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Decentralization of old-age benefits in Spain: lessons from other federal countries

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The decentralization of Social Security in general, and old-age pensions in particular, has been proposed by several nationalist parties in Spain. The purpose of this paper is to analyse the rationality of this proposal, taking into account efficiency and equity issues. This work is divided into three sections. The first reviews the most important literature on Fiscal Federalism, applying it to pensions. The second describes the degree of decentralization of public transfers for the elderly in several countries: Belgium, Canada, Germany, United States and United Kingdom. The final section analyses the current situation of the Spanish system, examining the evolution of the principal variables per Autonomous Region, and using the arguments of the previous sections to consider the possibilities of decentralizing Spanish old-age pensions.

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I. A brief note on Fiscal Federalism

I.1 Classical Theory

The classical theory of Fiscal Federalism was originally developed in the late fifties by public finance economists such as Musgrave, Tiebout and Stigler, among others. These authors used the background of Welfare Economics theory to analyze the consequences of decentralization of public policies on efficiency and equity.

From this point of view, economic efficiency seeks to ensure that there is no reallocation of society's resources which can make someone better off without making anyone else worse off[1] (Pareto criteria). The most famous model of this theory is that formulated by Tiebout [1956]. It states that the ability of individuals to move among jurisdictions produces

[1] For a general description of efficiency applied to decentralization, see Inman & Rubinfeld [1998]

a market-like solution to the *local public goods*[2] problem. This model is usually called *voting with your feet*, and is based on strong assumptions about rationality, mobility costs and perfect information. Tiebout's essential idea is the extrapolation of benefits of the *invisible hand* perfect competition to the public service[3]. It follows that rational public agents engage in competition, tailoring local policies and searching efficiency to maximize the welfare of mobile citizens.

Tiebout's model has been criticised for being of an exclusively American construction. It is therefore not applicable to European reality, which has higher costs of mobility (language and cultural barriers). However, as Oates [1999:1124] notes, this principle does not need mobility to produce gains in Welfare. In fact, it functions even with individuals and factors completely immobile. As long as different communities have different preferences about combinations of public goods, a decentralized solution will be Pareto-superior than a uniform centralized one.

Stigler[4] [1957] also favoured the decentralization cause, his work greatly influencing American politics. The main arguments were that *representative governments work best the closest the government is to its constituency*, and that *subsets of people within a country have the right to vote different kinds and amounts of public services for themselves.* Both principles are equivalent to the more European *subsidiarity concept.* Its main formulation establishes that public responsibilities should be allocated at the lowest level of government at which the objectives of that policy can be successfully achieved[5]. Regarding pensions, many have argued that, this *right to vote different levels of pensions* inside a Federal State might be irrelevant. In fact, it has been defended that the income level of the elderly is a national issue. However, if we think of a European Union unified Old Age policy, the issue becomes more problematic: *should the Swedish or the French accept the same taxes and pension level than the British or the Irish?* If the answer is negative, then, *which is the right size of territory that should vote about this matter?*

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[2] Local public goods are defined as those goods whose benefits are limited to those living in a locality. Stiglitz [2002:733]

[3] However, this model needs much stronger assumptions than the perfect competition model.

[4] As quoted in Tresh [2002: 834]

[5] The *subsidiarity principle* derives from the merging of many traditions (anarchist, liberal, Christian, etc.) but was extensively promoted by the Catholic Church. In fact, one of its most quoted formulations comes from an enclitic by Pope Pius XI. Good discussions of this origin can be found in Puljiz [2002] and Inmand & Rubinfeld [1998].

A more formal principle justifying decentralization is the *Perfect Correspondence Theorem*, by Oates [1972]. The optimal form of federal government to provide a set of public goods would be the one that includes all the population over which the consumption of a public good is defined. Oates' second theorem is the *Decentralization theorem:* for a public good, it will be always more (or at least as) efficient for a local government to provide the Pareto-efficient levels of output for their respective jurisdictions than for the central government to provide any specified uniform level of output. This principle formalises in terms of optimisation programming the idea that policies should be tailored to local tastes.

Summing up, the classical Fiscal Federalism theory establishes that local public goods should be delivered locally. With regard to taxes, the main principle is that *benefit levies* (used directly towards the costs of one public service) should be local. *Non-benefit taxes* have to be centralized to avoid the *free rider* and *race to the bottom* problems.

The difficulty comes when trying to bring those principles into practice. In other words, to decide which level of government can efficiently carry on certain public policy. Economists have attempted to solve this question, using both formal theoretical models and applied econometric research. However, for many public policies, there is no straight answer.

This *classical* Fiscal Federalism theory has been revised by modern economic theory. However its foundations are useful as preliminary criteria for the debate. From this *classical* perspective, redistributive programs in general, and old age benefits in particular, should be fully centralized. The case is not so clear for a perfect insurance pension system with no redistributive elements, as the contributions can be considered *perfect benefit levies.* Therefore, other things being equal, rational individuals will work (and pay contributions) in more efficient systems according to their preferences about present and *old-age* consumption. However, if the social insurance contains some redistributive elements, rich workers will move to systems involving less redistribution, thus paying them higher returns.

Therefore, the following question arises: how can economic theory explain the fact that social assistance pensions are decentralized in many countries? As we will consider later in more detail, there exist completely decentralized supplementary social assistance benefits for the elderly in Spain, US and Canada. Moreover, anti-poverty policies (which are by definition completely redistributive) are the competence of local authorities in some federal countries like the US (after the 1996 *devolutionary* reform) and Spain.

So far, we have talked mainly about economic efficiency. However, the issue of equity is basic in old-age pensions. There are several concepts of equity used in the economic literature regarding to decentralization. The first one is *guaranteeing a certain income level* to every old citizen. Some times this is called *categorical equity*[6]. Related to the former, the concept of *vertical equity* justifies the introduction of redistributive policies, in order to mitigate the inequalities in income created by the market. Another important concept is the *horizontal equity* (Feldstein) imposes giving equal returns to identical contributions. Finally, *territorial equity* refers to the harmonisation of the economic development between geographical areas. Using all the previous concepts as a framework, we could formulate the question of whether a decentralized system could achieve these *equity principles*, or if territorial differences in economic development will create important inequalities between pensioners. A final concern regarding decentralization is the future viability of the pension system in the current context of ageing of the population.

I.2 Additions to classical theory

a) Race to the bottom

Many arguments have been added to classic Fiscal Federalism to improve its positive and normative analysis. Some authors challenge the positive view of state competition in Tiebout's or Oates' models. In fact, they argue that decentralization can only lead to a vicious circle or *"race to the bottom"* in taxes and public services. A very extreme version is defended by Enrich [1996:378]. This author, commenting the devolution of American welfare policies, argued that "*the vehement interstate competition of economic incentives have harmed the states and its inhabitants creating a virtual second US civil war".*

Local policy makers, trying to maximise local GPD will tend to cut taxes to attract productive factors and wealthy citizens. Therefore, under-providing public goods. The argument is intuitively appealing. In the last twenty years, due to the increasing facilities for capital mobility, this argument has become very popular within public opinion. From more orthodox positions, some important economists like Vito Tanzi [2000] – Director of Public Finance of the IMF until 2000-, have defended a similar view of the impossibility of mantaining current levels of Welfare and tax revenue without international cooperation and harmonization of rules[7].

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[6] This concept was introduced in Economic Theory by Tobin, amongst others.

[7] He uses the concept of *fiscal termites* to refer to the new features of the economy that decrease the ability of the national states to tax economic resources.

However, this view has been challenged both in theoretical and empirical grounds. Game-theoretic formalisations[8] of the problem conclude that the *race* leads not to the bottom, but to a Nash equilibrium with sub-optimal production of public goods. The existence of this equilibrium derives from the fact that tax competition is a repeated game, where agents can use credible threats and promises to ensure cooperative results. The main problem is to measure the amount of this *suboptimality.*

There are not many empirical studies about *"race to the bottom"* in pension systems. However, it is easy to find many attempts of contrasting this hypothesis on other welfare policies. The most developed empirical literature refers to the American case (especially to the devolution process initiated in 1996). As Oates [1999:1137] points out, there is not clear empirical evidence proving the extent of this *race.*

While some articles find evidence of this problem, some others are skeptical about it. For example, Shroder [1995:189], analyzing American AFDC programs reported to have failed to find econometric evidence to support the belief of the *"race to the bottom".* Moreover, he notices that most other empirical studies find very small coefficients for the elasticity of welfare benefit amounts and recipiency ratio to a composite neighbour's benefit. Besides, positive signs are not uncommon. With regard to the same policy, Volden [2002] maintains that there is little proof that states are pursuing a race to cut social benefits as a consequence of decisions taken in other jurisdictions. He defends that what really happens is a slow delay of inflation adjustments, provoking not a race to the bottom, but a moderate slide.

