What Will Become of the Welfare State?

(draft—but okay to cite)

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A Conference in Honor of Professor Keith Griffin, University of Massachusetts,
Amherst, April 23-25, 2004
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Among the various forms of contemporary capitalism, the “welfare state” has become most firmly entrenched in continental Europe. The welfare state is based on a broad social consensus favoring relative equality and the assurance of access to the basic requirements for a decent living standard for the entire population. This implies access to health care and sufficient income to provide decent food, housing and other basic requirements. Retirees are assured of adequate pensions, and those who lose income due to unemployment, disability or the death of the main breadwinner are also eligible for regular payments. In addition, in much of Europe, the welfare state implies access to education and child care, and such benefits as parental leave to care for newborns, young children or sick children.

Over the course of the past decade or so, the welfare state has come under increasing challenge. There are a number of reasons for this, ranging from the intensification of internal contradictions within the welfare state itself to demographic changes, medical advances, globalization and technological change. The challenges confronting social democracy or the welfare state threaten to undermine the most humane form of capitalism the world has managed to produce. In addition to the welfare state, the other primary forms are the state-led capitalism of East Asia (for which Japan and South Korea are the primary prototypes, with China beginning to follow a similar path), and the “harsh” capitalism of the Anglo-American (especially American) variety. Under “harsh” capitalism, policy tends to be driven by market ideologues. That is, there is broad public acceptance of the idea that people get paid what they are “worth,” and that
redistributive taxation undermines fairness (people should be able to retain what they earn) and incentives. The social attitudes supporting harsh, market-driven capitalism in America are reflected in the fact that some 45 million people are permitted to go without health insurance and 20% of children to grow up in poverty, despite living in the wealthiest country the world has ever seen.

My concern in this paper is especially to examine the way in which globalization and technological change are undermining the welfare state model of capitalism (they are also undermining state-led capitalism, but that is not my focus here), and tending to make it more akin to its harsh capitalist cousin on the other side of the Atlantic. Besides considering the evidence for the existence of severe pressures, I will turn in the conclusion not to particular policy palliatives, but to consideration of how policy issues might be approached. Addressing the challenge to the welfare state and the issues it raises for public policy are in keeping with a conference organized to honor Keith Griffin’s consistently humane concerns and scholarship.

Internal contradictions in the welfare state

The initial impetus for the provision of welfare often begins with the observation that people are not, for the most part, responsible for the various calamities to which we are susceptible. If we happen to fall ill or become victims of recessions or accidents, or lose employment as a result of industrial change, there is often limited scope for individuals and families to protect themselves. If people consider themselves part of a national community, they may consider it quite natural to provide for the victims of misfortune. For those societies in which relative equality is a widely held value,
moreover, or where it is considered unacceptable to allow poverty and misery to exist in a society that provides ample means to eliminate them, it is quite natural to support various forms of public assistance to those who are less fortunate.

Once redistributive welfare policies become established, however, people’s behavior tends to adapt to the new institutions. In the United States, for example, income support for mothers with dependent children was initially motivated, in large part, by the feeling that they should not be punished because the (male) family breadwinner had died or abandoned the family. Over time, however, at least some young women were motivated, at least in part, to have children out of wedlock by the knowledge that they could receive financial support from the state to live in their own apartments if they did so.

To consider another example, in Sweden there is a tradition of a strong work ethic. It was broadly assumed that those without jobs were largely the victims of circumstance. When laws were created to pay those out of work for days missed due to illness, the incentives to stay out longer than necessary increased greatly. In the early 1990s, Swedish workers were eligible to receive some 60% of their basic salaries for the first three days of work missed due to illness, and about 90% for subsequent days. Under these conditions, absenteeism among younger workers came to exceed that among older workers by 50% (Angresano, 1992: 321). By encouraging such adaptive behavior, welfare support tends to become vastly more expensive over time, and to undermine the social consensus that typically underlies the initial legislation. As the assumptions about why people are unable to be self-supporting shift, support for the welfare state erodes. In this way, institutionalized welfare programs tend to bring about changes in behavior that
invalidate the initial assumptions upon which the welfare programs were based, an internal contradiction that is widespread in the welfare state. Other factors, however, are likely to prove still more significant in challenging the welfare state.

