

ERT VI

Stretching the Safety Net: Is the European Welfare State in Crisis?

Welcome to the Sixth ERT

On the face of it, it may seem that we have moved somewhat from the general to the specific. We have talked in the past about the EU, about the role of the past in European politics, about European-US relations – all fairly broad topics

Compared to that, speaking of “the welfare state” seems to be more specific, even specialized.

Not so, I would say. As I hope we can show you today, speaking of the welfare state means really speaking of the heart and soul of European politics.

Just take a look at what we have heard out of Europe over these last several months:

SLIDE 2

Just last summer, one of the more energetic governments in recent German history – that of Chancellor Schroeder – had to throw the towel after being soundly defeated in one state election after the other. Why? Essentially because of its efforts, for the first time in recent German history, to introduce some relatively modest changes in the welfare provisions for the German population.

Isabela Mares’ newest book just came out, on “Taxation, Wage Bargaining, and Unemployment”, and I am sure we will hear more about what she found out – but the book’s cover has a picture of those very demonstrations against the Schroeder government, effectively set against the background of the Brandenburg Gate. The thrust of the demonstrations was, indeed, against the Schroeder government’s reforms in unemployment compensation.

Or look at what we have been hearing for weeks now out of France about a seemingly continuous wave of protests against a law that is perceived (rightly or wrongly) as excluding an entire generation from one of the cherished protections of the welfare state, namely the protection from sudden and unsubstantiated layoffs (Marina, an expert on both French politics and licenciements – she wrote a thesis about it – may have to say a thing or two about this later on). In any event, as we speak, the French government is busy backpedaling and rewriting the law so as to contain the damage. Whether that episode in welfare state politics a la Française has meant the end of the political career of M. de Villepin remains to be seen.

And to just add a rather striking recent experience of my own, from my last visit to Berlin a couple of weeks ago, where I was invited to the presentation of a remarkable book, quite tellingly entitled: "The exploitation of our grandchildren". The book is written by Kurt Biedenkopf, one of the senior statesmen in German politics and one of the most critical minds in thinking beyond the politics of the day (with whom I have worked closely over the last few years in the development of a new private university in Berlin).

The book argues that the modern state and modern societies – and the argument certainly does not exclude the US – maintain an essentially unaffordable (and moreover highly inefficiently administered) system of social benefits at the expense of our children and grandchildren who will no longer have the means available that our generation is using up. Among his proposal for fighting this situation (in the German case) is a constitutional amendment that makes it incumbent on the state to have every one of its decision independently assessed as to whether or not it is "grand children safe". Should this generation not live up to this challenge, he argues, we will face an unprecedented age of intergenerational conflict.

Flashback to the cover photo on Isabela's book (see it on one of Isabela's slides: On the banners of the demonstrators, one name is singled out as the principal target of the people's anger: it's Wolfgang Clement, Schroeder's secretary of labor and economics and the lightning rod for popular discontent over what had been called the "Agenda 2010". I saw Wolfgang Clement again just a couple of weeks ago, because he was the one who introduced Kurt Biedenkopf's book on the exploitation of the grandchildren. He introduced the book alright, but he went much beyond that, in a speech that amounted to the remarkable admission that he, and his government, had done serious injustice to those very grandchildren by not being even more radical in challenging the traditions of German welfare state policies.

Such are the tensions and contradictions that have emerged around the notion and the practice of welfare state policies in Europe.

SLIDE 3

I will try to introduce this complex issue through five different lenses

- Some background on how attitudes towards the welfare state have to do with different conceptions of the state, particularly between Europeans and Americans
- A little case study on what welfare policies actually look like in one of the more pronounced welfare states in Europe: Germany
- A look at the kinds of challenges that the welfare state now increasingly faces
- Some comparative perspectives on what welfare policies look like in four different countries: the US, the UK, France and Germany, and finally,
- An empirical argument that, in spite of all the problems it seems to be having, there are a number of good things to be said about the welfare state.

SLIDE 4

1. Different conceptions of the state in Europe and the US

The tradition of thinking about welfare is closely tied to the tradition of thinking about the state, and those traditions have taken distinctly different historical trajectories on the two sides of the Atlantic.

As Tony Judt, one of this country's more knowledgeable observers of Europe, has said:

“Welfare, in its multiple forms, is the great Western European achievement of recent years. It is what distinguishes the region ... from the United States, where there is almost no formal community provision for the health and protection of all its members.” (1996, 97)

He isn't quite right, by the way, about the achievement of “recent years” – it's more like the achievement of a century, but I'll come back to that.

