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Are the Western Welfare States Still Competitive?

by Alfred Pfaller, Bonn*

Is there a contradiction between international competitiveness and the central principles of the welfare state? The following article examines both the negative and the positive ways in which welfare statism can affect a country's ability to compete on international markets.

It is being said on both sides of the Atlantic that the Western welfare states are becoming less and less competitive. They are, it is said, more concerned with economic security, with consumption and with distribution than with economic performance, efficiency, investment and adjustment to the international market.¹ This idea is reflected in a variety of theoretical concepts which not only denounce the anti-productivity and anti-efficiency bias of contemporary Western Europe and North America but also try to put it into perspective and explain it. Kindleberger's "aging economy" concept is one example, as is Mancur Olson's comprehensive theory of the sclerosis which almost inescapably affects rich, saturated societies.²

To be old, slow and inflexible becomes, of course, a serious danger for a nation's prosperity when there are more efficient producers who are able to offer better goods at more attractive conditions on international markets. In the best case, the relatively inefficient country then has to content itself with a more slowly growing income, as it must compensate for the competitors' superior productivity with lower wages, lower profits, and/or a devaluated currency. In the worst case, national producers are pushed out of the market, part of the country's productive capacity is eventually eliminated, and the national population loses some of its income sources.³

The competitors who are supposed to outperform the sclerotic Atlantic countries are, of course, Japan and the East Asian "NICs". Euro-pessimists would in addition expect the European welfare states to fall behind the less immobile USA.⁴

It seems easy to refute the notion of the welfare states' relative inefficiency by pointing at the hard statistical facts. Countries with highly developed welfare states like Sweden and West Germany have achieved high per capita incomes while being fully integrated into the world market. Others with considerably less developed welfare states, for instance the USA, have fallen back in international comparison. Likewise, it cannot be confirmed that the economic performance of countries with a relatively high share of government in GDP (a corollary of a highly developed welfare state) has been inferior.⁵ Nor is it difficult to find reasons for a positive correlation between economic performance and the kind of generalized economic security or income guarantee which is subsumed under the term welfare state: welfare state mechanisms provide for a secure supply of high quality labour to the enterprise sector as a whole. They thus assume important infrastructural functions.⁶ And they create legitimacy, thus facilitating social consensus and reducing the likelihood of disruptive conflict as well as the need for expensive controls. Therefore, while often appearing to be a

¹ Cf. e.g. B. Scott: *National Strategies: Key to International Competition*, in: B. Scott, G. Lodge (eds.): *U.S. Competitiveness in the World Economy*, Cambridge/Mass 1985.

² Cf. C. Kindleberger: *The Aging Economy*, in: *Weltwirtschaftliches Archiv*, Vol. 114, No. 3, 1978; and M. Olson: *The Rise and Decline of Nations. Economic Growth, Stagflation, and Social Rigidities*. New Haven/Conn. 1982.

³ On the importance of international competitiveness for a nation's prosperity see M. Dauderstädt, A. Pfaller: *The New Zero-Sum World. International Competition and Global Economic Growth*, Bonn 1985; A. Pfaller: *International Employment Competition*, in: *The Annals*, 492, July 1987; and B. Scott: *National Strategies*, op. cit.

⁴ Cf. e.g. H. Giersch: *Die Bundesrepublik und die USA – Wirtschaftssysteme und Zukunftschancen*, in: *Jahrbuch für Sozialwissenschaften* 35, 1984.

⁵ Cf. P. Saunders: *Public Expenditure and Economic Performance in OECD Countries*, in: *Journal of Public Policy*, Vol. 5, No. 1, 1985; and H. Aaron: *Economic Effects of Social Security*, Washington 1982.

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nuisance from a micro-economic perspective (costs, restrictions on entrepreneurial freedom), the welfare state may still ensure superior macro-efficiency.

Valid as these observations and arguments are, they do not necessarily settle the issue of the welfare state and competitiveness. Things are slowly changing on the welfare state side as well as on the side of international competition. It is possible that the evolution of the welfare state has altered unfavourably the balance of macro-efficiency effects and micro-costs. It is also possible that new production techniques are redefining the requirements of macro- and micro-efficiency, e.g. in the direction of more flexibility and less continuity. Finally, it is possible that new competitors have come up with a more favourable balance of macro-efficiency and micro-costs than the traditional Western welfare state can provide.

