinn et al. (2002).

160 Schedules B and C are abolished. For more details see Nightingale (2000, pp. 69).

161 Schedule B is divided in six cases: Case I taxes profits from trade, Case II taxes profits from profession or vocation, Case III taxes interest received gross (without deduction at the source) and interest on non-trading loans, Case IV taxes the income from foreign security, Case V taxes the income from foreign possessions, and Case VI taxes the income not falling under any other case or schedule. The taxable social security benefits, e.g., pensions and unemployment benefits, are taxed as Case VI income.

162 For details see ibid. (p. 70).

1996/97 direct assessment was changed into self-assessment,[163] so that two equal payments on the income tax due are made per tax year with the balancing payment due to the annual filing date in the following year.

The total income principally results as sum of the incomes from the Schedules A, D, E, and F as well as the interest payments (savings income), which were taxed at the source. In Schedule A carry forward of losses is allowed. In Schedule F a tax credit on dividends applies (one ninth of the dividends payment) and these income parts are (as the savings income) due to specific income tax rates. From the total income a whole basket of allowances are subtracted. The personal allowance depends on the age; the basic personal allowance (PA) is available to all taxable individuals resident in the UK. The annual amount is 6,691.75 Euros. For persons aged 64 to 75 the amount is 8,845.00 Euro and over 75 it is 9,236.5 Euro.[164] These amounts are generally beyond the social aid payments, so that basic security payments overwhelmingly remain untaxed. The minimum amount of married couple allowance is 3,059.50 Euro, for persons born before 1935 the married couple allowance is 7,924.25 Euro, and for persons over 75 it is 8,025.75 Euro. The children's tax credit 7,670.50 Euro, the babe-rate is 15,210.50 Euro. The blind person's allowance is 2,146.00 Euro. The rate of relief for the continuing married couple's allowance and maintenance relief for people born before 6 April 1935, and for the children's tax credit, is 10%.[165]

The income tax schedule (tariff) is directly progressive; the (marginal) starting rate up to 2,784.00 Euro is 10 %. For a taxable income between 2,785.00 Euro and 43,355.00 Euro the basic rate is 22 % and above 43,356.00 Euro the higher rate of 40 % is applied. Specific rates are applied for trusts (34 %) and Schedule F trusts (25 %).[166] The 10 percent starting rate of income tax includes savings income. Where individuals have savings in excess of the starting rate limit they will be taxed at the lower rate of 20 % up to the basic rate limit (43,355.00 Euro) and at the higher rate for income above the basic rate limit.[167] An overview on the single rates is given in chart 15.

Chart 15: Taxable Bands of the Personal Income Tax

Taxable bands 2001-02 (Euro)		**Taxable bands 2002-03 (Euro)**	
Starting rate 10%	0 – 2,726	Starting rate 10%	0 – 2,784
Basic rate 22%	2,727 – 42,630	Basic rate 22%	2,785 – 43,355
Higher rate 40%	Over 42,630	Higher rate 40%	Over 43,355

	2001-02	**2002-03**
Trusts	34%	34%
Schedule F Trusts	25%	25%

Source: Inland Revenue (2003) under http://www.inlandrevenue.gov.uk/rates/it.htm.

The firms taxation is much more complex; therefore, the details on the definition on business income have to be neglected.[168] Within the personal income tax residents in the UK having

[163] For the procedures see Inland Revenue (2003) under http://www.inlandrevenue.gov.uk/sa/faqs/index.htm.

[164] The income limit for aged-related allowances is 25,955.00 Euro; see Inland Revenue (2003) under http://www.inlandrevenue.gov.uk/rates/it.htm.

[165] See ibid.

[166] See ibid.

[167] See ibid. under http://www.inlandrevenue.gov.uk/rates/savings.htm.

[168] For details see Nightingale (2000, pp. 74).

business income are charged under Schedule D on the profits arising from any trade (Case I), profession or vocation (Case II). Their taxable profits are due to the above mentioned tax schedule with marginal rates between 10 % and 40 %. A separate tax on (limited and joint-stock) companies was introduced in the UK by the fiscal year 1965; the corporation tax follows the classical approach, where dividends are also due to the personal income tax.[169] In 1973 an imputation system was introduced, which alleviated the double taxation of dividends. The rates of tax for dividends are 10 % for income up to the basic rate limit and 32.5 % for income above the basic rate limit. As far as chargeable gains are due to the corporation tax, an indexation allowance does exist, which is linked to the Retail Price Index figures.[170]

In the financial year 2002/03 the starting rate for companies with taxable profits between zero and 10,000.00 Euro has been reduced from 10 % to zero. Marginal relief eases the transition form the starting rate to the small companies' rate (reduced from 20 % to 19 %) for companies with profits between 14,500.00 Euro and 72,500.00 Euro. The fraction used in the calculation of this marginal rate relief will be 19/400. Marginal relief also applies to companies with profits between 435,000.00 Euro and 725,000 Euro. The fraction used in the calculation of this marginal relief will be 11/400. The main rate for 2002/03 will be 30 %. For a better overview the different rate brackets are presented in chart 16.

Chart 16: Taxable Bands of the Corporation Tax

Financial year 2001-02 (Euro)		**Financial year 2002-03 (Euro)**	
Starting rate 10%	0 – 14,500	Starting rate zero	0 – 14,500
Marginal relief	14,501 – 72,500	Marginal relief	14,501 – 72,500
Small companies' rate 20%	72,501 – 435,000	Small companies' rate 19%	72,501 – 435,000
Marginal relief	435,000 – 2,175,000	Marginal relief	435,000 – 2,175,000
Main rate 30%	2,175,000 or more	Main rate 30%	2,175,000 or more

Source: Inland Revenue (2003) under http://www.inlandrevenue.gov.uk/rates/corp.htm.

In addition to the personal income tax and the corporation tax in the UK like in most of the Anglo-Saxon countries a capital gains tax exists. When persons makes a profit on the sale of a capital asset, they may be liable to the capital gains tax, which in the UK was introduced in the fiscal year 1965.[171] The annual exempt amount is 11,165.00 Euro for individuals, trustees of settlements for the disabled, and personal representatives of the estate of a deceased person. For other trustees the exemption is 5,582.50 Euro. The amount chargeable to the capital gains tax is added onto the top of income liable to income tax and is charged with the following rates: below the starting rate limit at 10 %, between the starting rate and basic rate limit at 20 %, and above the basic rate limit at 40 %. If capital gains are a substantial part of income and profits, these tax burdens have to be taken into consideration especially in international burden comparisons.[172]

169 For the different systems of corporation taxation see Petersen (1988, pp. 45) and the discussion of a modern integrated system below (4.3.1.).

170 For details see Inland Revenue (2003) under http://www.inlandrevenue.gov.uk/rates/cgt.htm.

171 In Austria and Germany capital gains are partly taxed within the personal income tax system, in Germany within the income kinds 1 to 3 and the miscellaneous income.

172 For information only the VAT rates for the UK are to be mentioned. For UK supplies there are three rates of VAT: the standard rate is 17.5 %, the reduced rate 5 % (on domestic fuel and power), and a zero rate (for food, books, newspapers, drugs, children' clothing). Fore more details see HM Customs and Excise (2003) under http://www.hmce.gov.uk/business/tradinginternet/tradinter-8.htm and Adams/Kaplan (2002, p. 16).

As in all the countries under investigation, it has become obvious, that even large stock corporations are taxed with a lower top marginal rate then at least the larger personally led companies or profits from self-employment. Therefore, the formerly dominating basic philosophy that large companies do have a higher ability to pay than small and medium sized firms has been sacrificed on the altar of international competition, especially to improve the conditions for foreign direct investment. That additionally employees in the middle and higher income brackets are often substantially higher burdened with marginal tax rates is just another reminiscence. If the companies tax burden is compared for the four countries taking the highest rates into account, then again Germany has the lead with 43.5 % followed by Austria (about 38.5 %) and the Netherlands (34.5 %); for the large stock companies the British rate of 30 % is the lowest if no capital gains are included.[173]

With regard to the burden of wage tax and social security contributions on the British employees the initial marginal burden of wage tax and social security contributions is with 22.8 % (10 % marginal tax rate and 12.8 % overall social security contribution) obviously the lowest, followed by the Netherlands (32.3 %) and Austria with 38.2 % (21 % marginal tax rate and 17.2 % employees social security contributions).[174] The rear light is for Germany with 40.75 % (19.9 % initial marginal tax rate and 20.85 % social security contributions) and if the solidarity surcharge (to be paid by ever taxpayer at an amount of 5.5 % of the individual income tax yield) and the church tax (9 % on the individual income tax yield for church members) are added, this rate increases to 43.6 %. Also with regard to the total social security contribution burden on the payroll and the enterprise sector, Germany has the lead, so that the poor growth and labour market performance is at least partially due to the delayed reform processes, which have already been made in the other countries under investigation.

3.5. The Overall Burden of Taxes and Social Protection Expenses

The country studies will be completed by a short comparison of the total burdens of wage taxation, social security contributions, and profit taxation on the micro level with regard to the marginal burdens, which are decisive for the behavioural adaptations of employees as well as employers. The institutional structure of the social protection administration within the four countries is presented in four charts in the appendix.

As higher the total burdens are as more likely are reaction to avoid such burdens, which might be in form of tax avoidance, tax evasion (both often connected with an escape into the shadow economy), capital flight, and transfer fraud – all well known reactions also in the high industrialised countries.[175] Table 8 presents a comparison of the marginal tax and contribution rates as already discussed above. It becomes obvious that the British total marginal burden is the lowest. Naturally this is partially caused by the fact that the NHS is tax financed. But even if the Dutch health insurance contribution rate would be added, the burden for the employees would remain the lowest.

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173 If the current capital gains taxation would be taken into consideration, many large stock companies would have a zero tax yield; but that is only due to a recent reform feature, which only in a short-term perspective is effective.

174 This comparison does not take into consideration the NHS costs in the UK as well as the AWBZ contributions in the Netherlands.

175 See the extensive research of Schneider (2000) and in his several other publications.

Table 8: Marginal Tax and Social Contribution Rates (%) in 2003

Insurance Branch	Germany			Austria			The Nether-Lands[7]			United Kingdom[8]		
	Total rate	Emp-loyees rate	Emp-loyers rate	Total rate	Emp-loyees rate	Emp-loyers rate	Total rate	Emp-loyees rate	Emp-loyers rate	Total rate	Emp-loyees rate	Emp-loyers rate
Pension Insurance	19.5	9.75	9.75	18.5	9.25	9.25	19.5	19.5	0	-	-	-
2nd rate	-	-	-	4.3	1.0	3.3	-	-	-	-	-	-
Health Insurance	14.0[1]	7.0	7.0[2]	7.6	3.95	3.65	7.95	6.25	1.7	-	-	-
Old Age Care Ins.	1.7	0.85	0.85	-	-	-	-	-	-	-	-	-
Unem-ploy-ment Ins.	6.5	3.25	3.25	6.0	3.0	3.0	8.55 0.85	3.6 0	4.95 0.85	-	-	-
Accidents Insurance	1.31	0	1.31[3]	1.4	0	1.4	-	-	-	-	-	-
Sum of Contri-butions	43.01	20.85	22.16[2]	37.8	17.2	20.6	36.85	29.35	7.5	23,84	12.8	11.0
Initial Marginal Tax Rate		19.9[5]			21.0			2.95			10.0	
Total Initial Rate		40.75			38.2			32.3			22.8	
Highest Marginal Tax Rate		48.5[6]			50.0			52.0			40.0	

[1] Average; the German social health insurance rates are between 11.9 % and 15.7 %.
[2] The sickness benefits for the first six weeks of sickness to be paid by the employees of between 4 % and 6 % are another burden for the enterprise sector.
[3] Contribution rate for 2000.
[4] The UK contribution rate as an overall rate for the National Insurance Fund (NIF).
[5] Including solidarity surcharge and church tax 22,78 % (income tax 19.9 %, solidarity surcharge 1.09 %, and church tax 1.79 %).
[6] Including solidarity surcharge and church tax 55.57 % (income tax 48.5 %, solidarity surcharge 2.67 %, and church tax 4.4 %).
[7] Without the AWBZ contributions.
[8] Without the costs of the NHS.

Source: Own Calculations.

With regard to the companies sector, again the German social security contribution rate on the payroll is with 22.16 % the highest and would be increased by five percentage points if the sickness benefits paid by the German companies would be added. The Austrian rate is with 20.6 % slightly less, while the British is 11.0 % and the Dutch 7.5 %. In the Netherlands as well as in the UK the bulk of the social protection burdens have be shifted to the employees. This is economically convincing because the employers contributions are a pure historical reminiscence and obviously are part of the employees' remuneration. The argumentation with the employers' contributions is overwhelmingly used by the trade unions, which want to avoid that the total burdens on the wages of their members would become too obvious.

The following table 9 depicts an international comparison of tax and social contribution burden in selected countries, including our four countries under investigation. The highest tax ratio is to be found in Austria; the German one is the second highest, while the UK has a tax ratio, which is substantially lower; obviously this reflects the much less generous character of the British social protection scheme. These average ratios only partly reflect the analyses of the marginal rates, because here the different tax and transfer bases do play another important role. The highest revenue burdens do have the Scandinavian countries and Belgium.

Table 9: Tax and Contribution Burden in an International Comparison

Taxation and Social Contribution Burden to GDP in %				
	Total Burden		**Tax Burden**	
	1997	2001	1997	2001
Belgium	47,4	47,6	30,9	31,2
Denmark	50,6	49,8	48	46,6
Germany	43,1	42,1	23,4	23,6
EU in total	42,5	42,4	27	28
Finland	46,7	45,6	33,3	33,1
France	46,5	46,6	26,2	28,4
Greece	36	38,6	22,7	25,1
Ireland	32,4	30,1	28,3	25,7
Italy	44,3	42,9	29	30,2
Luxembourg	42,5	42,6	31	30,1
The Netherlands	41,5	40,7	24,9	25,4
Austria	46,7	47,9	29,3	30,8
Portugal	35,9	36,5	24,8	24,5
Sweden	51,5	54,3	36,5	38
Spain	34,8	36	21,7	22,5
United Kingdom	36,6	38,7	29,2	31
For information:				
USA	29,3	29,7	22,3	22,5
Japan	27,7	27,5	17,5	16,9

Source: Deutsche Bundesbank (2002, p. 7).

In table 10 the revenue structure for the four countries is represented. In this definition for the total rate similar results can be observed, while in the mid-term trend in the Netherlands a remarkable decrease of the overall ratio can be observed, reflecting the fundamental policy change mentioned above. The relation of direct to indirect taxation is in Germany, Austria, and the Netherlands relatively balanced, whereas in the UK direct taxes are substantially higher. The social security contribution ratio is in Germany the highest, followed by Austria and the Netherlands. The UK has the lowest ratio, almost less than half of the Netherlands ratio. Obviously the social expenses are more financed by indirect, but especially direct taxation.

Table 10: Direct Taxes, Indirect Taxes and Social Security Contributions

Structure of State Revenue in Selected Countries						
	In Percent of the Nominal GDP			**In Percent of State Revenue**		
	1980	1990	2001	1980	1990	2001
Germany						
Revenue in total	43,7	41,8	43,1	100	100	100
Structure:						
Direct taxes	12,3	10,7	11,2	28,1	25,6	25,9
Indirect taxes	12,8	12,1	11,9	29,2	28,9	27,7
Soc. sec. contr.	16,4	16,3	18,6	37,4	39,1	43,1
Austria						
Revenue in total	45,2	46,4	49,5	100	100	100
Structure:						
Direct taxes	11,9	11,7	15,2	26,3	25,1	30,7
Indirect taxes	15,7	15,6	14,8	34,8	33,5	29,8
Soc. sec. contr.	14,7	15,6	17,1	32,5	33,6	34,5
The Netherlands						
Revenue in total	46,2	43,7	42	100	100	100
Structure:						
Direct taxes	15	14,8	12,2	32,5	33,8	29
Indirect taxes	10,1	10,3	12,1	21,9	23,7	28,8
Soc. sec. contr.	15,3	14,4	14,5	33,2	33	34,5
UK						
Revenue in total		37,5	39,3		100	100
Structure:						
Direct taxes		16,7	16,8		44,6	42,7
Indirect taxes		12,2	13,6		32,4	34,7
Soc. sec. contr.		7,5	7,7		20	19,5

Source: OECD (2002).

As at least one measure of performance in table 11 the unemployment ratios are depicted. As already mentioned above, Germany has not only had the worst growth but also the worst labour market performance. The Netherlands has made an enormous progress during the last two decades, which obviously is due to their exemplary methods to avoid the poverty trap. The Austrians have won the second rank because they have also implemented several reforms in taxation and the social protection scheme, which have brought especially the low qualified staff into employment. And the same is true for the UK also with an outstanding labour market performance.

Table 11: Unemployment Ratios in an International Comparison

Unemployment Ratios in Selected Countries, Seasonal Adjustment (EU-Method of Computation)				
Country	**2001**	**2002**	**Dez 02**	**Jan 03**
EU 15	7,3	7,6	7,5	7,8
ACC	14,5	14,8		
Belgium	6,7	7,3	7,6	7,7
Denmark	4,3	4,5	4,7	
Germany	7,7	8,2	8,5	8,6
Greece	10,4	10,3		
Spain	10,6	11,4	12,0	12,1
France	8,5	8,7	8,9	
Ireland	3,9	4,4	4,4	4,5
Italy	9,4	9,1		
Luxembourg	2,0	2,4	2,7	
The Netherlands	2,4	2,7	3,1	
Austria	3,6	4,1	4,1	4,1
Portugal	4,1	5,0	5,9	6,1
Finland	9,1	9,1	9,0	9,0
Sweden	4,9	4,9	5,1	5,3
United Kingdom GB	5,0	5,1		
Czech Republic	8,2	7,3	6,8	
Hungary	5,6	5,6	5,8	5,8
Poland	18,5	19,9	20,2	20,2
Slovenia	5,8	6,0	5,9	
Slovakia Republic	19,4	18,6	18,0	17,7
USA	4,8	5,8	5,9	5,7
Japan	5,0	5,4	5,5	

Source: Eurostat 28.2.2003.

The last table 12 is added to demonstrate the extent of social protection expenses within the single countries. Obviously the expenses heavily depend on the coverage of social protection with regard to replacement income as well as to the quantity and quality of transfers in kind. Therefore, a general benchmarking is not possible but we will come back to that problem in the summary (chapter 5.). The social expenses are related to the GDP, the gross wages (or the payroll) and total social expenses. Obviously the four countries pay most for pension expenses. On the second position are the health expenses, which are the lowest in the UK. Here obviously the co-financing for pharmaceuticals and the comparatively low sickness benefits play a decisive role. The highest expenses in case of unemployment expenses are with Germany what just reflect the high unemployment and the poor progress to re-integrate the low qualified workers into the official labour markets. On the other hand the Netherlands and the UK have much higher expenses for dwelling and social aid, which compensates a bit for the large differences with regard to unemployment.

If we take the British health expenses in relation to the gross wage, we get a proxy measure for the fictitious British social health contribution rate. This rate is 12.6 % compared to the German 15.5 %, which are pretty close to the higher contribution rates in the German social health system. But with regard to all these figures one should be extremely careful in doing over-interpretations. Every country has its own characteristics, which are at best partly reflected in such rough studies.

Always question remains if all kind are correctly gathered and assigned. Different definitions explain, while such crude ratios and quotas differ from study to study by several percentage points. Therefore, for correct analyses always case studies or microsimulation models are much better tools (see 4.4. below).

