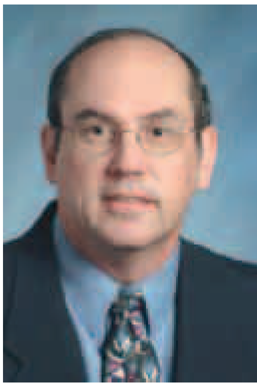
Panel 1

Economic Integration and the Welfare State

David E. Wildasin
Martin School of Public Policy
University of Kentucky



The "future of the welfare state" in Europe is becoming a common theme for discussion among policymakers and academics. This is well illustrated by the 2003 CESifo Munich Economic Summit, at which several participants commented on the prospective demise of the welfare state, or at least some of its elements, or on ways that it, or at least some of its important features, might be preserved.

The "welfare state" can of course mean many things. For the purposes of the present discussion, I propose to focus on fiscal policies. It is of course simplistic to speak only of the financial aspects of the welfare state, since a wide range of regulations (on wages, working conditions, etc.) accompany welfare state policies.[1] When viewed from this perspective, the most essential feature of the welfare state is that it redistributes economic resources. This redistribution takes many forms: redistribution from rich to poor (through taxation and cash transfers) is one part of the total picture, but so is redistribution from the healthy to the sick (through publicly financed health systems), from the employed to the unemployed (through unemployment insurance programs), and from the young to the old (through public pension systems), to name only a few.

These policies and programs are seen by some as crucial elements of a fair and compassionate society, protecting people against many of life's hazards, providing encouragement and hope to those who are disadvantaged by birth or by random forces beyond their control. Others look at the same welfare state and see powerful interests using the coercive force of government to take resources from the weak and transfer these resources toward themselves. It is all very well to invoke justice and fairness in a political debate, but we can all cite instances where entrenched industrial, labor, demographic, regional, and other interest groups use the tax, expenditure, and regulatory powers of the state to protect themselves at the expense of others who are politically, and often economically, relatively disadvantaged. In this, as in so many cases, we do well to remember the old adage about the alignment of policy opinion and self-interest: "where you stand depends on where you sit." Or, as that iconoclast H.L. Mencken once wrote, "Altruism, when analyzed, usually turns out to be self-interest dressed up in a long-tailed coat."

In this discussion, it is my intention neither to praise the welfare state nor to bury it. Rather, my goal is to discuss how economic integration, and particularly the integration of labor and capital markets, affects the fiscal systems of Europe's welfare states. Competition for increasingly mobile labor and capital affects the benefits and costs of these policies, especially when undertaken at the level of the individual nation-state. Competition may pressure governments to limit redistributive policies. There is a potential role for coordination of welfare-state policies among countries, possibly through "upward reassignment" of welfare-state policies to EU-level institutions.[2]

Economic integration: Why factor markets matter

The process of economic integration does not fit easily within the usual "boxes" of traditional specializations in economics. One part of economic integration takes the form of trade in goods and services; another part takes the form of financial flows through

---

[1] These in fact are often closely connected with welfare-state fiscal policies; for example, wage and employment regulations that raise the cost of labor can lead to unemployment, and thus to greater unemployment insurance expenditures.

[2] In order to spare readers any "trial by footnote," this paper makes no reference to a now-vast literature on its topic. Interested readers are invited to review "Economic Integration: Implications for Equity, Efficiency, Political Economy, and the Organization of the Public Sector," available on the author's web site, and "Public Pensions and Demographic Change in Developed Countries: Fertility Bust and Migration Boom?", available on request. Readers may also wish to consult statistical tables and charts that appear in an accompanying PowerPoint presentation.

capital markets; another part deals with monetary policy; another part concerns the migration of labor; still another part has to do with the organizational structure of businesses; and all of these, and their interactions, affect overall economic performance, fiscal systems, urban and regional economic development, and environmental quality.

