DEATH OF THE WELFARE STATE?

Europe will be able to compete, writes Fritz Scharpf, if benefits give way to job subsidies

The benign post-war environment for highly industrialised countries – where the national economy could for practical purposes be treated as a closed system under the control of the national government – is over. And so are the luxuries it permitted in terms of the European welfare state. For the first time, industrialised economies are confronted with the possibility that world markets may be captured by high quality industrial goods (and services) produced at very low cost in what used to be third or second world countries.

The question for these first world economies is not primarily how to avoid the welfare losses following the massive changes in the world economy – they are more or less inevitable. The question is how to allocate these losses in ways that will least disrupt the social fabric of affected countries or the viability of their democratic political systems.

The welfare state is of course part of the problem. Welfare costs are foremost among the cost burdens of first world economies and rising mass unemployment overtaxes the capacity of existing systems of financing welfare expenditures. And by providing income support for the unemployed and raising the reservation wage of job seekers, the welfare state is itself a cause of minimum wage unemployment. As a consequence, economic pressures and political demands to cut welfare benefits are mounting everywhere.

They are particularly acute in countries where welfare expenditures are primarily financed through payroll taxes or insurance contributions that directly add to the costs of production; countries where the welfare state is mainly supported from general tax revenues have a choice of allocating the costs in ways which reduce the competitive disadvantages of their internationally exposed industries. The least burdensome source of welfare finance (apart from protectionist tariffs) would, of course, be a form of consumption taxes but this would be very difficult to enact. Yet it would have the great advantage of reframing political disputes over the future of the welfare state in terms which replace the rhetoric of class conflict with a more realistic focus on the trade-off between public welfare consumption and the private consumption of goods and services. Regardless of the form of finance, however, the question remains how welfare states will cope with the causes and consequences of income losses and persistent mass unemployment.

If nothing is done, capital owners, but also employees in highly productive jobs (in management, marketing, r&d, design, communications and the media, for example) will gain from the race to increase competitiveness. Meanwhile employees in skilled white and blue collar jobs of average productivity will see their real incomes reduced and their jobs endangered. Low-skill jobs will either disappear or pay wages below the poverty level, unemployment will continue to rise, and governments will continue to cut unemployment and welfare benefits in order to reduce tax and welfare burdens on firms. The result will be a dramatic increase in inequality with implications of social unrest and political radicalism reminiscent of the last years of Weimar Germany.

Compared to these grim prospects, it might seem socially more attractive to spread the consequences of reduced competitiveness more evenly by a policy of gradual devaluation, even if it has inflationary consequences. But, of course, gradual devaluation and inflation will be anticipated by capital markets, interest rates will rise or capital will flee, real investment will decline, productivity will fall further behind and competitiveness will suffer even more. The result could well be a downward spiral in which impoverishment will accelerate. Similar consequences might follow from the adoption of protectionist strategies which, however, would require explicit political decisions on specific measures differing in their impact on individual sectors of the economy. But such measures would raise the level of international conflict and might, as they did in the '30s, destroy the positive welfare effects of an integrated world economy.

Of course, protectionism might take on a different, and more attractive, identity if it were practised, not within nation states but within the large economic regions of the world – Europe, the Americas, Asia. In order to be acceptable, however, each of these regions would need to include its advanced as well as its backward and newly industrialising countries. For Europe, for instance, this would not only imply the inclusion of central and eastern Europe, but also of the Near East and of Africa – a burden which may be too large to bear. At the same time, regionalism would prevent, or at least inhibit, the access of European industries to the growing American and Asian export markets. Given the present degree of integration of the world economy, the loss may already be greater than the benefits of keeping American, Japanese, Korean and Indian competitors away from European markets. In any case, the completion of the last Gatt round must also be read as a commitment against regional protectionism.

Not controlling, but coping

So what can be done? The foremost precondition of any effective solution is the explicit acknowledgement of the globalisation of capital markets and production, and the abdication of all illusions of continuing control at the national or even at the regional (European) level. In place of the old notions of controlling the economic environment through the instruments of national monetary policy, fiscal policy and regulation, governments need to develop strategies for coping with an uncontrolled, and basically uncontrollable, economic environment – where interest rates and exchange rates may fluctuate chaotically, where seemingly secure markets may be invaded by high quality competitors from low-cost locations, where production processes and products may become obsolete through technological and organisational innovations introduced elsewhere, and where conditions generally will be too unstable to permit long-range planning.

Under such conditions, coping implies exploiting temporary opportunities and niches in the environment, evading head-on confrontation with overwhelming forces, and immunising one's own system as best as possible against external shocks. This change of perspective from control to coping has important general policy implications which cannot be explored here. While the effectiveness of control is likely to increase with the size and the resource base of the political unit, successful coping depends much more on the fit between political strategies and given conditions. If environmental conditions fluctuate in time, there is a premium on flexibility and speed of adjustment; if problems and capabilities vary in space, coping may benefit more from economies of small scale then from economies of large scale. Under such conditions, small countries (and subnational governments in large countries) may be more successful then large nation states, and the EU may have to be redesigned with a view to facilitating and enhancing the coping capacities of its national and subnational units, rather than constraining them through excesses of centralisation, harmonisation and standardisation.