Table 12 : Social Protection Expenses Related to Payroll and National Income

				Social Expenses for Pensions, Health, etc. in 2000 in % GDP, GW, and SE																	
	Social Expenses (SE) in 2000 in Mill. EUR	**Gross Wages (GW) in 2000 in Mill. EUR**	**Gross Domestic Product (GDP) in 2000 in Mill. EUR**	**Pensions**			**Health**			**Family, Children**			**Disability**			**Unemployment**			**Dwelling, Social Aid, etc.**		
				In % GDP	In % GW	In % SE	In % GDP	In % GW	In % SE	In % GDP	In % GW	In % SE	In % GDP	In % GW	In % SE	In % GDP	In % GW	In % SE	In % GDP	In % GW	In % SE
Belgium	66.306,25	127.799,0	248.338,00	11,70	22,70	43,8	6,70	13,00	25,1	2,40	4,70	9,1	2,30	4,50	8,7	3,20	6,20	11,9	0,40	0,70	1,4
Denmark	50.829,12	92.180,0	176.490,00	11,00	21,00	38,1	5,80	11,10	20,2	3,80	7,20	13,1	3,50	6,60	12	3,00	5,80	10,5	1,80	3,40	6,1
Germany	**596.935,00**	**1.090.488,0**	**2.025.534,00**	**12,40**	**23,10**	**42,2**	**8,30**	**15,50**	**28,3**	**3,10**	**5,80**	**10,6**	**2,30**	**4,30**	**7,8**	**2,50**	**4,60**	**8,4**	**0,80**	**1,40**	**2,6**
Greece	32.500,77	40.060,0	122.986,00	13,00	40,00	49,4	7,00	21,60	26,6	2,00	6,00	7,4	1,30	4,10	5,1	1,60	5,00	6,2	1,40	4,40	5,4
Spain	122.366,19	304.535,0	608.787,00	9,30	18,60	46,3	5,90	11,90	29,6	0,50	1,10	2,7	1,50	3,10	7,6	2,50	4,90	12,2	0,30	0,60	1,6
France	417.218,18	733.571,0	1.404.775,00	13,10	25,10	44,1	8,60	16,60	29,1	2,90	5,50	9,6	1,70	3,30	5,8	2,00	3,90	6,9	1,30	2,60	4,5
Ireland	14.603,86	41.756,0	103.470,00	3,60	8,90	25,4	5,80	14,40	41,2	1,80	4,50	13	0,70	1,90	5,3	1,40	3,40	9,7	0,80	1,90	5,5
Italy	294.044,35	472.670,0	1.165.677,00	16,00	39,40	63,4	6,30	15,50	25	1,00	2,40	3,8	1,50	3,70	6	0,40	1,10	1,7	0,10	0,10	0,2
Luxembourg	4.396,14	10.278,0	20.934,00	8,40	17,10	40	5,30	10,80	25,2	3,50	7,10	16,6	2,90	5,90	13,7	0,70	1,40	3,3	0,30	0,50	1,2
The Netherl.	**109.898,39**	**205.925,0**	**401.089,00**	**11,60**	**22,60**	**42,4**	**8,00**	**15,60**	**29,3**	**1,30**	**2,50**	**4,6**	**3,20**	**6,30**	**11,8**	**1,40**	**2,70**	**5,1**	**1,90**	**3,60**	**6,8**
Austria	**58.731,15**	**106.968,0**	**204.843,00**	**13,90**	**26,50**	**48,3**	**7,50**	**14,30**	**26**	**3,00**	**5,80**	**10,6**	**2,40**	**4,50**	**8,2**	**1,30**	**2,60**	**4,7**	**0,60**	**1,20**	**2,1**
Portugal	26.162,89		115.255,00	10,40		45,6	6,90		30,6	1,20		5,5	3,00		13	0,90		3,8	0,30		1,5
Finland	33.147,66	61.895,0	131.670,00	9,00	19,20	35,8	6,00	12,80	23,8	3,20	6,70	12,5	3,50	7,50	13,9	2,60	5,60	10,4	0,90	1,90	3,5
Sweden	79.657,94	143.849,0	246.619,00	12,60	21,70	39,1	8,80	15,00	27,1	3,50	6,00	10,8	3,90	6,60	12	2,10	3,60	6,5	1,50	2,50	4,5
UK.	**415.667,68**	**855.557,0**	**1.547.903,00**	**12,80**	**23,10**	**47,7**	**6,90**	**12,60**	**25,9**	**1,90**	**3,40**	**7,1**	**2,50**	**4,60**	**9,5**	**0,90**	**1,60**	**3,2**	**1,80**	**3,30**	**6,8**
EU	1.356.703,53	4.335.481,0	4.969.610,00	12,70	14,50	46,4	7,50	8,50	27,3	2,20	2,60	8,2	2,20	2,50	8,1	1,70	2,00	6,3	1,00	1,20	3,7
Iceland	1.844,51		9.459,00	6,10		31,1	7,60		39,2	2,30		11,7	2,70		13,9	0,30		1,3	0,50		2,8
Norway	44.623,10	77.415,0	175.506,00	7,80	17,70	30,7	8,70	19,70	34,2	3,30	7,40	12,8	4,20	9,40	16,4	0,70	1,60	2,7	0,80	1,90	3,3
Swiss	74.500,03		259.582,00	14,80		51,6	7,00		24,4	1,50		5,1	3,60		12,5	0,80		2,8	1,00		3,6
Slowakia	-					38,4			32,9			9,3			8			4,6			6,8
Slowenia	-					45,2			30,7			9,2			9			4,3			1,6

Source: Own Calculations from Eurostat (2002).

4. Necessary Reforms, Lessons for Russia and a Basic Approach for a Blueprint

The description and analysis of the country studies have demonstrated the complex structures of the national social protection schemes. Because of the influences of the manifold interest groups being involved in the social protection schemes, clear-cut trends in the development of the systems and the partial reform processes that have already been implemented are difficult to identify. The lack in applied economic theory regarding social security, the badly missing systemic approach to social protection as well as specific group interests at least have produced some conversed developments. However, recapitulating all the post war experience with manifold reform efforts in social protection, three trends are worth mentioning:

First the PAYGO financing of pensions and other intertemporal transfers (e.g., the elements of intertemporal transfers in health protection) has come into the focus of the international critics and debates. Due to the demographic changes in almost all high developed industrialised countries, the relation between the current replacement ratios, benefit levels, in kind transfers, etc. and the social security contributions or payroll taxes is not sustainable in the mid term and long run without overburdening the future generations.

Second the strongly increasing welfare states have led to a marginal and average tax and social security contribution burden which impairs the supply of effort of employees (flight into the shadow economy) as well as of entrepreneurs (capital export to countries with more favourable profit taxation and employers contributions to social security). Because of the numerous questionable distributive effects, which also favour well-to-do groups within the societies, a necessary reduction of the welfare states has to take place. Hence, this reduction is connected with the renaissance of the basic security idea, so that social policy measures are strictly limited to the real poor in the society. Consequently the exaggerated welfare states have to be cut to an efficient social state in which the trade-off between the justice of needs and the justice of ability is reduced to an unavoidable minimum.

Third all people living above the well-defined poverty line (physical or socio-cultural minimum of subsistence, depending on the countries' stage of development) have to take primary responsibility for the own social protection. For that purpose information and education campaigns on the operation of private insurance schemes are necessary and the existing social security institutions have to undertake serious reforms, connected with outsourcing of some fields of activities or even privatisation.

These identified development trends are of utmost relevance for countries in transition like Russia; for most countries in the former capitalistic block are also passing through a period of transformation from the welfare state to a more efficient social state, which again would be in better accordance with the ideas of a social market economy developed in Germany especially after World war II. Therefore, an adaptation of the Russian system to the current European standards would be rather an aggravation of the current status than an improvement. Especially Germany does not give any longer a positive example for countries in a catch up phase, even if some representatives of our welfare associations are trying to raise such an impression. In fact transformation countries like Russia do have the extraordinary chance to take the reform discussion serious and to adapt an efficient system, which is far beyond the current European institutional settings, which suffer from historical shortcomings and often insurmountable group interests. Insofar the discussions of this chapter can be taken as a very preliminary attempt of in the direction of a blueprint for the Russian social protection reform.

4.1. Basic Features of the Reform Process

As already mentioned at the very beginning of that survey the general PAYGO financing of social protection is not sustainable for the full spectrum of social protection. Therefore the question arises if the funding system could be a reasonable measure for social protection and can fully or partially substitute the PAYGO financing. Closely related with that problem are the fundamental discussions on the justice of needs concept, especially which replacement level would be appropriate to overcome the poverty problem and how much primary responsibility should be given to the citizen to decide on the individual risk preferences and assurance levels.

4.1.1. PAYGO Versus Funding System

In any insurance setting the principal question arises which financing modus is the sufficient one to secure the insurance members against their particular risk and the insurances themselves to be successfully engaged in competitive insurance markets. As long as the costs of the occurring risks can be borne in one period, e.g. no intertemporal risks are involved as described above, even for private insurance schemes the PAYGO system represents a reasonable instrument. But due to the possible occurrence of hazardous events, most of the insurance regulation laws stipulate that the insurance have to have a certain security fund to take precaution even for such unlikely events.[176] Consequently private insurance schemes are always following a mixed strategy of PAYGO and funding. With regard to intertemporal insurance problems like in life and health insurances, funding becomes even more relevant because the assured are paying their insurance premiums for a substantial part of their whole life span. Insurance funds and reinsurances as prescribed within the insurance regulation[177] guarantee the later insurance claims because the bankruptcy of an individual insurance would mean an irreversible loss for the assured especially if they have already reached the retirement age.

Social insurance systems can abandon a general funding since in a mandatory setting the insurance institutions by virtue of sovereignty are able to raise compulsory contributions from the citizen or members. But even in the Bismarckian model it was intended to introduce stepwise a funding system, which never really happened.[178] Compared to the funding system at least in the very beginning a PAYGO system has an enormous political appeal: In a pay-as-you-go system the contributions compulsorily paid by the actively employed can be transferred in the same period to the retired people, so that such a pension system can be implemented in one step. The first generation of pensioners does make a windfall profit

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[176] Another precautionary measure is the enjoined reinsurance, which is also connected with the formation of insurance funds, which have to be invested in consideration of well-defined eligibility criteria.

[177] Obviously such regulations require a regulatory and supervisory authority, e.g., the Bundesanstalt für Finanzdienstleistungen in Germany which is controlling the banking and insurance system as well as the stock markets, bond markets and the asset management; see for detail http://www.bafin.de/.

[178] The „Kaiserliche Botschaft“ of 1881 proposed the introduction of social protection in Germany; for details see Petersen (1989, pp. 41).

because this generation has never contributed into the system. A funding system on the other hand would mean that a full pension claim could only be guaranteed for those pensioners who have contributed to such a system for a full active life span. The implementation of a funded pension system until the final completion of old-age protection therefore would need some decades. This specific political appeal has been the main reason for the triumphant march of the PAYGO system almost in a global perspective. But social politicians should have been aware that under different macroeconomic conditions such system could become a dishonoured bill for the future.

The PAYGO system does function sufficiently as long as the population and therefore the actively employed in the official labour markets is increasing and the population growth is accompanied by a growth in real incomes. In such periods an increasing number of insured causes higher contribution revenue for the social protection system, so that due to a smaller number of beneficiaries and rising real incomes the benefit formulas could be even more generous. Also in case of constant population and a stationary economy the replacement ratios can stay constant. If we take this latter case and compare a PAYGO system with a mature funding system,[179] within the PAYGO system the contributions of the actively employed cover all the pensions paid to the retired in the same period. In fact the PAYGO system creates an intergenerational redistribution (from the active to the retired), but it also seems to be an interpersonal redistribution within one and the same period. The generational contract then means that future generations should have the same entitlements on their replacement levels as the current generations.

Within a mature funding system the pension expenses are backed by a security fund; in the given framework the running expenses of the social pension insurance then are covered from two sources: the contributions of the actively employed and the interest on the existing capital fund. In a closed economy both sources are again financed by the working generations, while in open economies capital exports are possible, which also can contribute to finance the running pensions. But the decisive difference between both methods is that in case of the funding system a capital fund does exist. Therefore, the implementation of a mandatory pension scheme for an ever growing part of the society, even for the well-to-do, might have contributed to the fact that compulsory social protection has substituted private and voluntary provisions for sickness and old-age. PAGO financing is very likely connected with a decrease in private saving and capital formation, which has early been alleged by Barro (1974) and nowadays seems to be a secured theoretical and empirical fact.

If the populations is not any longer growing, but decreasing and – even worse – strongly ageing,[180] the PAYGO systems runs into serious problems because the intergenerational contract cannot be maintained. A declining number of contributing employed is confronted with an increasing number of retired persons, with other words the revenue is decreasing while the expenses are increasing. The PAYGO system runs into a permanent structural deficit if the relation between the contribution and replacement income (equivalence) remains constant. A simple economic model can illustrate the involved problem. N_C is the number of actively employed earning the average wage w and paying the average contribution rate c into

179 In a mature funding system all retired persons have reached the corresponding replacement income.

180 The population decrease is mainly caused by a reduced birth rate (declining fertility) while the ageing is mainly connected with the increasing life expectancy.

the PAYGO system. N_P is the number of pensioners getting the average pension payment p. The sum of the contributions paid into the system in the period t, C_t, then follows with

$$C_t \quad = \quad N_C \bullet w \bullet c$$

and the total pension expenses, P_t, result with

$$P_t \quad = \quad N_P \bullet p \,.$$

If a balanced budget is striven for, C_t and P_t have to be the same in each period, so that the following condition holds

$$N_C \bullet w \bullet r \quad = \quad N_P \bullet p \,.$$

If we solve the equation for the replacement income ratio p/w, we get the following result

$$p/w \quad = \quad c \bullet N_C/N_P \,.$$

In case of a decreasing number of actively employed N_C and an increasing number of pensioners N_P either the replacement income ratio (pension level) p/w or the contribution rate c has to be changed if a deficit has to be avoided. The involved political variables are the average pension p and the contribution rate c. Additionally the retirement age determines N_C as well as N_P, while N_C is also dependent on the political decisions on the duration of training. Trade unions and employers' associations determine the average wage in case of autonomy in negotiating wage rates. Because these negotiations also influence the number of employees, there is an indirect influence from both interest groups, too.[181]

Hence, in case of an ageing population and growth retardation – the latter often due to the enormous disincentives created by an inefficient welfare state – PAYGO systems are not sustainable and result in serious conflicts between the working and retired generations, what is especially the case if like in Germany the pensioners have extraordinary income tax privileges. The only existing alternatives are to increase the burden for the working generations (contribution hikes with all the connected disincentives) or to reduce the entitlements for the retired (reduction of the replacement ratio, increases of the retirement age). In view of modern public choice theory, both alternatives are politically unattractive. Even though the gloomy prospects for the PAYGO systems are already known since more than two decades,[182] political reactions have been much to careful are even totally avoided.

The advantage of a funding system in case of declining and ageing population is the possible recourse on the capital fund. Especially for closed economies there has been an intense discussion if a funding system would contribute to a higher security of pension entitlements. In case of ageing dissaving is necessary, so that the assets of the funds have to be sold. This dissaving has to be compensated by others who would have to increase their savings; otherwise an oversupply within the asset markets would have a negative impact on the asset prices. There remains at least a certain threat for capital losses; if also more consumption goods and fewer assets are demanded, there are additional fears that inflationary processes can lead to further macroeconomic turbulences.[183] In open economies dissaving could be

181 In case of a wage agreement, which is too high in real terms, additional unemployment results as consequence that reduces the number of employed persons N_C. Here insiders versus outsider arguments have to be mentioned; for that problem sees 4.2.3. below.

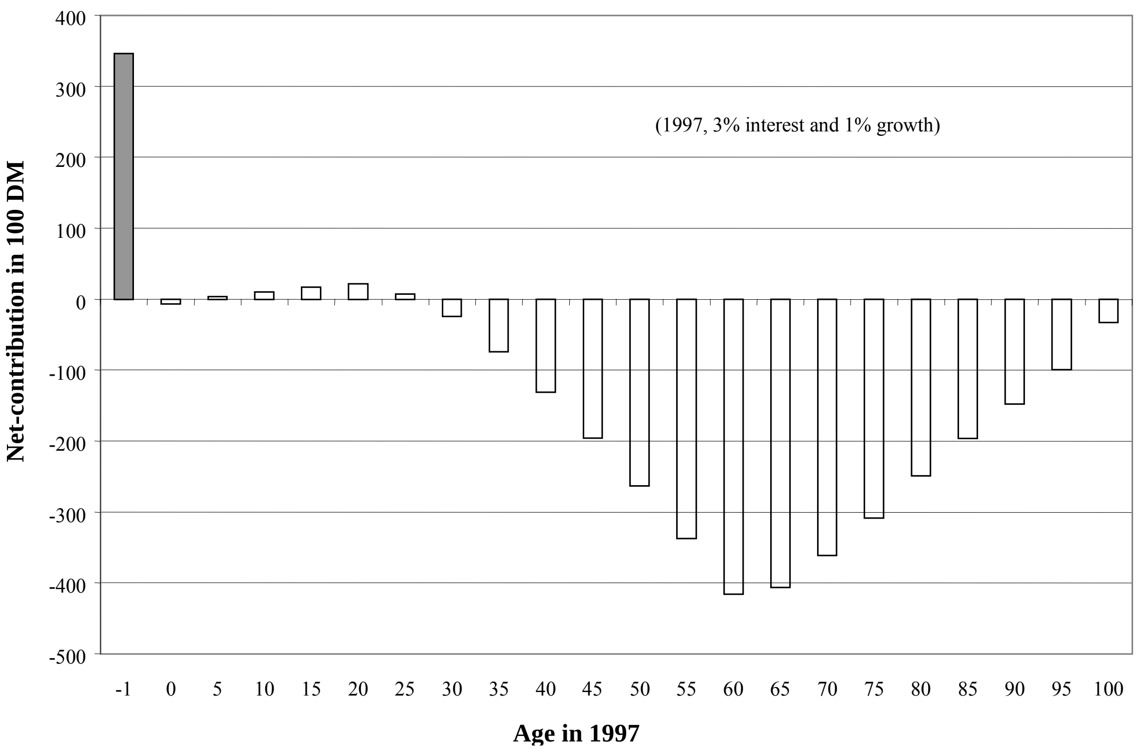
182 See, e.g., Petersen (1981 und 1986), Jüttemeier/Petersen (1982 und 1983).

183 See Petersen (1989, pp. 128).

much easier, because the risk of ageing could be distributed on a much broader number of people and external additional saving could compensate internal dissaving.

Being aware of the macroeconomic risks involved, an increasing number of experts are proposing a shift away from the PAYGO and to the funding system. Such argumentation is especially supported if the gloomy results from generational accounting are taken into consideration that in the meantime has been made for many countries facing the ageing problem.[184] Generational accounting is a method in which the present value of the future tax and contribution burden or the received benefits (transfers) of representative members of a specific age cohort is estimated under projected economic, demographic, and social as well as fiscal policy parameters. The figures for the cohort –1 (that is the cohort of children born in the next year) reflect the burden that would result if the intertemporal budgetary restriction would be met. Chart 17 shows the generational accounts for Germany in 1997 for the three branches of social protection (social pension, health, and old-age care insurance). This account is a clear proof that the current PAYGO system is not sustainable, because the net contributions paid by the younger cohorts (up to the age of 25) obviously do not cover the net transfers paid to the cohorts of 30 and older. These enormous structural deficits within social protection would create an additional burden for the coming generations (cohort –1), which is more than thrice as much as the current burden is. In other words, the relation between the contributions paid and the benefits from the pension system (replacement income) will be heavily downgraded for the future generations.

Chart 17: Generational Accounting for the German Social Pension, Health, and Old-age Care Insurance

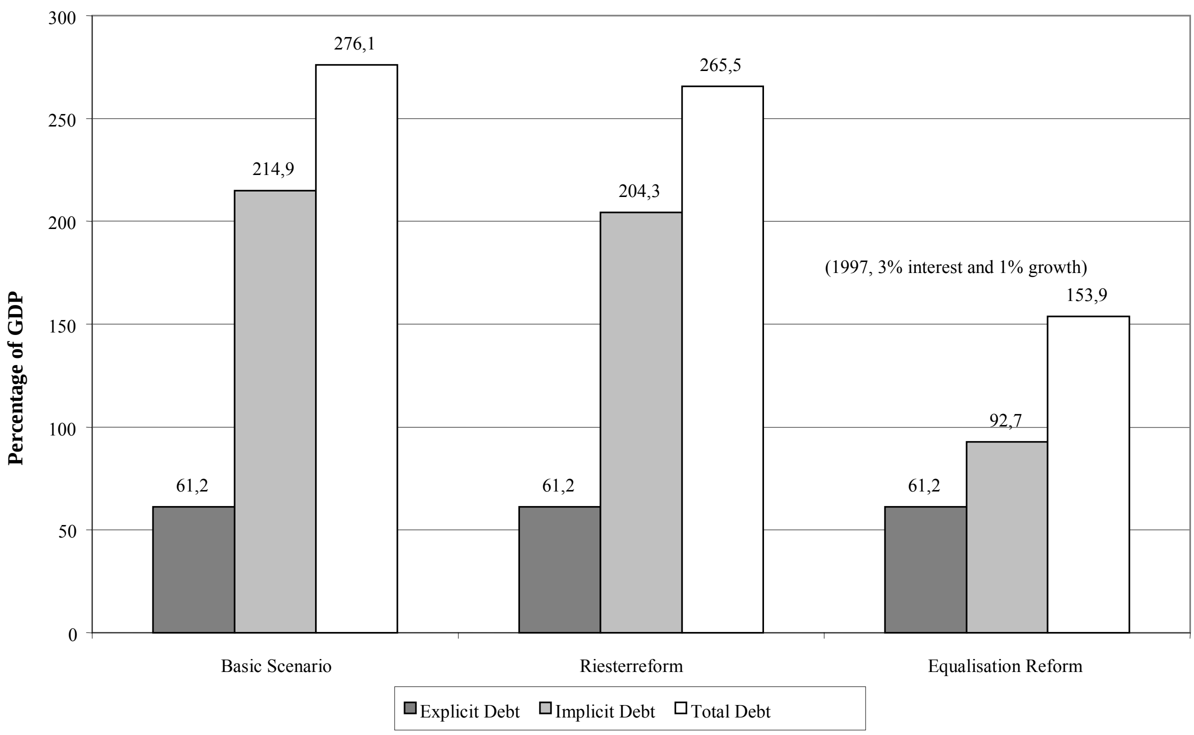


Source: Raffelhüschen (2000).