The integration of the markets for factors of production – the markets for labor and capital – is of particular importance for the welfare state, and will be the focus of attention here. To see why, let us return to our sweeping generalization that the fiscal policies of the welfare state are devoted largely to affecting the distribution of income. Labor and capital market integration affects both the rationale for these policies and their costs. Consider what some might think of as a "worst-case scenario" for the welfare state. Some fear that an unrestrained influx of low-skilled workers may depress wages and raise unemployment in West European economies, putting increased pressure on costly social policies designed to protect the incomes of low-income people. At the same time, the increased mobility of capital may limit the ability of governments to capture income from business activities or from wealthy individuals, thus constraining the revenue-raising capacity of the fiscal system. The integration of labor and capital markets might thus undermine the foundations of the welfare state, that is, its ability to take resources from some members of society and transfer them to others.

What for some is a "worst-case scenario" is for others a "best-case scenario." Countries facing competition for labor and capital may be restrained from using the coercive power of the state to extract resources from the politically weak and to transfer these resources to the politically strong. Competition, in this scenario, is a force for good: it induces governments to limit their costly and frequently unfair interventions in markets, reducing some of the many distortions of economic incentives created by high taxes, generous subsidies, and restrictive regulations. Competition leads to more efficient resource allocation, rising incomes and production, and economic growth.

Note that these two opposing characterizations of the effects of labor and capital market integration differ not in terms of their predictions of the economic effects of integration but in their evaluations of whether these effects are desirable or undesirable. In brief, they agree that integration of labor and capital markets might "unravel" the welfare state, but differ as to whether this would be a welcome or an unwelcome change.

As noted in the introduction, it is not my purpose to opine on the desirability of the welfare state. Instead, I would like to focus on the reasons why I consider factor market integration to be of fundamental importance for the welfare state, why it is occurring, and what some of its implications are likely to be in the shaping of the European economies of the decades that lie ahead. Some of these implications are surely favorable ones, others are perhaps less so; thinking about these broad issues helps to bring into focus some of the basic institutional and policy choices that will confront the citizens of Europe in the coming years.

Europe and the world: Demographic, economic, and fiscal status and prospects

The background

To help lay a foundation for discussion of fiscal policy, it is helpful to summarize a few relevant facts about demographic and economic conditions in Europe and elsewhere. Each of these basic facts is well known in itself, but, taken together, they carry important implications for economic policymaking in Europe. First, Europe is in the midst of a "fertility bust," the opposite of a baby boom. For some years now, fertility rates have been at very low and historically unprecedented levels. This is true both in Western and Eastern Europe, and in some of the other developed countries of the world. Less-developed countries exhibit higher fertility rates and higher mortality rates. Mortality rates are also at historically low levels. The combination of low fertility and low mortality means that the native European population is aging rapidly, both in absolute terms and relative to the world as a whole.

Second, Western Europe is rich, by world standards. Incomes in Western Europe are well above the levels found in poorer parts of the world. Per capita incomes in neighboring regions in the Middle East and North Africa, as well as in the Asian giants of India and China, have been far below West European levels for decades, and will remain so for decades to come, even if these economies develop rapidly. Incomes in Eastern Europe are also substantially lower than in Western Europe, though living standards there are certainly higher than in the truly poor countries of the world.[3]

Third, governments play a major role in the European economies. Government spending in these economies accounts for about 40 percent of GDP. This was certainly not true before World War II, when the public sector was much smaller; even as recently as the mid-1960s, total government spending was closer to 25 percent of GDP. Unlike in pre-twentieth century historical periods, the large governments of modern economies engage in massive income redistribution. Today, "social expenditures" (i.e., "welfare state" spending) alone amount to some 25 percent of GDP in advanced economies. While this redistribution takes many forms, an important share of redistributive transfers is accounted for by transfers to the elderly.[4]

