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Comment on Wolfram F. Richter: Social security and taxation of labour subject to subsidiarity and freedom of movement

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When labor becomes mobile across borders, it is necessary to have rules to assign citizens and jurisdictions to each other. Richter's paper analyzes this important question in the European perspective. He argues that the combination of the current assignment rule relying on employment and free mobility guaranteed by the Treaty of Maastricht does not work well, and suggests an alternative solution. In the Principle of Delayed Integration, migrants would only be reassigned from their previous country to the new country after a transition period as concerns social security and income redistribution. During the transition period, they would be subject to the rules of their previous country of residence. Richter's paper is an important contribution to a highly relevant policy debate, and offers a good starting point for further research on combining the subsidiarity principle in redistribution with an equal treatment of all citizens.

The modification suggested by the paper is a compromise between the current Principle of Employment and the Origin Principle. The Principle of Employment is problematic as it cannot be directly applied to the non-working population and therefore discriminates between citizens of the European Union. Furthermore, it distorts migration decisions, and can be expected to do so even more after the Eastern enlargement. In the Origin Principle suggested by Sinn (1994), the young citizens would have to choose their redistribution system at a young age without the possibility to escape it later. While this would result in efficient migration decisions and be applicable to non-workers, it would also make citizens more vulnerable to possible abuse by the government, as well as imply permanent discrimination between citizens of different origins. The Residence Principle applied in Nordic countries and giving access to social security benefits to all

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legal migrants could, on the other hand, lead to a race to the bottom. Therefore, it is unlikely that it could or should as such be adopted by all EU countries.

The solution Richter suggests is flexible, as it allows for different delays in different policy areas. The more distortive taxes and subsidies are, the longer the delays should be. With benefit taxes, there is no need for delays in integration. There are, however, still important questions waiting to be solved. With a heterogeneous population, distinguishing taxes for redistribution from benefit taxes is not easy. For example, citizens with children should view taxes to finance school expenditures as benefit taxes, whereas they have a redistributive character for those without children. Healthy citizens are net payers to health care, those stricken by illness net beneficiaries. While public health care can be rightly considered as an insurance mechanism ex ante, it encompasses redistribution ex post. Should taxes collected to finance schools and hospitals be collected with delayed integration or with immediate assignment to the country of residence? Whichever solution is adopted, differences in the provision of such public goods are likely to affect migration decisions. These distortions, however, would be much smaller than those with the current system.

The Principle of Delayed Integration does not stop benefit-induced migration when citizens are not myopic, even though it is likely to reduce it considerably. The problem of the erosion of insurance is still present, although in a weaker form. This raises the question of whether a further compromise would be warranted. As Richter highlights, the differences in the standard of living between the current member states and the applicant countries are vast. Therefore, it might be wise to establish a transition period during which the new member states would be subject to the Nationality Principle. In the current member states, the Principle of Delayed Integration would be a viable alternative. The European Union could, perhaps, agree on a specific transition period or a rule that the Nationality Principle would be applied to migrants from the new member states only as long as the GDP per capita in the new member states is below a certain threshold in relation to the GDP in the current member states. Such a solution would also allow avoiding limitations for migration from the new member states. Such limitations, if applied, would also result in the elimination of migration based on productivity differences and would, therefore, sacrifice important efficiency gains.

Applying the Principle of Delayed Integration also raises some problems related to temporary migration. A fixed transition period would be likely to distort the length of work spans abroad. Citizens could extend their stay to exceed the transition period in countries offering a favorable package of taxation and benefits, and leave countries with less favorable alternatives just before being integrated into their system. Another issue warranting attention is the treatment of key workers. Some rules are needed to avoid a situation where some member states would become tax havens from which high-wage workers operate, benefiting from low taxation during repeated working spans abroad but returning to the tax haven before the transition period were completed.

It would be possible to combine the Principle of Delayed Integration with the individual accounts suggested by Fölster (1997). According to Sørensen (2001), a considerable part of the current transfers to the active population could be financed by using individual savings accounts with mandatory contributions. Even though a large part of the taxes is, on average, recycled back to the taxpayer as social transfers, the lack of a direct link creates tax wedges with adverse incentive effects. Sørensen argues that the part of transfers which aims at consumption smoothing over the individual's working life should be seen as part of the allocation and not the redistribution branch. Therefore, it should be financed by benefit taxation. Citizens would be required to contribute part of their income to their individual savings account. When they claimed benefits from a transfer program considered as part of those financed by individual accounts, the benefits would be debited from the account. At the retirement age, the remaining balance, if positive, would be converted into an annuity. Insurance against longer spells of unemployment or sickness could be provided by establishing a debt ceiling. Once the debt ceiling were reached, payments would be financed from general tax revenue instead of the individual account.

According to the Principle of Delayed Integration, the balance of individual savings accounts should be transferable between countries. During the transition period, benefits and payments would be made according to the rules of the country of origin. When the transition period expires, the remaining balance would be transferred to the new system. It might be worth considering harmonizing the debt ceilings between member states in order to avoid distorting migration by citizens with negative balances in their individual accounts to member states with lower debt ceilings.

To conclude, the Principle of Delayed Integration seems a promising candidate for a better assignment rule between citizens and jurisdictions with free migration. It allows member states to pursue different redistribution policies according to the subsidiarity principle, simultaneously providing a guarantee against discrimination based on nationality. There might be considerable additional welfare gains available if the reform were combined with the introduction of individual savings accounts to better separate consumption smoothing and redistribution.

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