THE WELFARE STATE: PAST, PRESENT, AND FUTURE IN TRANSATLANTIC PERSPECTIVE

Symposium at the GHI, February 2, 2004. Co-sponsored by the GHI and the Hertie Foundation. Conveners: Christof Mauch (GHI) and Dirk Schumann (GHI).

Participants: Kurt Biedenkopf (Chairman, Board of Trustees of the Hertie School of Government and former Prime Minister of Saxony), Robert Kuttner (co-editor, *The American Prospect*), Waltraud Schelkle (London School of Economics), Martin Geyer (University of Munich).

Is the welfare state destined to disappear, given its huge and ever-increasing costs? Or is it an essential instrument for the preservation of social stability? To many observers, it seems obvious that under the pressure of aging populations, lagging economic growth, and the challenges of globalization, the current welfare state cannot be sustained without major transformations. Adopting a historical perspective helps clarify the key functions of the welfare state, the sources of resistance to change, and ways to overcome this resistance. With the generous support of the Hertie Foundation, the GHI brought together a group of prominent experts to discuss the development of the welfare state from American and European points of view. Christof Mauch, director of the GHI, was particularly pleased to welcome Kurt Biedenkopf, who has made seminal contributions to this debate during a long and distinguished career that has combined scholarship with public service in a unique way.

Biedenkopf began his remarks by describing the evolution of the German welfare state since its beginnings in the late nineteenth century. When Bismarck established the welfare system, it was meant to support families caring for sick and retired family members, rather than to enable individuals to maintain their standard of living during old age or illness. Accordingly, pensions and other benefits were rather low. The Weimar Republic explicitly defined the state as a welfare state, formalized the participation of organized labor in its institutions, and extended its programs. While the Basic Law of 1949 placed the Federal Republic of Germany in this tradition, chancellor Konrad Adenauer interpreted the social responsibilities of the state as limited. By providing protection against basic risks only, the state would prevent the necessary institutional arrangements from endangering freedom. Following the passage of the crucial legislation in 1957, not more than one-sixth of the Gross Domestic

Product (GDP) was spent on social expenditures. Biedenkopf pointed out that in the 1970s, these expenditures expanded to eventually reach one-third of the GDP. During this time, social expenditures increased much more rapidly than individual incomes, thus dashing hopes that the growth of the latter would reduce that of the former. As a consequence, labor costs rose sharply, bringing about a sharp rise in capital investments that drove up productivity and eliminated most low-income jobs. This resulted in rising unemployment and a concomitant rise of transfer payments as well as an expansion of the shadow economy. All these developments, Biedenkopf concluded, had produced an "overextension" of the welfare state that was no longer affordable.

Biedenkopf identified three key challenges that made serious reform of the welfare state inevitable: demographic developments, the changes of labor markets resulting from globalization, and the expansion of the European Union. In his view, the first was the most important. At present, the average German retires at age 60 with a life expectancy of another 18 years, having spent only 37.5 years actively working. Against the backdrop of a rapidly aging population all over Europe, this ratio would before long fail to provide both a decent standard of living and sufficient pensions for old age. While Germans are now beginning to realize that a change of the system is necessary, Biedenkopf warned that overcoming the likely resistance would be difficult and time consuming. In his view, however, there was no alternative to restructuring the welfare state by returning responsibility to the individual.

Robert Kuttner's response took issue with the argument that the present extent of the welfare state in Germany placed too heavy a burden on its economy. After all, Daimler had bought Chrysler, and Germany leads the United States in exports, not the other way around. Citing Karl Polanyi's *The Great Transformation* (New York, 1944), Kuttner argued that failing to balance freedom and social security could cause severe social and political crises. Dictatorships resulted from out-of-control capitalism, not the excesses of the welfare state. By investing in areas not covered by the market, that is in health and education, the state would make a market economy viable in the first place. As Sweden's introduction of competition into the system demonstrated, however, experimentation and reform were necessary. Kuttner emphasized that two types of risks needed to be distinguished: voluntary risks, related to the opening of a business, for example; and involuntary risks, such as the relocation of jobs as a result of globalization. Agreeing with Biedenkopf that globalization made it difficult to defend islands of high wages, Kuttner nevertheless dismissed the idea that this necessitated the abolition of the welfare state.

While acknowledging that a reformed welfare state could not follow the models set by Bismarck or the New Deal, Kuttner called for a "work-and-welfare state" that allowed individuals to participate in the economy without fear; otherwise, they might fall for political extremists. Unfortunately, in his view the United States has seen an all-out assault on its social security system since the 1980s.

In his reaction to Biedenkopf's remarks, Martin Geyer noted that, given the intensity and scope of the present public discourse on reforms of the welfare state, Germany was finding itself in another *Gründerkrise,* another attempt to rebuild the foundations of state and society. This should come as no surprise, Geyer emphasized, as the institutionalization of social interests over a long period of time had empowered many social groups and thus had helped to integrate Germany. But it had also created the potential for stiff resistance to reforms of the social security system. While farmers were often forgotten in discussions about the system, the reactions of civil servants had to be seen as a yardstick for the viability of changes. In contrast to Biedenkopf, Geyer described the 1980s, not the 1970s, as a crucial period. By providing new benefits for families, the Kohl government had increased the stakes families held in the system and made the welfare state even more resistant to reforms, in spite of attempts to cut it back elsewhere. Geyer found it puzzling that politicians in particular were voicing their disillusionment about the ability of the political process to change the social security system. Calling for more optimism, he interpreted the modification of the pension system that was associated with former labor minister Walter Riester as an example of successful piecemeal reform. Muddling through, Geyer concluded, might be a viable reform course for Germany, as it had been for the United States during the last two hundred years.

In the lively discussion that followed, it soon became clear that Biedenkopf's and Kuttner's positions were not as far apart as they had first appeared. Prompted by questions about the impact of German unification on the social security system, gender inequalities, the meaning of Hayek's theories, and the differences between the reform discourses in the United States and Germany, Biedenkopf made it clear that he did not advocate dismantling the welfare state, but instead favored adjusting it in such a fashion that the coming generation would be dissuaded from opting out of the system. Defining education as an investment in the future, Biedenkopf refused to categorize it as part of the social security system. While opting for a broader definition that encompassed education, Kuttner acknowledged that Biedenkopf's positions would place him to the left of the American discourse. Both agreed that globalization called for mechanisms of political control to avoid excessive emphasis on economic freedom in relation to social responsibility. Referring to the European Union, however, Biedenkopf pointed out that the nation-state had ceased to be the only institution capable of exerting this control. All in all, the presentations and the discussion shed new light on the enormous complexity of the debate about reforms of the welfare state on both sides of the Atlantic. Europeans and Americans seem not so much separated by different systems as they are close to each other in the problems of coming up with precise definitions and viable political strategies.

Dirk Schumann