Fourth, and partly in consequence of the previous three factors, international migration plays an increasing role in the demographics of Western Europe. For the OECD European countries as a whole, net immigration has outweighed natural increase as a source of population growth for more than a decade. Flows of immigration vary among countries and over time: Germany experienced especially large immigration flows in the early and mid-1990s; Ireland, traditionally an emigration country, experienced a remarkable migration turnaround during the mid to late 1990s; and, in recent years, Spain has experienced a rapid increase in immigration. While the magnitudes of immigration vary by country and from year to year, the overall trend for Western Europe as a whole is unmistakable: more than one million people per year have been arriving in Western Europe, legally, every year for more than a decade, with a cumulative inflow of over 13 million immigrants during the period 1992–2001.[5] Illegal immigration is intrinsically hard to measure but surely amounts at least to hundreds of thousands annually. Over the past decade and a half, immigration has become the major determinant of population change in Western Europe.

Fifth, increased international flows of capital accompany rising migration flows. What is especially noteworthy about capital flows is not merely that one country or another experiences net inflows or outflows of capital, but that West European countries are experiencing large gross flows of capital in both directions. Gross inflows and outflows of foreign direct investment have amounted to 10 to 20 percent of total investment or more in many OECD countries for well over a decade. Foreign-affiliated firms account for 25 to 35 percent of employment, value added, and investment in the manufacturing sector in major West European economies.

In short, the economies of Western Europe are rich and aging; their governments engage in large programs of redistribution, especially but not only toward the elderly; they are quite open to international capital flows; and they are the destination for millions of immigrants from other countries, most of which are relatively poor.

Fiscal systems, demographic change, and economic integration: Current trends and prospects

Public pensions and demographic shifts. The aging of the European populations, coupled with massive systems of redistribution from young to old, is placing major stress on the fiscal systems of these countries. The obligation to provide cash, health, and other benefits to old people, financed by taxation of the working population, is just like government debt: it imposes fiscal burdens on future workers (i.e., redistributes away from these workers) in order to confer benefits on current retirees (i.e., redistributes toward the current elderly). This problem is not new. For at least a decade and a half, knowledgeable observers have drawn attention to the stresses that demographic change can create for public pension systems. The baby boom by itself, even if followed by replacement-rate levels of fertility, would have given rise to significant variations in the relative sizes of different age cohorts.[6] The remarkable declines in

[3] A few figures based on World Bank data: In 2001, the EMU countries had a per-capita GDP of US $26,579. Per-capita GDP in Eastern Europe and Central Asia was $2,316, in the Middle East and North Africa it was $1,992, and in South Asia, $471. Decades of rapid growth in poorer countries will be required to shrink these differentials markedly.

[4] Spending on old-age pensions presently amounts to about 7 percent of GDP for OECD countries and is projected to rise to about 11 percent by 2050 under mid-range demographic and economic assumptions. For France and Germany, current pension spending is much higher and is projected to rise from the current 12 percent of GDP to about 16 percent by 2050. (To illustrate that generalizations can be treacherous, it should be noted that the UK only spends about 4 percent of GDP on public pensions, an amount that is projected to fall by perhaps 0.7 percentage points by 2050.)

[5] It should be emphasized that this represents immigration from beyond the boundaries of the EU. Intra-EU migration is comparatively modest (though intra-EU sojourns for work or for pleasure are very much larger).

[6] History casts long demographic shadows. The age distribution in European countries in 1950 reflected the loss of life – especially by young and middle-aged adults – during World War II. The ensuing baby boom represented a fertility resurgence following the reduced fertility rates of the Great Depression and the interruption of family formation during the war years. For both reasons, age distributions were favorably aligned for underfunded public pension systems during the 1960s and 1970s.

fertility during the 1980s and 1990s mean that age distributions are becoming exceptionally unfavorable for underfunded public pension systems as well as for other elements of fiscal policy – explicit government borrowing is noteworthy in this respect – that shift fiscal burdens to future working populations. The old-age dependency ratio in Western Europe (the ratio of elderly to working-age populations) is today already at a historically-high level of about 25 percent, and, barring either a major increase in old-age mortality, emigration of the elderly, or immigration of younger people, this ratio will increase to about 50 percent by 2050. This means that the fiscal burden of supporting the elderly will increase markedly in coming decades.