A possible explanation of this fact is given by Holahan et al. [1998]. They analyse the Health Care and Long Term Care for the Elderly in 14 US states, and conclude that health care is "viewed by tax payers as a positive good that everybody should receive" [1998, 58]. Therefore, the policy makers, when facing the decision of *cutting popular social policy programs,* face a trade-off between the loss of public support and the benefit of attracting capital*.* This is coherent with Volden evidence. Indeed, it is easier to race in the more subtle way of not raising up the benefits than actually cutting them off.

The argument of the political risk of cutting health programs can be used by referring to old-age benefits (even non-contributory). There is a consensus that poor old people should not work, but be sustained by the community. In fact, the Spanish case of regional supplements[9] of the

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[8] See Oates [1999: 1136] or Wilson [1996] for revisions on this literature.

[9] The decision of the central government of non-raising this pensions to compensate inflation was contested by Andalucia government, which provided a supplement pension

social assistance pensions for old people shows that sometimes it is possible to find a positive elasticity to increases in pensions of neighbour regions. In other words, a *"race to the top"* is not impossible in certain circumstances.

b) Laboratory Federalism

Many supporters of decentralization argue that it creates the positive effect of innovation in public policies. The main idea is that local governments are more flexible than central governments to respond to social needs in a context of imperfect information and *learning by doing*. Therefore, subcentral States act as *"laboratories"* to experiment on a small scale with innovative policies that, if successful, can be disseminated elsewhere. This term is thought to come from US Justice Brandeis back in 1932. "It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country[10]".

Again, the theory is controversial about this matter. In fact, it has been argued from a rational behaviour model[11], that the States can face a free-rider problem concerning innovation, due to the problem of externalities. Another drawback of this argument is that a centralized state can also develop some new policies affecting only a small size of the territory as a *laboratory*, in order to extend it if the results are successful.

The empirical evidence is not clarifying either. According to Lieberman and Shaw [2000:234] any evidence of laboratory federalism should first find some variety on local programs, and later some spread of this innovations. Both processes are difficult to model econometrically in an uncontroversial way. Most econometric articles refer to the American reforms that *devolved* welfare programs back to the State authorities. Among others, Gramlich [1987:309] has argued that the decentralization of welfare policies *"worked beyond almost anyone's expectations"*, permitting States to make their own innovations, control the expenses and improve efficiency.

With respect to pensions, the current challenge of the ageing process implies that this *laboratory federalism* could be useful in order to preserve the sustainability of pensions systems. In fact, inside the European Union, there is a great interest in comparing the effects of

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financed with own resources. Other regions, like Cataluña and Pais Vasco, rapidly followed this policy.

[10] As quoted in [Osborne, 1988].

[11] Models of this kind have been developed by Rose-Ackerman and Strumpf [Oates 1997, 1133]

policy changes, and some trends seem to transmit between the states. Nevertheless, we have to consider the trade off between this potential benefit of innovation with the numerous drawbacks of decentralization, such as the *race to the bottom* or the small size of the Spanish AR, German *Länder* or Canadian provinces to deal on their own with social risks.

c) Reducing public sector size

The argument of the reduction of the public sector size has been often presented to defend the case for decentralization. The core statement was developed by Brennan and Buchanan [1980:185]. Those authors defend the theory that the government behaves as a revenue-maximizing agent. Therefore, a centralized government has a monopolistic power to confiscate the wealth of its citizens *(Leviathan)*. However, in a decentralized system with mobile citizens, *tax competition* among federalised entities may prevent this Leviathan process. The impact of the tax competition depends on the number of alternative jurisdictions available with low mobility costs *(fragmentation effect).* Within this framework, reducing the size of the public sector is a desirable goal as it is supposed to improve the overall performance of markets.

When it comes to welfare in general, and *old-age pensions* in particular, this argument has been used by conservative and market-preserving politicians who wish to reduce the social expenses from the State. Therefore, decentralization can be a subtle way to achieve this goal of reducing public pension expenditure and increasing the role of private retirement insurance. In fact, this was one of the arguments of the Reagan administration in their reform of welfare policies.

However, the Leviathan thesis has been contested both on theoretical and on empirical grounds. On the former, Feld et al. [2003:5] defend that the effect of decentralization on the size of public sector is ambiguous. On one hand, tax competition favours a smaller jursidiction. On the other hand, tax exporting has a revenue expanding effect, by reducing the pressure on the citizens of one jurisdiction. Bruce [1995] proposes a theoretical model of the effect of decentralization on public debt. His conclusion is that decentralized entities tend to issue more debt than the efficient level. This proposition is based on the ground than benefits from the debt are concentrated in the region, whereas the future costs are diluted on the neighbour states. If this model is true, it is very relevant for the old age policy. On an environment of ageing of the population, the excessive issue of public debt can introduce an extra risk in the sustainability of the pension systems.

The empirical evidence is not conclusive either. Whether decentralization of public policy has played a role in controlling the size of the public sector is still a controversy matter. It is important to mention the work of Feld et al [2003]. Those authors analyse empirically the Swiss case to conclude that the overall effect is reduction of the tax revenue, partially compensated with increment of taxes to user charges [2003, 28]. Excellent literature review can be found in Feld et al [2003, 5-11] and Oates [1998, 1138-1141]. Both authors conclude that the econometric analysis does not allow drawing a definite conclusion about the sign, the nature or the extent of the causal relation between decentralization and public expenditure.

Focusing on pensions, there is a fear that in the next decades –as the average age increases- the public expense on pensions will become unbearable, with negative consequences on economic growth. Many changes to benefit regulations have been proposed to control this future expense (e.g. increasing the age of retirement, partial privatization of the system, etc.). However, some argue that altering benefit regulations will be politically difficult if not impossible, due to the future majority of people approaching retirement age. Assuming all the precedent arguments to be true (which is not uncontroversial), decentralization of pensions can be viewed as a way of controlling this future public deficit[12].

d) Increasing political participation

It is generally assumed in political science that one of the benefits of decentralization is the increase in political participation, leading to strengthening of the democracy. Inman and Rubinfeld among others have taken this argument into economic analysis. These authors comment on evidence of the political influence and effort increase in systems with smaller governments [1997:6]. Local politicians are viewed to be closer to the people, and locally elected legislatures more responsive to citizen preferences. Citizens perceive that political influence increases as the size of government declines [Cain[13] et al. 1987]. It also has been argued that decentralization *makes space* for the operation of small, informal, or self-help groups. Therefore, decentralization may also increase the strength of social networks, with positive effects on the economic performance.

Increasing political participation is not only good *per se,* but it also can help the efficiency of the democratic system, via controlling rent-

[12] In line with the thesis that decentralization prevents *"the tyranny of majorities",* it could be argued that in a decentralized pension system, future elderly majorities will not be able to control political power.

[13] as quoted on Inman and Rubinfeld [1997:6]

seeker behaviour or the influence of lobbies defending particular interests. Moreover, a deeper involvement of citizens in political decision usually dismisses opportunistic behaviour of welfare recipients. It also makes it less unpopular to raise taxes and redistribute income. All of this is very relevant to the correct functioning of public pensions. In American literature it has been argued that decentralized pensions can make citizens more fond of paying taxes due to the fact that individuals might prefer to support poor elderly from their own community, than those in far away national territories.

Another advantage of the increased political participation relates to lobbies. It is commonly accepted that a higher degree of involvement of the citizens in public affairs will decrease the possibilities of lobbies and rent-seekers. However, it has to be kept in mind that small governments have less defences to the influence of lobbies.

From an economic perspective, it is very difficult to measure the extent of the increase in political participation, and its positive effects on welfare. However, it is important to account for this argument when evaluating the trade-offs involving decentralization.

e) Some other arguments regarding decentralization

Besides *tailoring public policies to local needs,* beneficiary *market-like competence* between public providers and innovation, the fourth most common argument justifying decentralization is *local knowledge.* Local governments have a better understanding of problems, necessities and changes of local communities. Therefore, they can regulate and administer better than central authorities. With regard to welfare policies, this argument has been used to defend that anti-poverty measures have to be decided locally, as poverty manifestation and alleviation varies from one community to each other. Indeed, rural and urban poverty may be characterised by different indicators, and even between two rural regions we can find substantial differences. This local knowledge is supposed to lead to more efficiency in redistributive policies. Some econometric works, like Alderman [1998], have tried to measure this effect. However, there is a huge problem in trying to measure these gains in targeting. If local officials have some knowledge about the recipients that is not in the income surveys and administrative registers used by the central state, then the researcher can not use this information to measure poverty alleviation, or efficiency of transfers. Nevertheless, it seems that there is strong evidence in favour of this thesis.