Fritz Scharpf, one of the most distinguished German scholars of public policy, puts it even more fundamentally and connects the welfare state to the very essence of democracy:

“The democratic state ... derives its claim to legitimacy from a commitment to the public interest and to distributive justice, and governments are constrained, through the mechanisms of electoral accountability, to orient their policies toward the interest of the broad majority of its voters. They are therefore under political pressure to protect groups in the electorate against the losses caused by structural change, to prevent mass unemployment, to regulate labor markets and production processes in the interests of the workers affected, and to achieve a normatively defensible distribution of incomes.” (1999, 30)

The fact that, at least in Europe, the democratic state has acquired this connotation and has come to be seen as so inextricably linked with the notion of wide-ranging welfare policies, especially in comparison with the United States, has indeed a great deal to do with a fundamentally different conception of the state between Europe and the US. When we, in the American tradition, think of the state, we tend traditionally to think of it not quite as a necessary evil, but certainly as something that should be kept as much at arm's length from the individual citizen and its life as possible. Much of the American tradition is the story of putting the state in its place, and keeping it there.

SLIDE 5

Let's look at some telling data on public opinion here. (SLIDE) When you ask people what they consider more important: To be free from government intervention to pursue one's own goals OR to have the government guarantee that no one is in need,

- a solid majority of Americans opts for the "freedom" option over the "welfare" option: 58:34
- an almost equally solid majority of European opts the other way around: 60% plus for the welfare option and a little over 35% for the freedom option.

SLIDE 6

You get a similarly striking difference (SLIDE) from a slightly different set of questions, which confirms not only the dramatic differences between Americans and Europeans, but also the fact that at least some of the orientation towards welfare policies are very much on the increase in Europe – notably where the responsibility of the state for not leaving anybody in need is concerned. When it comes to the state's responsibility for the poor, the difference between Europe and the US are as dramatic, but there is a slight decline in the importance that Europeans attach to this aspect of the welfare state.

Jürgen Habermas, the famous German philosopher, makes the point about these different views of the world quite nicely:

"Europeans have a relatively great confidence in the organizational abilities and directive capabilities of the state, while they are skeptical with regard to the efficiency of the market... They have a preference for the security guarantees of the welfare state and for solidaristic regulations." (2004, 48)

Solidarity rather than competition, confidence in the state rather than the market, protection rather than self-reliance, distributive justice rather than entrepreneurship – those are gross simplifications to be sure, but they mark some of the major normative differences in the ways in which Europeans and Americans look at the relationship between individual, society, and the state.

That attitude, one has to say, has served Europe and the Europeans well, ever since the origins of welfare legislation in the days of Bismarck in the 2nd half of the 19th century, and corresponding developments in other European countries as the growing social cost of the industrial revolution was more and more clearly perceived and as the state began to assume its role, in Fritz Scharpf's words, "to protect groups in the electorate against the losses caused by structural change".

The system has since then developed into a solid safety net – solid enough to avoid destitution, though not poverty, to guarantee acceptable standards of medical care and medication for everyone, to ensure old-age income for everyone at a tolerable, though not comfortable level, and to protect people and

families on a sustained basis from at least the monetary effects of temporary or permanent unemployment.

At the same time, and for reasons that have to do with the shape of the economies of advanced industrialized societies, with these societies' present and future demographics, and with patterns of work and lifestyles, the welfare state as it has developed in Europe over more than 100 years is now facing some serious problems. In the process, one of the key contentions in European politics has become the contention between those (typically on the political right) who don't think reforms of the welfare state go far enough, and those on the left who feel that they are going much too far and erode the much fought-for achievements of the last hundred years.

SLIDE 7

2. A case in point: Welfare policies in Germany

Let's take a closer look at the system, taking Germany as an example both of the system of social welfare as it has developed and of the attempts at changing it – attempts that already cut short Schröder's political career, and that may well jeopardize the careers of other European politicians in years to come.

We will look at the scope and volume of the German welfare state up until 2003 when the Schroeder government began to introduce its corrective elements in what came to be known as the Agenda 2010.

SLIDE 8

First, some background data on the social fabric within which Germany's welfare policies were situated.

Note:

- The big jump in population, as a result of unification in 1991, accompanied by
- A major jump in unemployment
- A major increase in the share of women in the labor market (almost all in East Germany), and
- The typical development for all advanced industrialized countries of a move from blue collar labor (significantly down) to white collar labor (dramatically up)

Next, an overview of the components of the German welfare system

SLIDE 9

- Insurance-based benefits

Most of the major social services are based on the principle of private insurance, even though most of the insurance funds are subsidized by the state's budget

- Social security (old age) pensions (similar in structure to US SS system)

A case in point. Mandatory insurance for old age and disability social security, paid for by premiums assessed on wages, comes out of a total benefits assessment of 19.5% of wages, shared equally between employer and employee.