To advance beyond the state of vague suspicions and generalized beliefs, it may be useful to map out the complex relationship between the competitive challenge as it presents itself in the 1980's and the response to it on the part of the Western industrialized nations. The warranted and unwarranted pressures on the welfare state can then be localized.

By the welfare state we mean more than just social security schemes, transfer payments by the state to the needy, and free government services like education. We mean the basic normative principle that each citizen ought to enjoy a certain minimum standard of living, independently of how he fares in the market, and the totality of social arrangements which serve this purpose. They include income guarantees linked to employment status such as protection against dismissal and sick payment, they include governmental policies to protect the income sources of citizens (from full employment policies to import protection) and they include guarantees as to certain qualities of life (from holidays to clean air). It is important to note that the concrete manifestations of Western "welfare statism", as we may call the multitude of institutionalized practices and policies, flow in part (albeit not exclusively) from a value pattern which clearly subordinates economic life and its central principle, the market, to other social priorities: to equality and to the enjoyment of life. Within this value pattern production for, and distribution through, the market are simply a means to an end and readily restricted and supplemented if the higher values seem to be at stake.

Our question is a double one:

- ☐ How do the institutional and ideological patterns of welfare statism fit with the requirements of a nation's competitiveness? Or to put it more simply: can the welfare states compete?
- ☐ How does international competition affect welfare statism? At the extreme: will the welfare states survive?

Means and Ends of Competitiveness

International competition does not just set firms from different countries against each other in their struggle for market shares. Implicitly, it also subjects to comparison the various societies' capacities for generating and supporting successful enterprises.⁷ The ability of national producers to earn comparatively high incomes on the international market depends on their productivity and their ability to offer goods and services which achieve premium prices because of their superior quality. Productivity and qualitative excellence, in turn, depend on systematic efforts which are in a sense the outflow of specific organizational structures. Some ways of organizing society are more conducive to high economic performance than others. And the concept of welfare statism is concerned with these organizational structures.

On the other hand, for us the competitiveness of a nation refers to its ability to achieve high factor incomes when exposed to international market forces. Whereas an enterprise can derive its competitive strength from its access to cheap labour, for a nation this does not make much sense beyond short-term technical considerations. On the contrary, a nation is competitive if, and to the extent that, it can afford a high real income for its labour force.⁸ If we extend this notion, we can also say that a country is competitive if it can afford an expensive welfare state, because welfare statism can be considered an element of social consumption. Like high wages, it must be earned on the market, with the help of superior productivity and product quality. In this regard, the option for welfare statism can be considered

⁷ Cf. M. Dauderstädt: Free Markets versus Political Consensus. The International Competitiveness of Societies, in: *INTERECONOMICS*, Vol. 22, No. 1, Jan./Feb. 1987; A. Pfaller: Internationale Produktionsstruktur, nationaler Wohlstand und neo-mercantilistische Politik, in: A. Pfaller (ed.): *Der Kampf um den Wohlstand von Morgen*, Bonn 1986; and B. Scott: *National Strategies*, op. cit.

⁸ On the meaning of national competitiveness in the international market see e.g. D. Orłowski: *Die internationale Wettbewerbsfähigkeit einer Volkswirtschaft*, Göttingen 1982; or *Global Competition – the New Reality*, The Report of the President's Commission on Industrial Competitiveness, Washington 1985, pp. 6 ff.

⁶ Cf. e.g. I. Gough: *The Political Economy of the Welfare State*, London 1979.

a premium which the world market grants to the highly competitive countries – and withdraws if competitiveness declines.

But there is also a distributive dimension to it. Even though the world market sets limits to the costs which can be burdened upon enterprises, society can still opt for different ways of letting the limits be felt. Restraint can be put primarily on money wages and/or on the value of the national currency. The first option would restrict individual consumption of commercialized goods and services in general, the second option that of tradables. These restrictions can be seen as the price for having a welfare state. If society refuses to pay this price because, for example, of interest group resistance, it could live for a while beyond its means, expanding its internationally unexposed sector and running a trade deficit. But ultimately it cannot avoid the decision as to which type of consumption should be restricted. Political forces might then lead to cuts in welfare statism rather than in individual consumption (which probably would have to be reduced anyway in such a situation).⁹ Thus, tougher international price competition which enhances the pressure on a country's production costs could affect the welfare state because it strains the distributive structures which used to support it.¹⁰ Still, the causal sequence in this case is that diminished competitiveness (in the sense of productivity and quality advantages) reduces the national income which is available – *ceteris paribus* – for welfare statism.