This argument applies better to old-age social assistance that to insurance. However, even in social assistance benefits for the elderly, the classical problems that local knowledge solves (like principal-agent or moral hazard) are not present, as old-age poor people are not suppose to *go back* to the labour market.

A considerable part of economic literature concerning decentralization focuses on the problem of fiscal discipline. If the decisions of raising public funds and expenditure programs are separated, there is a clear incentive for local politicians to be too generous in their social programs. This happens because in such a case, the benefits are local, while the financing is federal. Developing a proper analysis about *fiscal co-responsibility*[14] is beyond the scope of this paper. Nevertheless, it is important to point out, that any proposal of decentralization of an expenditure policy (like pensions) should be done looking carefully into this principle.

f) Decentralization under perfect capitalisation

As is well-known, perfect capitalization does not exist in any country in the EU (neither in North America)[15]. Nevertheless, it is interesting to comment on this possibility, due the fact that in many European countries there is an increasing degree of partial capitalization, in order to protect the system against the ageing of the population.

In principle, a perfectly capitalized system, where some entities (public or private[16]) invest the contributions in capital markets could be easily administratively decentralized. The size of the entities could be regional, national or supranational. However, there is strong evidence in private markets that investment funds of a certain size work better. This is due not only to reduction of administrative costs, but also to be more protected against fluctuations in the capital markets[17], and liquidity constraints.

Regarding regulation, it seems obvious that there is a need for a centralized (and supranational if possible) regulation for the functioning of financial funds. An example of this is the success of the Basilea I convention. This international agreement, - originally signed by the countries belonging to the G10 – was adopted rapidly by other countries. Regulation regarding the compulsory minimum amount of the contributions, or fiscal deductions will face fewer problems in being

[14] Fiscal *co-responsibility* is a term used in Spanish economic literature to refer to the right distribution of tax power and monitoring rules to ensure the right incentives in decentralized policies of public expenditure

[15] The main attempts to finance the whole pension system using capitalization have been done in Latin America, being Chile the paradigmatic case.

[16] Those ho defend perfect capitalization also advocate for privatization. In fact, it seems that there are not enough economic arguments to justify that the Public Sector should administer the investment of the funds [Zubiri 2004].

[17] In principle, a bigger fund might have better chances to diversify the asset risk.

regional. However, it is important to take into account the potential distortion in the allocation of enterprises and individuals due to differentials on the rules.

In conclusion, the major advantages of decentralization (freedom of choice, tailoring policy to local preferences and political participation) do not seem to play an important role in a pure capitalized pension system. In fact, if society wants a greater flexibility in individual choice of funds, then it makes more sense privatization (or the creation of several public funds) than decentralization.

II. Decentralization of the old-age cash benefits in different countries.

This section will describe briefly the functioning and the degree of decentralization of old-age pensions in several countries. Our purpose is to extract some lessons from the international experience, in order to apply them to the Spanish reality. For a more detailed description of the degree of decentralization of social security in different countries it is particularly important to mention the various works of Dr. Stefen Vaanstenkiste.

Canada

Canada is one of the most highly decentralized federations in the world. The British North American Act of 1867[18] granted a high level of self government to the provinces that that would allow them to maintain their identities, cultures and special institutions, while the federal government maintains competence in defence, currency, commerce, banks, criminal law and other matters that surpass the private sphere. This particular form of organization considers the expanse of the territory, as a possibility of integration of the French speaking and catholic population that resides in Quebec (Poirier,1999:29).

In 1867, when the Canadian constitution was written, the concept of Social Security did not yet exist as such; while the scarce social protection was looked at as a minor matter, it was considered to be of a "private or local" issue and assigned as the exclusive competence of the provinces. (Vansteeskiste, 2002:3). However, there were exceptions to this rule, such as assistance to war veterans, refugees and immigrants that was commanded at the federal level.

The first Canadian pension programs consisted of provincial aids to people of 70 and above with a low level of income. In 1927, it was

[18] renamed 'The Constitution Act' in 1982

established that the central government would finance 50% of the cost of these programs. This program and its subsequent modification brought up a conflict of competences between the Federation and some provinces. This conflict was solved after some modifications of the Constitution, which established concurrent competences of the provinces and of the Federation with regard to old age pensions, but with the priority given to provincial norms in the case of a conflict. Based on this new competence, the federal government established that same year a new non-contributory program of old age pensions of a universal character. The provinces were limited to supplementing these federal benefits.

Further, in the early sixties the federal government decided to establish a new program of retirement pensions, this time of a contributory manner. Article 94A was modified to grant concurrent competence on the new program to the federal government. Quebec decided to stay out of this plan and established its own contributive pension program (Quebec Pension Plan). Equally, the government of Quebec attempted unseccusfully to create its own universal old age pension program. The attempt was unsuccessful due to the lack of agreement for financing the pensions. Therefore, the universal program in Quebec continues being federal.

The first pillar of Canada cash benefits to the elderly is the Old Age Security (OAS). This pension is a federal pension program of a quasi-universal nature. The right to receive complete benefits is reached after 40 years of residency in Canada. Until the year 1989 this pension program was of a universal nature. From that year (1989), income test was established as a requirement. If the house income exceeds a determined limit, the amount of pension is reduced. This limit is sufficiently high, thus only 5% of the elderly receive a reduced pension and only 2% do not receive any form of pension. The OAS is financed by the general taxes.

The Canada Pension Plan (CPP) is a contributory public program operating in all territories except for Quebec, which has its own Quebec Pension Plan (QPP). Both programs were created around the same time and there exists tight coordination between two of them that gives mobility between the two systems to the workers. Even though the government of Quebec has an absolute competency over all normative and administrative aspects of its program, both contributory insurance programs have been from the very beginning an object of a parallel regulation and a voluntary harmonization over the years. This includes many initiatives originally adopted by one plan and later passed on to the other.

Both programs are a classic example of Bismarckian social insurance. In 1997, partial capitalization of the funds was introduced. Some social contributions on salaries rose, that were kept separate from the rest of the general tax. In theory, one part is paid by the worker and another by the employer, but it is the employer who is legally responsible for the payment of the whole tax. The amount of pension is calculated taking into account all the employment history of the beneficiary. The pension's maximum ceiling is 25% of the total base. This percentage may appear small, but one must keep in mind that this quantity is added to the pensions OAS, private pensions, and sometimes collective plans organized by the employer.

With regard to the distribution of competences, the general social system is administered and regulated at the federal level. The administration is provided by the autonomous body: Income Security Programs. The collection of contributions is done by another federal body, the Canada Customs and Revenue Agency (CCAA). The theoretical primacy of provincial regulatory competence on contributory pensions is demonstrated by the following mechanism: the normative modification to the contributive CPP requires the approval of two thirds of the provinces which represent two thirds of the Canadian population.. Even Quebec is allowed to participate in this process, although it has adopted a position of non-intervention observer in the discussions about the general system.

There are some federal assistance programs that provide additional money to low-income seniors living in Canada. However, certain provinces have considered this quantity insufficient. Therefore, they have also developed supplementary social assistance programs to increase the minimum guaranteed standard of living of the elderly.

Summing up, Canada has a complex system of distributing competences for old age pensions. The theoretical superiority of provincial legislation in a matter of old age pensions is not reflected in practice. The federal government, through the use of its higher fiscal capacity and so called "spending power" had imposed and maintained the most important programs, both on contributory (CPP) and non-contributory level (OAS and GIS). The provinces have the possibility to leave these federal programs and to create their own contributory or non-contributive pension plans. However only Quebec has developed this possibility, and solely on the contributive level. Ironically, the only experience of this possibility (QPP) has resulted in a program of pensions that is very similar to the current federal program practised in the rest of the territory. When making comparisons with the Spanish case, it is very important to emphasize that CPP as well as QPP are both contributive programs of a supplementary character (maximum 25% of previous earnings). However in Spain, the contributive pensions are the fundamental pillar of the system. They replace almost the whole regulatory base and constitute the main source of income of the elderly.