**Demographic change and medical advances**

The rising costs of the welfare state are based on much more than adaptive behavior on the part of welfare recipients. If the cost of old age pensions and public health care, two of the most expensive components of welfare-state spending, is taken into account, then the impact of demographic change and medical advances comes to the fore. With regard to demographic change, the aging of the populations in the industrialized countries and the decrease in their fertility rates play an especially prominent role. The impact is especially severe since all of these countries have essentially been on a pay-as-you-go retirement program. Under such programs, no real assets are set aside by the state to provide for retirement by those currently in the labor force. Rather, each generation pays taxes (generally payroll taxes) that are then transferred by the government to the existing retirees. When the existing generation of workers has retired, its pension/social security needs are supposed to be met through taxes on the next generation of workers.

The problem for such schemes arises when the ratio of those who are currently employed to those who are retired diminishes dramatically, something that is certain to happen to a greater or lesser extent in the coming decades throughout the industrialized world. In Europe as a whole, there are currently about 3 workers per retiree; within 30 years there are likely to be 1.5 workers per retiree (*The Economist*, 9/27/03: 15). This
implies that for current benefits to be maintained, the payroll taxes devoted to pension
support will have to be doubled. Since payroll taxes covering all forms of welfare
benefits are already very high (in Germany they are more than 42% of gross wages, half
each paid by employer and employee), it is questionable whether much higher taxes are
feasible. It is not just a matter of whether future employees and employers would be
willing to pay them, but already strong incentives to locate new jobs outside of Germany
or other high-tax states would be immensely intensified, and the incentives to replace live
workers with automated production would be increased as well. Any loss of jobs these
consequences could be expected to bring about would require even higher taxes on those
remaining in the labor force.

Pay-as-you-go (PAYG) retirement schemes are inherently unsound, since the
most basic accounting principles suggest that if a worker earns a retirement benefit by
working in a particular year, funds should be set aside in that same year to fund the
eventual benefit (the funds need not be equal to the full benefit, since some return on the
funds set aside can be assumed). Indeed, in the United States, corporations are now
required to fund their defined benefit programs—it is only the state that gets away with
improper behavior in this respect. When public pensions were initially begun, however,
there were so many taxpayers and so few beneficiaries that the various countries did not
have to face up to the future problems they were creating. When Bismarck introduced
the PAYG scheme in Germany in 1889, the retirement age was 70 and the average life
expectancy was 48 (Ibid: 70). Similarly, when social security was introduced during the
New Deal in the United States (in the 1930s), the ratio of taxpayers to beneficiaries was
extremely high. Falling birth rates and rising life expectancies have since changed circumstances rather dramatically.

In the European Union, between 1960 and 1965, the overall birth rate was 2.7 children per woman, higher than the 2.1 required to maintain the size of the population. By 1995, the ratio had fallen to 1.5 children per woman (Ibid). In 2000, the average fertility rate for German women was 1.36 children, higher in the EU only than Spain’s 1.25 and Italy’s 1.26; these are countries increasingly dominated by dinkies (double-income, no children; The Economist, 12/6/03: 47). The problem of declining fertility and eventually population is still more serious in Japan, where “official demographers now say that Japan’s population will peak at 127 million in 2006 and halve to 64 million by the end of the century” (Financial Times, 3/20/04: W1).

Countries with aging populations whose retirement is supported by a public PAYG pension scheme face serious, unavoidable welfare problems. A few countries, most notably Chile followed by several other countries in Latin America, have instituted dedicated retirement schemes under which 10% of earnings must be saved. The transition to such schemes is made more difficult in the West because they imply that the current generation of workers would have to pay for both their own retirement and the pensions of those who are already retired. The problem is not that reform is impossible, but the more it is delayed, the more costly and difficult it becomes. And by and large, with moderate qualifications to be discussed below, the political will to address the problems of pension/welfare reform has been lacking.