It may be that advancing low-cost, yet high-performance competitors make it increasingly difficult for the old industrial nations to maintain high welfare standards as ends.¹¹ In the following we are concerned, however, with the ways in which welfare statism might affect a country's capacity to achieve the highest international standards in productivity and product quality. For such standards to be achieved, the economic structures of a country must guarantee two things:

□ Comparatively, a great deal of effort must be devoted to the formation of productive capital in general and to innovative capacity in particular. The resources needed for this purpose have to be withheld from other uses,

such as private or public consumption or the formation of non-productive capital.

□ Optimal use must be made of capital, labour and other productive resources. This second imperative concerns allocative and x-efficiency. It implies that people are ready to adjust their economic activities comparatively quickly to the changing efficiency requirements of the market. It also implies that each productive activity is organized efficiently and that the performance of workers and managers is permanently high.

Formation of Capital

Even though different investment ratios can only explain part of international differences in productivity growth,¹² it is essential for a country's long-term competitiveness not to invest permanently less in the formation of productive capacity than its competitors – at least those who are broadly at the same, or an even higher, level of productivity and technological capacity.

The formation of productive capital is put in jeopardy if entrepreneurs do not get sufficient resources and if they do not have sufficient incentives. Profits are considered a key variable in both respects. And the costs of welfare statism are liable to erode profits. Whether they appear as non-wage labour costs, as expenditure to meet environmental and safety standards, as salaries for excess personnel which cannot be dismissed, or as taxes to finance government programmes, they make production more expensive than it would otherwise be. Like all costs they tend to squeeze profits if competitors exert pressure on prices. This repeats the above argument on the allocation of costs, adding the notion that adequate provision has to be made for profits. In other words, welfare state costs do not need to affect profits if other cost elements, including the exchange rate, are properly adjusted. Direct taxes on profits constitute a special case because they come with a built-in multiplier which increases the need for any compensatory cost-saving effort.¹³

If it is theoretically possible to compensate enterprises for the profit-squeezing effect of welfare state costs it is also possible to leave enterprises

⁹ However, the tremendous exchange rate fluctuations which Western industries had to cope with in the past decade dwarf all potential cost effects of changes in non-wage labour costs and the like. It would seem, therefore, that adjustments on the currency front are the more "natural" solution to cost pressure problems.

¹⁰ In this respect, Rosanvallon points to the need for a new social contract which explicitly takes account of what is required to implement under the changed economic conditions that degree of solidarity that society considers essential; cf. P. Rosanvallon: *La crise de l'Etat-providence*, Paris 1981.

¹¹ Cf. A. Pfaller: The Changing North-South Division of Labour. Promises, Threats and EC Policy Options, in: *Kyklos*, Vol. 39, No. 1, 1986; and A. Pfaller: International Employment Competition, op. cit.

¹² Cf. E. Denison: The Contribution of Capital to Economic Growth, in: *American Economic Review, Papers and Proceedings*, May 1980.

¹³ It is mostly in this regard that policy-makers speak of the international competition of tax systems. Cf. e.g. G. Stoltenberg: Soziale Marktwirtschaft und die Funktion der Staatsquote, in: *Handelsblatt*, 26 May 1986, p. B 11.

untouched by these costs to start with. The state would then take care, for instance, of maintaining the incomes of unneeded employees. Most important, the state would finance its expenses predominantly through taxes on households and consumption.

But profits are neither the only source of investment finance nor does guaranteed profitability ensure a high ratio of capital formation. Another important aspect is the flow of household savings to investing enterprises. Welfare statism could affect this flow negatively because it does away with the motive of providing on an individual basis for future needs like children's education or old-age income. This is said, for example, to be at the roots of the high savings ratio in Japan. On the other hand, a detailed analysis was unable to discover clear effects of social security on savings.¹⁴ More important are probably government deficits (presumably due in large part to expensive welfare statism) which absorb private savings, lifting the costs of capital and, thus, crowding out productive investment.¹⁵ In turn, if welfare statism is largely financed by taxes, resources are withdrawn from private consumption rather than from investment.