Belgium

As is well known, decentralization in Belgium is of an extraordinarily complex nature. The federal structure is organized on two levels: the three communities (Dutch, French and German speakers) and three territories (Wallonia, Fländers and Brussels). The communities and regions overlap both in territory and in population. To solve this problem, on the one hand the Flemish Parliament assumed the competence of the Flanders territorial authorities and on the other the Wallonia region assumed the competence of the French speaking community. The Communities originated from the Flemish ambition to develop cultural autonomy and to protect its language, while the Regions were a later response to the desire of Walloons to develop economic autonomy, because of the threat of being converted into a minority group dominated by the Flemish majority (Peeters 2001: 58).

For the moment, and until the definite development of the list of federal competences, the Communities have constitutional competences on matters of education, professional training, health, and social services. The Regions have competences over housing and employment politics. The actual situation is not definite, as the Belgian devolutionary process is still developing.

In the Belgian system there exists two forms of old age income protection: Social Security (contributive retirement pension) and Social Assistance (Minimum Income Guaranteed for the Elderly). The system of Social Security is composed of several regimes for distinct professional groups, even though there is a clear tendency towards harmonization of benefits. The system also includes supplementary pension funds (occupational or individual) provided by the means of fiscal deductions. In 2000, 31% of the population was subscribed to one of these funds. The financing of Contributive Pensions is based on the pay-as-you-go system. The financial sources are social contributions (37, 94% of a base salary in 2002) and State transfers (from general taxes). The reform of 1997 had established that the part of Belgian Value Added Tax goes to Social Security. The Social Assistance program is financed entirely by the State (through general taxes).

The Belgium Constitution does not assign competence over Social Security to any particular governmental level. There are special laws of distribution of competences regarding Social Security. Those laws establish that this is exclusively a matter for the federal government. Belgian Social Security could be considered as a unitary system for the whole country. However, Belgian State Counsel had interpreted the term Social Security in its strict sense: the federal level only provides benefits directed towards professional groups, financed through social contributions (Bismarckian model); while Social Assistance benefits are those directed to the whole population and financed by general taxes.

Those federal laws concerning the sharing of competences (1981) confirm that the Communities have general competence over the policies of elderly, with the exception of "determination of conditions of access and financing of minimum income guarantee for elderly people".

The Belgian system mainly functions through public organizations created by the Government, with their proper jurisdictions and administrative autonomy, although subject to control by the competent Ministry. These autonomous organizations are controlled by a committee composed of an equal number of representatives from business organizations and syndicates, and headed by an independent president. The National Office of Social Security is in charge of the collection of contributions and their distribution. The National Pensions Office is in charge of paying the contributive benefits, while the National Office of Family Endowments is responsible for providing the minimum income assistance to the elderly. As suggested by the names of both organizations, they are both of a national character.

The applications are presented to the local administration of the city where the beneficiary resides. The City Halls then forward these applications to the appropriate political organs. The local administration also has some competence over social services.

In conclusion, Belgium has been going through a complex process of federalization. When it comes to old age pensions, it is not very different to the situation in Spain. Contributive Social Securities (in general) and Minimum Income for the elderly (when it comes to the financing and conditions of access) are under the exclusive federal competency. Economic law (pay and coverage) of both programs is realized through autonomous organizations of a federal character. The Communities have competences on assistant benefits. In particular, the laws of sharing competences grant them the possibility to create supplementary assistance benefits to the minimum federal income. None of the Communities has developed any supplementary benefit program of this character (Vansteenkiste 2002). The possibility of supplementing central benefits under the limit of using assistance techniques is very similar to the criteria used by Spanish Constitutional Court to validate the regional supplements.

Germany

A well known feature of German federalism is that the *Länder* are states with sovereign rights and responsibilities, which are not devolved from the Federation but granted by the Constitution.

The Fundamental Law divides authority between the federal government and the *Länder*. The general principle governing relations is Article 30: "The exercise of governmental powers and the discharge of governmental functions shall be incumbent on the *Länder* insofar as this Basic Law does not otherwise prescribe or permit." Thus, the federal government can exercise authority only in those areas specified in the Basic Law. The federal government is assigned a greater legislative role and the *Land* governments a greater administrative role. The federal and *Land* governments share concurrent legislative powers in several areas, including public welfare.

There are exist three main levels of cash benefits in Germany: Social Security, Social Compensation and Social Assistance. Social Security includes invalidity insurance, work accidents and pensions. Social Compensation was created after the World War I, with the objective of compensation and assistance for war victims. Later it was applied to other groups, such as victims of criminal violence. Finally, Social Assistance offers diverse monetary assistance to the groups whose earnings are below the established income level.

German Social Security is largely centralized [Vaanstenkiste 2002]. It is administrated by public organizations who respond directly to the Federation. The legislative competence over the Social Security is Federal. The Federation is also responsible for the financing of the most part of the Social Security.

Old Age pension payments are primarily funded out of contributions. Employers and employees each pay half of the current contribution rate (19.5 % of the employee's gross monthly pay as of 2003). German public pensions are roughly proportional to labour income averaged over the entire life course. The total entitlement is calculated as the average of all (compulsory and voluntary) contribution periods.

Regarding Social Assistance, the German case is peculiar, because there is not a specific pension for the elderly. Therefore, those elderly with low income can claim general social assistance benefits, which have special regulations. Social Assistance comes in various case-specific forms-assistance towards living expenses or assistance for special circumstances (such as disablement, illness or old age). The amount paid to a needy family is determined by the number of its members and their respective ages.

Social Assistance is decentralized to a large degree and it is mostly administrated by the local authorities or by the *Länders*. *Länders* are responsible for the regulation of the executive structure. *Länders* also have certain legislative powers. The most important legislation governing Social Assistance is established in the Federal Social Assistance Act. This Act sets the *minimum standard of necessity.* The *Länders* complement this regulation, determining the concrete amount necessary to reach this standard inside their territory. Germany's rural and municipal districts are social assistance authorities and, as such, are responsible for carrying out the Federal Social Assistance Act.

Summing up, the German system also coincides with the Spanish in having a completely centralized social insurance. However, the *Länders* play a much more important role in Social Assistance than the Spanish AR.

United Kingdom

The different territories inside the UK always had some sort of independence (for example, the judicial system is different in Scotland). However, up until very recently UK was a strongly centralized state. In the last years of XX century the process of "devolution" of competences to the nations began. This process was of an asymmetric nature, in a way that every territory had developed different institutions. Scotland reached the highest level of legislative competences. Northern Ireland also attained exclusive legislative competence, while the legislative assembly of Wales had minor legislative competences, in what has been named the secondary legislative responsibility. Equally, autonomous administrative structures have developed in every territory for the execution of policies in which they had competences, abandoning the central control of the Whitehall. The matters devolved to the distinct nationalities are education, health, social services, housing, planning and local government. This process of devolution is more complex regarding England, which did not develop any parliament independent from the United Kingdom. The only process of devolution in England is the establishment of Regional Development Agencies in areas within England such as North West or the West Midlands.

As is well-known, the process of decentralization in the UK is very recent and is not yet completed. Its autonomous nations have not yet reached the maturity and competency level of German Länders, Canadian Provinces, or even Spanish Autonomous Regions.

Old Age pensions in the United Kingdom continue being under the exclusive central level competency, as well as the regulation, finance and law. Britain's main pension programs, the British National Insurance and the National Assistance, were established by the Labour Government after the World War II following the recommendations of Beveridge Report. This government's vision was the creation of a centralized national welfare system that guaranteed access by all the citizens of the United Kingdom to certain preferable goods and to a system of monetary transfers on the condition of equality.

The system of Old Age pensions in the UK has several contributive and assistance levels. The peculiarity of the UK system in comparison with the Spanish system (and the majority of European systems) is the possibility of *opting out* from the public system of complementary pensions and a choice of using private plans, both individual or on the company level.

The contributory pillar in the UK is composed of two benefits. The first one is the Basic State Pension, which covers a modest part of the income. The amount covered depends on the number of years contributed and on the existence of dependants, but not on the income base. The second one is the Additional State Pension. Its function is to grant complementary pensions that would permit safeguarding of spending power previous to retirement. The amount depends on the years of contribution as well as on the amount contributed. Companies account for the possibility of abandoning the public system to organize its own contributive program. Equally, workers can choose private plans of capitalization.

The Social Assistance pillar is also composed of several programs. The Minimum Income Guaranteed is a benefit that guarantees a minimum level of income to households composed of individuals 60 years of age and older, subject to an income test. This program may include some extra amount for special needs.