Premiums account for 75% of fund's revenue, remaining 25% public subsidy
Amount of pension varies with time of payment, age of retirement, level of wages
People with higher incomes or self-employed can opt out of the statutory pension scheme and buy private retirement insurance

- Unemployment insurance

Also paid for in part by payroll deductions, major public subsidy. For 18 months (as of 2005: 12 months): unemployment compensation (AL-Geld), ca. 70% of last wages. After that, for 32 months: unemployment assistance (AL-Unterstützung), 10-15% below AL-Geld. After that: Social assistance (need-based, fully funded by state)

- Mandatory health insurance

So far, virtually free, including prescription drugs (for changes, see below) and hospitalization, and rehab and convalescence in special sanatoriums and clinics; possibility of private supplementary insurance for private room, and other special services. Paid for by payroll deduction, heavily subsidized by the state.

- Mandatory hospice insurance

Relatively new, to cover home and hospice care

Summary: much of the welfare state is NOT state-funded, but is based on insurance payments (augmented significantly by state funds, to be sure), but those are not voluntary, but obligatory.

- Contract-based benefits: Company pensions

Part of many employment contracts (especially older ones), assures pension income over and above social security.

Special case: civil servants (state employees of federal, state, local government), including teachers and university profs: old pension: 100% of last salary, now 80%, with a generous free medical plan that replaces most of the coverage of the general health plan.

SLIDE 10

- Need-based benefits

- Social assistance

Major public program to assure reasonably comfortable minimum living conditions for everybody (including foreign residents, asylum seekers, Russians of German descent immigrating from Russia). Includes special allowances for housing, children, clothing, Christmas. Needs-tested – also kicks in when unemployment benefits run out

This is the real “safety net”.

- Unemployment assistance (after exhaustion of unemployment insurance)

Bit of a borderline case, since it is still partly funded by unemployment insurance, but with heavy state subsidy – now to be joined with social assistance anyway.

- Policy-based benefits

These are benefits that reflect certain policy priorities or targets

- Child allowances

Reflection of general commitment to families and children, but also a population policy to encourage procreation

Rather generous: Family with 2 children gets 308 Euro/mo (up from 224 in '98), plus numerous supplements for single parents, families with special health problems, etc.

All this comes on top of the kind of tax relief that we have in this country as well through tax exemptions for children.

Total cost of child support programs (combining Kindergeld and tax relief) came to 35 Mio Euro in 2002

We will see later how serious a problem population growth is.

- Educational services and financial assistance

Essentially publicly funded financial aid programs for higher education students, until very recently in a tuition free university system.

After this typology of welfare services, let's look at the volume and scope of it

SLIDE 11

Overall welfare picture

Tremendous increase of total welfare bill (N.B.: translated from DM into € equivalent), especially after unification when West Germany had to assume welfare obligations (including unemployment assistance) for 16 Mio East Germans

Significant increase in share of GDP consumed by welfare payments

But also: Growing burden on employees (and employers) in terms of the contributions they had to pay out of their wages for the various insurance schemes (see later for cumulative impact on labor cost)

SLIDE 12

Corresponding rise in # of welfare recipients – especially old age pension because of the ageing of the population, and recipients of unemployment benefits – in both a major jump after unification

SLIDE 13

Same dramatic picture when breaking welfare payments down by category amplifies the growth of benefits in all categories – more than doubled over last ten years, more than quadrupled in unemployment benefits (higher unemployment overall, very high in East Germany)

SLIDE 14

Reiterating arrangements for contributory pension fund – see above

The Agenda 2010

Faced with this kind of a crisis situation, it has been clear for years that something needed to be done. Some things were done, but most of it remained patchwork, until the Schroeder government launched the Agenda 2010 project in 2003.

After a lot of horse-trading with both the CDU, for whom some of the reforms did not go far enough, and the left wing of the SPD, for whom they went much too far in curtailing the welfare state, the final package – toned down quite a bit – was finally passed in both houses of parliament on December 19, 2003.

Taking a look at it is one of those half-full/half-empty exercises. Given some of the solid and hallow tradition of the German welfare system, the glass certainly looks more than half empty. Considering, on the other hand, the dimensions of the economic, demographic and labor market challenges that we have talked about, the package looks more like a drop in the bucket, and leaves a system in place that is bound to come in for some more reform and curtailment in the foreseeable future.

Specially thorny issue, continues: The high rate of non-wage labor cost, which continues to damage very severely the competitiveness of German companies and products.