As far as the availability of resources for investment is concerned, the allocation of the costs of welfare statism is in several respects crucial. It is not expensive welfare statism as such which eats up the funds which could otherwise be used for capital formation. It is the way welfare statism is financed, especially the absence of explicit and transparent cost allocation, which can bring about this result. But another question is whether enterprises still want to invest in capital formation if welfare statism allows only for low returns on the invested capital. That they should be more hesitant seems immediately plausible. But there are other considerations which raise doubts on the issue. The perspective of cost advantages and hence higher profit margins should also stimulate productivity-enhancing investments under conditions of generally tight margins, maybe even more so than with lots of easy profit opportunities around. The same applies to product innovation, which widens profit margins on the selling-price side. On the other hand, for existing enterprises investment is not just an optional response to a favourable business climate but a matter of survival in the face of international competition. It is imposed by the market dynamics of the specific industry and

corresponds to the firm's strategy in its struggle for an advantageous market position (for instance, regarding the achievement of scales or the maintenance of a technological lead).¹⁶

Allocation of Financial Resources

If we look at the significant differences in investment ratios between major industrialized countries, the independent variable "welfare statism" cannot explain very much of them. Much more important seems the way decisions on the allocation of financial resources are made. In the USA, which has had comparatively low investment ratios during the whole post-war period, the decentralized preferences of the public on the capital markets practically determine under which conditions potential savings, including corporate profits, go into productive investment, into financial speculation or back into household consumption. In other countries, the long-term growth preferences of certain elites who control a significant part of the finance flow (executives of big banks in Germany, the "political-industrial complex" in Japan) have much more weight, because enterprises are more dependent on them and less responsible to a broad public of shareholders. Whatever the concrete institutional arrangements are, they have in common that they insulate to some degree the area of investment decisions from the preferences of those who aliment the system with their savings.¹⁷ Thus, they not only provide cheaper finance, they lend themselves also to long-term, strategic approaches to investment activity. This institutional explanation is supported by the very modest investment-strengthening effect of both Reagan's and Thatcher's economic reforms with their deregulative drive, their tax cuts and their heavily pro-business attitude.¹⁸

If corporatist patterns of economic organization lend themselves to the pursuit of high rates of capital formation they might also have the least problems in extending welfare statism without impairing investment. Sweden, West Germany and Austria come to the mind. But it may be that increasing "footlooseness" of

¹⁶ On the dynamics of market structures and enterprises in general see e.g. R. Nelson, S. Winter: *An Evolutionary Theory of Economic Change*, Cambridge/Mass. 1982. On the dynamics of decline in a particular industry see e.g. W. Abernathy: *The Competitive Status of the United States Automobile Industry*, Washington 1982, or W. Goldberg: *Ailing steel. The transoceanic quarrel*, Aldershot 1986.

¹⁷ On the comparison of financial mediation systems see M. Dauderstädt: *Free Markets versus Political Consensus*, op. cit.; and J. Zysman: *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change*, Ithaca/N.Y. 1983.

¹⁸ Cf. J. Sawhill, C. Stone: *The Economy: The Key to Success*, in: J. Palmer, J. Sawhill (eds.): *The Reagan Record. An Assessment of America's Changing Domestic Priorities*, Cambridge/Mass. 1984; and *Financial Times*, April 1st, 1987, p. 11.

¹⁴ Cf. H. Aaron, op. cit.

¹⁵ On the importance of the cost of capital for a country's competitiveness cf. e.g. G. Hatsopoulos, S. Brooks: *The gap in the cost of capital: causes, effects and remedies*, Cambridge/Mass. 1986.

industrial production tends to force states more and more into a bargaining relationship with enterprises. This means that the balance between the costs a country imposes on enterprises and the facilities it offers to them has to compare favourably with that of other countries. This would imply that countries become principally vulnerable to "social blackmail" by investors if other countries set less costly standards of welfare statism while providing equally favourable conditions with regard to infrastructure, labour qualification, industrial peace, access to markets, etc. The large-scale migration of American business from the traditional industrial centre region with its pronounced welfare statist and regulative tendencies to the south-west with its ample liberties for capital indicates very clearly that with capital mobility investment becomes something like a reward for a well-behaved community rather than the outflow of its collective effort.¹⁹