The Non-Contributive old age pensions is a program destined to protect elderly of 80 years old and above. To have access to this program it is necessary to reside in the UK at the time of claim, and at least for 10 years after your 60th birthday, as well as not being eligible for the basic pension (or be receiving less than 60% of the total basic pension amount).

Summing up, the United Kingdom is a completely centralized country when it comes to Old Age pensions. The recent devolution process has affected other social programs such as education, housing and social services. The debate in the UK has tended more towards their privatization than their decentralization.

United States

There are two main interpretations of federalism in the US. The first, dual federalism, holds that the federal government and the state governments are co-equals, each sovereign. In this theory, parts of the Constitution are interpreted very narrowly, such as the 10th Amendment, the Supremacy Clause, the Necessary and Proper Clause, and the Commerce Clause. The federal government has jurisdiction only if the Constitution clearly grants it. In this case, there is a very large group of powers belonging to the states and the federal government is limited only to those powers explicitly listed in the Constitution.

The second, cooperative federalism**,** asserts that the national government is supreme over the states, and the 10th Amendment, the Supremacy Clause, the Necessary and Proper Clause, and the Commerce Clause have entirely different meanings. For the most part, the United States' branches of government operate under the presumption of a cooperative federalism. The shift from dual to cooperative was slow steady.

The Old Age Survivors and Disability Insurance (OASDI), known by most Americans as Social Security is the largest income-maintenance program in the United States (about 96% of the jobs are covered). Entitlement to benefits and the benefit level are related to earnings in covered work. To qualify for Social Security a person must be insured for benefits. The OASDI benefit amount is based on covered earnings averaged over a period of time equal to the number of years the worker reasonably could have been expected to work in covered employment.

Workers finance the program through a payroll tax. The revenues are deposited in two trust funds (the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund), which pay benefits and the operating expenses of the program. The Board of Trustees is responsible for managing the OASDI Trust Funds and for reporting annually to Congress on the financial and actuarial status of the trust funds. The Commission of Social Security is responsible for administering the OASDI program.

The main Social Assistance Program for the old age is also federal, the Federal Supplemental Security Income (SSI), which – despite the non contributory character- is administered by the Social Security

Administration (SSA). The Federal program guarantees uniformity in requirements to access the benefit, and a minimum lelvel of income to the elderly throughout the nation. Federal SSI payments and administartive costs are financed from Federal Governemnt general revenues. The States have the possibility to supplement the SSI inside their territory. In the year 2002, 41 states had their own supplementary program for old age. A state may administer its supplemental payments or choose to have them administered by the Federal Government.

III. Organisation of the Spanish system of old-age pensions

The Spanish transfer of income to the elderly is built on two pillars: the *contributory* and the *non-contributory* pensions. The contributory retirement pension scheme is based in the Bismarckian principle of Social Insurance. It was originally established at the beginning of the XX century. Under Franco's rule it was developed as a corporate system, trying to promote cohesion of the State and social peace. Therefore, it was organized as a social insurance divided between numerous regimes for different professions. Nevertheless, it was not until the coming of Democracy when we can talk about the existence of any form of Welfare State in Spain. In fact, in the early seventies, still one third of the individuals over 65 years old had no right to a pension. The amount of the benefits was small (average pension was less than 60% minimum wage), and there wer many differences in rights depending on the professional regime.

The development of the Welfare State in Spain led to an important increase of the expenses on retirement pensions. This growth was determined by the increment of the number of pensions (in 2001 there was twice the number of pensioners than in 1980), the increase of the amount of the benefits, and the generalisation of the assistance principle. In fact, the Spanish contributory pensions are not purely social insurance. There is an important redistributive element: the minimum pension. This figure guarantees that old people with few contributions still reach a certain level of income. In 2002 more than 31% of the contributory retirement pensioners perceive this complement. The development of the retirement pensions in the eighties and nineties come together with a rationalization process. This process consisted in a reduction of the number of special regimes, as well as a harmonisation of the different regulations. Currently, there are only six regimes: general, self-employed, agriculture, sailors, miners and household employees. Every regime has a different regulation about contribution and benefits.

However, there is no separate financing structure. Indeed, the general regime *superavit* is used to finance the deficit of the special regimes.

The second pillar of the system is the *non-contributory pensions.* Those benefits were established in 1990, by the Social-Democrat government. The aim was to fulfil the goal proclaimed in the Constitution of *"sufficient pensions for all citizens (art. 49 CE)".* This law eliminated the old social beneficence for the elderly. These new benefits were considered a *subjective right*. Therefore it was possible to claim them on court, if the individual fulfil the entitlement requirements: age, residence and income test of the household. The relative importance of those benefits is still small. In contrast to the almost four million contributory retirement pensions, the assistance benefits for the elderly are less than a quarter million.

III.1 The partition of competencies of old-age pensions in Spain

Table 1: Competence partition in Spanish old-age pensions.

Pillar	Beneficiaries	Regulation	Administration	Financing
Contributory	**Workers** that have fulfilled contributory requirements.	**Central** (basic legislation and economic regime) **Autonomous Regions** (non basic legislation)	**Central** (recognition of rights and administration: INSS; economic regime: TGSS).	**Central** (through contributions for the insurance elements, and general tax for the minimum guaranteed pension).
Non-Contributory	**Citizens** that do not reach a certain income level.	**Central** (basic legislation and economic regime) **Autonomous Regions** (non basic legislation)	**Autonomous Regions** (through the entities that have assumed the old IMSERSO competence).	**Central** (general tax finance the non-contributory pensions). The **Autonomous Regions** finance exclusively their own complements.

Source: own work based on legislation.

The Spanish old-age pension system is quite centralized. The Constitution of 1978 stipulates the basic rule of partition of competence. Art 149.1.17ª establishes that the Central State has exclusive competence on *"the basic legislation and the economic regime of Social*

Security, without precluding the administration of these services by the Autonomous Regions". Art 148.1.20ª states that the Autonomous Regions (AR) can assume competence of *social assistance.* In addition, the Constitution recognises three fundamental principles on decentralization: *autonomy*, *solidarity* between regions, and *equality* of rights and duties of all citizens in the whole Spanish territory.

The interpretation of those articles has been the subject of debate. In fact, the Constitutional Court had the occasion to pronounce several times on this matter. The main issue is to understand what *"basic legislation"* of Social Security means. The Court has been quite generous in its interpretation, using a normative criterion. *Basic legislation* covers all Social Security regulation that ought to be common and uniform through the State (STC 102/1995). The argument is almost tautological: the Central State has competence on the *basic legislation,* and *basic legislation* is what ought to be competence of the Central State. Fortunately, the Court has pronounced on practical matters on various occasions, delimiting what concrete functions are covered in this concept: a) population covered (requirement of access to benefits) b) protection (amount and duration of benefits) c) legal regime d) economic regime (rules about contribution) e) administrative punishment.

Summing up, the concept of *basic legislation* is very wide. Therefore, the Central State has an almost absolure regulatory power concerning Social Security, whereas the AR plays a secondary role.

The second issue is the interpretation of the concept of *economic regime.* Again, the Court gave a wide interpretation in STC 27/1983. It understands that the Constitution is aimed to guarantee the existence of a unitary regime for all Spanish citizens. Therefore, the contribution funds are completely central, until the point that the AR can not even give instrumental orders of payment (as Catalonia intended).

The third issue is the possibility of the administration of the Social Security pensions by the AR. Only five AR statutes have assumed this potential for contributory pensions. Nevertheless, the Court has interpreted this power narrowly. Indeed, it has established that the administration can only cover aspects that do not compromise the unity of the system (STC 24/1989).