[184] See Raffelhüschen (1999) and the literature cited there.

With the generational accounting method also the burden of the accumulated public debt (interest and amortisation) is taken into consideration; this part is often called explicit public debt, because it is openly represented in the budgetary statistics as well as in the national accounts statistics. But also the acquired entitlements to the social insurance system within the currently employed generations and the running expectancies of the retired people reflect a similar claim against the coming generations as the explicit public debt does. If the present value of all these entitlements is estimated, this sum can be interpreted as the implicit public debt that is hidden within the social protection systems. Chart 18 represents the explicit and implicit debt in 1997 in Germany as result of the generational account method.

Chart 18: Explicit and Implicit Public Debt 1997 in Germany



Source: Raffelhüschen (2000).

If the basic scenario of 1997 is taken, the explicit public debt was 61.2 % of the gross domestic product (GDP); the sum of entitlements against the social protection scheme under the 1997 given legal framework accounts for 214.9 % of the GDP, so that the implicit public debt is 3.5 time as much as the explicit public debt. The pension reform implemented in 1999 (Riester reform) brought a first slight step in direction of capital funding and reduced PAYGO pension entitlements. Consequently the implicit public debt was slightly reduced. But only a fundamental equalisation reform could bring a real burden relief for the future generations (see the third example in chart 18).

The PAYGO system in the current form cannot be maintained without overburdening the coming generations; because of its substitution effects it reduces saving and voluntary provisions for social protection. Hence, PAYGO as dominating instrument for social protection also for the well to do impairs capital formation. The high tax and social security contribution burden, which is inevitably connected with a PAYGO system, on the one hand frustrates the labour supply on the official labour markets. On the other hand the high ancillary wage costs increase the price of the factor labour, thus inducing further substitution processes. Additionally the gloomy profit perspectives in high tax countries induce a capital export to more promising locations. Impaired capital formation, flight into the shadow economy, and capital exports then strongly reduce the growth potential of the market economy, so that unemployment is steadily increasing. Therefore a stepwise shift away from the PAYGO system in the direction of increasing funding is another measure that should be strongly recommended. Even though the ageing effect in Russia due to a strongly increasing life expectancy is currently not of such relevance, the aspired and desired economic growth sooner or later will change the demographic situation into the same direction, so that with a certain time lag similar trends will emerge. If then the signals are already directed to more capital formation, such problems could be overcome quasi automatically.

4.1.2. Basic Security Versus Upgraded Insurance

The switch from PAYGO to funding has some implications with regard to the fundamentals of social protection and security. If we take the former German model of a social market economy as basis for a societal concept, not the current excessive welfare state, fighting poverty on the level of a socio-cultural minimum income is a political core commitment. Even if such social target is generally accepted, still the question remains how such a minimum should be defined because this figure considerably determines the costs of the redistribution. These costs of income distribution have to be borne by the capable citizen (see chart 1 above), and this burden considerably determines their tax and social security burden. Only if this burden is accepted, no disincentives will occur, so that no economic distortions are created. In a social market economy blueprint social policy and all mandatory social protections measures should be exclusively directed to the real poor which would be a clear limitation for the expenditure side. Therefore, a well-defined basic security system is the main prerequisite for a successful social market system, in which both, the poor and the capable parts of the population, accept the paid transfers as well as the connected costs.

Basic security and basic protection means that the maintenance obligation of the family still holds. Following the principles of subsidiarity and solidarity, a socio-cultural minimum income as well as a basic coverage of health services have to be defined, which is appropriate for individuals and families in different life circumstances. Such life circumstances are specific situations of children rearing as single parent, disability, and old-age; in case of people who are principally capable of work, specific rules for social aid should be applied. The definition of the socio-cultural minimum income has to take in consideration the alternative incomes that could be earned in the official labour markets. Especially in case of people who are able to work, clear incentives for market employment should be set by the social aid system. Education programs as well as a specific job service should promote the re-integration into the labour markets (for details see 4.2.3. below). If such measures fail and supplied jobs are refused, work on the dole programs[185] or cuts of the social aid payments[186]

[185] Work on the dole programs have to be defined very carefully because the threat is involved that private activities will be crowded out. Especially work programs connected with municipal facilities are reasonable measures.

should give clear signals and incentives that the society demands from unemployed able to work that they actively contribute to their own living costs.[187]

As important as the socio-cultural minimum income for the labour market participation is the changeover from the maximum transfer paid to market income that is usually burdened with social security contributions (at least in social insurance schemes) or payroll taxes. Then the combined marginal burden of transfer reductions and beginning contributions or taxes is another serious obstacle against labour market participation. A rational basic security system therefore would comprehend a guarantee of all kinds of social protection on a basic level for all transfer receivers independent form the market income part they currently earn. For a smooth switch from the transfer brackets into market income, a gradual increase of the wage tax and especially the social security contributions should be striven for, which would mean a certain subsidisation of such contributions even within the first positive market income brackets. The re-integration into the official labour markets means new career opportunities for the former unemployed, so that a good chance is given to leave the subsidised income brackets in the near future. That would also strongly reduce transfer payments; consequently the solidarity of the whole society would be released, which would strengthen the acceptance of the basic security system.

With regard to health protection solutions within the basic security setting are a bit more complex. A pure guarantee of the basic health care – beside the problems of its reasonable definition – would follow the basic needs approach but give no incentives for a careful demand of health goods and services by the transfer recipients. Therefore an alternative way seems to be promising. Within an existing social or private health insurance system the transfer recipients could get an earmarked transfer for health care purposes, which they have to use for health insurance purposes. If we assume a private (or modern social) insurance scheme with premium reimbursement in case of periods with zero health costs, the transfer recipients would also profit from such a reimbursement and therefore have incentives to a rational use of the health goods and services. Prerequisite is that the consumers sovereignty of the transfer receivers is principally accepted and no paternalistic arguments apply, which often state that such consumers would likely consume the wrong products.

Such earmarked transfers for health purposes for the transfer receivers would also solve the problem of societal solidarity. If that solidarity is limited to the basic needs within the proposed basic security system, then all members of the society do finance the basic needs by their general tax payments (in form of direct and indirect taxes). The question remains how the basic health care should be financed for people beyond the poverty line (for details see 4.2.2. below) and if disabled people in the higher income brackets should also be compensated for their additional risk premium.

Basic security means – as mentioned above – always income redistribution from the people above the poverty line to the people below the poverty line, e.g., personal income

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[186] Special incentives can be set if in case of job refusals the monetary social aid payment is substituted by transfers in kind; work incentives then can be supported if with increasing labour market participation the transfers in kind are stepwise transformed into monetary payments; see, e.g., Raffelhüschen (2000).

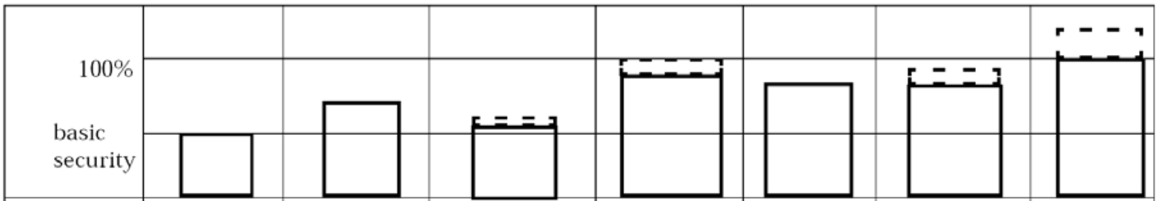
[187] Here the "Welfare to Work" program of the United States is to be mentioned which consists of two components: the "Earned Income Tax Credit" (EITC) and the "Wisconsin Works" program; see Ochel (2000 and 2001) and Prewo/Franke (1998). The "Working Families' Tax Credit" (WFTC) has already been mentioned above (see 3.4.5.) and Whitehouse (1996) as well as Feist (2000) and Sinn et. al. (2002).

redistribution. The redistributed income parts are exclusively used for consumption purposes because the creation of saving capacities for the poor cannot be justified by solidarity and such target would not meet the acceptance of the majority who have to finance that redistribution by their earned income. Therefore the costs of basic security are an intra periodical burden and not intertemporal, so that only the PAYGO financing can be applied. That also means that income redistribution has always to be financed by running tax revenue and not by public debt – a fact that have been often violated by many governments in the past.[188]

The arguments against basic security predominantly are going into two directions: First basic security would destroy the incentives of an ability orientated social insurance scheme. This principally false argument has already been vitiated in so far that the existing social insurances have lost their insurance character and overwhelmingly redistribute income – connected with enormous disincentives for the tax and contribution payers. On the other hand the presented basic security system has all features, which give the social aid receivers clear incentives to be re-integrated into the official labour markets. Second basic security is much too expensive to be financed. This second argument is at least as false as the first one because in all social protection systems basic security is already implemented, perhaps in a hidden and partially in a counterproductive way. The German example again will help to clarify the problem. Chart 19 presents a stylised overview on the replacement income levels for a single person in Germany.

188 Especially by German governments because the transfers connected with the German unification were overwhelmingly financed by public debt, thus increasing the burden on the coming generations.

Chart 19: Stylised Overview of Social Benefits in Germany in 1998



replacement net wage ratio	45-50%	70%	60/53%	100/90%	75-80%	75-91.75%	100%
kind of social benefit	Social Aid System (one person)	Social Pension System	Unemployment Insurance (benefit and aid; for families 67/57%)	Social Health Insurance (sick leave compensation and sickness benefit)	Pension System of Civil Servants	Pension System of Public Employees and Workers	Wages (gross, net)
employees contributions	no	individual	individual	individual	no	individual	gross wage oriented
benefits	household	individual, partly household	individual (benefit), partly household (aid)	individual	individual, partly household	individual, partly household	individual
Calculation according to	social cultural minimum	calculation: gross wage; adjustment: net wage increase	Net wage	Net wage	Calculation: gross wage; adjustment: gross wage increase	Calculation: gross wage; net wage ceiling at 91.75%; adjustment: gross wage increase	
Comments	depends on family status and net wage, family maintenance obligation, needs based	reference old age pensioner (45 years of contributions), usually income tax free	aid is needs based, provision concerning progression	Sickness benefit individual, non cash benefits: household oriented, provision concerning progression	reference pensioner with 40 years, due to income tax	Supplementary insurance (VBL) without employees' contributions, reference pensioner with 40 years, taxed as social pensions	The average wage tax burden is about 20.0% for singles and 18.6% for families

Source: Petersen (2000, p. 29).

The replacement level of the social aid system (column two in chart 19 for a single person) in fact reflects the basic security that principally is open for all needy people under the assumption of a means test (no market income and property). This level compared to the net wage (set to 100 % in the last column) is in the range of 45 % to 50 %, dependent on the rent costs directly paid by the social aid offices.[189] If we accept this level as a proximately correct basic security level, it can be easily seen that the other social insurances branches and public pension schemes are well above that level. With regard to replacement net wage ratios, sick

[189] In cities with higher rent levels for flats the replacement income ratio is higher than in cities with lower rent levels.

leave compensation corresponds to the net wage,[190] whereas the sickness benefit paid after six weeks of sickness by the health insurance is 10 % less. After 45 years of employment, the social pension is almost 70 % (replacement income ratio),[191] while the replacement gross wage ratio is slightly below 50 %. These ratios only apply if the employee has always worked for the average wage within the social pension insurance. In case of wage periods below the average level the replacement ratio would be more or less lower. The lower gross replacement ratio is due to the fact that pensioners only pay a reduced contribution to social health insurance, and the social pension itself is overwhelmingly income tax-free.[192]

In both the federal and state government, officials (Beamte) receive the higher replacement ratio of 75 %; and this is received in accordance to their last active wage after only 40 years of employment.[193] The pension of government officials is taxed like wages (albeit with a maximum annual exemption of 3,068 Euro). Their replacement net wage ratio is between 75 and 80 %. In contrast to civil servants, public employees and workers (Angestellte and Arbeiter) contribute to the social pension system while their supplementary system (which secures the standard of the civil servants system) has worked until recently without own contribution.[194] Because their pensions are predominantly tax-free, their corresponding replacement net wage ratios are substantially higher. About 10 years ago, however, an upper net wage ceiling of 91.75 % was introduced to avoid replacement ratios of over 100 %. This limitation is regulated in the supplementary pension system (Versorgungsanstalt des Bundes und der Länder, VBL).

The unemployment benefit (the dole) from the social unemployment insurance (see details in 4.2.3. below) and the unemployment aid (or assistance[195]) from the unemployment assistance are again net wage orientated and differ for singles and families with children. The dole is paid dependent on the age of the unemployed for at least 12 until 32 month (for unemployed above 55 years) while the replacement net wage ratio for the dole is 57 % for singles and 67 % for spouses. The corresponding unemployment aid or assistance is 10 percentage points less, means tested and is also subject to the family maintenance obligation. If the remaining replacement income is below the social aid minimum, the person under consideration falls back under the social aid system.

The argumentation above should have made clear that in every branch of the German social protection the replacement income of the social aid system is guaranteed and all the insurance systems are setting even higher replacement incomes. Therefore, a basic security system is already existing and financed. An additional system like a negative income tax or similar

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190 For the first six weeks of sickness the employers are obliged to proceed with the wage payment. This in 1974 introduced measure has been at least temporarily connected with serious disincentives (to have a saint Monday or Friday) and heavily been criticised by the employers associations. In addition to the employers social security contribution the sick leave costs mean another additional 4 % to 6 % (regarding the number of staff away sick which also depends on the labour markets situations) burden on the payroll.

191 This replacement ratio will be reduced to about 67 % as consequence of the above-mentioned Riester reform over a period of the coming two decades.

192 Because of specific concessions, income tax would only begin to be levied at pensions above 26,600 Euro (almost doubled for couples), but such social pensions exist only in theory; see Petersen/Raffelhüschen (2000).

193 As consequence of the Riester reform this replacement level was reduced to 71,25 %.

194 For details see Anton/Brehe/Petersen (2002, pp. 46).

195 For the terms also see Burda (1997).

measures are unnecessary and would only contributes to double subsidisation. Because precise estimations on the volume of basic security have not yet been made, a rough guess based on own experience would be that the basic security target causes about two-thirds of the current expenses for the systems mentioned in chart 19.[196]

The main difference between the current German system and a basic security system is to be seen in the fact that in a rational setting basic security would be PAYGO financed from the general tax revenue what currently is only done in case of social aid or if governmental grants are paid to the social insurance system.[197] This misconstruction creates the counterproductive effects mentioned above that basic security or more precisely income redistribution is more and more financed by social security contributions which principally should have quite another foundation: a contribution should lead to an individual entitlement for a corresponding pension payment (equivalence or benefit principle) and should not be misused for income redistribution. In case of misuse the contribution transmute the character to taxation with all the possible disincentive effects.

And not only the possible disincentives are counterproductive; moreover the justice of ability is heavily impaired what can be demonstrated with regard to two simple examples: First the replacement ratios of the social aid system are heavily dependent on the family status. While in our example in chart 19 the replacement income ratio for a single is close to 50 % of the average net wage, in households with children (e.g., four-persons household, two income-earners, two children), social aid depends also on the age of children. The social aid payment for families with two children under 13 years of age is less than for a family where the children are over 13. In the first case the replacement income ratio of social aid reaches about 65 % of the average net wage for that type of household, while in the second it is about 78 %. If not the average net wage for families of that type but families with two breadwinners from lower income brackets are taken into consideration, it becomes obvious that the gap between active labour income and social aid diminishes.[198] This is explicitly true for families living in large cities with high rent rates, since rent and all extra costs are borne by the social aid system. In specific cases social aid payments exceed the net wages, which naturally challenge the question if that corresponds with the ability-to-pay principle and also creates serious disincentive effects for the work supply in the official labour markets. This problem is not only dependent on the amount of social aid apportioned, but also on the fact those even low-income groups are heavily burdened by social security contribution and the abolished transfers as mentioned above (see chart 5 above). The so-called difference principle, which is anchored in the German social law, requires that there be a considerable gap between wages and social aid payments (about 15 % in favour of the employees), is at least partially impaired. Additionally, the combination of social aid payments and income from illicit work is often much more attractive than income from a job in the official labour markets. Consequently serious disincentives have been set with respect to transfer fraud.

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196 If we would the corresponding social aid payment assign to every beneficiary of the social protection institutions mentioned above, the whole costs of basic security could be easily estimated. Such estimations will be done in the near future with help of the Potsdam Microsimulation Model; see Bork (2000) and Anton/Brehe/Petersen (2002) and 4.4. below. A problem would remain with the transfers in kind of the social health insurance system because in Germany a minimum basket of health goods and services has not yet been defined. In Switzerland that has already been done for the basic health insurance system.

197 That is for instance in Germany the case for the social pension and unemployment insurance; see for details 3.1.1. and 3.1.3.

198 See Boss (2001).

The second example again puts the justice of ability question: While social aid is paid without any individual contribution from the general budget or tax revenue (what principally is rational for a basic security system), employees have paid a substantial part of their annual or lifetime market income in form of employees' or employers' contributions towards basic security within the social insurance systems. An illustrative example is provided by comparing the social aid payment of an old-age social aid recipient with the net pension payment of an unskilled worker who has worked all his life in a low-wage group. During his retirement period the single unskilled worker gets – dependent on housing costs – nearly the same amount as he could have got from the social aid system. The only difference is that his active lifetime income was substantially reduced by contributions made to the social security system throughout his active life, so that his total net lifetime income is very likely smaller than that of a comparable social aid recipient.

The fact remains that such impacts of social insurance and social aid contradict with all ideas of a fair and just treatment and create enormous disincentives. Another fact remains that the basic security currently guaranteed by the social insurance system is financed by contributions, which especially burden lower income groups. This does not only hold true for replacement income but also for transfers in kind from social health insurance, which are granted to social aid recipients without any contribution being made.

Hence the notion of a reasonable basic security strategy as proposed above has often been discussed,[199] one which would guarantee that all contributors to social insurance institutions receive the socio-cultural minimum of the social aid system. If the target is to stay with the current social insurance schemes, the component of social insurance expenditures that is needed in order to secure the basic income or care level should be born by a grant from the federal government, financed by general tax revenue. Then the solidarity of the whole society is engaged in that fundamental societal target and the task of the social insurance institutions would be reduced to financing the insured amounts above the basic security level via individual contributions.

In case of a possible switch from a health care system which is currently existing in many transformation countries the question arise if a social insurance system is a necessary and efficient step in the direction of social protection reform. Frankly spoken: it is not. Social insurance to overcome poverty has been an important historical step because at the end of the 19th century in most countries private insurance systems were in an infant stage of development and state regulation not yet existing – with enormous negative consequences for the funds security and the benefit security for the assured. The long-term continuance of life as well as health insurance systems was not adequately assured. In view of the modern regulations of banking and insurance systems, competition laws, ideas of one-stop finance, etc. the states themselves with their questionable political guarantees of future replacement levels are not more secure than the banking and insurance systems. Therefore, social insurance as a mandatory group insurance or even worse as compulsory insurance for the whole population has had its historical justification, but is not any longer a constructive proposal for the Russian social protection reform. Here one should think much more straightforward and introduce a private insurance system which upgrades the basic security assured by the peoples solidarity.

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199 In Germany, like elsewhere in the world, many basic security proposals exist; some literature can be found in Hüther (1990), Petersen/Hüther/Müller (1992) und Petersen (1997).

Why is a social insurance scheme only a third best solution? As a general rule social insurance schemes are monopolies, which show all the negative behaviours as described in modern institutional theory. Especially rent seeking and principal agent problems paired with beaurocratic behaviour always have an impact on cost increases as well as a lot of other inefficiencies.[200] As far as some competition exist like in the German social health insurance system, the efficiency gains of single insurances then are redistributed in between the insurances by newly invented risk sharing procedures to avoid adverse selection within the single insurance. The long-term outcome is new inefficiency without any problem solving. The basic health insurance approach of Switzerland with a mandatory membership for all citizen and per capita contributions is a beloved model by many German experts, but almost as inefficient as the German system. Even more, the Swiss model produces costs, which are the highest in the world shortly behind the United States. Public monopolies and missing steering mechanisms of market approaches do not create a sufficient degree of primary responsibility that would lead people to reasonable behaviour and demand for the supplied benefits.