The question is how far intra-US migration can serve as an analogy for capital mobility between countries. For one thing, the threshold for the decision of a firm to move abroad seems considerably higher than that for moving within a country. But decisive is, in addition, whether, say, Swedish or German firms do have reasons to assume that producing in the USA, in Great Britain or in Italy would be more advantageous for them than producing at home. If we neglect the motive of securing market access this boils down to a cost comparison with the exchange rate, productivities, and factor costs (including the ones of welfare statism) as crucial parameters. That is to say, welfare state costs affect a country's competitiveness on the world market for industrial locations in very much the same way as on the commodity markets: at given exchange rates, the country has to "earn" the welfare state burdens it imposes on capital with its productivity potential and with moderation in wages and other costs. One cannot say that welfare statism creates a productivity disadvantage by systematically diminishing a country's attractiveness as a place to start and expand production. As with competitiveness on commodity markets it is, rather, a superior productivity potential which would allow the imposition of costly welfare statism

and high wages (at prevailing exchange rates) on internationally mobile enterprises. Of course, persistent failure to adjust welfare state costs to the conditions of comparative productivities is liable to deprive a country of the investments which are needed to maintain or improve its comparative productivity potential. There is scope for vicious as well as virtuous circles.

Rigidities

Changes in demand, competition and technology make the productivity of capital and labour dependent on the economy's ability to adjust their deployment to the requirements of the market. Welfare statism, however, has tended to create entitlements, not only to a certain income but often also to specific economic positions from which the income is derived. Such entitlements tend to resist the adjustments which are called for on behalf of maximum productivity. They are a source of costly rigidities.

But the cost of these rigidities can be of very different kinds. They can accrue to enterprises which are burdened with unneeded personnel on their payroll. In this case our earlier considerations on the allocation of costs, on substitutes, and on compensations apply. Tax-financed income maintenance and retraining programmes could for example replace job entitlements at the expense of specific firms. Enterprises may also be kept from organizing production more efficiently or from innovating due to the resistance of position holders or due to obstacles which are imposed on behalf of extra-firm objectives like environmental protection and consumer safety. Concern for jobs can lead to the conservation of relatively inefficient structures to the benefit of firms and their employees alike but at the expense of consumers in general, of producers who have to pay higher input prices, and/or of taxpayers who finance subsidies. All these non-adjustments to changing market conditions imply immediate welfare losses in terms of lower output per input unit than otherwise obtainable. But they also may have more serious long-term consequences. They may discourage adjustment efforts and innovation and thus cause a general decline in economic dynamism. For the rigidities do not only absorb tangible production factors but also two very scarce intangible resources: opportunity (very important in fast-changing environments) and entrepreneurial initiative in seizing opportunities.

In assessing the impact of welfare-state rigidities on competitiveness, we must recognize that to some degree freedom from the imperative of total flexibility constitutes a legitimate goal whose price in terms of

¹⁹ This symptomatic case can be interpreted in a double way. One can see the American north-east and its welfare statism as the victim of "social underbidding" by the south-west, which allowed business to improve its distributive position vis-à-vis labour and the rest of the society. Cf. for this view e.g. B. Bluestone, B. Harrison: *The Deindustrialization of America. Plant Closings, Community Abandonment and the Dismantling of Basic Industry*, New York 1982. But one could also say that the south-western option revitalized American business, saved it from the sclerotic tendencies of the north-eastern setting and re-strengthened it for international competition. Cf. R. Norton: *Industrial Policy and American Renewal*, in: *Journal of Economic Literature*, Vol. 24, March 1986.

foregone allocative efficiency society can be prepared to pay. Again in this respect, not the costs as such are problematic but the refusal of society to pay. Beyond this rationally acceptable trade-off, however, rigidities imply waste. The social utility of mitigated adjustment pressure is inferior to its costs, or there are less costly alternatives for providing economic security.

