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**STATEMENT BY MINISTER ANDREJ BAJUK AT THE EU-LAC  
INTERNATIONAL FORUM ON "FISCAL POLICIES FOR SOCIAL  
COHESION AND THE FIGHT AGAINST POVERTY"**

***BERLIN, 12 MARCH 2008***

Damas y Caballeros, ladies and gentlemen,

Es para mi un alto honor y por cierto un gran placer poder dirigir la palabra a este importante foro. En particular, porque a través de los años he tenido la oportunidad de poder ver muy de cerca tanto la experiencia latinoamericana como la europea respecto al rol que tiene y puede llegar a tener la política fiscal en relación al fomento de la cohesión social y la lucha contra la pobreza.

I would like to focus my address on some of the challenges and policy responses in the EU aiming at fostering welfare improvements and maintaining social cohesion within the boundaries of sound fiscal policy. Within the EU, different social models and political preferences coexist. Nevertheless, we all face the same challenges and perhaps that is why we have agreed on a broad policy framework to address them under the so-called Renewed Lisbon Agenda with its emphasis on growth and jobs.

The renewed Lisbon Agenda, launched in 2005 rests on the following pillars:



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- i) **Broad economic policy guidelines** at EU level that provide an agreed upon common policy framework for the reforms needed to modernise European economies;
- ii) **National reform programs** at national level addressing country specific priorities in the labor, capital and product markets;
- iii) A steering mechanism of cross country monitoring and evaluation of reforms.

At the EU level the national reform efforts are supported by **the Community Lisbon Program** and underpinned by EU budget that supports EU priorities and cohesion among countries.

Just now, during the Slovenian presidency, a new cycle of the renewed Lisbon Agenda for the years 2008-2010 is being launched. The preparation process included a successful fine tuning of the broad policy guidelines in line with new challenges and policy priorities. The focus for the new cycle is now on implementation. In the forthcoming months the social dimension of the Lisbon Strategy will be strengthened based on a renewed Social Agenda by taking into account Europe's new social and labor realities and also covering issues such as youth, education, migration and demography as well as intercultural dialogue.

Which are the common challenges facing EU and to a similar extent also Latin-American countries?

- i) **globalization** and ensuring that benefits and opportunities are shared between all citizens,



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- ii) technological change that is biased against low-skilled workers and maintaining social inclusion,
- iii) **ageing populations** and ensuring long term fiscal sustainability and;
- iv) **climate change** and pursuing adequate global response.

These challenges, in the context of new economic risks, have placed under strain the ability of the welfare state systems in providing the security and the higher degree of social cohesion that common citizens legitimately expect. They also highlight the age old trade-off between equity and efficiency. With globalization, the mobility of tax bases increases. Tax systems at large and in particular the downward pressures on tax revenue collection question the capacity of the state to effectively pursue social inclusion and equity. On the other hand, ageing places increasing pressure on the sustainability of public-sponsored pension and health insurance systems and is introducing the potential crowding out of other expenditures.

Responding to these challenges requires additional efforts to modernize the welfare state and its policies. At the EU level the response to the challenges is framed within the Stability and Growth Pact that pursues macroeconomic stability and a three-pronged strategy to deal with long term pressures of ageing. The three elements of this strategy are (i) fiscal restraint, (ii) pension reform and (iii) increase in labor participation. Common principles have also been adopted concerning “flexicurity” – an EU brand name for policies that pursue flexibility in labor market but at the same time improve employment possibilities for those individuals more adversely affected by changes in the market realities.



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Beyond this framework, the Slovenian presidency of the EU, together with our partners in the Council has placed a particular emphasis on **investing more and better in human capital** as a means to facilitate the movement towards a "knowledge-based economy", to enhance social inclusion, "create more and better jobs" and contribute to sound fiscal positions. Enhancing the efficiency and effectiveness of expenditure in education has important effect on social transfers by discouraging excessive reliance on them while increasing revenue capacity of the state. Nevertheless, in order to facilitate the orientation of policies towards human capital formation, it is important to make more efficient use of public expenditure. This requires addressing the need for rigorous policy evaluation and careful prioritization of all expenditure.

In reforming the welfare systems one should look at its elements. This would encompass not only the composition and level of social spending including education, but also tax expenditures, including the degree of progressivity of the tax systems.

However, agreeing on the principles to enhance delivery of social cohesion within the framework of sound fiscal policy is just the beginning. The fact of the matter is that challenges vary from country to country. Welfare systems also vary not only because of different historical background, social preferences and models. Among the issues that we can have a broadly agree upon, is that social cohesion should be pursued within the boundaries of fiscal responsibility. Adequate level of social spending should be financed through tax structures, which in their interaction with benefit systems should increase the incentives to work and to invest and hence, promote higher growth. On the expenditure side,



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given the challenges and social deficits, priority should be given to enhance the efficiency and effectiveness of social spending, redirecting it towards human capital formation given its impact on employability and social cohesion.