Due to scarcity considerations especially in countries with a high poverty as exists in many transformation countries,[201] oversupply and dissipation of resources is intolerable and unbearable. Therefore, the implementation of an efficient basic security system would be an important and fundamental step to fight poverty and to gain again trust of the people into the state activities and social policies. The parallel implementation of a well-regulated private insurance system, which is put into the hard international competition, would guarantee a supply of risk sharing and efficient assurance possibilities on which the citizen can decide in primary responsibility. Such upgrade of replacement incomes as well as of transfers in kind then would happen in accordance with the risk preferences of the single assured. For a substantially part of their market income, which otherwise would be bound in mandatory systems, people would get back their consumers sovereignty. Insurance contracts would consequently be bought as other private goods and services; the voluntarily paid premiums therefore would not create any negative incentives because they are fully equivalent to the agreed insurance volume, so that the participation within the labour markets would not be impaired. Compared to the currently enormous social security contribution in many countries,[202] the incentives to switch over into the shadow economy would be substantially reduced.

Obviously the switch to the basic security strategy as proposed here would not mean a strong decline in the overall burden of the social protection scheme; but a slight and noticeable decrease would happen because all transfers to the income groups beyond the poverty line are abolished at least in the high industrialised countries which could afford such guarantees. The costs of the basic security systems then have to be born by the tax system. If that is efficiently constructed (see 4.3 below), the negative incentives of the contribution financing can be reduced. And the contributions for the remaining upgrade insurance would be substantially

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[200] See Petersen/Müller (1999, pp. 63).

[201] See, e.g., Golinowska (2000).

[202] Specific bad personal experience has been made in the Bulgarian example; social security contribution rates were between 43.5 % and 58.5 %, while the minimum wage was tax and social contribution free. The high social contribution rates then have led all employers to engage the employees officially for the minimum wage, paid from illicit cash a higher remuneration; see Petersen/Naydenov (2000, pp. 140). Such regulations just feed the shadow economy without any positive effects for the public budgets.

decreased, so that in countries with existing social insurance schemes the ancillary wage costs could decline to about one-third of the current level. This also holds true for the employers contribution, so that wages and profits would be substantially released form a direct burden, especially if the costs of basic security would be financed by consumption orientated or eco taxes.

As important as the institutional setting of social protection is the reduction of transfers with increasing market income (see chart 5 above). Even if an additional negative income tax system is not necessary, the abolition of transfers in all transfer schemes have to be well coordinated with the tax and social contribution scheme. On the one hand that means that the income brackets within the tax and transfer system are simultaneously and uniformly defined. On the other hand the marginal transfer reduction, tax and social security contribution rates have to be as low as possible and in the scope with increasing market income all marginal burden hikes have to be avoided. Therefore it is necessary to take the negative income tax model (NIT) into consideration because then the basic problem becomes obvious. Both existing NIT forms are closely connected with the income tax system because a basic exemption is usually included in the income tax schedule with the purpose of exempting a certain minimum income (the physical minimum of subsistence or the socio-cultural minimum as mentioned above) from income taxation. Such basic exemptions only provide tax relief for those taxpayers whose taxable income is above the amount of the basic exemption. Therefore the idea was hit upon giving corresponding relief in the form of a transfer to those whose taxable income was below the amount of the basic exemption.[203]

The social dividend type of NIT (SD) – elaborated in detail by Lady Rhys-Williams (1953, pp. 128) – guarantees a basic allowance, X_B, or minimum income which has to be paid as a transfer or is credited to the individual income tax yield of every taxpayer. The formula is given as follows

$$tr = t' y - X_B,$$

where tr is the transfer, y the market income, and t' is the marginal tax and transfer rate. Once the minimum income X_B (basis income) and the marginal tax rate t' are defined, linear tax schedules result in the critical income X_K. The corresponding tax schedule is shown in chart 20, in which X_K is the critical (market) income at which the transfer and the tax yield are equal to zero.

The poverty-gap type of NIT (PG) – proposed by Milton Friedman (1962) – initially fixes the critical income X_K; then the formula is given as follows

$$tr = t' (y - X_K).$$

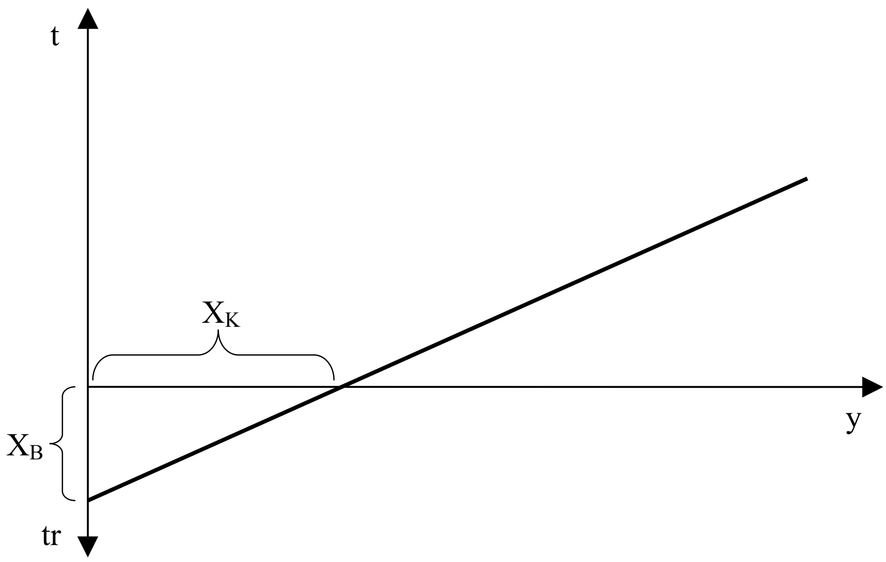
Whereas the SD formula corresponds to the tax credit method, the PG formula represents the tax exemption method. Assuming linear tax and transfer schedules, there are in principle no differences between the two types – one can easily is transformed into the other. This is true for proportional or indirect progressive tax schedules, where marginal rates are kept constant (as in case of a flat-rate system).[204] The simple linear negative income tax schedule with a single marginal rate for both, the tax and transfer bracket, is only a theoretical model. On the one hand, because of the necessity to limit the transfer volume to an acceptable amount, the

203 For details, see Petersen (1997, pp. 56).

204 See Pfähler (1972/73).

marginal transfer reduction rate has in practice to be close to or slightly above the 50 % margin. On the other hand, marginal rates of 50 % and more already for the lowest market income brackets are totally unacceptable, thus leading to serious work disincentives, not to mention the problem of justice of ability. Therefore, different marginal rates for the transfer and tax brackets have been proposed in which the latter is much less then the former.[205]

Chart 20: Linear Negative Income Tax Schedule



Source: Petersen (1993 a, p. 228).

Chart 21 shows a NIT with marginal transfer reduction rates of 100 % and 50 %, respectively. If X_B and the marginal reduction rate t' are fixed, X_K follows just as result of the both variables; consequently at given values of X_K and t', X_B results. If we take the social aid transfer as defined by the existing social aid system, in the German example the marginal reduction rate is close to 100 % for the social aid and the unemployment assistance.[206] At a fixed minimum income X_B and a marginal transfer reduction rate of only 50 %, X_K doubles (from X_K^0 to X_K^1). Obviously that singles and households who are located with their market incomes between X_K^0 and X_K^1 increase the number of transfer recipients. The strongly growing number of transfer recipients would also mean a substantial increase within the transfer volume. This rise can only be avoided if – as mentioned above – the existing basic security expenses from the other social protection sources (as shown in chart 19 above) would be merged and especially the social aid payments to recipients in the employment age (say, e.g., below 60 or 65) strictly limited. If the basic security transfers paid by all the existing social protection branches would be well coordinated, such a smooth and gradual reduction of transfers could be reached. This would avoid sudden hikes in the marginal burdens and give sufficient incentives for the re-integration into the official labour markets. Increasing

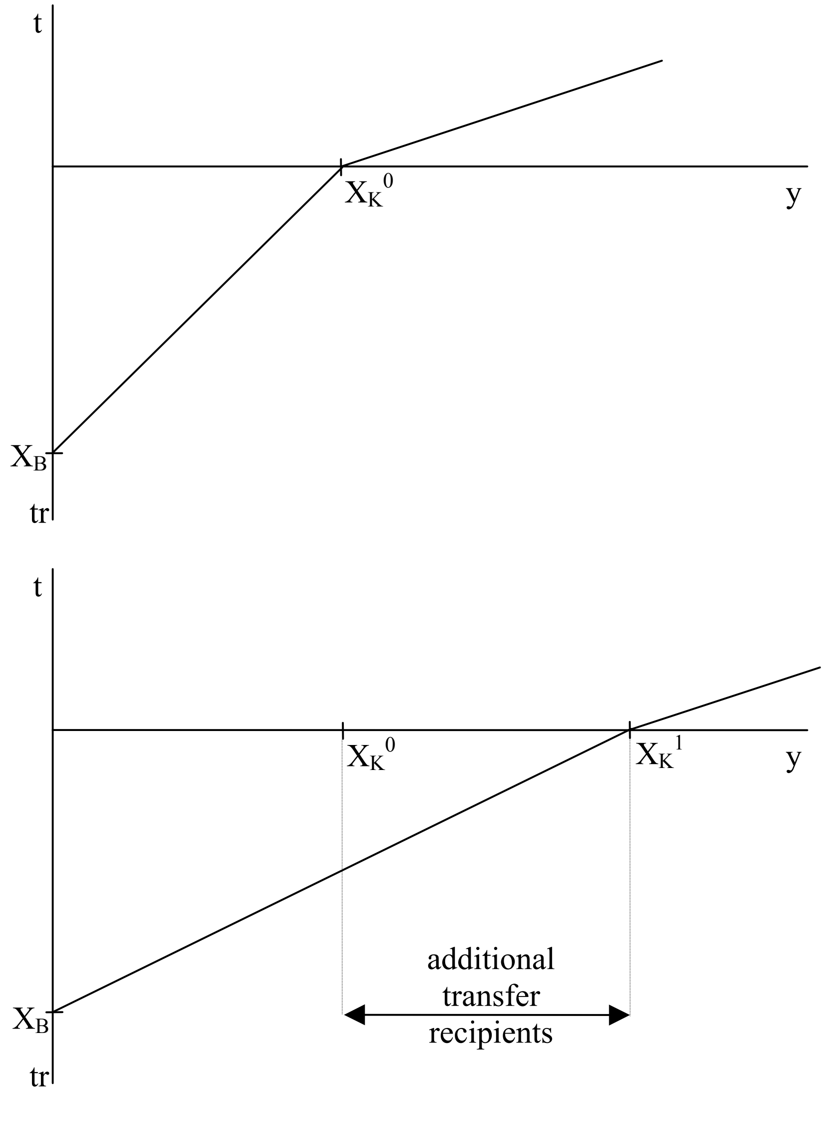
205 After a transition period of about 10 to 15 years, in Germany a marginal transfer reduction rate of 50 % and a flat rate income tax with a marginal tax rate of 25 % could be implemented; for details see Petersen (1997) and Petersen/Rose (2003).

206 For details see Boss (2001).

employment and decreasing unemployment then would lead to a further reduction within the social aid costs.

Both NIT proposals, however, are connected with another important feature: whereas the SD type is a non-tested transfer program with universal payments for every citizen, the PG type is a means tested (income tested) one. Although Keselmann and Garfinkel (1978) have shown, on the basis of very specific assumptions within a labour/leisure model, that the former might be economically more efficient than the latter, this alleged advantage should not be taken to be a general one.

Chart 21: Negative Income Tax Schedule with 100 % (Above) and 50 % (Below) Marginal Transfer Reduction Rate and 25 % Marginal Tax Rate



It is obvious that means testing is a labour-intensive procedure for the social and/or the fiscal administration and is connected with comparatively high costs. But as long as direct (income or consumption) taxes are levied by complicated assessment procedures, including a detailed declaration of personal income, wealth and (at least some) expenditures, income testing for the poor is not only a question of social symmetry. In countries in which a right to (or liability for) support payments (maintenance payments) exists for spouses and relatives of the first degree (in Germany for children and parents as already mentioned above[207]), the introduction of a non-tested transfer program would destroy the important role of self-responsibility in the family. As in other areas, the role of the family would be further impaired. Hence, the income testing and maintenance obligation for close relatives is a fundamental limitation for transfer programs in using this important role of the family. Because of the above-mentioned reciprocity that rules in sound families, voluntary private transfers would take place, which are not (or are much less) connected with disincentives for the donors (or the recipients). In case of non-tested transfer programs, public transfers that normally lead to serious disincentives for the recipients as well as for the taxpayers who have to finance such programs very frequently replace private transfers. Hence, individual or family problems are socialised, and the reduced self-responsibility invites unethical behaviour (moral hazard), as already mentioned above.[208]

4.2. Reforms within the Branches of Social Protection

After the discussions of the basic reform features, the possible trends within the pension system, the health protection and old-age care systems, the unemployment insurance and the accident insurance will be analysed in a more detailed form. As already mentioned under 4.1.2. in view of the existing efficient regulations of numerous private insurance schemes, the states' influence on social security could be substantially reduced. But as far as social insurance schemes are already existing, strong interest groups have been formed which especially express the interests of the management and the employed staff, even if these groups often argue to act in the pretended interests of the mandatory assured. Therefore, at least for a longer changeover period social insurance schemes will survive. But in any case market elements have to be introduced and the existing system have to be set in competition with private insurance markets.

4.2.1. Pension System

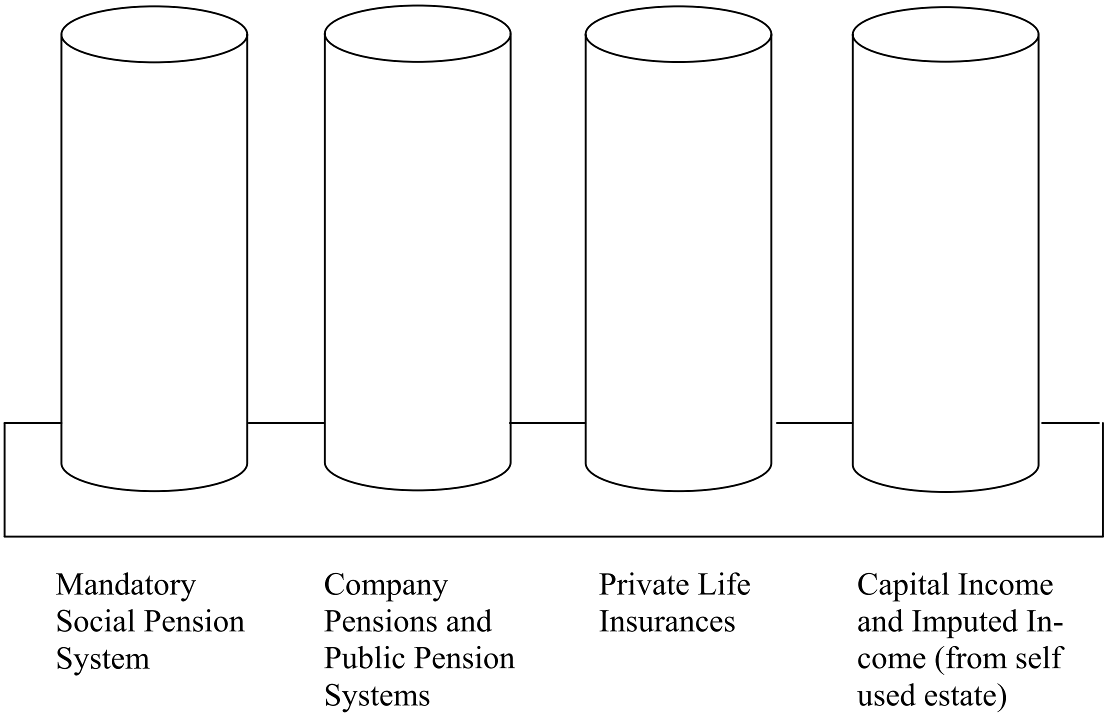
In most of the high developed industrial countries the pension or old-age security system are being composed of a multi-pillar system. At least in existing social insurance schemes the pension payments from the social pension system were the main source for old age security; while today in most of the households the social pension payments play still a decisive, but not any longer a dominating role.[209] Due to that tradition the social pension system was named the first pillar of the whole pension and old-age security system. Especially as consequence of the income growth in the post war period beside the first pillar at least three others have to be mentioned which partially have played an important role even before (see chart 22).

[207] For details see Hinterberger (1991, pp. 174).

[208] Here, the discussions in the United States have to be mentioned again. It has been conjectured that the social aid payments might have impaired the self-responsible behaviour of husbands and fathers, especially in the slum regions of large cities; see Herf (1992, p. 146) and Schlesinger (1992). In the highly developing countries of Southeast Asia, the role of the family is still dominating with regard to social protection; therefore, their public expenditures on social protection are substantially lower than in the European countries.

[209] For the German situation compare Petersen/Raffelhüschen (2000, pp. 14).

Chart 22: Four-Pillar System



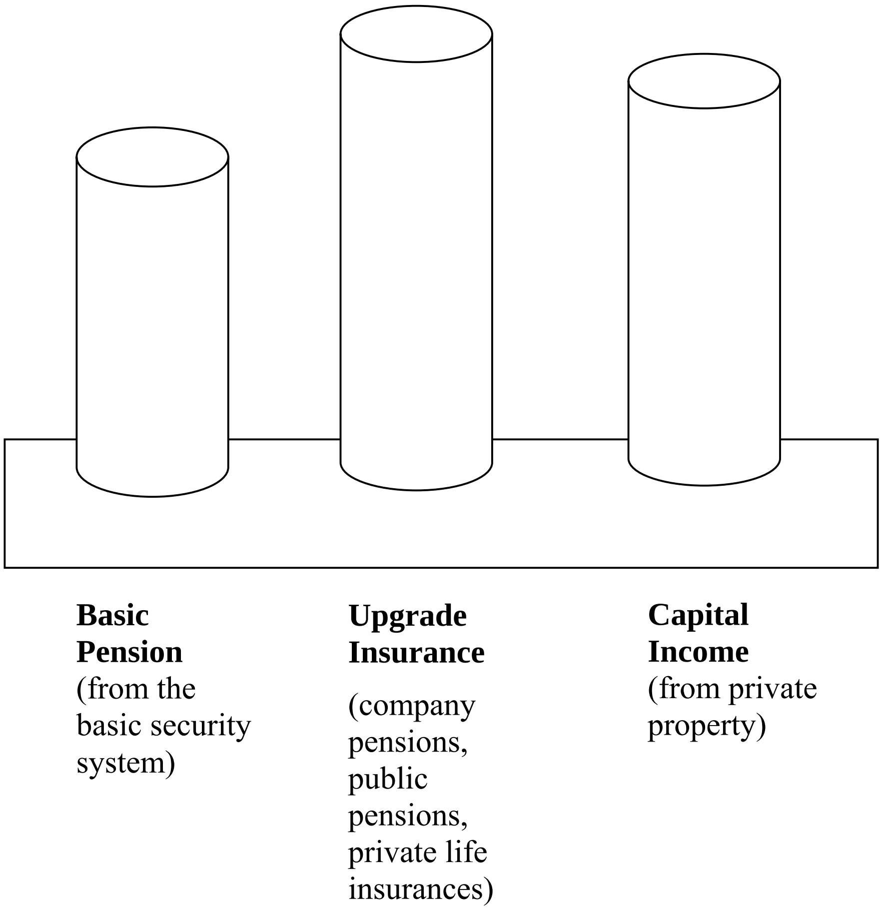
In addition to the mandatory social pension system the voluntary company pension systems are to be mentioned which have the task to upgrade the replacement income levels of the mandatory system. The extent of such upgrades heavily depends on the qualification status of the employees, so that usually managers get higher payments than ordinary blue- or white-collar workers. The coverage of such systems is often limited to the industrial sector and larger firms, while some systems are part of the wage negotiations between the trade unions and corporations associations. In contrary to the mandatory social pension system and the public pension schemes, most of the companies' pensions are based on funding.

The private life insurances have been the most successful insurance branch in the post war period. The growth of the life insurance contracts as well as of the single insured volume has been several times as high as real income growth. In Germany almost in every employee's household there is at least one, very often more than one life insurance contract. The average insured volume has strongly risen to amounts of some ten thousand Euros each. Naturally, the private life insurances have to apply the funding system. But it has critically to be mentioned that in the German insurance system at least for several years investment in public bonds was the predominating funding source. If funding is just another expression for public debt, such a system is very close to the PAYGO approach. Therefore, it is highly recommendable that the capital investment of the life insurances should be regulated in such a way that the investment in eligible public bonds is limited and investment in capital and stock markets is preferred.

Beside the social and occupational pensions as well as capital payments or rents from the private life insurances, the capital income form private property complements the effective replacement income for the old-aged people. Capital formation has traditionally been the most important source for the old-age security of self-employed persons. Capital income stems from profits and participation, rents and leasing as well as interest payments. Empirical studies in the highly industrial countries show that such income has an increasing relevance for employees' households, too. Furthermore for old-age security the ownership of accommodation or the connected fictitious rents (imputed income) are of particular importance. Again empirical evidence demonstrate that in the highly developed countries clearly more than 50 % of the household with an old-aged head of household do have such property which means a substantial increase of the effective replacement income. Therefore, capital income is an important source for old age security, especially since the property itself is an additional source, which in case of unexpected events could be sold. But most of the old-age people rather form additional saving than consuming the results of their lifetime work. The bequest motive of saving obviously plays an important role for such behaviour.

