Book Reviews

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This book pursues the very ambitious goal of putting together in a single and consistent theoretical framework three of the most fundamental events in contemporary economics: aging of population, migration and globalisation. The Authors fully succeed and offer a clear perspective for analyzing the implications of such trends on the size of welfare state schemes in industrialized countries. They use a political economy approach and present empirical findings that support the main predictions of their theoretical model.

The ageing of population increases the cost of most existing welfare programs and may alter the political support for the redistributions that such programs imply (from the rich to the poor and from the young to the old); low skill migration puts additional strain on welfare state while globalisation generates international tax competition that may erode the tax base for financing these programs.

Intuition may suggest that aging and low-skill migration jointly strengthen the pro-welfare-state coalition. The main merit of this book consists in showing that the opposite is likely to be true: it provides an integrated theoretical framework for analysing the overall effects of these joint trends and shows that (under standard but nevertheless strong hypothesis) demography and globalisation “team up” to downscale existing programs. The joint effect on the tax rate of an aging population or a higher share of low-skill migrants is a priori ambiguous: on the one hand we have a larger protax coalition (the retired and low-skill migrants are net beneficiaries of transfers); on the other hand, an aging population or a higher share of low-skill migrants increases the tax burden on the people around the median voter as it is necessary to finance transfers to a
larger share of the population. As some voter (for whom the costs of higher taxes outweighs benefits) moves to the antitax coalition, it is possible that an increase in the dependency ratio or in the share of low-skill migrants results in a decline in the equilibrium tax rate. The theoretical analysis also shows how the response of the equilibrium tax rate to a widening in the wage gap depends on the median voter being unskilled or skilled: in the former case the equilibrium tax rate rises, in the latter case it can fall. The empirical analysis uses data for the US and ten European countries over the period 1965–96 and supports the theoretical prediction of the model: the interaction of the return to education and the share of the highly educated in the population is positively correlated with the size of labor tax rate and social transfers; on the contrary, the dependency rate has a negative effect on the labor-tax rate and transfers. Low-education immigrants have a negative effect on the tax rate while the opposite occurs for high education immigrants.

Since under any life cycle model the elderly are the social component that most relies upon capital income, in general aging tilts the political-power balance against capital income taxation. The Authors show (chap. 5) that aging can determine a larger capital-financed welfare state. This finding too receives support from empirical evidence from European Union. Indeed this result catches an important recent feature of real economies: the risk sharing role of many welfare programs can justify the elderly support for schemes (e.g., Long Term Care (LTC)) whose financing lies disproportionately on their shoulders. For instance, in Japan people younger than forty is exempt from a special tax aimed at financing LTC; furthermore, several Italian regions have recently introduced a means testing referring to both income and wealth indicators in order to provide access to long term care services. Unfortunately for welfare state supporters however, this book shows that moving from labor income to capital income taxation hardly provides a route for social security programs survival (at least in their current size): globalisation and capital mobility generate tax competition that puts severe constraints on capital income tax revenues. Recent developments in the European Union, in particular the recent enlargement process, provide significant empirical evidence in support of this (chap. 8).

As usual, the merits of important books do not consist exclusively in the results that are put forwards but also in the capacity of generating curiosity and appetite for future development in the field. In my opinion, this is the case of this book.