The same logic applies to the welfare state. Here, too, the question must be how its goals may be reached without undercutting the coping capabilities of national and regional economies under conditions of global competition. Shifting all or part of the burden from payroll taxes to consumption taxes (including taxes on the consumption of energy) will certainly help. But without effective solutions for the problems of rising mass unemployment, the welfare state itself will either become an intolerable burden on the economy or lose its viability.

Employment in the internationally exposed sectors of the economy cannot be the solution. If competitiveness is to be maintained or regained, these will be sectors where labour productivity is bound to increase more rapidly then output. Thus, full employment strategies must focus on segments of the economy where local and regional demand is met by local and regional producers. Among these segments are the construction and maintenance of housing stock, retailing and servicing of industrial products, some branches of agriculture and food processing, environmental protection, the media, education and training, childcare, healthcare and care for the aged, household services and the like. These fields are often neglected in the discussion of employment strategies, but it is here, rather than in the internationally exposed industrial and service sectors, that additional jobs are likely to be found at all.

In many of these areas, however, labour productivity is low and cannot be raised very much through the introduction of modern technology. Thus, if wages (and payroll taxes) should be close to those paid in the highly productive sectors, these jobs will be driven from the private market and may, at best, survive in the public sector. If, on the other hand, wages were paid at a level corresponding to the productivity of these jobs so that private employers could still expect to make a profit, working incomes are likely to fall below the poverty level. In the US, this is true of a large percentage of the new jobs created in the domestic service sectors. Thus, the much admired American employment miracle has been accompanied by a rapid increase in the number of working poor.

American-style low-wage sector unacceptable

In European welfare states, where social incomes at or above the poverty level are still assured, an American-style low-wage sector could not develop in the past, and would even now be politically and socially unacceptable. As a consequence, however, the share of persons who are permanently excluded from contributing to the processes of wealth creation, and from participating in socially recognised forms of employment, is considerably larger in Europe than it is in the US. From a social and political point of view, this is unfortunate. Even if replacement incomes for the unemployed were to be maintained above the poverty line, they are not enough to stabilise personal self-respect, to assure social integration and to prevent political alienation.

From this perspective, it would be better all round if European welfare states could be reconstructed so as to subsidise incomes from low-wage employment, rather than to provide replacement incomes to those people who are unemployed full-time. This suggests solutions that apply the logic of a negative income tax which, however, should not include the option, much discussed in the '80s, of a basic income or citizen's wage paid to all, regardless of their need and their participation in the labour market. The scheme should not replace existing programmes of income support for persons who are unable to work for reasons of health, disability or family responsibilities, and it should probably not interfere with insurance-based (and time-limited) unemployment benefits either.

Instead, the scheme could define a lower and an upper limit of eligible (hourly) wages at the bottom end of the present labour market. Within this range, an income subsidy would be paid which would increase take-home pay at the lower end to a level above the poverty line, and which would only gradually decrease as wages increase toward the upper limit of subsidisation. The rate of decrease would have to be set in such a way that employees would always have a strong interest to seek higher-paying jobs. In other words, the subsidy scheme would need to avoid the Speenhamland trap, which also characterises present-day social welfare regulations that impose a confiscatory tax on any additional income from work.

If such a scheme were in place, wages at the lower end of the labour market could be determined by the market or by collective bargaining with regard to the actual productivity of the various kinds of jobs. Under such conditions, it would be profitable for private employers to invest in additional employment opportunities in service sectors where market demand depends crucially on price. At the same time, the scheme would assure incomes above the poverty level for those who accept these new jobs. In other words, European welfare states could benefit from the expansion of an American-style low-wage employment sector without having to accept the spread of American-style poverty and social degradation. And since, under the conditions of European welfare states, every additional job will reduce present expenditures for unemployment relief and welfare payments, the net fiscal costs of such a scheme would be quite low even though it would, of course, also have to apply to workers who are presently employed at low wage levels. In Germany, for instance, the subsidy would begin to pay for itself if 500,000 new jobs could be created.

The conclusions are clear. What matters is the ability of national governments to cope successfully with the vagaries and challenges of an inherently turbulent and increasingly inclement global economic environment. This places a premium on relatively decentralised capacities for political action, and on strategies that support, rather than impede, the efforts of internationally exposed industrial and service sectors to reduce production costs and to increase productivity and innovation. The implication is that mass unemployment cannot be solved in these exposed sectors. If it is to be solved at all, there is a need to expand employment in less productive jobs in the domestic economy. At present, European welfare states impede, rather than facilitate, the utilisation of such employment opportunities. It seems worthwhile, therefore, to explore options of reconstructing the welfare state in ways that would facilitate the expansion of a low-wage sector without creating a subproletarian population of the working poor.■

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