If reforms of the social pension system are taken into consideration, the demographic problems as described above connected with some necessary cuts in the replacement levels by pension reforms and/or a more severe income taxation of pensions will further increase the relevance of the other pillars of old-age security. If politically intended or not, the social pension system is actually already moving in the direction of basic security, and such trend can be observed in many European countries. In a rational perspective the citizen should be made aware on the necessity of primary responsibility for old-age protection, so that in due time the necessary behavioural adaptations can be made. Education and information on efficiently regulated private insurance markets – as mentioned above – are the best prerequisites that would lead to a preference steered insurance volume without creation of negative incentives. Especially if the development within a country only allows for replacement ratios close to the physical minimum of existence, the introduction of mandatory social pension insurance with the connected administrative expenses has the character of a political false labeling. It would be much more honest to make clear that already the realisation of a basic security, which guarantees a sufficient physical minimum of subsistence, is a serious task and all levels beyond would exhaust the societal vigour. Consequently the number of basic pillars for old-age security would be reduced to three (see chart 23).

Chart 23: Three Pillars of Old-age Security



The basic pension would be fully PAYGO financed; then the question remains if such a basic pension should be guaranteed to everybody within the society, including the well to do, which would substantially increase the costs of that system. If the system should be targeted to the lower income brackets, the question of the upper ceiling has to be answered. Then households above that ceiling would totally depend on self-reliant old-age protection (including the basic pension), but also contribute with their taxes to the basic security system, so that the solidarity principle is met. Upgrade insurance could also be organised by companies and the public sector for their respective employees, or, in a more liberal setting, it could be exclusively left according to the individual preferences for the private insurance coverage. An alternative to life insurances would be private saving and capital formation, which is not connected with risk sharing between the individuals. Naturally, all the private old-age protection activities would be connected with funding. Compared to most of the existing systems, the PAYGO financing would be decreased and the funding substantially enforced.[210] Due to the demographic trends such enforcement of capital formation is urgently necessary and has to be accompanied by income tax changes that are described below.

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[210] In the German example that would mean an increase of the funding financing from currently about 20 % to around 50 % within the coming 30 to 40 years; see Petersen/Raffelhüschen (2000).

4.2.2. Health Protection and Old-age Care

The basic lines and problems of social health protection systems have already been discussed above. Our analysis has made clear that the current social health insurance as well as the health care systems is fundamentally faulty constructed. The only possible reform perspective is causal therapy because curing symptoms has already failed in the past. As far as social health insurance schemes are taken into consideration, only the introduction of market elements could overcome the current malaise of permanent cost explosions. Market elements on the one hand consists of clear cost signals for the assured connected with better control mechanisms of the medical supply, e.g., detailed information for the assured on the quantity, quality and prices of health goods and services. On the other hand the introduction of market elements have to deliver the correct incentives which would steer the assured demand for health goods and services much more efficiently. As far as the institutional setting is taken into consideration, the question has to be answered if all that elements could better be organised within a private insurance scheme, because only in such a scheme a sufficient extent of necessary competition can be secured which is always necessary for price control.

A fundamental and comprehensive health protection reform has to solve two tasks: First such a reform should secure the framework for a long term optimal allocation of public expenditures for health protection; second – and perhaps more important – is the necessary re-formulation of the role of the societies solidarity and the role of the state with regard to their responsibilities connected with health protection. Hence, it becomes more and more clear that even the West European countries are unable to guarantee the highest possible quality and quantity of health goods and services in the sense of a sufficient coverage for every citizen with all technical possible, expensive medical services. Demographic change, ageing and the badly lacking incentives for an economically demand for medical services intensify the financial pressures.

The social politicians being interested in re-election overwhelmingly stick to a guaranteed full coverage for every citizen and deny any unequal treatment regarding the access to medical services. Often they almost swear to the classless society with regard to medical services, thus impairing the scarcity conditions which are fundamental for every economic system. If any rationing is refused, there are no chances for the introduction at least of some market elements. If rationing by the price system is rejected, as the real existing socialism has proofed, waiting queues are the outcome, as can be easily observed as consequence of the UK health care system. Then, step-by-step, private parallel markets for health care services emerge in which the unsaturated demand meets a sufficient supply, partly at relatively high costs.[211]

If the rationing mechanism of markets as consequence of the mechanism of relative prices is abolished, the scarcity condition is switched-off in that sector, one and perhaps the main reason for the permanent cost explosions that are only prolonged by curing symptoms instead of causal therapy. The classless society just for one sector is as an illusion as for the whole society. With regard to consumption possibilities for "ordinary" goods and services, the differentiated income class society is at least in market economies accepted since generations,

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[211] In many transformation states, or even already in socialistic times, the health care systems were not able for a sufficient supply of medical services, so that on illicit markets (or below the tables) medical services were traded.

thus creating the necessary incentives for the supply of effort. The emergence of private markets is expression of the consumers' sovereignty, which is obviously suppressed in the social protection systems. The ban of private medical service markets would be a clear offence against a market economy and is a clear interference into the constitutional rights. Even in view of the current discussions in Germany that medical services for a basic coverage should be only supplied by social health insurances,[212] such change would be a clear step backwards to an increased interventionism of the state and even worsen the current situation.

One important argument for a justified and well-dosed state intervention is the general interest of the public on a sufficient state of health and on the existence of satisfying precautions in case of sickness. As important is the individual interests of the citizen with regard to their own health situation. Due to the consumers' sovereignty, the general interest of the public can only justify complementary and accompanying measures of social protection if the individual precautions are not secured in a sufficient way. However, many medical services are indispensable to live. In case of need, any refusal of such services would jeopardise the physical existence of the affected people. Therefore, in the European setting it is out of question that vital medical services are made available, independently from the needy individuals ability to pay for such services. The health protection for the persons in need has to been overtaken by the state, following the justice of needs concept (or the solidarity principle) as already discusses in connection with the basic security problems.

In the health protection scheme, following the justice of needs concept can be expressed in two demands: First the identification of basic security services in the medical sphere has to be limited to that services which are indispensable for life. Obviously this identification is connected with ethical reasoning, with individual as well as social norms, and the technically possible medical services. Because even in such an important service sector, a permanent breach of the general scarcity conditions cannot be accepted without endangering the existence of the whole economic system. Therefore, the identification of the really necessary medical services is a permanent task for the societal discourse that finally influences the voting behaviour of the citizen. The second demand is connected with the principle of subsidiarity, which states that in the very first instance the responsibility even for such basic and important health good and services is with the individual. Society and state should concentrate their care on those who are unable for individual health protection. If free rider behaviour is a frequent and individuals who are principally able for protection in self-responsibility do not care, a mandatory obligation for health protection could be legitimate.[213]

The identification of the basic catalogue of the medical goods and services is a complex task that can be only solved by politicians, physicians and economists in an interdisciplinary approach, e.g., done in official ethical commissions. The volume and structure of such a catalogue has to be permanently adapted to the technical standards as well as to the economic possibilities. In that identification process the highest possible extent of transparency should be striven for. Economics and health economics have developed a real bundle of criteria,

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212 The Rürup commission currently discusses such ideas.

213 But one should be fully aware that alleged free rider behaviour is often a pure interest group argument to press the whole population into mandatory systems because only a comprehensive system secures solidarity. Comprehensive, monopolised systems mean on the one hand the largest possible political impact for the lobbyists, and on the other hand the necessity of permanent political interventions from the social politicians. Both impacts are overwhelmingly counterproductive; for details see Petersen (2000a).

which allow a classification in basic and upgraded health services.[214] Here the criteria of the medical exigency, the medical effectiveness, and the cost criteria are just to be mentioned.

Principally the individual insurance approach is the most conformable alternative for social market economies, even if most of the existing health insurance systems follow – due to the above-mentioned historical reasons – quite another approach. The premiums are fully orientated to the individual risk. Changes in the risk situation have then consequences for the future premiums. The intertemporal risk sharing necessitates individual funds for the old-age, which should be clearly defined and transformed to a competitive insurance in case that the assured will change into another insurance.[215] The problem of adverse selection, which does exist in all insurance schemes, can be easily solved by a subsidisation of the part of the premium, which is above the standard risk for disabled people, and in case of poverty the full premium could be transferred as mentioned above. Poverty and disability are clearly defined facts while only in case of psychological diseases some problems of identification remain, which are also creating problems within the current institutional settings. Hence, an efficiently regulated private health insurance scheme with a basic insurance and a upgrade insurance is able to overcome all the limitations of private insurance schemes mentioned above if the problems of relative poverty and adverse selection are solved by premium grants for the concerned groups of assured persons.

Naturally such a health protection reform needs a certain trust in the regulative powers of the government as well as in the efficiency and justice of the connected market solutions. Even in the Western European countries often such trust is badly missing – in spite of the obvious failures of the existing systems. Whether the introduction of a private health insurance system would be the silver bullet in the direction of a social market economy, for a transition period even a social insurance scheme might be a system which is only political feasible. This is especially true if the change form a publicly administrated care system has to be organised.[216] But if such an interims solution is striven for, the decisive elements of a well indicated catalogue of basic health services as well as the necessary steering mechanisms for the demand of health services and the control of the supply side have to be integrated into such a model. Then the future switch to a private scheme would be far easier because the basic market elements have already been integrated with the interim reform step.

Beside the health insurance problem, a specific problem of old-age care has been identified in Germany during the mid 90s of the last century. The answer has been a new social insurance scheme: the old-age care insurance as mentioned above. Principally the old-age care problem would not have been a problem at all if the social health insurance scheme would follow the funding approach for the old-age people as it is in the case of private health insurance. The old-age care insurance therefore is the consequence of a falsely constructed social health insurance, so that in an efficient private setting there is no pride of place for such an insurance branch.

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214 See, e.g., Sowada (2000, pp. 55).

215 In Germany these funds are lost in case of an insurance change that creates a trap against any change and impairs the competition between the insurances.

216 In the Polish example a social health insurance has been introduced; for details see Sowada (2000). Because of constructive failures this system has recently come under enormous pressures.

4.2.3. Unemployment Insurance

As described in the country studies, the replacement income ratios for the unemployed are quite differently treated, partly within the social aid systems, partly as social insurance schemes. In the former case the replacement income is basic security oriented, while in the latter it depends on the formerly earned wage in some given limitations. The main tasks of the insurance schemes were to prevent the affected people from the consequences of unemployment and to back their re-integration into the labour markets by placement agencies. While the first task has been overwhelmingly accomplished, the re-integration policies of the public labour placement agencies were predominantly ineffective. Additionally the unemployment benefits and the unemployment assistance have contributed to serious work disincentives,[217] which have led to increasing unemployment from business to business cycle especially in those countries with comparatively generous replacement income levels. If we concentrate on the duration of unemployment, cyclical unemployment due to the business cycle is rather a minor problem. The long-term structural unemployment has become the currently dominating political problem because unemployment decreases the wage tax and social security contribution and increases the expenses of the unemployment insurance and social aid system. Hence, the public budgets are running into serious deficits.

Structural unemployment is often caused through a certain mismatch between the structures of demand and supply on the numerous labour markets. Beside an excess supply with regard to low qualified workers, on other labour markets an excess demand for high-qualified workers is possible. Another important cause can be seen in the fact that a job deficit exists because of not sufficiently available profitable production capacities. Such capital shortage unemployment is characterised by an excess demand on the goods and services markets while an excess supply on labour markets does exist, a situation, which has been described as classical unemployment by the New Macroeconomics. The firms do not serve the excess supply because goods and services cannot be produced for cost covering prices. The causes for the high costs are to be seen in real wages or the ancillary wage costs, which are to high. The latter are often dependent on the tax, social and distributive policies, which again demonstrate the mutual dependencies of economic problems.

If the current structure of unemployment in those countries with an above average unemployment is taken into consideration, obviously a sustainable change has taken place compared to the early 70s of the last century. Whereas in former business cycles in boom periods the former unemployment was quickly absorbed, since then a new business cycle always has started from a higher base of unemployment (hysteresis-effect).[218] This is another proof for the fact that structural unemployment is more and more dominating the cycle effect, even if a clear statistical split in between both is much more difficult than in case of frictional and seasonal unemployment. Beyond that labour market statistics point up to the fact that the fraction of long term unemployed (with a duration of unemployment of more than two years) is steadily increasing. Among them the groups of low skilled but also of older and female employees are dominating. A further group that creates specific problems is beginners, especially those with a bad school or vocational education. Of particular importance is the fact

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[217] One of the first publications on this matter is Grubel/Walker (1978).

[218] See Petersen/Müller (1999, p. 317).

that in long periods of unemployment the human capital is devaluated and loss in motivation occurs.

Curing structural unemployment would mean an improvement of the quality of human capital, as well as an increase in the regional and sectoral mobility. Is structural unemployment the result of changes in the relations of factor prices, a basic approach for the economic policy should follow the line to cheapen the high priced factor, especially to release wages from the often much too high ancillary wage costs. Growth might also be enhanced if by sectoral mobility work force from traditional sectors switches over into modern branches, which have bright perspectives on the world markets. Are the instruments of the public labour market policy not sufficient enough to overcome structural unemployment, the focus has to be set on the collective bargaining policy which finally determines the structures of nominal wages. In social market economies like Germany the responsibility for wage negotiations is with the trade unions and corporation associations. In the consensual models of partnership in wage negotiations (like the "konzertierte Aktion" and "Bündnis für Arbeit" in Germany or "Sozialparnerschaft" in Austria), trade unions and corporation associations in full autonomy are negotiating regional and sectoral binding wage contracts, from which only not-bounded firms are allowed to withdraw.[219]

Although in a societal perspective labour markets may have a very particular characteristic, however, the usual economic rules apply. Is the price of the factor labour fixed on a level that is too high, and then a high labour supply will find only a low demand, so that excess supply is the outcome. Are the different qualities and productivities taken into consideration, the neoclassical marginal conditions might at least approximately be a rough benchmark. Consequently the real wage rate should be coinciding with the marginal revenue product, as far as a job is profitable for a corporation. In the process of consensual wage negotiations from the trade union side social and distributive beliefs have entered which obviously have been approved (or temporarily ignored) by the corporations associations. Therefore numerous wage contracts have been signed in which especially the wages in the lower wage groups were stronger increased than in the higher. For decades such measures have reduced the range between low and high wages, while the severe income tax progression even more has leveled the net income distribution connected with negative work incentives.

Consequently the low qualified workers were not any longer able to yield a productivity, which would have been in accordance with the real wage they have earned, whereas at the same time the ancillary wage costs (due to increased social security contributions) almost exploded. All that resulted in a process of job destruction on the side of the corporations in which the low skilled workers were thrown out of the labour markets, damned to inaction drawing social aid, dole or an early retirement pension. Trade unions and the corporation associations, predominantly burdening the social pension insurance or the social unemployment insurance, heavily supported early retirement. Consequently the social security contributions were even more increased. Short-term labour market problems have been allegedly solved, but in reality the problems have been shifted into the future.

It should also be taken into consideration that the active employees represented by their trade unions (insiders) have been overwhelmingly acted in their own interests and not in the

[219] The number of not-bounded firms is steadily increasing what is especially the case in the new states of Eastern Germany.

interests of the unemployed (outsiders), whose situation developed from bad to worse especially if the re-integration into the official labour markets is taken into consideration. In spite of high unemployment rates for almost three decades high real wage contract have been signed; consequently the insiders have won whereas the outsiders lost. Trade unions, overwhelmingly interested in the contribution paying insiders, demonstrated no real interest in the destiny of the outsiders. Rather they behaved as closed shop, supported by the corporation associations, which often agreed to high wage contract just to avoid strikes. Since the liberalisation and globalisation the corporation sector has found a new valve: the dislocation of unprofitable jobs into foreign countries with more promising perspectives.

Although generally the real wages might not be too high, at least several labour markets for low skilled workers have been destroyed. Collective and sectoral wage bargaining does not adequately take the specific problems of single regions and firms into consideration. More and more employees are interested and willing to seek for individual solutions. Consequently the influence of the trade unions via co-determination and work councils are increasingly repressed. Not the interest of the trade unions officials (as agents) but the interest of the individual employees (as principals) becomes more and more decisive, so that in future this principal agent problem at least would be diminished.

The unemployment problem remains the most jeopardising one for the future of an efficient social state within a social market economy setting. Fundamental changes in fiscal as well as social policies and the collective bargaining processes are necessary; the switch form a co-determined system by trade unions and corporation associations, both connected with serious principal agent problems, to a self-determined system, where the interest of employees as well as employers find a fair solution in their own interests, perhaps supported by an efficient legal framework, is the most recommendable pattern. Investment wages and profit as well as risk participation are much more promising perspectives than co-determination. The employee as shareholder in his own enterprise has to equalise the capital interests with his wage interests, being careful in avoiding excess wage increases, which would jeopardise the existence of his own firm, so that so historical antagonism between labour and capital is finally solved.

If the low skilled workers were taken into consideration, the above reform of the basic security system would be of utmost help. The merger of social aid and unemployment assistance, as already done in some European countries and currently seriously discussed in Germany, is one important step. Putting the public job placement system of the unemployment insurance in competition with private firms, temporary work firms and job centers are other efficient measures. Naturally the reduction of the high social security contributions is the non-plus ultra to reduce poverty traps. If collective bargaining should be a model for the future, then both bargaining parties should overtake the responsibility for the unemployment insurance. The wage negotiations have the main influence on the unemployment level. If the unemployment insurance is organised by the state which itself has no influence on wage determination and if deficits are financed by the federal budget like in Germany, the consequences of the false wage bargaining process are socialised by such a system. Failures are without any risk; consequently the costs of unemployment are ignored within the wage negotiations. If both, the trade unions and corporation associations would be responsible for the unemployment insurance including the produced deficits, it is more than likely that wage negotiations would show different results. Therefore, different patterns do exist, which would improve the unemployment problem at least with regard to structural reasons, which shortly have been at least partly overcome by several European countries.

4.2.4. Accidents Insurance

As was demonstrated in the country studies, the accidents insurance is especially in the Bismarkian tradition an own social insurance institution, but most of the services of that insurance could also be covered within the health protection system. The most important question is, which accidents should be covered; because of increasing costs but especially due to a general reduction of ancillary wage costs, recently the discussions on the possible separation of occupational and private accidents have been intensified. The idea is to limit the social accident insurance to occupational accidents while the consequences of private accidents should be borne by private means or private insurance.

Especially the costs of sport accidents in risky sports are under specific investigation, so that their exclusion from the social health insurance is also discussed. The connected problem is how risky sports are to be defined and how the injuries of such risky activities can be identified. Additionally the control of the possible and in such cases comparatively easy moral hazard behaviour has to be taken into consideration. Up to now such ideas are cyclically developed due to the financial problems within the social insurance schemes and usually have been rejected. Because the problems of replacement ratios and transfers in kind are almost the same as in the other branches, a more detailed analysis seems to be unnecessary.

4.3. Integrated Tax and Transfer Reform

If a switch in the direction of a basic security system seems to be the most promising alternative to the existing social insurance schemes, it becomes obvious that the total tax burden must be increased due to the reduction within the social security contributions. Principally two tax revenue sources have to be taken into consideration: the direct income tax as well as the indirect value added and eco taxes. Because all taxes do have impacts of the supply of effort and of the consumption structure, a quasi-optimal tax mix has to be taken into consideration that is shortly presented in the following chapter.

4.3.1. Easy Tax Proposal

For a successful and fast transition to a socially orientated market economy strengthening the private saving and capital formation is the primary aim to shorten the catch up phase and to overcome distress and mass poverty in the population. As longer such miseries have to be borne, as more the people in transition countries are disappointed by the change. Hence, further reform processes do not meet the necessary acceptance, which creates a vicious circle as consequence of lacking political support for the reformer.[220] The most decisive problem for capital formation, in form of human capital and real capital as well, is the above-mentioned tax and social contribution burden on wages and profits. Therefore, the income tax reform is the core of any integrated tax and transfer reform perspective. Only with an efficient and fair (in the sense of justice of ability) income tax system the growth retardation can be overcome.

[220] Such problems could be seen in many transformation countries in which political back slashes have hampered necessary development processes; for the Bulgarian development see Christev/Petersen/Fitzroy (2000, pp. 179). Even in the Polish Transformation process such problems could be observed; see, e.g., Petersen/Müller (1995).

While until about one decade ago in most of the income and corporation tax systems profits where usually higher taxed than wages, in many European countries reform processes have brought almost a revolutionary change. The former argumentation predominantly was that firms, especially in form of legal entities (corporations), do have a higher ability to pay, so that the maximum marginal tax rate of the corporation tax should be as high (or close to) the highest marginal tax rate within the individual income tax. In connection with other income or property related taxes (property tax, capital gains taxes, and the "Gewerbesteuer" in Germany), the annual profits were often burdened with average tax rates far beyond 70 %. As consequence of the increasing capital mobility due to the globalisation process,[221] tax competition with more favourable locations has pressed many European countries even under left wing governments to a fundamental change in the tax policy patterns. While until the 90s of the last century the rule was dominating that capital income (or income from property) is unearned income, which can be severely taxed without negative incentives,[222] the slow down in capital formation and increasing tax evasion and capital exports have advised the tax politicians to be much more careful with capital income taxation.