It is not only the problem of pensions that challenges the welfare provisions of continental European countries. The advance of medical science is also raising costs
dramatically, creating a further drain on state budgets. This has both direct effects—
higher costs of hospitalization, drugs and so forth—and indirect ones; an aging
population with longer life expectancies due to medical progress consumes a
disproportionate amount of health care spending (besides adding to the pension deficit).
In the United States, health care spending in 2003 is estimated at $1.7 trillion, more than
15% of GDP (Wall Street Journal, 2/12/04: D2). Spending increased by 9.3% in 2002,
7.8% in 2003 and is expected to grow faster than GDP for the next 10 years, reaching
$3.4 trillion by 2013, more than 18% of GDP. While there is some inflation in these
figures, much of the increase is reflected in the cost of new medicines and procedures.
With the rise of biotechnology, moreover, which promises the development of targeted
medicines through enhanced understanding of disease mechanisms (as well as an era of
personalized medicine based on individual genetic characteristics that knowledge of the
human genome will make possible), the advances in medical science may well accelerate,
with commensurate increases in cost.

Like Germany, France’s public health care system is supported by some of the
world’s heaviest payroll taxes, but it nevertheless ran a deficit of about $12 billion in
2003, and its costs are rising at some 6.4% annually (Business Week, 10/13/03: 60). The
French government had planned to introduce cost-cutting reforms in late 2003, but put
them off until late 2004 in the face of widespread opposition. In Sweden, the health care
system was ranked as the best among OECD countries in a British Medical Journal study
of December 2003, but as is true elsewhere in Europe, the system has entered a state of
crisis. Hospitals have been closing wards and laying off staff, and telling patients to turn
to the private sector for some surgeries. Although access to health care is seen as a basic
right, the government has begun to ration procedures for which it will pay, and some
newspapers have begun to publish price lists for private treatment. Since 1998, health
care costs in Sweden have been rising by 8% per year (Los Angeles Times, 12/7/03: C4).
The financial problems in European health care systems, it should be noted, have
emerged despite the fact that price controls on medicines keep their cost some 60% below
U.S. levels (The Economist, 1/31/04: 59). The increase in health costs associated
especially with advances in medical science, then, combines with the pensions pressure
created by an aging population and rising dependency ratio of retirees to workers to
intensify fiscal pressures on the European welfare state.

Globalization, technological change and the welfare state

While capitalism has been global from its outset, as Immanuel Wallerstein has
argued, the nature of globalization today is qualitatively different from what it has been
in the past. The revolution in information and communications technology (ICT)
especially has facilitated the rise of international supply chains and international
outsourcing. Multinational or transnational corporations (MNCs or TNCs) have found it
increasingly easy to locate their production facilities in low-cost countries, or to contract
work out to those countries to minimize their costs of production. The ICT revolution,
together with improvements in transport, has made it more feasible to track more
precisely the status of overseas material goods production to ensure timely deliveries.
Further, types of work that would not previously have been outsourced abroad, such as
software projects and call centers, are increasingly being sent abroad to India and
elsewhere.
Although labor costs are of greater or lesser importance for the many firms capable of international outsourcing, they are just one of the costs that must be taken into consideration. Taxes must also be considered, both at the corporate and the personal level. The welfare states of continental Europe depend on high levels of taxation to fund their social benefit programs. Personal and corporate income taxes, payroll taxes, value-added taxes, and in some cases even wealth taxes play a role. When taxes are much higher than those charged abroad, an incentive is created above and beyond labor-cost differentials to move work abroad. And even when work is not moved abroad, strong incentives are created to substitute capital for labor in the production process. This also contributes to keeping new hiring down and to rising unemployment rates. Taken together, the set of incentives created by globalization and technological change tends to deprive the welfare states of the tax revenues necessary to fund their various social benefits.