Migrants to the rescue? Assuming, hopefully, that the European populations will not suffer major increases in mortality from war or disease, and that older Europeans will not relocate, on a large scale, to other countries, immigration provides the only path available to redress the age imbalances embedded in past fertility and mortality experience. Immigration to Western Europe is now quite substantial, and has been so since about the time of the collapse of the Soviet Union. Immigration rates in Western Europe have exceeded those in the U.S. during the past decade, and immigrants to Western Europe, as has traditionally been the case for international migrants, are indeed disproportionately young, working-age adults. Recent immigration has thus eased the age imbalances of Western Europe, and can continue to do so for the indefinite future. Realistically, however, only truly massive inflows of migrants could fully offset the future aging of the populations of Western Europe.[7]

Migrants: Part of the solution, or part of the problem? While migrants to Western Europe are generally young, they are not generally rich. This is naturally a consequence of the high incomes of the destination countries of Western Europe relative to the low incomes of the destination countries of the rest of the world. It is also a consequence of the relative youthfulness of immigrants: twenty-somethings do not attain the high earnings levels of more mature workers, nor have they had enough years of savings to have built up the personal wealth that older people tend to have, on average.

Whether immigrants are net fiscal contributors or net fiscal beneficiaries is a matter of the greatest importance for the fiscal systems of Western Europe. In static terms, and as a broad generalization, it appears that immigrants may well be net fiscal beneficiaries, that is, that they may impose fiscal burdens in excess of their fiscal contributions. Studies of immigrants in Sweden, Germany, and Denmark find that while immigrants account for a bit more than 10 percent of the total population, they are the recipients of upwards of 30 percent of total cash welfare expenditures. Of course, a static view is necessarily an incomplete view: as young immigrants assimilate into local populations, gaining employment experience and enjoying increased earnings, their contributions to the fiscal system will increase relative to the benefits that they derive from it.

But this is only a broad generalization. Some immigrants definitely make enormous fiscal contributions, and others definitely impose enormous fiscal burdens, depending on their individual characteristics and on the characteristics of the fiscal systems in the countries where they reside. These are linked: the characteristics of immigrants – their ages, incomes, skill levels, wealth, health, and family status – are influenced, to some degree, by public policies. When relatively poor, low-skilled, low-wage, sick people arrive in a modern welfare state, they tend to pay relatively little in taxes and to receive relatively high levels of fiscal benefits. When rich, highly-skilled, high-wage, healthy people arrive in modern welfare states, they pay a lot in taxes and qualify for relatively little in welfare-state benefits. For these reasons, welfare states stand to gain by attracting the well-off, and to lose by attracting the badly-off, and for these very same reasons, generous welfare states are attractive locations for the poor and are less appealing to those who are better off.

An important question for public policy is whether to attempt to attract more "attractive" immigrants, by reducing fiscal burdens on those who are net fiscal contributors, and whether to reduce the flows of "unattractive" immigrants by reducing fiscal benefits for those who are net fiscal beneficiaries. This indeed could amount to a scaling back or unraveling of welfare state redistributive policies – the "best-case" or "worst-case" scenarios described above. Tax cuts for the rich, benefit cuts for the poor, better fiscal terms for young workers, and reduced retirement and health benefits for the elderly are all examples of fiscal reforms that would reduce the fiscal burdens on

[7] A UN study found that immigration inflows would have to rise from current levels of about 1.5 million annually to about 13 million annually to keep old-age dependency ratios at current levels through 2050, by which time cumulative immigration in Western Europe would have risen by about 700 million people.

net fiscal contributors as well as the fiscal benefits received by net beneficiaries.