Consequently many countries (like the Netherlands and the Scandinavian countries) have introduced a so-called dual income tax system which taxes wages and capital incomes with different tax schedules.[223] While for wages overwhelmingly the traditional directly progressive tax schedules (with strongly increasing marginal rates) are applied, for capital gains usually a much lower flat-rate has been adopted, or like in Austria a withholding tax on interest payments with a comparatively low flat rate was introduced. The outcome is that at least middle and higher wage income is marginally taxed with rates, which are often much higher than for individual capital income or profits. Therefore, equal income amounts consisting of different sources are often unequally treated, so that the equality of treatment is hurt. Obviously the efficiency target (growth enhancement, capital formation, and job creation) is dominating fairness and justice of ability.

Such a fundamental breach of equality would at least in Germany raise serious constitutional problems. Therefore, the "Heidelberger Steuerkreis" has developed an "Easy Tax Proposal",[224] which on the one hand integrates income and corporation tax into one law and on the other hand secures an equal treatment of wages and capital income as far as ever has been possible. The conflict between efficiency and justice is reduced to an absolute minimum. Here only the basic elements will be presented.[225] The fundamental change is to be seen in the newly interpreted ability to pay principle based on the already above mentioned lifetime perspective. In spite of this long term perspective the traditional juridical perspective only considers the annual impacts on the burdens for the taxpayer. If we take this latter interpretation of ability to pay, the annual income is the source for consumption as well as saving. Saving, property and capital formation (in form of human and real capital) are permanent processes in course of the life cycle, whereas in some periods (especially for retirement) liquidation of real property or capital assets is possible. All this different kinds of

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221 See Petersen (2003a).

222 See Petersen (2003b).

223 For details see Bach/Seidel/Teichmann (2000).

224 The members of the „Heidelberger Steuerkreis" are Joachim Lang (Köln), Hans-Georg Petersen (Potsdam and DIW Berlin), Bernd Raffelhüschen (Freiburg and Bergen), and Manfred Rose (Heidelberg); the draft law and additional information are to be found under www.einfachsteuer.de.

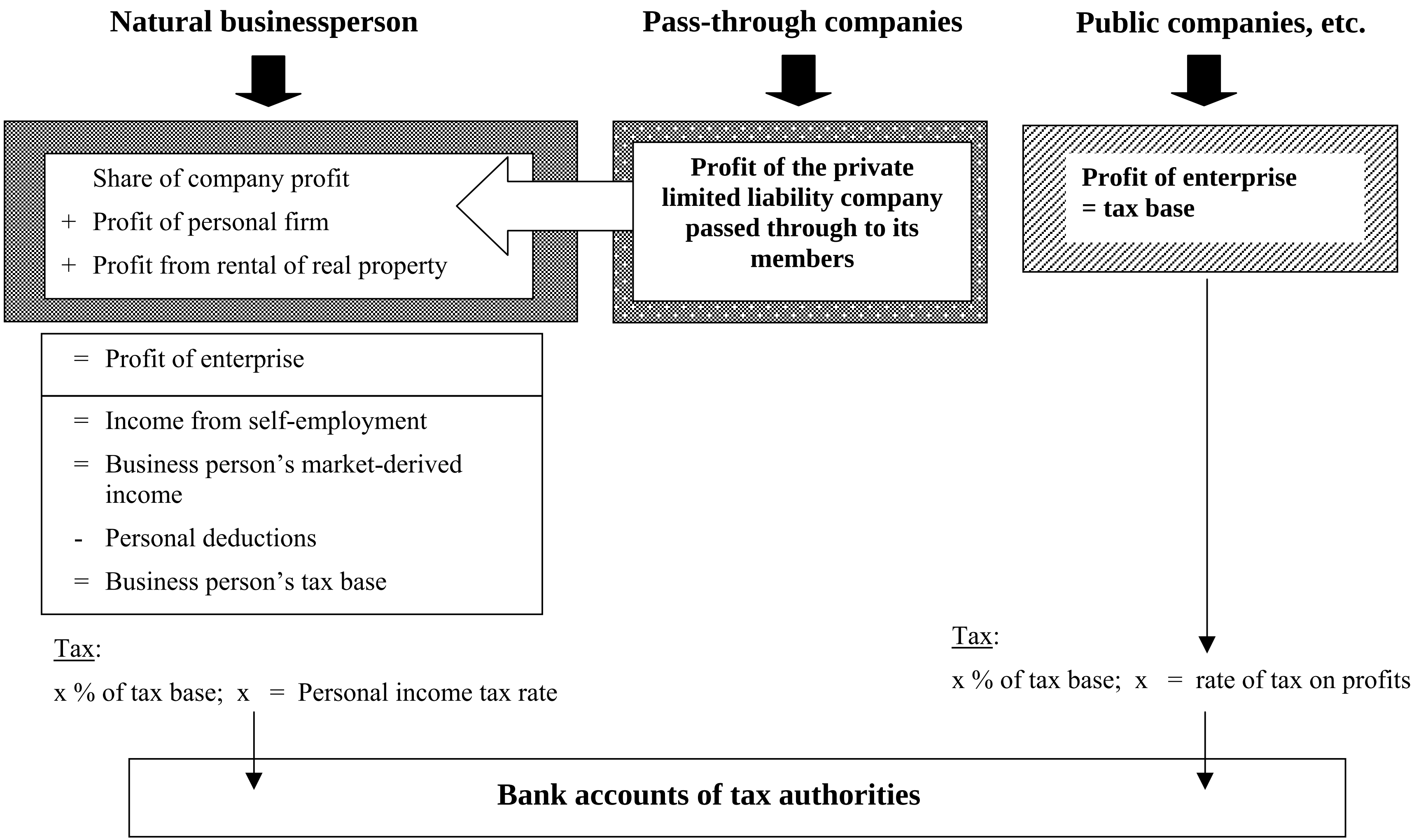
225 A short description is to be found in Petersen (2002a); for more detail see Petersen/Rose (2003).

capital as a general rule are the outcome of the annual work performance of the citizen (except the inherited property); at their end of life the capital ownership reflects their accumulated life effort, which has not been consumed. Naturally, property and real capital generate additional capital income (interest, profits, rent, etc.) but the primary source of such income has been abnegation of consumption or additional work efforts. If consumption and saving preferences of the taxpayers should not be distorted, income from labour (predominantly wages) should be equally treated as income from capital within an efficient income tax system because the source of capital always once has been work effort.[226] Therefore, § 1 of the Easy Tax draft law states: "The lifetime income of a natural person has to be taxed once, equally and in an easy manner."

If such a lifetime perspective for undistorted preferences is striven for, consequently an integrated income and corporation tax system has to be developed, which for wages and capital income applies the same tax criteria. The Easy Tax (§ 3) has two specific forms of tax collection: the personal income tax and the profit tax. The taxable income is composed of three sources (§ 6): income from wages, income from self-employment, and retirement income. The expenses for vocational education are to be subtracted. The profits of the so-called small corporations, which are corporations with a small number of shareholders, are taxed as income from self-employment. The S-corporation is an element of the US corporation tax; the profits of the S-corporations, named as pass-through companies in the Easy Tax draft law, are distributed on the shareholders and taxed as their other personal incomes. Chart 24 clarifies the role of the pass-through company.

226 Except in case of property gained by historical privileges or by criminal action.

Chart 24: Taxation of Enterprises



Source: Rose (2002, p. 30).

The profit of a small corporation, e.g., in form of a limited liability company is passed through to its members, the natural businessperson. Then their share of company profits is added to their other business profits as shown in chart 24 and summed up to the profit of enterprise, which corresponds to the income from self-employment mentioned above. After the personal deductions, which also apply in the case of wage taxation, are subtracted, finally the businesspersons' tax base result on which the income tax schedule is applied. The resulting tax yield is then transferred to the bank accounts of the tax authorities.

The public companies, also shown in chart 24 are big corporations with a large number of shareholders, while the stocks are listed on the stock exchange. The profits of enterprises whose profits are not taxed at the level of natural persons, i.e. are not passed through, are taxed within the framework of the tax on profits. The taxation of these profits is concluded at the level of the enterprise, i.e. there is no subsequent taxation of dividends through the personal income tax. In this way the double taxation of dividends is avoided. In most cases companies that are liable to taxation have a constantly changing international body of shareholders. The taxation of their profits solely at enterprise level is the simplest means of taxing the respective incomes of shareholders. The applied marginal tax rate is the same (flat) rate as in case of the personal income tax.

The integration of profits as far as possible into the personal income tax due to the pass-through company has the overall important feature that small and medium firms are taxed equally independent from their legal construction (neutrality of the legal construction). The big corporations are taxed with the highest marginal rate of the income tax, whereas no personal deductions apply.

For the equal treatment of wages and capital income in a lifetime perspective, the above-mentioned avalanche effects (see chart 8), in other words the multi-burdening of savings, have to be avoided. Two different methods could be applied, which in their impacts on capital income taxation are equivalent but would heavily influence the periodical distribution of the tax revenue. In case of the interest adjustment method a standard market interest rate must be subtracted from all capital income. If the saving adjustment method is applied, the saving itself has to be tax-free while the latter earnings in the payment period must be taxed. Consequently the saving adjustment procedure shifts the taxable base into the future, so that the fiscal administration at least for a longer chain of periods would be threatened by large tax revenue losses.

However, the Easy Tax provides pragmatic solutions: in case of all sources of capital income (interest, profits, rents, etc.) a basic rate of return – for instance the interest rate for a two years government bond – remains as remuneration for the abnegation of consumption tax-free. Consequently only capital incomes above this basic rate of return (also called protective interest rate) are taxed whereas a steady tax base on capital income remains. The protective interest rate avoids the avalanche effects, and in the dynamical perspective the equal treatment of wages and capital income is assured. The calculation of profits follows a modified cash-flow method, which defines the profit as (cash) surplus of earnings to business expenses. The modifications are related to the expenses for depreciations and the discount for the protective interest rate. Then profit taxation takes place only in the period of highest liquidity, which is of utmost relevance for young enterprises in countries in transition. All accrual methods – overwhelmingly also applied in the VAT system – often bring enterprises with bad access to the capital markets in liquidity shortage, which is one important reason for bankruptcy in the transformation period.

In case of retirement income (all forms of pensions) the saving adjustment method is preferable in which the premiums and contributions to old-age protection are tax-free. This form of pension taxation corresponds to the downstream taxation, which has been described in detail under 2.2.3.3. above.

Interest and saving adjustment are the measures for a dynamical design of the annual taxation which necessary remains the basic tax period due to pragmatic reasons. Both methods assure that all components of lifetime income are taxed once and only once, independent from their sources. At the same time the equal burden on the whole lifetime income and the intertemporal neutrality for the consumption decision is guaranteed which abolishes the discrimination of saving as consequence of the traditional income tax systems. Regarding the enterprise taxation, the Easy Tax draft law also establishes the above-mentioned neutrality of the legal status for small and medium sized enterprises, while the deductible protective interest rate secures neutrality for investment and financing as well as inflationary neutrality. The latter prevents from any taxation of pure inflationary windfall profits. All those features are of utmost relevance not only for countries in transition.

As important as efficient enterprise taxation is a socially fair balanced personal taxation, especially with regard to the taxation of families. The Easy Tax proposal corresponds with the target of a just family taxation by specific exemptions for the consumption minimum (§ 24), which should be equal to the aid payments of the basic security system mentioned above. This consumption minimum also comprehends the expenses for persons underlying the maintenance obligation at the amount of the basic exemption. The family equalisation for children has to be organised by child allowances (or as tax credit) within the basic security system. The proposed tax schedule is a flat rate, as it already exists in Russia.

The Easy Tax promotes saving, capital formation, and investment. With regard to the fair flat-rate and the capital income treatment, such a tax avoids all the built-in disincentives in the traditional income tax systems, which together with the social security contributions or payroll taxes have strongly contributed to tax avoidance and tax evasion, connected with an erosion of the income tax base and a permanent growth of the shadow economy.[227] As consequence of the announcement of such a long term orientated tax reform, the tax base would permanently increase because activities in the current underground economies would be switched back into the official markets. Another increase of the tax base would be connected with the enhanced growth potential that would favour domestic investment and the creation of new jobs in comparison to capital exports into countries with former location advantages. If the increasing tax revenue would at least partly be used for an increase in the basic exemption, especially the lower income brackets would be less burdened, which would allow a substantial reduction of the marginal transfer reduction rates. Hence, the impacts of the poverty trap would be strongly diminished.

227 See Schneider (2000).

4.3.2. Value Added and Eco Taxes

Because the PAYGO financing of the basic security system in countries with a Bismarckian social insurance scheme would mean a shift form contribution to tax financing, such re-financing could not only be done by tax hikes in the traditional income tax systems and even not in the Easy Tax. Marginal rate increases then would create additional disincentive, which are similar or even worse compared to those of the former social contributions. Instead of strong hikes of the marginal income tax rates, increases in the VAT rates or of other indirect taxes seem to be more promising. As far as ecological taxes have not yet been implemented, also their revenue could at least be temporarily used, until such taxes do deploy their full steering capacity, so that due to the substitution effects the tax revenue will decline.

Tax hikes with regard to indirect taxes are often evaluated as unfair, inequitable, and unjust, due to the alleged regressive effects of indirect taxes. The regressive effect means that the average tax rate of single indirect taxes is decreasing as far as the individual tax yield is related to the gross income. Such a regression would make the pre-tax income distribution more unequal than the gross income distribution. The regression is substantially diminished if within the VAT different tax rates are applied for goods and services that belong to the basic need. In many of the European VAT systems reduced or even zero rates are to be found and in several empirical studies it was proofed that a rate differentiation in favour of the lower income brackets strongly reduced the regression effect.[228]

From the above mentioned lifetime perspective, the regression effect is a typical phenomenon of annual taxation. In case of saving for future consumption (in old-age or to purchase durable consumption goods in the future), the saver has to take the consumption taxes as they are existing in the future into consideration; if tax hikes are to be expected, he has to increase his current saving if he wants to consume the same real amount of goods and services in the future. From this viewpoint, future consumption taxes are burdening the current consumption because of the necessary increase of savings. Therefore, relating consumption taxes to income does not make any sense. In relation to consumption the VAT is always proportional, and the rate differentiation would yield in a progressive scope of the tax burden form low to high consumption brackets. Also other indirect taxes like the motor vehicle and the gasoline tax are often progressive, because consumers in the lower income brackets consume much less of such goods as consumers in the upper income brackets do.[229]

If not the annual but the lifetime income and consumption are taken into consideration, the progression effect of the VAT and some other indirect taxes is even increased.[230] Therefore, the VAT as well as other indirect taxes are appropriate substitutes for contributions, which themselves are also proportional related to wages or – above the upper wage ceiling where the maximum amount of contribution is reached – even regressive. From the redistributive perspective such taxes are unobjectionable.

In a systematic approach to taxation beside the taxes, which have the revenue perspective as main justification, the ecological taxes have their justification in their steering capacity, which is expressed in the substitution effects caused by such taxes. In the long run the dominating

228 See Nagel/Müller (1992, pp. 104) and Petersen (1992, pp. 190).

229 See Müller/Nagel/Petersen (1997).

230 For the US Metcalf (1994, pp. 59) has observed that from a lifetime perspective many of the American States sales taxes have been progressive and not regressive.

substitution effect reduces demand and the tax revenue, respectively, so that the consumption of polluting goods and services is reduced. Because behavioural adaptations with regard to an ecological desired behaviour only gradually happen and are often lagged, at least in transition periods such taxes are connected with a high tax revenue.[231] If the steering capacity should be stressed, the tax burden of such eco taxes have to become aware for the taxpayers; with other words such taxes have to create a sensible tax burden to give a sufficient incentive for behavioural adaptations. The taxes with social steering effects on demerit goods like the alcohol and tobacco tax traditionally have comparatively high tax rates. Due to the overwhelmingly low price elasticity of demand for such addiction goods, the effective steering capacity is often rather low. If the tax rates are substantially increased, tax avoidance and evasion becomes a frequent reaction,[232] so that – similar as in case of prohibition – illicit markets are set up, which even more thwart the politically intended steering effects.[233]

Regarding the ecological orientated traditional indirect taxes like gasoline tax, heating oil tax, gas and electricity tax – unless true eco taxes, which are related to the pollutants, exist – the tax avoidance and steering effects are dependent on the elasticities of supply and demand. Naturally such tax burdens must also come to the awareness of the taxpayers; but similar to the social steering taxes, possible steering effects with positive impacts of behavioural adaptations have to be balanced with avoidance reactions, which could have unintended side effects. The fact that in case of eco taxes the steering capacity is the main aim connected with the intended behavioural adaptations on side of the taxpayers, excludes to evaluate such taxes under aspects like distributional justice and ability to pay. Of course the implementation of eco taxes or increases of their tax rates, respectively, create an additional burden, possibly even with a regressive burden on the lower income brackets. But this burden is politically intended to motivate behavioural adaptation that just would avoid such a burden. If a lack in consciousness or illusion should exist, the affected groups should be informed before compensations by transfers are taken into consideration.

Summarizing the tax complex, VAT and eco orientated indirect taxes are an adequate substitute for the high contributions connected with the current social insurance schemes. The decrease in the ancillary wage costs as well as the new enterprise taxation in the Easy Tax would strongly enhance future economic growth; consequently the Easy Tax revenue would strongly increase which in a mid to long term perspective could be used for declines in eco tax revenue and/or the decrease in VAT tax rates. Distributive targets would not be hurt because in connection with the basic security system the real poor are much better protected than in most of the existing systems while all distorting effects of taxation and social security contributions are minimized.

As already mentioned above regarding the Easy Tax, the VAT should not follow the accrual approach as is often proposed by international consultants. Without doubt the accrual method secures the VAT tax revenue for the fiscal administration. But the method is also connected for the firms with enormous risks of liquidity bottlenecks, which in transition periods are caused by bad payment morality of the business partner and the difficult access to banking

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231 Such adaptations often require the invention and introduction of new technologies, which often are prerequisite for the behavioural adaptations themselves.

232 Similar effects have been often described in the literature, e.g., see Petersen (1981, 1982, 1984, and 1993, pp. 296).

233 See on the problems on alcohol taxation in Sweden Graf (2001).

loans. The accrual method together with a long time lag until the input VAT is refunded is important reasons for bankruptcy.[234] Both problems then cause a flight into the shadow economy, which further reduces the tax capacities. The cash approach avoids such problems and the revenue security could also be reached if only transactions via bank accounts entitle the firms for a VAT refund. Beyond that experience in transformation countries have shown that the firms bank accounts have to be registered, so that a cash-flow income Tax and VAT could be easily controlled by the fiscal authorities just have the monetary transactions under investigation.

4.4. Empirical Evaluation of Tax and Transfer Reforms

Tax and transfer reforms can only be rationally designed if simultaneously with the development of the draft law the possible consequences on revenue and system costs as well as the distributive effects are empirically determined and compared to the existing systems.[235] The microsimulation method is the most advanced one, which allows an exact analysis on the level of the individuals (taxpayers, transfer recipients) or households as far as micro data from tax assessment, tax statistics, household surveys, or other questionnaire studies (as socio-economic panels) are available.[236] Microsimulation is embedded in the modern annual budgeting as well as mid term political program planning methods.[237] Short- and mid-term tax forecasts necessitate sufficient macroeconomic data, which is usually available through the national accounts statistic. The macro-projections on the most important variables form the necessary background information (see chart 25).

The microsimulation model as well as additional econometric estimations then allow for analyses on the state as well as on the individual level. Changes in tax (and transfer) revenue (costs) can be simulated, and the distribution of the tax burden on taxpayers (transfers on beneficiaries) as well as on the different jurisdictional levels (revenue sharing) inclusive reform models investigated. If unintended effects are observed within such simulations, revisions of political program planning can also be analysed with their effects on revenue as well as fiscal equalisation between the different jurisdictional levels. On the individual level (see chart 25) changes in the distribution of disposable income (due to tax and transfer reforms) and behavioural adaptations can be analysed, which might affect tax revenue as well as tax and transfer distribution. All these estimations can be done under “laboratory conditions”, that means without any environmental disturbances, and before a draft law is discussed in the public. Hence, microsimulation fulfils the purpose in social science that experiments do have in natural science.[238]

Tax Simulation Models are able to describe in detail the impacts of changes within the tax base and the tax structure. They allow a detailed analyses of the distributive consequences of single taxes, tax base and tax schedule changes and of the whole tax system (and – if included

[234] Such experiences especially have been made in Bulgaria after the introduction of the VAT system; see for more details Petersen/Naydenov (2000, pp. 137).