International mobility exists at an individual level, moreover, as well as at the corporate level. Younger people with strong qualifications especially may be tempted to work in locations with lower tax rates. The “traditional” brain drain has been from less developed countries to more developed ones. The new brain drain, however, includes as well people within the industrialized world seeking to locate in lower-tax countries. To attract the most qualified personnel, this creates an added incentive for corporations to expand their operations in lower-tax locales. Thus in the early 1990s, Germany was hoping to have Frankfurt compete with London as the financial center of the new Europe, but in recent years Germany’s largest banks have been cutting employment in Germany
in favor of expanding employment in London, with foreign banks (such as Spain’s Santander) making similar moves (Wall Street Journal, 7/11/03: A7).

The international wage and tax competition promises to increase with the European Union expanding by ten nations in May 2004, including eight countries in eastern and central Europe. Relatively low flat personal income taxes have been widely adopted in the region, with Russia and Ukraine at 13%, the Slovak Republic at 19%, Estonia at 26%, Lithuania at 33%, and Latvia at 25% (Wall Street Journal, 1/19/04: A12). Bulgaria, Romania and Georgia are all considering flat taxes as well.

The problem of high taxes and labor costs is intensified by another aspect of contemporary globalization: the intensification of competition. In the middle of the twentieth century, a great deal of corporate behavior could be described as “satisficing” rather than profit maximizing; many companies were able to survive and prosper without being low-cost producers. As the economies of Japan and Europe were rebuilt following the devastation of World War II, however, global competition began to intensify. In the U.S., companies like Chrysler were able to survive only with the aid of a federal government bail-out. As globalization intensified at the end of the century, including the rise of China to become the “workshop of the world”—much like England had been in the eighteenth century—companies that failed to take advantage of every possible means of cost-reduction became increasingly at risk. Competition is no longer merely national but increasingly global, and companies that fail to take every possible advantage of cost-reducing opportunities are subject to failure.

It is within this context that traditional measures of assuring popular welfare have become increasingly problematic. In the case of Germany, for example, when firms lay
off employees, they are required to start with those most able to find alternative employment. This is mandated by the Kundigungsschutz or job protection law, which has been little-changed since the 1950s (*Business Week*, 2/17/03: 47). In effect, that means that firms often are required to lay off their most able employees first, while retaining those who are least productive. A recent proposed reform would have increased the exempt firms with five or fewer employees to include those with twenty or fewer, but opposition to the reform forced a cutback to exempt firms with ten or fewer employees.

The difficulty of firing workers throughout Europe has made firms extremely hesitant to employ new workers. Hiring someone in his or her early twenties might mean an employment commitment lasting as long as forty years. Since firms have difficulty estimating their outlooks for more than a few years, most are hesitant in the extreme to make such long-term commitments. It is within this context that while the unemployment rate in France is about 9.6% overall, the unemployment rate for those under twenty-five is 21% (*The Economist*, 1/10/04: 44). Thus, legislation meant to protect workers from arbitrary firing has, paradoxically, slowed the rate of new hiring and contributed to sluggish economic performance throughout continental Europe. In general, the continental commitment to income, job and health security has come under increasing challenge as globalization and technological change lead to heightened competition.

### Sluggish economic performance in continental Europe

One might expect the various problems affecting the welfare-state economies of continental Europe to be reflected in weak economic performance, growing difficulties in
maintaining the array of benefits to which people have become accustomed, and intensifying pressures for reform. This has indeed been the case despite the adoption of a common currency, the euro, which might have been expected to give the participating economies a meaningful boost. The stability and growth pact, which penalizes those euro-zone countries maintaining budget deficits in excess of 3% of GDP per year, has also played a role in the poor economic performance, especially since the concentration of control over the region’s interest rates in the European Central Bank (ECB) deprives individual countries of monetary policy tools to stimulate their economies; the ECB’s interest rate policies depend on the rate of inflation in the euro-area as a whole, which have been in excess of its 2% target, so that individual countries like Germany experiencing stagnation and low inflation have had to live with interest rates higher than their domestic conditions warrant. Despite the loss of control over monetary policy associated with economic integration, however, it is clear that deeper economic difficulties derive from structural problems associated with the existence of the welfare state.