Fiscal Competition: Labor and capital both? Just as countries might alter their fiscal treatment of individuals in response to the migration of people, so they might also wish to alter their fiscal treatment of businesses. Investment can be attractive in part because businesses pay taxes, or because it stimulates growth in employment, output, and income that lead to rising tax revenues and declining welfare-state expenditures. How, then, to attract investment? Lighter tax burdens, coupled perhaps with subsidies or with public expenditures on infrastructure or other public services that raise profitability, provide a set of policy tools that can influence investment flows. Of course, the process of reforming fiscal policies to attract investment is likely to reduce the net fiscal contribution generated by investment, in the same way that fiscal competition for people will tend to limit the net fiscal contributions and benefits paid or received by migrants.

To summarize the discussion so far: the aging and rich societies of Western Europe face present and prospective fiscal imbalances associated with their extensive programs of redistribution. Thanks to their high incomes and perhaps also, in part, thanks to their fiscal systems, they are attracting millions of immigrants from around the world. Capital mobility is also now a well-established characteristic of these economies. Since capital and population flows are affected by economic conditions, nations must compete for labor and capital, and fiscal policies – tax and transfer policies, especially – are one principal means by which they can do this. Competition encourages countries to reduce the amount of burden that they impose on people and businesses that are net fiscal contributors, and to reduce the amount of benefits that they provide to those that are net fiscal burdens. In this way, competition tends to bring fiscal benefits and contributions into alignment for people and for businesses, and thus to reduce the extent of redistribution – that is, to reduce the size of the welfare-state.

Policy and institutional responses to fiscal competition

Is the welfare state doomed? Will competitive pressures lead to a "race to the bottom" in which taxes and expenditures are driven down to dramatically lower levels? There are several reasons to think not. First, the phrase "race to the bottom" is highly misleading. To see why, think about competition among businesses. Do businesses in competitive industries race to a situation of zero prices? Certainly not, even though it is possible for any one business to attract many customers by reducing its prices. In business, competitive pressures lead to prices that reflect costs, rather than the pricing power associated with monopoly. Competition keeps the prices of Rolls Royce automobiles or 20-room mansions very high: their prices will never approach zero because these cars and dwellings are costly to produce. Similarly, in the fiscal sphere, competition does not lead to zero public expenditures or to zero taxes. Rather, it leads to a revenue system that reflects the costs of public services. When governments incur heavy costs from providing public services to businesses or to households, competitive pressures would lead them also to recover these costs through taxes, fees, and charges that reflect these costs. This may mean reductions in social benefits to the poor. But it may also mean privatization of loss-making public enterprises (whose customers are no longer the recipients of subsidies from taxpayers), reductions of subsidies to politically favored regions or industries, or higher tuitions and fees for students attending universities. Furthermore, political resistance to productive public expenditures – on education, infrastructure, health services, or transportation – is bound to diminish when these activities are financed not by transfers from the general taxpaying population but from revenues derived from those on whose behalf these expenditures are made.

By way of example: state and local governments in the U.S. vary widely in their provision of public goods and services and in their levels of taxation. In general, the fiscal systems of these units of government tend not to be highly redistributive – at least, not by comparison with the redistribution undertaken at the national level.[8] Competition among these governments has not led to a "withering away" of public expenditures and taxation. There are some places where some types of public services are very good – and costly – and other places where public services, and the taxes that support them, are more limited. In other words, competition sometimes leads to high levels of public service provision.

[8] As one simple indicator of the amount of redistribution embedded in the federal tax system, one may note that the top 2 percent of taxpayers paid over 40 percent of personal income taxes in 2002. No state or locality imposes fiscal burdens of this magnitude on its high-income taxpayers.