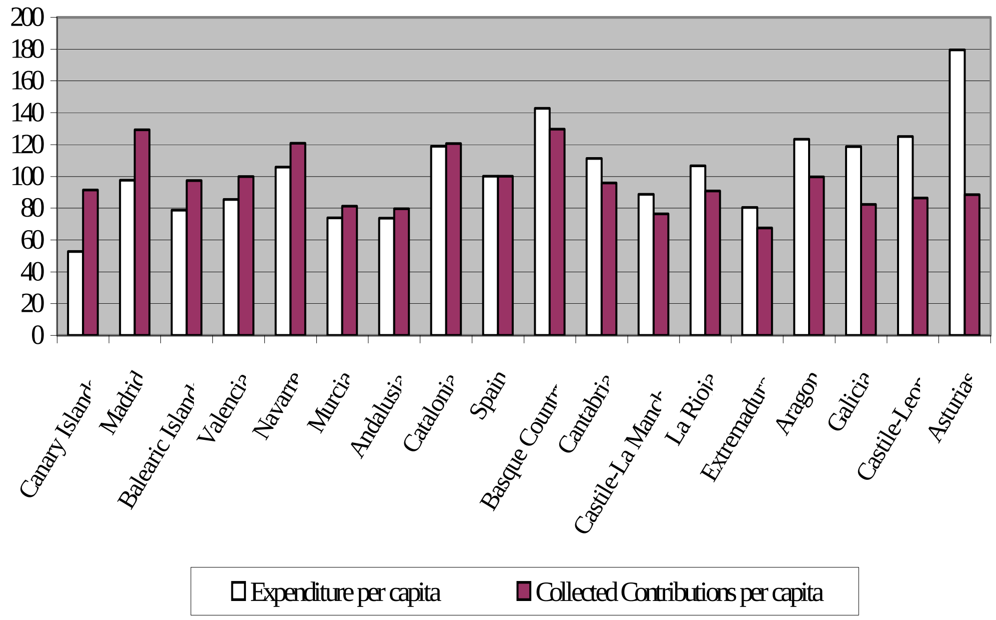
The fourth and more problematic issue was the interpretation of the concept of Social Assistance. When the Constitution was enforced, there was no complete system of assistance benefits covering the population. In fact, those benefits were considered part of the public *charity.* However, in 1990 the Central State established a level of *non-contributory income protection* for the elderly. The election of this name for the new benefits (refusing to call them *assistance)* was to avoid falling within the competence of the AR. Nevertheless, the AR developed their own system of assistance monetary benefits: *the insertion benefits*, aimed to fight social exclusion. Those benefits were developed first by the Basque Country in February of 1989 (Statue 39/89), which initiated a *domino effect*. After a few years every AR developed its own system, completely regulated and financed by each AR.

The main attempt of the AR to play a role regarding *old-age* pensions was the development of a *supplementary benefit* for the old people who already receive the central non-contributory benefit. Andalusia developed the first complement at the end of 1998. Andalusia's social-democrat government decided to protect the elderly with low-income against the inflation, after the conservative central government decided to freeze the amount of those benefits. Some other AR like Catalonia, Basque Country and Navarre followed this example and also supplemented some central non-contributory benefits. The State government answered back starting a process on the Constitutional Court. However, this time the Court decided on favour of the AR, recognising that those benefits are constitutional due to their assistance character (that falls into the scope of art. 148).

III.2 The territorial effect of the old-age pensions in Spain

The first question we can ask is the following: is the incidence of the old-age pensions homogeneous in the Spanish territory? One attempt to answer this question is to look at the level of expenditure and contributions per AR. The table shows that there is a wide range of variation. As we have just explained, the Spanish contributory pensions are completely centralized. Therefore, the regulation is homogenous throughout the whole country. The financing of the benefits is provided in accordance with the principle of a *unique fund.* Nevertheless, there are substantial territorial differences on the incidence of the contributory system. The graph bellow shows an index of expenditure and contributions in social insurance old-age pensions. The range in expenditure per capita varies from almost half of the national amount (52,84) in the Canary Islands to almost 80% more in Asturias (179,54). This diversity can be decomposed in two factors: number of beneficiaries and average pension.

Graph 1: Comparison index on Expenditure and Collected Contributions (estimation*) in Old Age Pensions per capita (Spain = 100). Years 2001-2002

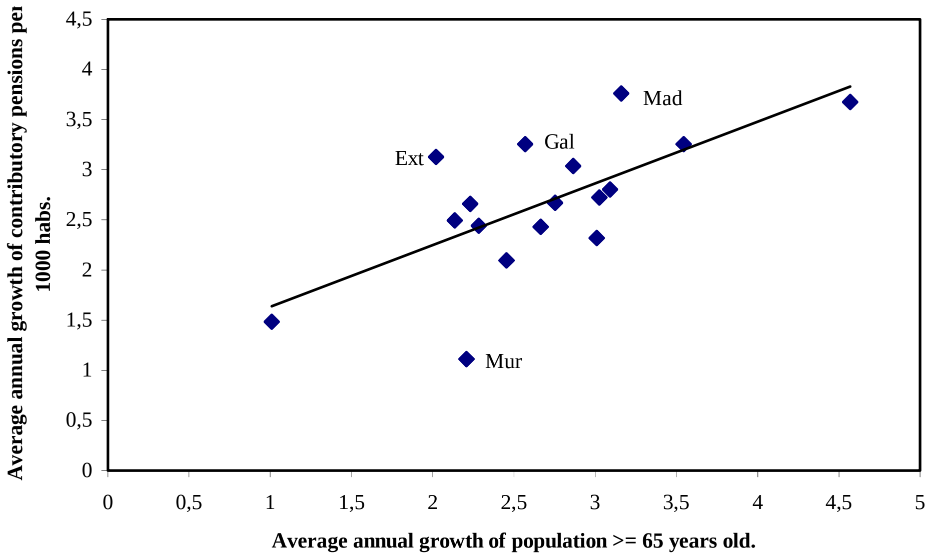


Source: Own calculations using INEbase database. www.ine.es *The amount of collected contributions per person was estimated using data from National Institute of Statistics (INE) about number of affiliated workers, average contribution per AR and regime, and territorial distribution of special regimes. It takes into account all general compulsory contributions (excluded unemployment).

The number of pensioners depends mainly on demographic factors. In fact, the process of ageing of the population has not been homogeneous all over Spain. Some AR like Castile-Leon, Aragon, Galicia or Asturias already experienced the ageing process in the late eighties. These regions suffered an exodus of young people looking for job opportunities in richer areas like Madrid or Catalonia. Other AR, like the Canary Islands, have a much younger population, which leads to a smaller number of pensioners.

To check this effect in the last 15 years, we have plotted the average annual growth of all contributory pensions, with the ageing of the population, finding a direct relation between both variables, as expected.

Graph 2 : Changes in the relative growth of pensions and ageing of the population (1984-2000)



Source: Ruiz-Huerta, Ayala & Diaz Pulido [2002]. Own calculations based on data of the MTAS.

The second explicative factor about the variation of the aggregate expenditure in old-age benefits is the difference in the average pension by AR. The table bellow shows that there is also an important variation of this magnitude per region. The range goes from 83,5% of the national average of Galicia, to more than 120% in the Basque Country and Asturias.

Table 2: Relative average pension per AR (Spain =100%)

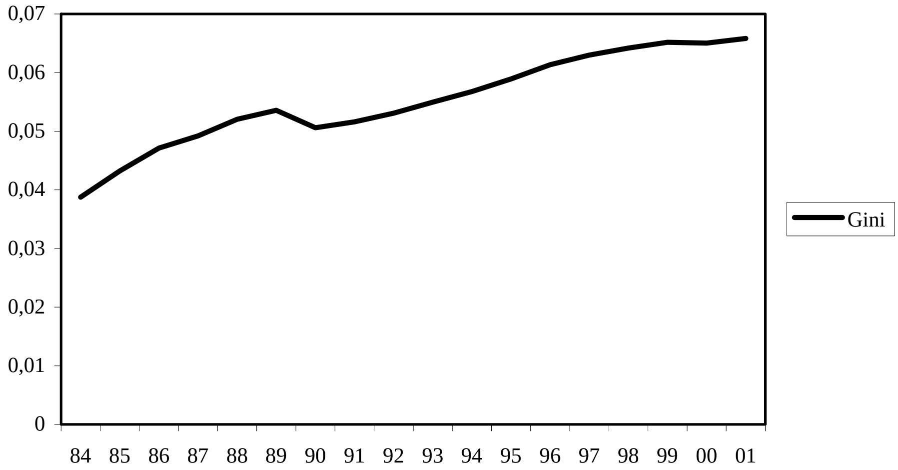
	1986	1991	1996	2001
Andalusia	94,5	94,8	93,7	92,8
Aragon	101,6	102,1	102,0	102,3
Asturias	120,3	121,3	121,5	121,8
Balearic Islands	93,6	91,3	90,3	90,5
Canary Islands	97,1	97,1	95,8	94,2
Cantabria	103,5	102,9	102,4	103,4
Castile-La Manche	95,8	95,8	93,0	91,9
Castile-Leon	97,7	98,5	96,9	96,6

Catalonia	101,9	101,0	102,2	102,8
C.Valencia	92,0	91,9	91,7	91,7
Extremadura	91,0	91,7	87,9	85,8
Galicia	90,0	87,3	84,5	83,5
Madrid	114,8	115,2	117,7	118,7
Murcia	93,9	91,9	90,2	89,2
Navarre	105,8	107,5	107,1	109,4
Basque Country	117,4	120,4	124,2	126,3
La Rioja	95,2	96,0	95,8	96,1
Spain	100,0	100,0	100,0	100,0

Source: Ruiz-Huerta, Ayala Cañón & Diaz Pulido [2002]. Own calculations based on data of the MTAS.