It is not the welfare state alone that has created these problems. Rather, it is the high levels of social spending that take place in the context of an increasingly competitive global economy on the one hand, and the rising costs associated with an aging population and medical advances on the other, with additional burdens created by adaptive behavior that adds to the cost of welfare provisions. In addition to the examples of adaptive behavior cited above, the increase in those receiving disability benefits in the Netherlands is also a case in point. Although the Netherlands has made more concerted reform efforts than the larger economies at the heart of the continent, given the remaining
difficulties of firing workers, some companies have been putting unwanted workers on
disability. Thus in the Netherlands 13.5% of the labor force is classified as sick or
disabled, and the proportion is expected to rise to 15% by 2006 (Wall Street Journal,
7/18/03: A14). The challenge to the welfare state, then, is created by the interaction of
multiple factors leading to rising costs and declining competitiveness. The expected
outcome is sluggish economic performance, and that indeed has been the case over the
past decade. Table 1 below compares average annual European and U.S. GDP growth

Table 1: Average annual growth rates, 1995-2002

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<tr>
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<tbody>
<tr>
<td>Ireland</td>
<td>7.6%</td>
<td></td>
</tr>
<tr>
<td>Britain</td>
<td>2.8%</td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>4.0%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Greece</td>
<td>3.6%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Spain</td>
<td>3.4%</td>
<td>2.2%</td>
</tr>
<tr>
<td>U.S.</td>
<td>3.3%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Portugal</td>
<td>3.0%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.8%</td>
<td>1.4%</td>
</tr>
<tr>
<td>?</td>
<td>1998-2002</td>
<td></td>
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<td>??</td>
<td>1996-2002</td>
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</tbody>
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Source: Business Week, 2/17/03: 51.

Although the overall figures in table 1 do not appear disastrous at first sight,
several factors must be taken into account when evaluating their significance. First, the
major countries and or those with the most extensive social welfare programs tend to be
among the weakest performers (note in particular the placing of Germany, Italy and
France). Second, some of the smaller countries on the periphery of the continent have
been reform leaders (such as Ireland and Finland). And third, the creation of the euro as a common currency created an economic reform imperative for countries wishing to join the euro-zone, leading to more balanced budgets, curtailment of national debt and so forth, resulting in a number of cases in stronger economic performance than might otherwise have been achieved.

Relative productivity performance may give deeper insight into the problems Europe is experiencing. In the European Union, output per labor hour in the 1995-2000 period grew at 1.42% per year, compared to the 1.97% in the U.S. In the three years to the third quarter of 2003, the gap widened as American productivity growth moved up to 2.5%, with Europe’s slowing to 0.89% (Becker 2003: 22). Germany, at one time the most vigorous of Europe’s economies and influencing economic performance throughout the continent by virtue of its size—the unified Germany accounts for about one-third of European GDP—is now contributing to the economic weakening of the entire continent. More significantly, countries with sharply rising demands on their social welfare systems cannot afford to be lagging economically. In the absence of reform, unsustainable tax increases would be required to finance existing benefits, putting the entire welfare-state project at risk. Fortunately, reform options do exist.