And yet – I come back once more to the protest demonstration in front of the Brandenburg gate that you find on the cover of Isabela's book - even this relatively modest package has caused a major political casualty

Let's take a look at what the Agenda 2010 consists of.

SLIDE 15

- Tax Reform (former rate >1/1/04 > 1/1/05):
 - Lowest tax bracket: 19.9 > 16 > 15%
 - Highest tax bracket: 48.5 > 45 > 42 (U.S.: 35%)
- Loosening of job security (esp. for small firms): facilitating termination – major complaint of industry over being tied down by overly rigid job security provisions (competing with need to retain older employees, who are usually the ones whom companies want to get rid of in the interest of productivity)
- More flexibility for mini jobs (to alleviate joblessness, part-time jobs are given tax and insurance breaks)

SLIDE 16

- Tightening unemployment compensation
 - Unemployment insurance: 18 > 12 months
 - After that: Combine unemployment assistance with social welfare (“Arbeitslosengeld II”)
 - Any job offer must be accepted (by those on the latter kind of support)
- Reducing health care benefits
 - Co-payments of 10% for physicians, prescriptions, hospital (min. €5/max. €10 per service, max. 2% of gross income/year)

SLIDE 17

- Scaling down social security benefits
 - No increase of payments in 2004 (previously, COL increase automatic)
 - “Sustainability Factor” for adjusting future pay levels to ratio contributors/recipients (a real sleeper, allowing the government to reduce very significantly the payout from the soc sec fund if contributions from a dwindling labor force are not adequate)
 - Cap premiums (now 19.5%, keep steady through ‘20) at 20/22% (‘20/’30)
 - Increase age of eligibility for retirement to 63, from now effectively 60 (thoughts about moving to 67 in 2035?)
 - Enhance employment opportunities for older workers (including tax breaks and funds for retraining)

SLIDE 18

3. Challenges to the welfare state

Germany’s welfare system faces the problems that most adv. Industrialized societies face: combination of contracting economies and hence both public and

private resources and a demographic development where the effects of longer life expectancies and a low birthrate are cumulative (typical of welfare systems which, like ours as well, are based on an intergenerational compact where those who are part of the active work force pay for the retirement (and, to some extent, health) cost of their elders.

Let's look at some of these developments

SLIDE 19

Dramatic projection for Germany

Total pop. Decreases between now and 2050: 82.5 > 72.1 Mio

Under 20 decrease: 17.1 > 12.1 Mio

20-60 (active pop): 45 > 35 Mio

The only group that grows is the 60+: 20 > 27 Mio

(Already assumes annual immigration of 200.000, and life expectancy of 81 for men and 86.6 for women in 2050)

It is obvious that this kind of demographic dynamic provides an extremely serious challenge for all welfare systems that are based on intergenerational compensation – same is true for US SocSec.

The problem is exacerbated in Germany through two factors:

First, the fact that early retirement has become extremely popular in Germany – undoubtedly also as a result of relatively comfortable retirement and health care conditions

SLIDE

Only 40% of age group 55-64 are still employed in D, compared to 70% in CH and 62% in Sweden.

The mean age of starting retirement in Germany is now down to slightly over 60, facilitated by a rather flexible arrangement for early retirement at almost the level of income as that which would become available if one waited till 65.

This trend is also exacerbated by the tendency of many employers to try to get rid of older employees in favor of younger ones.

The second problem that is unique to Germany is the continuing and staggering welfare cost associated with German unification. Literally from one day to the next, the German welfare system had to absorb the welfare cost of a heavily welfare-dependent population of 16 Mio East Germans – welfare-dependent both in the sense of being used to a relatively high level of social security in the GDR, and in the sense of living for the most part under economically very

disadvantageous conditions (high unemployment, few private resources or personal property, etc.). The cost of this burden, which continues for at least as long as the East German economy lags behind in contributing its share to the various welfare funds, is hard to calculate, but as you have seen from the increases in the overall expenditures between 89 and 2000 (above), we are talking in terms of billions of Euros.

SLIDE 20

But the problem is fundamentally not just a German one. The projections for many of the advanced industrialized countries show that the statistical mismatch between working and retired population gets exacerbated dramatically over the 20 years 2000 to 2020.

In the US by 2020, there will be just three people working for every one retired person. In Germany and France, by 2020 there will only be 2 people working for every retired person!

SLIDE 21

Here we can see the impact of the welfare state on the fiscal situation of the advanced industrialized countries. Our total tax volume (over which you are probably laboring this weekend) is still at 25% of our economy (GDP), while in the welfare states of Europe, it is either approaching 40% (UK, DE) or already past it, as in France. Clearly, from the point of view of stimulating econ growth through moderation in taxation, there is very little room for making this tax burden even heavier.