This spread has increased during the last twenty years of expansion of the system. To prove this fact, we have calculated a Gini index of dispersion of the average pension per regions in the period. The following graph shows that the difference has increased in the whole period. However, it is possible to appreciate a reduction of the slope in the last five years.

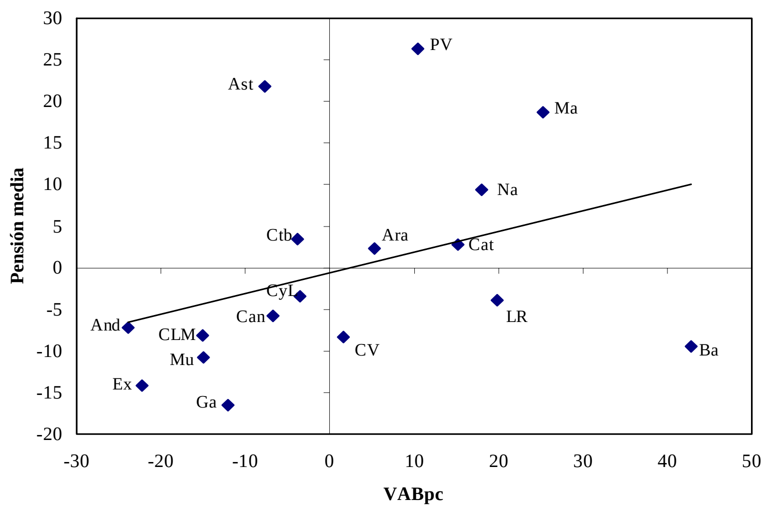
Graph 3: Evolution of the dispersion of the average pension per Region (Gini Index) by year.



Source: Ruiz-Huerta, Ayala Cañón & Diaz Pulido [2002]. Own calculations based on data of the MTAS.

What explains these important differences if the rules are the same for all regions? The answer has two parts. The first explanation comes from the degree of economic development in each AR. This factor (especially the average wage) has an important role in the calculation formula of the pensions. The graph below shows that there exists a correspondence between the Gross Added Value per capita and the average pension. To illustrate this fact we divide the graph in four quadrants, plotting the axes in the average national values. The intuition is that the south-west quadrant should contain the poorest regions, which also have low average pension. Whereas the north-east quadrant should contain the richest AR. However, 5 regions are located in different quadrants. In the north-west we find Asturias and Cantabria, two regions relatively poor, but with high average pension. Whereas, Valencia, La Rioja and Balearic Islands are relatively reach but have a low average pension. In all of these cases there are specific reasons different than the average wage that explain this fact. One of the main explanations of Asturias and Cantabria case is that both have a great percentage of retired miners, with relative generous regulations compared to the general regime.

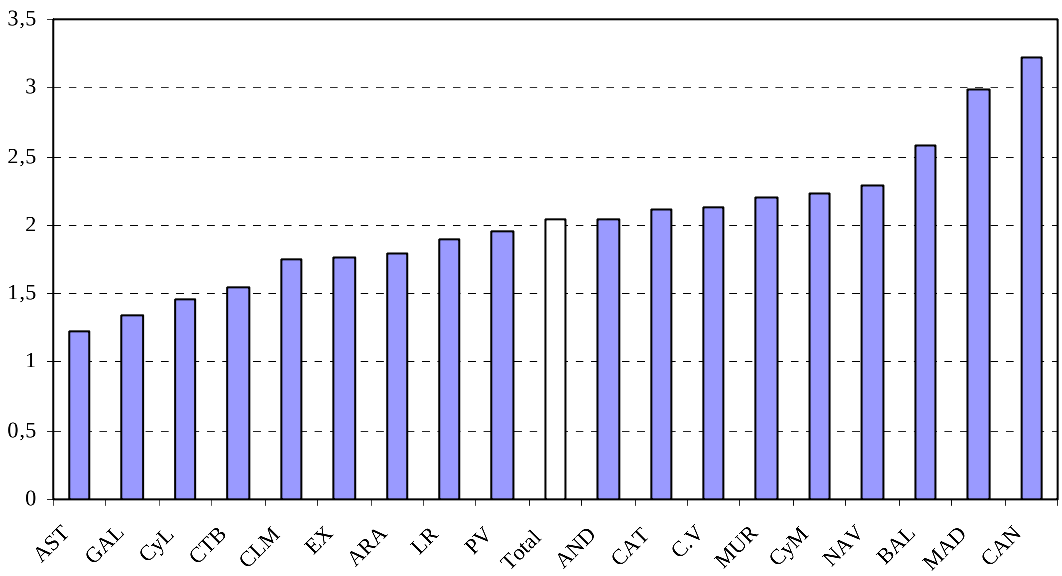
Graph 4: Average pension and Gross Added Value per capita by AR



Source: Ruiz-Huerta, Ayala Cañón & Diaz Pulido [2002]. Own calculations based on data of the MTAS.

Finally, we should look at the relation between beneficiaries and contributors of the Social Insurance. Again, this index shows an important spread between regions. The range goes from 1,2 workers per pension in Asturias to around 3 in Madrid and Canary Islands. This ratio is very important to ensure the future viability of a pay-as-you-go pension system. Therefore, the superavit of contributions in some AR is currently financing the deficit in others. It is not possible to get official data of these *implicit regional transfers*, as long as the administration of the contribution is central, and the Social Security Treasury does not publish these values per region. The ratio workers/beneficiaries is a good proxy, taking into account that the richer regions pay higher average contributions and receive higher average pensions than the poorer ones. Some authors like Calonge and Manresa [2000] have estimated the amount of these inter-regional transfers for the whole Spanish tax benefit system, concluding that the Social Security contributions and payments are a very important source of inter-regional compensation transfers.

Graph 5: Dependence ratio per Region (2001)



Source: Ruiz-Huerta, Ayala Cañón & Diaz Pulido [2002]. Own calculations based on data of the MTAS.

The conclusion of this brief quantitative analysis is the following. Despite the common regulation and economic administration of the system, the evolution of the economic and demographic factors in the last twenty years in Spain has favoured a spread both in the number of beneficiaries and in the average pension.

This fact, along with the diverse *inverse dependence ratio* (workers/pensioners) shows how even a unified system can not escape different economic evolution. Therefore, any attempt of decentralizing the social insurance retirement pensions should take account this regional diversity of economic development and demographic variables, in order to preserve the sustainability of the Social Insurance and economic cohesion.

IV. Conclusion

IV.1 International comparison

The degree of decentralization of old-age monetary benefits in the international context shows some patterns of regularity. In all countries we studied the Social Insurance pensions are heavily centralized. In fact, basic regulation and financing are completely federal in all analysed countries. The only exception to this rule is the Quebec Pension Plan (QPP) in Canada. However, it is important to clarify some points about the QPP. Firstly, it is a complementary pension, which covers only a part of the income. In contrast, contributory pensions in Spain, Germany, Belgium and USA are the main source of income of the elderly. Secondly, despite its *provincial* character regulation and administration of both programs (CPP and QPP) are indeed very similar, with homogeneous rules and a high degree of coordination.

In most studied countries the role of regional governments is more important when it comes to the Social Assistance programs. The only exception is the UK, whose *devolutionary* process is still very recent. All countries we have analysed have some federally-determined minimum assistance benefits homogeneous for all the territory. The US Supplemental Security Income, the Canadian Old Age Security and the Belgian Minimum Income Guaranteed for the Elderly are regulated, financed and administered[19] at the federal level. Spain used to belong to this group, until the decentralization of the National Institute for

[19] Or at least, the more important tasks of administration, like paying the benefits. Generally the administration is performed by autonomous bodies: the Social Security in the US, the Income Security Programs in Canada, and the National Office for Family Benefits in Canada. Some small tasks of administration, like admission of applications are performed at local government offices –e.g. in the Belgian case-.

Migration and Social Services. Presently, regulation and financing of assistance benefits for the elderly[20] are centralized, but administration has been transferred to the Autonomous Regions (AR). The German system is different. There, the federal state establishes the basic regulation, but the *Länder* plays an important role in regulation, financing and administration of the benefits.