Second, and more importantly, it is crucial to recognize that economic integration is not, or at least need not be, a zero-sum game. When driven by market forces, migration and capital flows tend to raise productivity and incomes, as workers and businesses are attracted to places and uses where they are highly valued and away from places and uses where they are less productive. The importance of this basic observation should not be underestimated. From its inception, liberalization of markets has been one of the underlying foundation principles of the EEC/EU. This certainly includes liberalization of trade in goods and services, through the progressive reduction of trade barriers, but it also includes liberalization of labor and capital markets. Economists struggle to understand the process of economic growth and development, but none would dispute the role of markets as fundamental resource allocation mechanisms that have raised West European living standards far above those found in poorer regions of the world. Increased scope for freedom of commerce and employment, embodied in the Treaty of Rome and extended to ever more countries as the EU has gone through successive expansions, contains the promise of continued economic growth and increased prosperity.

In European experience to date, migration from outside the EU has featured more prominently than intra-EU migration. The recent accession of numerous East European nations means that significant amounts of erstwhile extra-EU migration will now become intra-EU migration. Quite aside from the impact of eastward EU expansion, however, labor and capital mobility will play an important and growing role in the future development of the European economic region, at least if US experience is any guide. Interregional flows of labor and capital are a durable feature of the U.S.'s highly-integrated market economy, and mobility is especially prevalent among the better-educated workers that comprise a persistently rising fraction of the workforce.[9] To date, migration from outside of the EU has been especially important, but Europe's young professional classes will surely follow career paths that are increasingly EU-wide, especially as they work in modern business enterprises with EU-wide operations.

[9] The U.S., like the EU countries, is the destination for significant numbers of international migrants. International migration, however, is small in magnitude compared to migration among regions within the U.S. For the past half-century and more, each year has witnessed large movements of people among states and regions (gross migration flows dwarf net migration flows), showing no tendency to subside over time. Reallocation of labor and capital among regions is evidently part of the US economy's response to ever-shifting market conditions.

While the linkage between economic development and the growth of the welfare state is complex, it is an inescapable fact that welfare states flourish in rich countries, not in poor ones. "Unwinding" some welfare-state redistributive policies, for example by reducing taxes and transfers, may be an important element in growth-promoting economic reforms, and fiscal competition in increasingly integrated markets for labor and capital will likely create pressures for such reforms. Perhaps more prosperous economies will be more unequal ones. But there is no reason to expect that the political forces that have made the modern welfare state such a characteristic feature of prosperous democratic societies will disappear over time.

Third, however, implementation of welfare-state policies may become increasingly difficult for individual countries due to competitive pressures. As mentioned earlier, competition among states and regions within the U.S. has not resulted in a race to the bottom in taxes and public services, but it may well have contributed to limits on the amount of fiscal redistribution by lower levels of government. Public pensions in the U.S., which (as in many EU countries) are a major element in the system of intergenerational redistribution, are a responsibility of the national government. Government borrowing, another form of intergenerational redistribution, is also far larger at the national level than at the level of subnational governments. The national government gives generous financial support to the state governments in their expenditures for major programs of cash and health benefits (AFDC/TANF and Medicaid) for the poor, and perhaps these benefits would be far smaller if their financing were left entirely to the states.

It is possible that the Member States of the EU will increasingly find themselves in a competitive environment like that facing states in the U.S., and that nations that were able to sustain large redistributive programs in earlier decades will find themselves under increasing pressure to reduce the scale of redistribution. Under these circumstances, national governments may decide to resist competitive pressures by coordinating their redistributive policies, for example by maintaining high income tax rates or by maintaining standard levels of income, housing, or health benefits for the poor. Detailed coordination of policy is difficult, however.