**Economic reform in Europe**

The central issue of economic reform in Europe is finding a way to restore competitiveness and financial viability while sidestepping the pressures generated to emulate the “harsh,” market-driven capitalism that characterizes the United States. These pressures, as I have indicated, include the internal contradictions that welfare systems
tend to create, and the problems generated by aging populations and advances in medical science. All of these are intensified, however, by the forces of globalization and technological change, which have made contemporary capitalism much more price competitive than its mid-twentieth century counterpart. Since capital, both financial and real, can move more readily than ever before to low-labor-cost and/or low-tax sites, and since individuals can choose to live and work in low-tax locations, the economic foundations for the welfare state have been seriously undermined. Given these conditions, full recognition of the need for reform—and the political will to carry it out—are necessary if the best elements of the more humane form of capitalism that has emerged in Europe are to be preserved. Fortunately, there have been experiments with reform in various parts of Europe, and both France’s Agenda 2006 and Germany’s Agenda 2010 reflect a genuine if belated understanding that reform is necessary.

In France and Germany, a 35-hour work week is fairly standard. The 35-hour week was mandated in France in the late 1990s and supported by (false) arguments that with a fixed amount of work available, a shorter week would assure higher employment (similar arguments have been used by German unions since the late 1970s). Since the French legislation mandated no reduction in weekly pay along with the shorter hours, the hourly payments rose, making France less competitive (it created other problems as well, since with doctors, nurses and other health care personnel working shorter hours, health care services had to be curtailed even while costs rose). High labor costs in both France and Germany contribute to high unemployment, currently about 9.6% in France and 11.5% in Germany.
French and German workers do work less than those in other countries, and if the choice is simply one between work and leisure, there is obviously no imperative in favor of work. Table 2 indicates the hours of work in various countries.

Table 2: Average hours worked per person employed in 2002

<table>
<thead>
<tr>
<th>Country</th>
<th>Hours</th>
</tr>
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<tbody>
<tr>
<td>Germany</td>
<td>1,444</td>
</tr>
<tr>
<td>France</td>
<td>1,459</td>
</tr>
<tr>
<td>Britain</td>
<td>1,707</td>
</tr>
<tr>
<td>Japan (2001)</td>
<td>1,809</td>
</tr>
<tr>
<td>U.S.</td>
<td>1,815</td>
</tr>
</tbody>
</table>


When French and German workers work about 20% fewer hours per year than their American counterparts, they are not the ones, for the most part, who bear the burden of their choice. Rather, with labor costs high, their companies become less competitive and less willing to create new jobs. This results in the high unemployment and especially the high youth unemployment already noted. It also means that the full array of social services financed by the payroll tax—pensions, unemployment insurance and health care—is deprived of adequate financing. The real choice, then, is not whether workers prefer higher income or more leisure, but whether they are entitled to both at the expense of those members of the population who face reduced health care, unemployment and pension benefits.

The French government is seeking to reduce welfare benefits for unemployed workers who turn down jobs. At present, unemployed workers are eligible to receive 75% of their most recent salary for as long as two years on the conditions that they
register as job-seekers. The problem with this system is that they can turn down job offers without losing any benefits (a leading French union has said that the proposed reform is unacceptable since it would force workers to accept jobs unsuited to their qualifications; *Wall Street Journal*, 11/21/03: A10).

The welfare reform issues that confront continental Europe, then, are fairly straightforward, although there is some evidence that the German population is ahead of its French counterpart in recognizing the inevitability and indeed the urgency of economic reform. This may reflect in part Germany’s higher export share in GDP, and a correspondingly greater willingness of German companies to shift jobs abroad for the sake of competitiveness, a willingness that may be further enhanced by the proximity of the eight eastern European countries joining the European Union in May 2004.

Although relatively modest in the aggregate, the December 2003 reforms (part of the Agenda 2010) agreed to in Germany by the Social Democrats and the Christian Democratic opposition represent the most substantial changes to the country’s economic framework since the Second World War (*Wall Street Journal*, 12/16/03). The reforms involved

1) bringing forward tax cuts valued at some $19 billion to 2004.

2) requiring the unemployed to accept jobs paying less than union wages or lose benefits.

3) easing protection against lay-offs in firms with fewer than 10 employees (versus 5 previously).

4) toughening criteria for receiving social benefits.