[235] See Petersen (1992a, pp. 13).

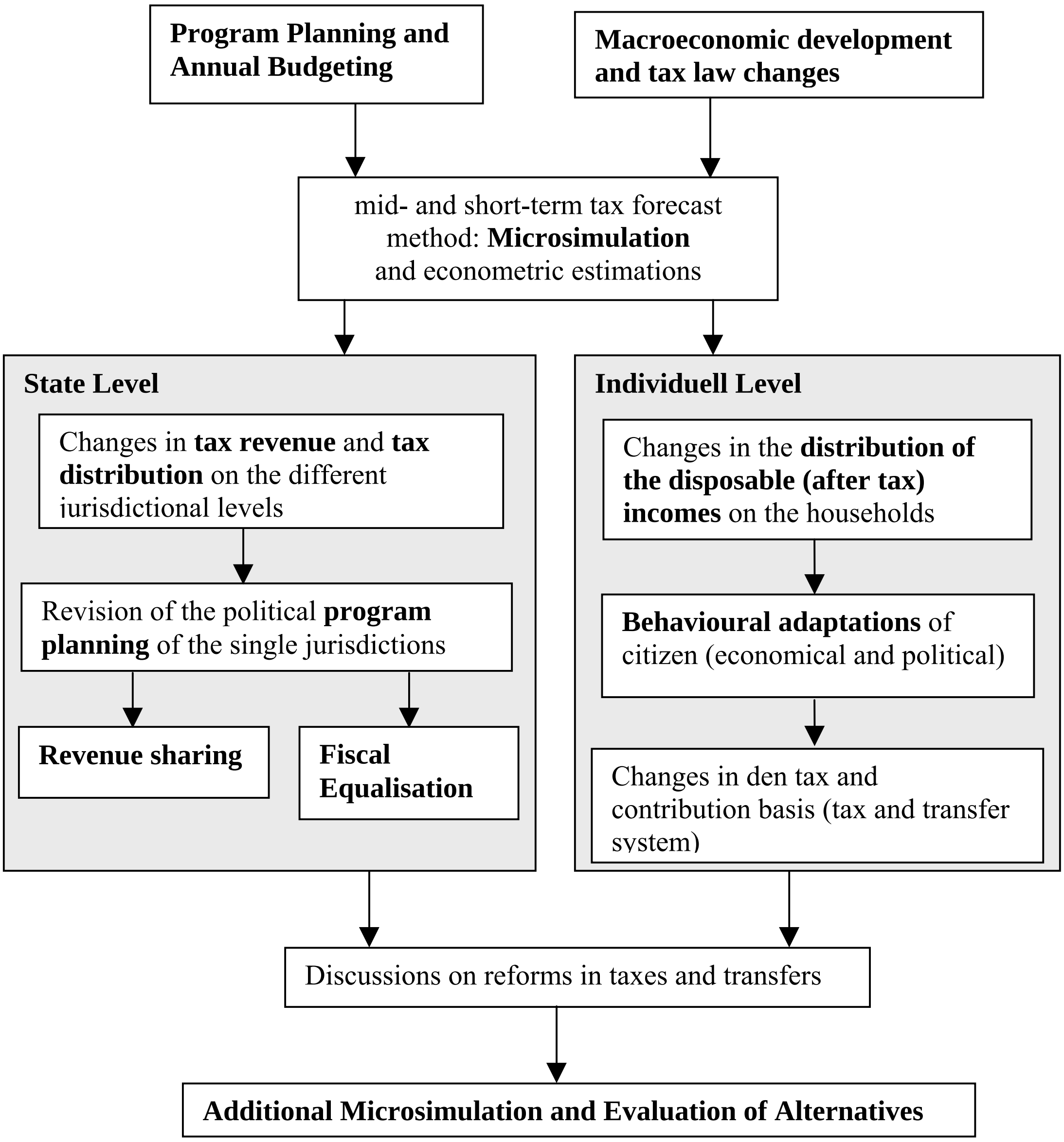
[236] For details see Bork (2000).

[237] See, e.g., the most modern program planning examples in New Zealand (Fiscal Responsibility Act) or Australia (Charter of Budget Honesty Act).

[238] See Brunner/Petersen (1990).

– the transfer system). Tax law changes lead to economical behavioural adaptations (supply of effort) and political behavioural adaptations (voting behaviour). Consequently tax simulation models improve the analysis of the political decision process and the acceptance of tax and transfer law changes within the society.

Chart 25: Microsimulation as Instrument of Program Planning



Tax simulation models request a detailed knowledge and modeling of the tax and transfer system; because of the complexity and high entrance barriers, there is a certain lack of experts. Simulation models also request a high and complex data input. Different statistical data have to be prepared and data stemming from different statistic have to be matched and merged. Modern econometric methods are necessary. If there is good access to the fiscal administration and the administration itself is convinced that only simulation models can deliver the necessary information, then it is principally possible to prepare a sufficient data set from the material which the revenue offices do already have within the individual files of the taxpayer.

A full range microsimulation model would comprehend the tax law, the (social and private) insurance law as well as the transfer law (see chart 26). This law system is then transformed into an equation system, which contains of all variables to be relevant for an exact model description. Micro data on the level of individual persons, households, and enterprises deliver the necessary model input, whereas the modules for estimations like determination of the basic population from the sample size, updating (with macro data) and correction of weights allow for the necessary aggregation process. The analyses modules then deliver the results for different aggregation forms, the revenue and the distributional effects.

Chart 27 demonstrates for the German example how the Potsdam microsimulation model is structured. The database stems from three different sources, the income and consumption sample, a tax file date sample, and the Socio-economic Panel, which is generated from questionnaire studies made by the DIW Berlin. This model is currently limited to the household sector because data on enterprises are badly missing. The number of micro units is also presented in chart 27 as well as the number of variables within the single data set. By matching and merging procedures the integrated micro data files is generated which consists of 51,356 taxpayers and 1,339 different variables which describe the current structure of the German tax and transfer system.

Chart 26: Basic Structure of a Micro Simulation Model

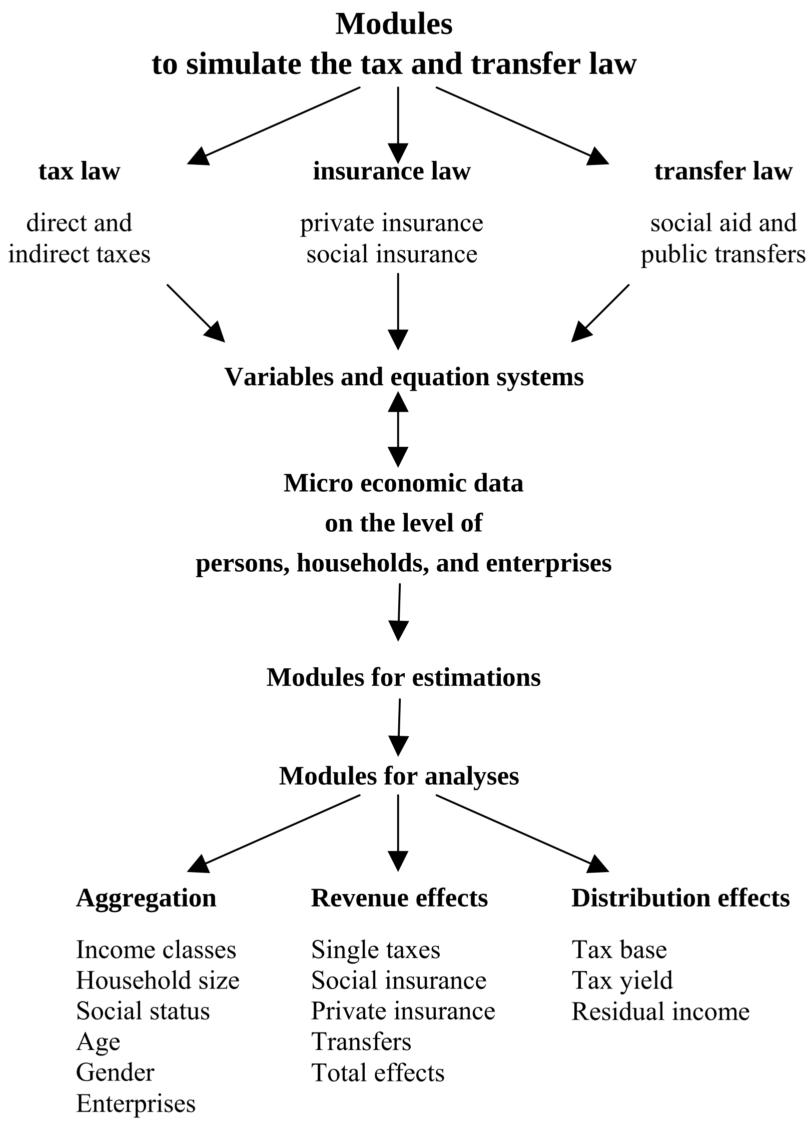
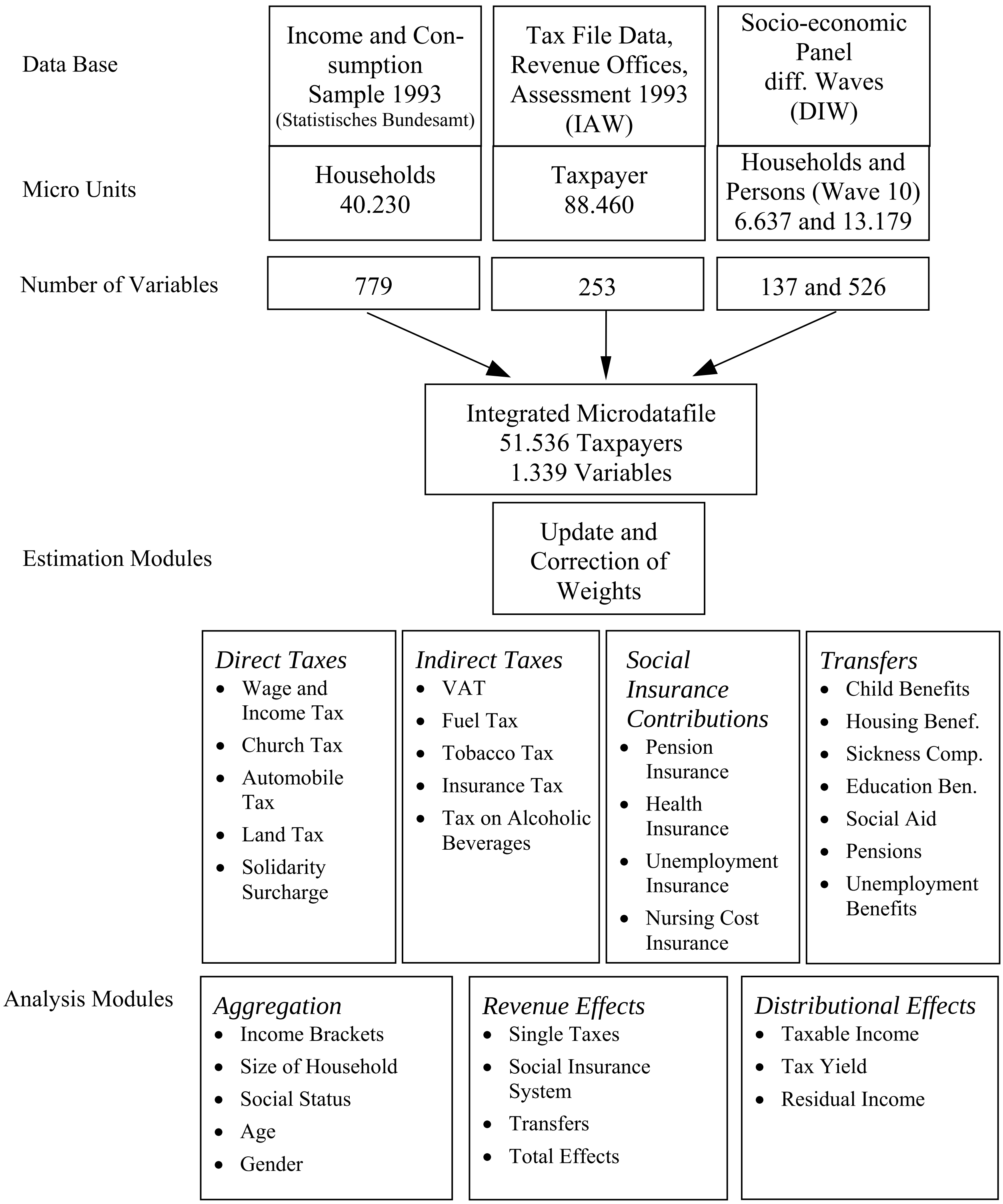


Chart 27: Systematic Structure of the Microsimulation Model



Because changes in tax and transfer law are important political processes, which have strong influences of the citizens' behaviour regarding their economic supply of effort as well as their reactions in coming elections, experiments and false tax and transfer draft laws should as far as possible be avoided. Otherwise their patience and understanding of political processes would be overburdened getting the feeling to be political guinea pigs. Especially in transformation countries very careful reform processes have to be implemented, so that a further increase of doubts in the abilities of politicians and bureaucrats would raise their general mistrust in government. Then the acceptance even of efficient reforms would be heavily impaired. Therefore, especially in transition periods careful and reliable microsimulation studies are of utmost relevance to prevent the politicians and administrations from serious mistakes, so that the implementation of such models on the level of ministries of finance and/or the central bank are highly recommendable.

4.5. Some Final Public Choice Remarks

The argumentations on the basic security approach as well as the tax proposals presented here are derived from the experiences made in Western styled market economies but also reflect a lot of knowledge on human behaviour, which can be found in almost every political setting. But the interpretations and views of the author are naturally not (or, hopefully, not yet) shared by many representatives of the political parties, the social administration, interest groups, and last but not least the science. And even this differentiation is incorrect because one and the same person might be a member of more than one if not all of these groups.[239] Assuming the politicians as the most important group then the today’s success of a politician is dependent on the prevailing picture, which the society has developed. The popularity mainly depends whether a politician maximizes his interventions into public or - even worse - private sector activities. Even if the politician would be fully aware about the shortcomings of his personal resort - an assumption which is in view of the current personalities slightly too optimistic - no rational incentives do exist to abolish the failures of the system by a fundamental reform; in the contrary, such a behaviour would be a serious mistake. On the one hand the politician has to intervene into the personal interests of the involved persons, thus impairing his popularity. On the other hand a fundamental reform would lead to the fact that the politicians has destroyed the base for his own job - the necessity of permanent interventions. From the politicians point of view it is rational not to cure the causes but the symptoms and this strategy is in accordance with the moral hazard theory.[240] Their pretended preference for market solutions is a pure lip service.

Instead of a fundamental market oriented reform temporarily effective measures to decrease the costs of the social security system are much more promising, which only work until all involved persons and groups have adapted their behaviour to the new regulations. If these reforms are coordinated with the re-election cycle, the short-term effects are realized appropriately to increase the personal popularity. The next cost explosion several months later does not terrify an experienced politician; it is possible for him in hearings, interviews, TV talk shows, etc. to demonstrate his importance again, which newly strengthens his popularity. If such political behaviour cannot be led back to lack in information, ignorance, indolence or simply stupidity - all not very attractive attributes for a politician - it must follow a certain system. And that could be seen in the fact that the politician is able to exploit the systemic failures for his own interests. Every fundamental reform would block his possibility for the political self-representation. Therefore, efficient and frictionless tax and transfer systems are

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239 Just to mention the personal experience within a hearing of the Federal Parliament, where among the scientist some „Honorarprofessoren“ were invited who in their main occupation are heads of interest groups.

240 See Petersen (1995).

politically counter-productive because of the political self-interests.[241] To sum it up: we are surrounded by moral hazard.

The basic security approach is in accordance with a revival of the „Ordnungspolitik“ - namely by a reformulation of the institutional settings to obtain a reduction of the discretionary interventions via a strategy of de-politicisation. An improvement of the institutional framework also includes strengthening the ethical behaviour of the responsible persons. Institutional ethics have a higher degree of universal acceptance than individual ethics; therefore politicians and bureaucrats, acting in social institutions, should have a higher societal obligation than private persons. Corruption and scandals are pointing to the fact that many are overstressed by this claim. The consequence of this moral hazard cases can only be: immediate re-privatisation.

Is it time for such de-politicisation strategies? This is the general question of feasibility. Politicians are gradually facing the fact that during the last decades they took over too many duties formerly solved by self-responsible actions within families or on markets into the political responsibility. Because of spreading information and a growing discontent and annoyance of the citizen they are increasingly unable to solve the complex societal problems. The arrogance of knowledge (Hayek) what is good for the people or what is allegedly unnecessary, the merit and demerit argumentation, is recognized by well-educated citizen who mention the limited abilities of political planning procedures. The last euphoria should have been destroyed by the fundamental political change of the last years, but still the interventionists within the political class are dominating. But some politicians have become aware that they would like to get rid of the ghosts they have called. The international discussion on privatisation and an improved efficiency of a reduced public sector is only one proof. The standard role of a successful politician should be changed from interventionism to causal therapy of the imperfect contemporary institutions and instruments. Permanent and overwhelmingly blind activism is no character or political proof of the quality of democratic leaders.

In Germany, the erosion of the political influence especially on the tax and transfer system has become obvious since more than two decades; almost all substantial interventions into the social network can be led back to verdicts of the Constitutional Court - another proof for the lack of perspectives or courage on the side of tax and social politicians. The lack in courage is obviously connected with fears that the bureaucrats and interest groups that are engaged in the numerous welfare institutions might strike back by des-information, thus leading to diminishing popularity and loss of votes. But even scientific advice is not easy to have because usually politicians do not have enough expertise to choose experts. They have a preference for experts who confirm the own presuppositions or opinions. And if at all political action seems to be unavoidable, then an expert group or a leading economic institute is appointed to analyse the problem, which lasts for several month or better years, giving the politicians the alibi for no actions. And within the group of scientist there are many wolves in sheep’s clothing. Like in the case of the behaviour of the politicians mentioned above, more inefficient institutions and inefficient instruments mean more demand for experts and their

[241] Here one has just to mention the discussions on the formula flexibility instead of discretionary interventionism in connection with the business cycle policy some decades ago which ended in favour of the latter.

important reports - not to mention their prevailing presupposition that on old (tax) system is a good one.

This presupposition might have been correct under conditions in the past where the total public budget was less than 30 percent of GDP; the built-in flexibility of our contemporary systems results in an ever increasing state influence, which can only be overcome by substantial reform processes. And here the next problem is hidden: Conservatives are not in favour of reformism; but if also conservatives and liberals are infiltrated by socialistic ideas, the result of their reforms again leads to more socialism.

Nevertheless, even under regimes as proposed above the risks of representative democracy still exist; to limit the political interventionism, Niskanen demands a „new fiscal constitution".[242] In the parliaments the annual debt limit, the introduction of new taxes or tax rate hikes have to be decided with two-third-majorities. The today's relative or absolute majority would not longer be sufficient; therefore, the danger to exploit wealthy minorities might be reduced. In addition, also politicians of the opposition would be included into the decision process, thus enhancing the common responsibility of government and opposition for the future. The limitation against an ever-growing public sector would even be stronger, if the above-mentioned integrated tax and transfer system would be introduced and decisions on its marginal and average rates have to be made not within the parliaments but by plebiscite. Then the influence of politicians, bureaucrats, and interest groups would be substantially reduced.[243]

All this is no scientific news but well known by the happy few who still follow some liberal norms and the still convincing model of social market economy. What is badly missing is the transfer of knowledge into the public via education and mass media. This transfer is delayed because of the aging society in which the elderly do not have this knowledge and the young not the power. Even falsely steered societies have been able for spontaneous order. In view of the fundamental upheavals of the very recent past one can be optimistic: For the young generations open societies which rely upon self-responsibility have always been attractive; the integrated tax and transfer system with reduced personal redistribution, which is controllable by the public is a roll-call for the young not to drop-out but to be engaged in all the other serious problems we have to face in this comparatively new century.

242 See Niskanen (1992).

243 For more details see Vaubel (1991).

5. Summary and Final Remarks

In the timing and sequencing of the transformation process, macroeconomic stabilisation and the liberalisation of goods and service as well as capital markets have been the most important fields for political action. The reforms of the public sector and the labour markets have required time and enormous personal input, so that the simultaneous reform of the social protection would have overstrained the administration as well as the population.[244] Therefore, the necessary social reforms were partly delayed for almost one decade, which has in many countries created poverty and declining life expectancy.[245] Due to the necessary structural adaptations and the still enormous productivity backlog, social protection within the transformation countries is often below the physical minimum of subsistence, which people are compensating by activities in the shadow economies or household production. Hence, the most important task for social policy is to develop new minimum standards with regard to replacement incomes as well as to health protection. The core instrument for such a purpose is basic security, which has to be PAYGO financed by the current tax revenue. Parallel to a basic security strategy the insurance markets have to be implemented and efficiently regulated. Dependent on the cultural and political traditions, also a social insurance approach might be a successful feature but is not a necessary development step. In any case the insurance character of such schemes has to be stressed, while the necessary income redistribution to prevent from poverty has to be organised in the basic security system. In other word, if any social insurance schemes are considered, they have to include all the steering instruments of the private insurance schemes to overcome the moral hazard behaviour and have to follow the funding approach as far as intertemporal risk sharing is involved (for upgrade insurance in the pension system and for life-cycle orientated assurance premiums in health insurance).