Let me now touch upon some of the critical issues in the EU social agenda and its manifestation in different EU Member States. European societies attach great importance and merit to their social models. However, as stated before, the challenges to combat poverty and social exclusion, to promote active inclusion and increase employment opportunities differ from country to country. For example the inequality of the income distribution differs substantially among Member States as measured by the ratio of total income received by the 20% of the country's population with the highest income to that received by the 20% of the country's population with the lowest income. While in 15 of the 27 countries this ratio is below 4 (including Slovenia) there are others in which this ratio goes up to 7. The evolution of the ratio over the period 2000-2005 indicates that, on average, inequality has been increasing with a particular strong increase in some of the new member states.

Another important indicator of the social situation and policy effectiveness can be obtained by considering the **part of the population exposed to poverty risk** after social transfers. The total risk of poverty rates varies substantially between EU member states from 9% to 20%, and even more so for different age groups (children (aged 0-17) and the old (65+)). The strong divergence between the poverty risks of different age groups can be seen as an indicator of the challenges for anti-poverty policies.



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**Unemployment** is one of the prime causes of poverty and social exclusion. Moreover, unemployment is a factor of economic inefficiency, since the economy's labor resources are not put into productive use. Despite improving labor market performance across the EU in recent years, unemployment remains relatively high and unevenly distributed. Unemployment rates at country level range from below 5% to 15%. Unemployment and risk of poverty remain too high, for those without or limited or outdated qualifications and skills. The average unemployment rate for low skilled workers is around 10 per cent compared to around 7 per cent for those with upper secondary education and 4 per cent for those with tertiary education. This again underscores the importance of investing in human capital.

Approaches and strategies with respect to social expenditure vary among EU Member States. This is reflected in the level and the composition of social expenditure. EU average total social spending, excluding spending on education represents **27.3% of GDP**. It ranges from 32.7% of GDP in Sweden to 12.9% in Latvia. Social spending is the main spending category of government budgets in the EU amounting to more than half (54%) of total government expenditure. Member States devote most resources to pensions (12% of GDP), followed by health care (9.5% of GDP) and unemployment transfers. Spending on education is on average at 12.5%.

Information on **the dynamics of social spending** indicates that on average, social spending has slightly increased slightly in the EU from the late 1990s to the early 2000s. On average, expansion of social spending has been most pronounced in health care (including sickness and disability), increasing by 0.5 % points of



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GDP, which indicates particular spending pressures in this field. Pensions spending has also increased as a percent of GDP, but only slightly. Reductions could be seen on average on unemployment transfers. There is a high variance of unemployment benefits which is the result of different levels of economic performance as well as different conditions prevailing in labor markets.

On the **tax revenue side** over the last few years, we have witnessed certain stabilization in the overall tax burden. By and large, the EU remains a relatively high tax area and tax rates in some Member States are among the highest in the developed nations family which reflects differences in social preferences. In 2005, the tax to GDP ratio including social security contribution ranged from 50% in Sweden to 28% in Romania.

The structure of taxes indicates that indirect taxes are the main source of tax revenues, about 35% of the total. One noticeable trend has been the decrease in labor taxation in a number of countries over the last decade. As for revenues from capital taxation, they have shown some tendency to increase during the last decade, although tax rates on corporate income have been reduced in many countries.

This is due to the interplay of various causes such as base broadening and cyclical factors. Reforms have been driven by several interrelated factors. **First**, the growing awareness that an excessive tax burden on labor and its interaction with the benefit systems lowers work incentives. **Second**, Member States have managed to rationalize and simplify their tax systems, almost always by broadening the tax base in order to reduce the tax rates. Last but not least,



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globalization is increasing the mobility of tax bases. Tax reforms also impact directly on overall welfare as they affect the level of social expenditures, through the direct income taxation, indirect taxation of consumption and tax breaks for social purposes. Decreases in the degree of progressivity of tax systems have also underpinned welfare changes since, broadly speaking, taxation effects welfare through its impact on incentives. A well-designed tax system is a factor whose importance cannot be underestimated.

Looking forward and taking into consideration the two main challenges facing EU countries, globalization and ageing, the most outstanding question is how to assure the sustainability of the European social models. It will be increasingly difficult to make room for a further reduction in the overall tax burden given the looming impact of ageing populations on public spending. Ageing will increase some social spending while at the same time it will reduce the revenue potential of some tax bases such as labor. On the other hand, globalization has the potential to increase the mobility of capital and high-skilled workers, making it more difficult to rely on them as a source of revenues.

The challenge is to pursue reforms that maintain and improve the high social achievements. Maintaining or improving social record on the revenue side will require finding alternative robust and broad-based tax bases, more efficient and simple tax structures, not prone to fraud, while remaining fair. On the public expenditure side it requires increasing its efficiency and effectiveness while orienting its composition towards higher human capital formation. Investing more and better in education will reinforce sustainability of public finance, maintain and improve social cohesion and provide more opportunities to



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individuals. But it will require a much more rigorous and comprehensive policy evaluation.

In summary, to assure the continuous provision of current high levels of social protection and even more if further developments are desired, inevitably requires a better balance between expenditure and structural reforms that should significantly improve outcomes. But at the very basis of it all there is a need to build a broad political consensus as to the desired evolution of the welfare states.

Muchas gracias!