An alternative would be to reassign major redistributive functions upward to the level of EU administrative units. Of course, this just transfers the political problem of coordinating policies among countries to the political problem of deciding how to share the costs of redistribution among countries and how to set the levels of benefits on an EU-wide basis.[10]

Neither solution is a politically easy one, nor are these alternatives mutually exclusive. The experience of US states indicates that coordination of fiscal policy, even in the presence of a powerful superior government, is challenging, to say the least. To take one example, in the sphere of business income taxation, the states generally define business income in somewhat different ways, apply different rules to the division of income among jurisdictions for tax purposes (apportionment/allocation rules differ widely), and choose quite different rates of taxation (from zero to about 10 percent on corporate net incomes). This is true even though these states share common legal and administrative traditions, and even though they generally rely on Federal government income taxation to determine the starting point for state income taxes. How much harder will it be for the EU countries to negotiate consistent principles and practices for the taxation of income from business activities?

On the other hand, delegation of responsibility for fiscal policy to higher-level institutions like the EU is also a difficult undertaking. The establishment of the social and regional development funds represent halting first steps toward EU-wide expenditure policies. The recent accession of East European nations to the EU will complicate the already problematic implementation of EU-wide social and development expenditure policies. The building of the institutional structures for the redistributive policies of modern welfare states took place over centuries. The establishment of EU-wide institutions that could supersede national government authority in this area, if it occurs at all, surely will require some decades of institutional evolution.

[10] To illustrate just one of the many difficulties that arises in the "upward reassignment" approach: the mix of old and young people differs among EU Member States. Those with disproportionate numbers of old would benefit from off-loading costly public pension programs to other EU countries by making public pensions an EU-wide responsibility, but those with higher proportions of younger workers would then bear disproportionate shares of the fiscal burden. In the give and take of political haggling, these problems are potentially soluble through the use of direct or indirect compensatory transfers or other forms of logrolling.

Conclusion

Labor and capital mobility are important elements in the overall process of economic integration in Europe. People from Eastern Europe, the former Soviet Union, the Middle East, South and East Asia, and Latin America are attracted to the high present and future earnings, and in some cases to the social benefits that life in Europe can offer. Migration and capital mobility within Europe, and especially within the expanded EU, are likely to be increasingly significant features of the EU regional economy. Because the welfare states of Europe .redistribute incomes on a large scale, inflows and outflows of capital or labor can expand or contract the sources of revenues, and the populations of welfare state beneficiaries, in ways that can enhance or undermine fiscal balance and thus the sustainability of redistributive policies.

In order to attract workers and investment that are positive net contributors to the fiscal system, a nation can choose combinations of tax and expenditure policies that offer more favorable fiscal treatment. Less favorable fiscal treatment for net fiscal beneficiaries – the poor, the sick, the elderly – can discourage their entry into a country. The fiscal stresses associated with population aging, the increasing ease of migration resulting from improved transportation and communications and the falling costs of information, and large and persistent income differentials between Western Europe and the poor countries of the world all can be expected to intensify fiscal competition and put pressures on EU nations to limit, to some degree, the extent of redistributive policies that they undertake. Coordination of redistributive policies can limit the extent of fiscal competition. Delegation of responsibility for redistributive policies to EU-level institutions can also mitigate competitive pressures on the welfare state. It would be difficult for the original EC Member States, or even the Benelux countries alone, to sacrifice the policy-making autonomy implied by such coordination or upward delegation of fiscal responsibilities. For the now expanded EU, a very diverse population of nations with quite different administrative, legal, political, and fiscal traditions and institutions, coordination or delegation of policy-making authority is likely to be especially challenging, and will certainly evolve, if at all, only gradually.

The positive impacts of economic integration must never be neglected. Mobility of labor and capital expands economic opportunities for workers and promotes economic growth and development. Prosperity is a critical underpinning of the welfare state. Enhanced economic growth in Europe, partly attributable to liberalization and integration of factor markets, can contribute to the future prosperity not only of native Europeans but of people around the world. The process of sorting out the proper functions of government in an integrated world is complex and time-consuming, and this evolution will not produce universally-shared benefits. But growth-enhancing economic reforms increase the opportunities for widely-shared improvements in living standards, and the experience of modern advanced democracies should reassure us that concern for fairness will always figure prominently in the evolution of economic policy.