SLIDE 22

A similar logic applies to the cost of labor. In the US and the UK, already 30% of labor costs are taxes and benefits contributions; that rate in Germany and France now hovers around 50% - with an ever so slightly downward trend, due to initiatives like the Agenda 2010.

4. Some comparative perspectives on the welfare state

Liking or not liking the welfare state is clearly a matter of deep-seated philosophical differences about the nature of social life and about the ways in which societies should organize themselves. These kinds of different philosophies are reflected not just in the attitudes of people in different countries, but also in some of the data on the extent of, and the commitment to, various kinds of welfare measures.

Let's look at some of them.

SLIDE 24

Clear difference between North America and Europe, when we look at the state's expenditure for social programs, as % of both GDP and of total public expenditure.

Differences of a factor of 2 on GDP, and significant as well in terms of budget.

SLIDE 25

Here are those same data again for all of the OECD countries, with Germany and France approaching 30%, twice the rate of the US, exceeded only by Denmark and Sweden.

SLIDE 26

The same pattern holds when we look at unemployment comp and health benefits, in the case of unemployment compensation between continental Europe and both the UK and the US.

SLIDE 27

Health benefits is a particularly interesting case. Here, all the major ind countries provide public funds on a major scale, including the US, both as % of GDP and as % of public budgets.

SLIDE 28

Where the US stands out, however, is in the tremendous amount of private money that gets piled on top of public health benefits – more than the same amount again. In all other countries, public health expenditures make up the bulk of all expenditure on health, with France and Germany close to the US in their public share but – true to what we have said about different conceptions of the role of the state and the individual – with rather modest private shares.

SLIDE 29

But the amount of health expenditure does not necessarily translate into better health. If you take infant mortality as an indicator, the US scores almost twice as poorly as France and Germany – which confirms what we all know: that health care in this country is incredibly expensive, but not necessarily always all that good.

5. What's so good about the welfare state?

Finally, a look at the results of a major comparative study of the correlates of the welfare state, i.e., of what kinds of political characteristics go together with high or low commitments on the part of the state to welfare benefits.

Study places most North American and European states (n = 13 for most analyses) on a scatter plot (of the kind attached to your handout), and calculates correlation coefficients to indicate the strength with which the two characteristics are related (i.e., the probability that, if one element is strong – e.g. social welfare -, another one – e.g., criminality – is also high).

I know who did the study and how it was done, and attach a good deal of confidence in the data (most of which have also been analyzed through multivariate analysis – a more rigorous statistical procedure even – and have held up very well).

SLIDE 31

I have pulled together some of the results of the study in the next two slides.

Some of the connections will not knock you off your feet, like the first one, on the relationship between welfare expenditures and poverty. The finding: when welfare is high, poverty is low (or vice versa: when welfare is low, poverty is high) - it's a negative correlation, but a very strong and robust one, as these kinds of data go – and it's kind of nice to verify that the welfare state does what it is supposed to do.

That comes out even more clearly in the next analysis, which reflects an analysis over time and shows that, as welfare goes up over time (ten years in this case), poverty goes down – again pretty strongly correlated

The third one is, again, what one would expect, but with the strongest correlation of the three: as welfare goes up, income inequality (measured by something called a Gini coefficient) goes down – and that relationship accounts for over 60% of the variance. Again, the data show that welfare states do what they are supposed to do – so if you want to keep income inequality or poverty down, going the way of the welfare state is a pretty good formula.

SLIDE 32

The last three analyses are somewhat more surprising. The first tests a commonly held assumption that the welfare state makes people complacent and stifles social and civic activity. So Jens Alber and his colleagues ran the social expenditure rate (the percentage of GDP devoted to social expenditure) against the percentage of the population in a given society engaged in volunteer activity. There IS a statistical relationship, and even though it's small, it's positive,

suggesting at the very least that the notion of welfare leading to complacency is not born out by the data.

Very different for the relationship between welfare and criminality, where in two different tests there are two rather strong correlations: the less welfare expenditure, the higher both the number of prison staff and the number of police and other security personnel, both per 100.000 inhabitants. Again, that's what you would expect, but since the world does not always behave the way we expect it to, it's interesting to have some evidence that, indeed, a country's higher collective commitment to the welfare of its citizens does have some systematic and tangible results in such areas as poverty, equality, and security.

SLIDE 33

ERT website – will have all .ppt slides and other information pertaining to this session as of the middle of next week.