If such scheme of combined basic security and upgrade assurance is ability orientated and motivating people to be engaged and re-integrated in the official labour markets, long-term growth performance is also assured. Within that process more and more people will get the necessary ability to be insured in primary responsibility within private insurance schemes. Because only the necessary redistribution is PAYGO financed, capital shortage is avoided, so that increasing capital formation itself will back the future growth process. In such a long termed catch up process, Russia will also face the problems of strongly increasing longevity because the demographic patterns are generally the same in all countries with European value systems. But with a well balanced system of PAYGO financing for basic security and funding for upgrade insurance in social or private insurance schemes as well, such problems are much easier to be handled than in most of the Western European countries.

Naturally, capital formation has also to be backed by the tax system and the contribution or premium system, which has to finance social protection and upgrade insurance. If at least for the lower and middle income groups political decisions are made to a compulsory assurance in the social or private insurance scheme, then the additional marginal burdens on wages and income have to be taken into consideration, because these burdens determine the labour market participation of men and women. In the industrialised countries the poverty trap is the outcome of at least too generous benefits for unemployed people in working age, the high

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244 See Müller/Petersen (1995) and Petersen/Sowada (2000).

245 See Golinowska (2000).

marginal burden, which is connected with transfer reduction in case of income from the official labour markets, and the sudden hikes of social contribution rates as well as wage tax rates in the cross over from transfers to take up employment in the official labour markets. In transition economies similar effects can be observed, while here the trap is more between employment in the illicit labour markets and official employment.

Especially the case studies of chapter 3 have shed some light on the fundamental problems. It has become obvious that generous social aid and unemployment benefits connected with high marginal burdens on the income and wages earned in the official labour markets are one of the core problems for mass unemployment. The British example demonstrates that Spartan rules with regard to replacement income levels obviously generate an enormous pressure to be engaged in the official labour markets. Those schemes are supported by a convincing Working Families' Tax Credit system, which reduces the marginal burden in the cross over income area and awards labour market participation of both couples. In Austria on the other hand, especially the social aid is comparatively generous, but the small size of the country as well as the numerous rural areas allow a better societal control of moral hazard, so that the negative incentives are compensated by social pressures not to become a recipient of social aid.

Such social control mechanisms usually fail in urban areas and large cities. Typically in Germany the social problem groups are concentrating in the urban areas where social control is much less because of increasing anonymity. The latter also favours transfer fraud, so that more intensive controls become necessary. Therefore, social aid expenses as well as the administrative costs are increasing. In the UK as well as in Germany the approach is to reduce the costs for income redistribution by excluding transfers from income taxation and any social security contributions. Additionally high basic exemption, orientated to the minimum guaranteed in social aid, should leave the employed untaxed if their income is close to the critical income (see chart 20 above). In Germany most of the benefits and aid payments are net income orientated (health benefits, unemployment benefits and aid, net pension adaptation), in the UK at least the social aid payment. While the British try to reduce the marginal burden in the cross over area by a zero contribution up to a certain threshold, the German system has a total unsystematic approach of negligible employment, which creates enormous problems for equal treatment of all forms of income.

The Dutch have invented just an opposite strategy; the minimum income includes the single social security contributions as well as the wage tax. This increases the volume necessary for fighting poverty and redistribution, but on the other hand all people are used to pay taxes and contributions from the very beginning. That reduces the marginal rate hikes in the cross over market income areas and motivates people to be re-integrated into the labour markets. If not jet implemented, it also allows the refund of contributions for the health insurance in case of cost saving behaviour, so that the Dutch system is very close to that proposed in chapter 4. If some remaining shortcomings would be abolished, the Netherlands almost delivers one possible blueprint for the Russian social reform.

A general benchmarking with regard to the system costs and the necessary contribution rates is almost impossible, but at least some rough hints can be derived from historical patterns as well as experience. The costs of a social protection system are determined by the coverage (basic or upgrade), replacement income ratios, the base for contributions and premiums (wages or total income), the living standards, family sizes, traditions, cultures, etc. Because of the currently not very promising conditions in social protection in Russia, any clear formulated protection standards with sufficient basic coverage in the main areas of old age and health protection for the real poor in the society would mean a fundamental progress. Such a systemic change has to take into consideration that the current retired generations do not have any chances for behavioural adaptations and self responsible insurance because such entitlement can only be built over a full span of working life. Consequently some perhaps cost intensive separate treatments have to be seriously pondered. However, all such measures have to be financed from the general tax revenue.

In the insurance schemes the intra-periodical expenses have to be financed by contributions and premiums, whereas the above-mentioned intertemporal elements have to be backed by capital funding. If an efficient social insurance approach should be applied, the main question is, which groups of the population should be (compulsorily) covered, and which income base is the correct one? Another important question is if any limitations for an obligatory assurance should be implemented or contracting-out being allowed? If an obligatory insurance limit of twice the average income (wage) is taken, the experience from our case studies (see tables 8 and 12) would allow the following estimation of possible contribution and premium rates[246] for the Russian system:

The contribution rate for a *pension system*, which would guarantee a minimum pension and a small upgrade pension as in the British example, could be in the range of 7 % to 8 % of the wages (if the self-employed would be included perhaps one percentage point less).

The *health insurance* contribution or premium could be about 7 % for a basic insurance scheme with clearly defined medical services (basic catalogue of medical protection).

The *unemployment insurance* is on the one hand heavily dependent on the labour markets conditions and the replacement income levels guaranteed, on the other hand on the generosity of benefits. Following the British basic security approach, a contribution rate of about 6 % could be possible.

Taking that altogether, total social protection should not yield a higher rate than *20 % of the payroll* (or the additional income of the self-employed if also covered by the system). And this burden should be exclusively financed by employee's contributions because the employer's participation only hides the true social protection burdens for the population. The effective burden sharing between employees and employers is finally determined by the labour market conditions (elasticities of demand and supply), independent from the illusions some politicians, trade unionists or representatives of employers associations might have. Enough Experiences from transformation countries with social insurance schemes exist, which are unable to provide even minimum standards, but have total contribution burdens beyond 40 %. Such schemes almost squeeze employees and employers into the shadow economy. If then a minimum wage, which is non-contributory for social insurance, exists, at best most of the employees are officially paid this minimum wage, while they get in-official by-payments below the table. Such behaviour ruins social insurance as well as people's trust into state and social protection.

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[246] The figures are more a guess than reliable estimations; the latter could only be done if in case of reliable data a microsimulation model would be implemented in Russia.

Comparatively low and fair insurance contributions are the best prevention against illicit work and reduce the poverty trap effects of the shadow economy. For the re-integration of illicit work into the official labour markets, effective control mechanisms within the tax and social contribution systems are inevitable. As experiences in Croatia and elsewhere have shown, the introduction of wage tax cards is the most efficient method. Connected with the pay as you earn system (PAYE in the UK) for wage tax and social security contributions an outstanding control is guaranteed, especially if all VAT relevant transactions are only accepted for tax refunds if they were done via registered bank accounts. Obviously tax, contribution, and transfer fraud has to be combated by the criminal law. The foundation of new firms and the existence of young firms has to be supported by an income and value added tax law, which is not accrual but cash-flow orientated, a feature, which is of specific relevance considering the very limited access to banking loans and the emerging capital markets. The modified cash-flow taxation as mentioned above additionally enables tax administration and tax investigators to an easy control of only very few cash accounts within the single companies.

Modern economic theory as well as lots of experiences in highly industrialised and many transformation countries backs the general philosophy of social protection and taxation as it is presented in this survey. The choice of the different possible solutions has to be made in view of the important traditions and cultural characteristics of the single country under investigation. The Russians themselves are therefore the natural decision makers; their social politicians have to take the challenge and to formulate their own blueprint. Foreign consultants can only give some hints and make some pros and cons if single measures would fit in an efficient reform framework. The most important fact is that a systemic approach has to be found and not a chaos, which currently is typical for the German approach. Even the other systems in Austria, the Netherlands and the UK are much to complex to deliver a real suitable blueprint. Because of the obsolete ideology of doing justice to everybody in the society connected with the ever growing influence of permanently emerging interest groups, the systems have become so complex that the single citizen is overstrained and often misinformed about his real entitlements: the outcome is injustice and mistrust in government. Therefore, the Easy Tax as mentioned above connected with a transparent insurance scheme, both integrated like in the Dutch example, are the silver bullet on the roadway to a successful open society.

Appendix

Organisation of social protection

Germany

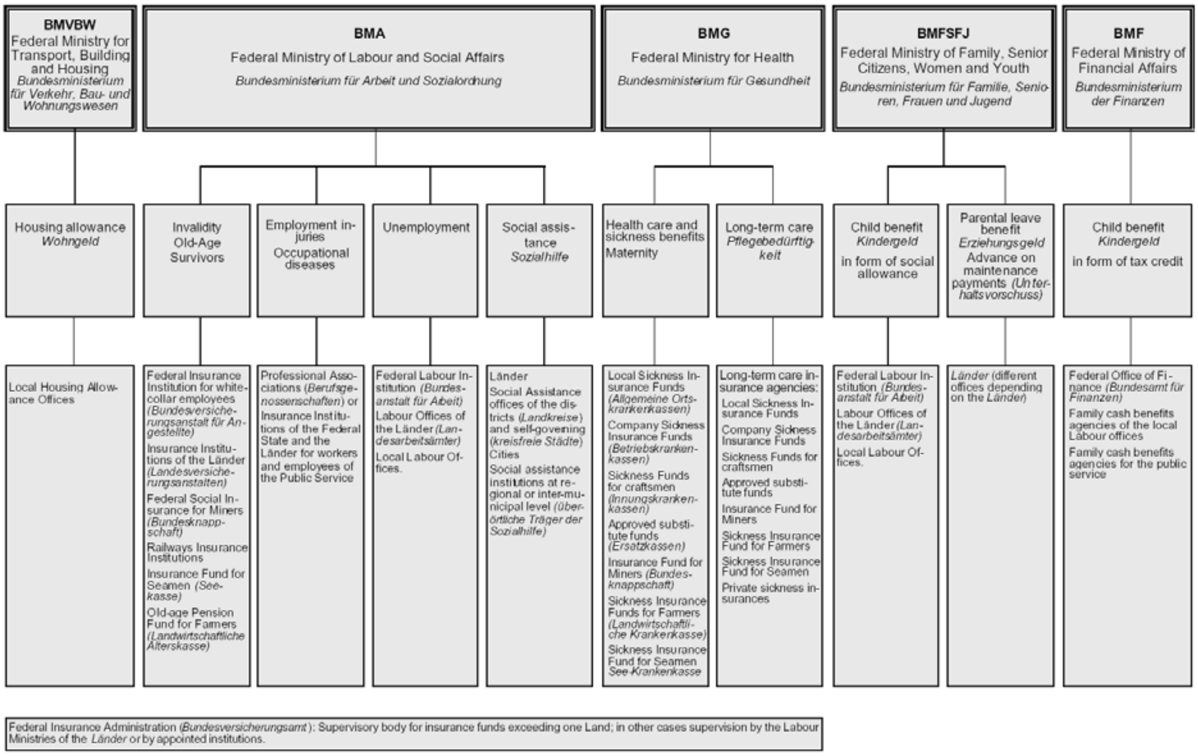
Austria

The Netherlands

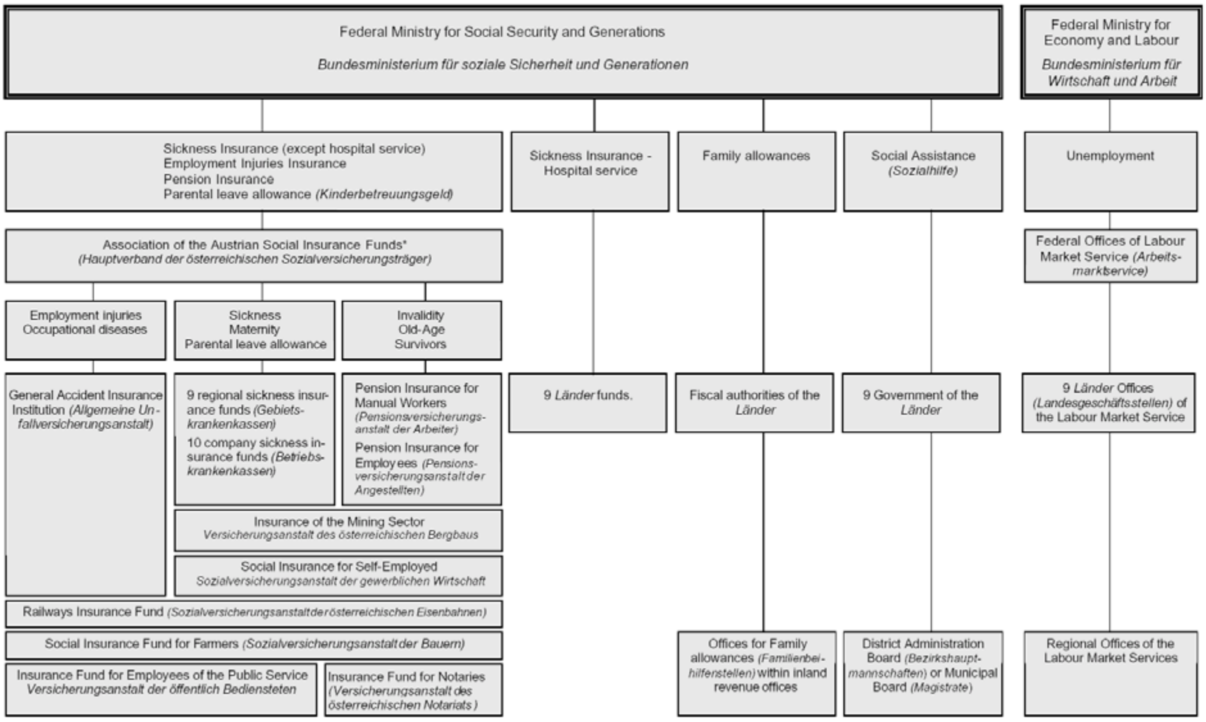
United Kingdom

Source: European Kommission (2002) under
http://europa.eu.int/comm/employment_social/missoc/2002/org_de.pdf

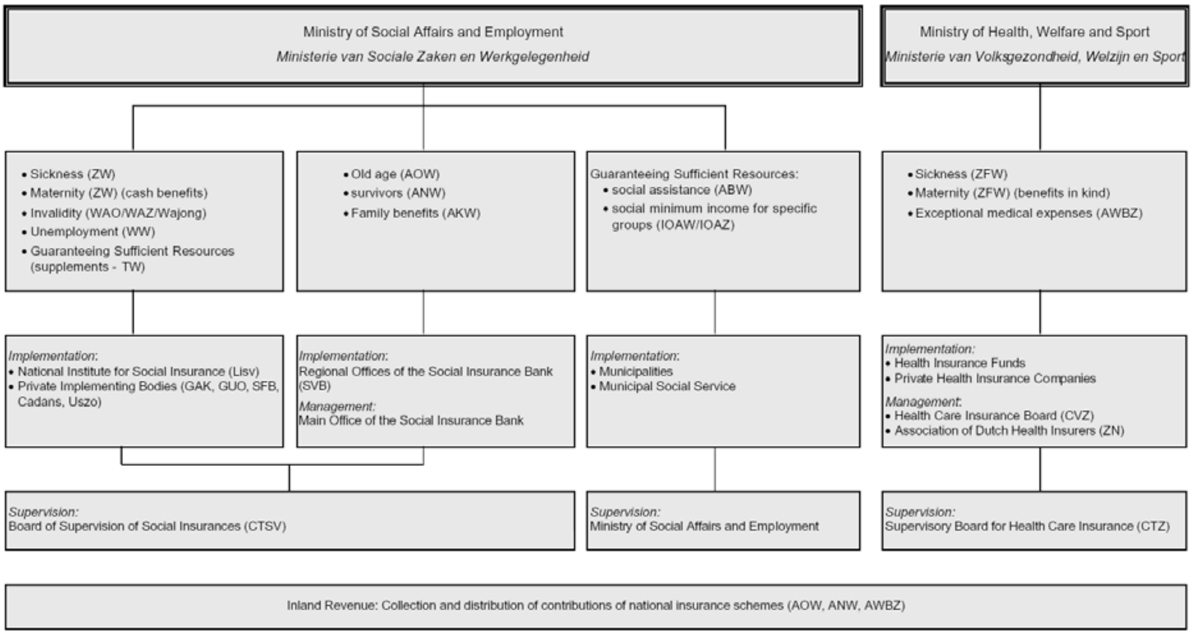
Organisation of social protection **Germany** 1.1.2002



Organisation of social protection **Austria** 1.1.2002

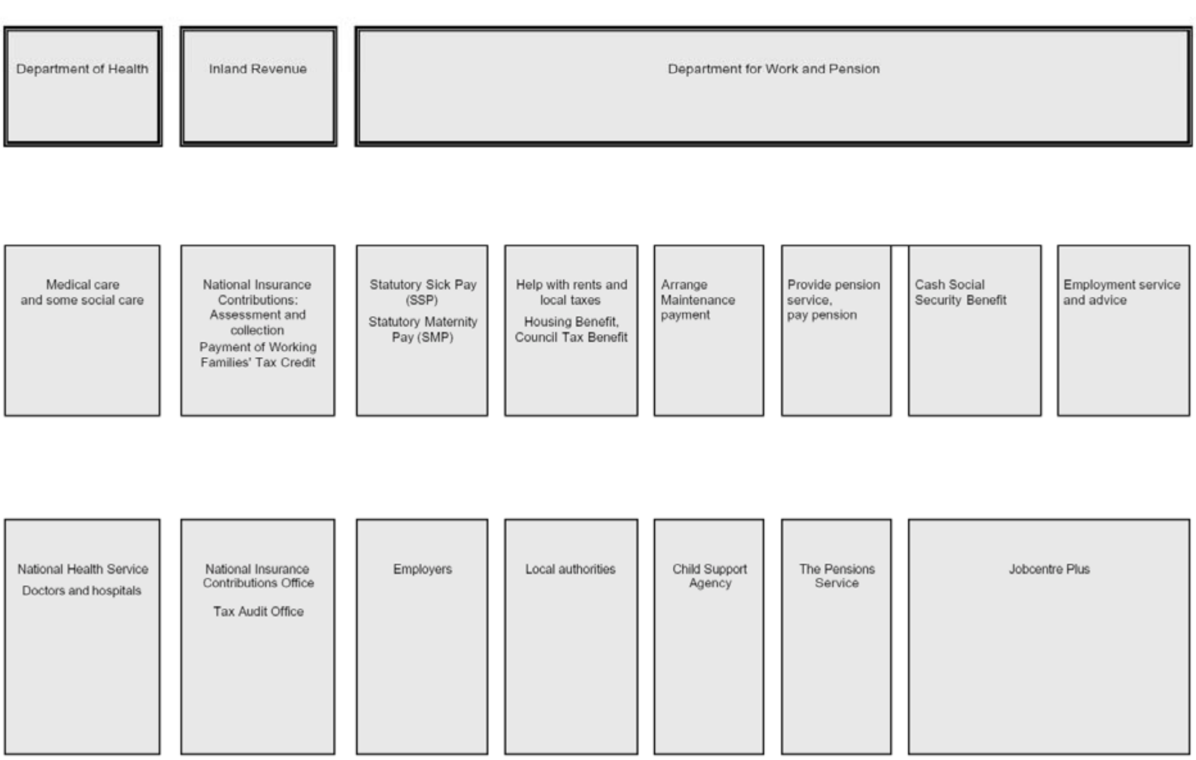


Organisation of social protection **Netherlands** 1.1.2002



ABW: National Assistance Act. **AKW**: General Child Benefits Act. **ANW**: General Surviving Relatives Act. **AOW**: General Old Age Pensions Act. **AWBZ**: Exceptional Medical Expenses Act. **IOAW**: Act on Income Provisions for Older, Partially Disabled Unemployed Persons. **IOAZ**: Act on Income Provisions for Older, Partially Disabled Formerly Self-employed Persons. **TW**: Supplementary Benefits Act. **Wajong**: Disablement Assistance Act for Handicapped Young Persons. **WAO**: Disablement Insurance Act. **Waz**: Self-employed Persons Disablement Benefits Act. **WW**: Unemployment Benefits Act. **ZFW**: Health Insurance Act. **ZW**: Sickness Benefits Act.

Organisation of social protection **United Kingdom** 1.1.2002



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