In addition to this Minimum Income Guaranteed to all citizens at the Federal level, we find many examples of regional supplemental assistance programs. In Canada and the US most regions have developed these supplements. However, in Spain the AR with their own supplementary programs are still a minority. To explain this fact, it is important to notice that the first supplement adopted by Andalusia was very recent, and it was followed by litigation in the Constitutional Court started by the central government. The Court found in favour of the Regions only one year ago.

IV.2 Decentralization of Social Insurance

Despite these similarities in the international situation, in Spain there are many proposals for decentralizing old-age pensions[21]. From another point of view, it is argued that a better alternative to the current situation would be *more centralization*, giving some competences to the European Union level. In order to analyse both proposals it is necessary to take into account the nature of the pension system.

According to the classical Fiscal Federalism theory, social contributions are benefit levies (individuals perceive that these taxes are the paid as a *price* for a concrete service). Therefore, decentralization will be possible. Then, why are social insurance pay-as-you-go systems centralized almost everywhere?

Firstly, contributions do not fit perfectly under rules of insurance, but they include a redistributive element in most countries. This element makes individuals with high income perceive a smaller return rate than individuals with low income. Therefore, under classical theory (with rational individuals, perfect information and low mobility costs) there is the fear that regions with a high degree of redistribution would become *welfare magnets*. Regarding the enterprises, the risk of mobility is even greater. For a company, social contributions are viewed as a tax on the use of labour. Therefore, everything else being equal, employers would prefer to move to regions with low contributions and low pensions. It is important to note that the last argument does not work under the

[20] Called non-contributory pensions in Spain.
[21] For example, the Basque government recently claimed the administration of the contributory system.

assumption of perfect competence in the labour market (then, workers in low pensions regions would only accepts contracts that pay them an extra wage to compensate the reduction of future income).

There are many other arguments that justify the centralization of the Pay-As –You-Go. One of them is the existence of Social Risks. A risk is considered social when it simultaneously affects most members of a community. Small regions can not efficiently react to these social risks. Imagine, for example, that the small Spanish AR of Asturias would have to finance on its own the extra-cost of early retirements and the migration of actives due to the industrial conversion of the eighties. The smaller the risk-sharing community is the bigger the probability of social risks. As we have shown in the preceding section, in Spain (as well as in all other countries), there are regional differences in the economic development and the ageing of the population. If the local governments had to organize their own Pay-As-You-Go system, some of them (like Asturias, Galicia or Castile-Leon) would have many problems of sustainability. In fact, decentralization means penalising the regions that are net exporters of labour force.

It is relevant to mention that decentralization of contributory pension systems would raise the administrative costs. It would be necessary to organize a system of coordination for migrant workers. Different regulations would also bring an extra cost for the companies with offices in many regions.

The subject of decentralization of Pay-As-You-Go pension systems raises many equity issues. Pension systems are a very important source of regional redistribution of income. Decentralizing them will lead to fewer regional transfers. The economic cohesion of different regions is a wide-accepted principle in the European Union and inside the national states. Therefore, if the pensions are decentralized, it should be necessary to create some other regional transfers.

However, there are some arguments in favour of decentralization. In the current context of *searching for solutions against the ageing of the population*, learning by doing and trying new policy can be very useful. This is the sense of the Fiscal Laboratory argument. In fact, there is evidence supporting this argument in Canada, where some successful modifications in the national plan were rapidly adopted by the Quebec plan, and vice versa. Another argument is allowing the different regional preferences to conform different policies. However, do the preferences regarding pensions differ much inside a national state? If so, are there efficient mechanisms to make explicit this diversity? And are the benefits of this diversification superior to the losses in efficiency? Definitely, if we are talking inside a national state (e.g. Spain), it seems that the answer to these three questions is negative. Nevertheless, if we think about the European Union context, it seems that there are enough differences in social preferences to justify the existence of different pension programs.

IV.3 Decentralization of Social Assistance

From a classical Fiscal Federalism point of view, assistance pensions –being purely redistributive- should never be decentralized. Nevertheless, again we find contradictory evidence in all the countries of our study. Fortunately, additions to the classical theory can help us to explain this fact. Firstly, in all the analyzed countries, there is a minimum guaranteed throughout the federation for old-age assistance. Therefore, the possibility of a *race to the bottom* is restricted to a *race to the federal minimum.* However, we do not observe this race happening in any of the described countries, which is coherent with the econometric evidence we have referred to in previous sections. The main argument seems that the *homo economics* seems to acquire some utility in living in a society which takes care of its old. In other words, old-age benefits are one of the most popular assistance benefits. Therefore, cutting them is politically risky (especially in a context of ageing of the population). Even in more liberal economies like US or UK, no one expects the low-income elderly go back to the labor market. Therefore, the main justifications for cutting assistance transfers (dependence of the benefits and disincentive of labor offer) are not applied to this benefit.

Local knowledge is a principle that applies more to Social Assistance than to Social Insurance. In fact, definitions, indicators and remedies for poverty can vary from one region to another. Therefore, there is a potential benefit in decentralizing a part of the social assistance. Indeed, the declared purpose of many regional supplements to low-income elderly was presented in terms of compensating for higher living costs in the region. Other argument that can explain the certain degree of decentralization in welfare policies is the control of the public expenditure, in line with Buchanan and Brennan Theory. However, this argument seems not to have been used in Spain (and not much used in Europe). Increase of political participation and regional differences in social preferences are the main arguments used in Spain to justify decentralization of Social Assistance. However, we have to counterweight this potential benefits with the losses in efficiency and territorial equity.

IV.4 Final considerations

As we have seen, economic theory can not provide a clear normative criterion about the right degree of decentralization on pensions. On theoretical grounds, models regarding decentralization take into account possitive and negative effects on economic efficiency and equity. Moreover, decentralization of social insurance policies is a topic that has not been analysed deeply enough in Fiscal Federalism theory yet. The econometric evidence is not conclusive either. The attempt to measure the gains and losses in welfare presents many practical problems. The assumptions and the econometric models used are not neutral in the results of those papers. Further, decentralization involves many important non-economical considerations, like sovereignity, social cohesion, etc.

However, economic theory can be useful as an analytical tool to clarify the trade-offs involved in any decentralization process. In this paper we aimed to bring the salient issues of this perspective to the larger debate about decentralization of social security. The main advantages of decentralization are linked to the possibility of diversity in preferences, the better match between public decision and citizens's preferences, the *local knowledge* of smaller public authorities and the gains in efficiency and innovation due to public competence between regions. All these arguments seem to play a more important role in Social Assistance (SA) than in Social Insurance (SI). This fact justifies the current *status quo*, where SA benefits are subject to a higher degree of decentralization than SI pensions.

There are many risks associated with decentralization of social policies. Firstly, it is important to take into account the *sufficiency risk.* The question is whether regions or local states can raise enough taxes to guarantee an adequate level of public pensions. Moreover, the existence of social risks can damage the sufficiency principle. Therefore, any attempt of decentralization of pensions has to take into account this fact, in order to guarantee enough resources to mantain adequate old-age pensions (e.g. through inter-territorial transfers). Secondly, there are some *equity risks* in any decentralization process. The issue is to decide whether it is acceptable or not that people from different regions receive different pensions (even with similar contribution effort). Connected to this decision is the issue of *inter-territorial equity.* As we have seen, social security contributions and benefits are important sources of *implicit* territorial redistribution. This redistribution will be absent in a complete decentralized system. The third risk involved is the *public character.* It has been argued that decentralization (without guaranteing enough resources to regions or local states) can be a subtle way of introducing privatisation of pensions, due to fiscal competence between states. The fourth set is the *coordination and monitoring risks.* In a fully decentralized system it is more difficult to control the fulfilment of the objectives and the efficiency of the policies. The final risk regards to social cohesion. As Danny Pieters amongst others has pointed out, Social Security is one of the most important elements in the creation of national identity and social cohesion. Apart from the above mentioned risks, it is important to note the losses in efficiency derived from decentralization of pensions, such as loss of economies of scale, increased administrative costs and distortion of incentives for the geographical allocation of resources.

Therefore, from an economic point of view, a complete decentralization of old-age pensions to regional level seems very difficult. The losses in efficiency, equity and sustainability of the systems might probably exceed the benefits. The current situation in all analysed countries seems rational. Indeed, the harmonization of rules inside the European Union could follow this path of guaranteeing a minimum protection and certain homogeneity of the rules, while letting the national States (or regions) supplement the benefits. In conclusion, decentralization of old-age pensions raises a lot of theoretical and empirical challenges which are not solved yet. Therefore, any proposals have to be analysed carefully, in order to avoid unexpected effects on equity and efficiency.

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