The opposition and the corporate sector had also hoped to give more flexibility to the bargaining process by allowing firms to bargain individually with unions, rather than rely
on industry- or region-wide bargaining; this would allow bargaining to adjust to situations where the lack of competitiveness might require the closure of entire plants. The reform agreement gave unions and employer groups a year to figure out on their own how to make the system more flexible, with further government action a possibility if no progress is made.

In both France and Germany, modest efforts are under way to increase the retirement age. In France, a reform passed in 2003 requires public sector employees to work as long as private sector workers, 40 years, to qualify for full pensions (they could previously qualify after 37.5 years; *The Economist*, 10/18/03: 49-51). In both Germany and France, however, the pensions remain, for the most part, pay-as-you-go systems.

Reform remains, however, an especially difficult project in France. In the mid-1990s, Prime Minister Alain Juppe was forced to retreat after a series of paralyzing strikes and protests. The current Prime Minister Raffarin’s 2003 reform was cut back to the pension change indicated in the face of opposition to his proposals for health care reforms, the consideration of which had to be postponed. It is of interest that in Germany, only 35% of the population believes that comprehensive social protection is possible without high contributions as opposed to 53% with that belief ten years ago, and that 70% of the population agrees that reforms are necessary (*Ibid*). In France, by contrast, only 51% believe that the government should continue with reforms.

Other types of reforms have been under consideration or have been implemented in these two countries as well as elsewhere in Europe. In Germany, the aging population issue will be addressed in part with new initiatives to encourage families to have children and women to enter the labor force. Although family support was 2.7% of GDP in 1998,
about three-fourths of the public support took the form of direct benefits and tax breaks rather than child care support. Child care facilities in Western Germany are often poor or non-existent. Thus the government plans to spend 1.5 billion euros on child care after 2005 and to invest 4 billion euros on all-day schools (most pre-schools are now half-day) over the next four years (The Economist, 12/6/03: 47).

In Denmark, a reform package included higher indirect taxes and a cut in entitlements, with more public resources devoted to higher education and research and development; GDP growth in Denmark was 2.6% between 1994 and 2003 compared to Germany’s 1.4% (Business Week, 11/17/03: 58). In Sweden and the Netherlands (as well as in New Zealand and the state of Oregon), health care reform includes an attempt to ration health care by considering the cost-benefit ranking of various procedures and medicines to determine which ones will be publicly covered (Los Angeles Times, 12/7/03: C4). Under a corporatist agreement in the Netherlands during the 1980s, unions agreed to limit wage demands, government to limit taxes and corporate costs, and companies to hire more workers and consult with unions on major staffing decisions (Wall Street Journal, 7/8/03: A14). In addition, regulations limiting part-time work have been eased. The system appeared to work well in good times, with economic growth in the late 1990s exceeding 3% compared to a European average of 2.5%. During and after the 2001 downturn, however, the Dutch economy has struggled with sub-par growth.

The future of the European social market economy

Attitudes toward economic reform in Europe are changing slowly, but they are changing. What is at stake is whether the European social market economy or welfare-
state will survive—in anything like the form it has thus far assumed. The pressures that will be confronting it over the coming decades are extremely powerful, with internal contradictions, aging populations and the revolutionary transformation of medicine promising to raise the costs of existing systems significantly. The pressures created by these changes are further intensified by the interacting impact of globalization and technological change, which increasingly forces firms throughout the capitalist world to focus on competitiveness and maximizing shareholder value as opposed to focusing on the welfare of their entire community of stakeholders.

Under capitalism as it exists in the world today, the prevailing forces of global competition promote the harsh, market-driven type of American capitalism at the expense of Europe’s social market economy. If the latter, more humane form of capitalism is to be preserved—hopefully until post-capitalist society arrives—the need for flexibility and reform must be recognized. In the absence of flexibility and reform, the capacity of states to maintain their social welfare commitments cannot be sustained, and the threat of extreme breakdown cannot be dismissed.