More Efficient Alternatives

Welfare statism can bring about such waste because it can be associated with a one-sided awareness of its social utility and with a lack of concern as to the costs. This can be reflected in a pluralistic structure of interest groups which all have the power to block unpleasant adjustment demands while the responsibility for the costs does not have an institutional base.²⁰ But the welfare-state principle of economic security does not necessarily demand the protection of given structures. An ideal-type example of a more efficient alternative is provided by Sweden, where the community finances the individual's mobility. Generous income maintenance during joblessness and active re-employment support are the pillars of the Swedish system.²¹ Pertinent in this respect are also work-sharing schemes which distribute, in times of general mass unemployment, the forced leisure time among wage-earners. Combined with continuous re-training efforts these even tend to increase the stock of human capital.²² As to the scope of such schemes, it seems that society-wide solutions are more flexible than enterprise-based employment guarantees Japanese style. In times of prolonged economic adversity the new jobs to which enterprises can shift their workforce might not show up in sufficient quantity, which in turn can jeopardize the whole system.²³

Of course, general income maintenance and active redeployment support have to be paid for by the rest of society. Full exposure of individuals to the market is – if it can be enforced at reasonable costs – cheapest for those who stay on the sunshine-side. But it simply defines away people's preferences for security from the indifference curves towards which the market system is supposed to orientate its optimizing exercise.

The industrialized countries exhibit significant differences as to the rigidity of their welfare statism. And it appears that an early conquest of political power by the labour movement (as for example in Sweden) was conducive to centralized and generalized welfare state patterns which proved relatively adjustable in view of flexibility requirements. On the other hand, where security guarantees were largely the result of decentralized but confrontational bargaining between

labour unions and management outside of the political sphere, as was the case in the USA, they later turned more easily into rigid obstacles to adjustment and modernization.²⁴ But throughout the West one notices a trend towards more rigidity since the general slow-down of economic growth let the demand for labour dry up while at the same time more and more industries became exposed to international competition and flexibility began to demand sacrifices rather than the seizure of new, profitable opportunities. Popular demand for economic security was less and less satisfied by a well-functioning high-growth economy and therefore turned increasingly to welfare statism. From its initial function as a supplement to a steady-course, full-employment market economy, welfare statism was increasingly – albeit in an uncontrolled and non-premeditated way – extended into a market substitute. However, sacrificing economic security is only one way towards re-flexibilization. The development of adequate welfare state institutions to satisfy the demand for security in a more rational manner would be another.

Human Performance

High labour commitment is the third core factor of a country's international competitiveness. It is a function of workers' identification with the productive tasks to be performed and with the success of the enterprise, on the one hand, and of disciplinary pressure on the other. It is in the latter respect that the welfare-state generated income security, which is completely delinked from performance criteria, appears highly negative because it removes the pressure on people to work hard and well.

This is but an extension of the old argument as to the discipline-eroding effects of full employment, which

²⁰ This is, of course, the classical Olson pattern. See also Pluralismus unter Konkurrenzdruck. Expertengespräch der Friedrich-Ebert-Stiftung, Bonn 1982.

²¹ Cf. R. Meidner, A. Hedborg: Modell Schweden. Erfahrungen einer Wohlfahrtsgesellschaft, Frankfurt 1984.

²² For such a proposal see L. Emmery: Intervening on the Supply Side of the Labour Market, in: *The Annals*, 492, July 1987. See also Piore's concept of making labour and firms more adaptable to varying productive tasks rather than financing the ease of hiring and firing: M. Piore: Perspectives on Labor Market Flexibility, in: *Industrial Relations*, Vol. 25, No. 2, Spring 1986.

²³ Already, in the wake of the tremendous currency shock to Japan's export industries, Japanese companies find it increasingly difficult to keep up this traditional practice. US companies which have tried to emulate it were confronted with similar problems.

²⁴ Cf. I. Gough, op. cit., pp. 79 ff. On the flexibility of different industrial relations patterns see e.g. H. Katz, C. Sabel: Industrial Relations and Industrial Adjustment in the Car Industry, in: *Industrial Relations*, Vol. 24, No. 3, Fall 1985. An important aspect of the American rigidity problem refers to the so-called post-Fordist production methods to which old-style US labour relations are badly adjusted. See M. Piore, C. Sabel: *The Second Industrial Divide: Possibilities for Prosperity*, New York 1984.

tends to enhance workers' conflict potential, move wages up and work efforts down.²⁵ It holds if there is no other strong motive for people to do a good job than the fear of dismissal, wage cuts and the like. But, if this is the case discipline and performance hinge crucially on the effectiveness of controls. Depending on the tasks to be performed, controlling the efforts of a completely unmotivated workforce can be very difficult, costly and a major source of rigidities itself.²⁶ Especially when it comes to qualitative excellence and intellectual inputs the superiority of labour commitment is generally acknowledged. In fact, it is regarded as a major cause of Japanese as well as German economic success, and among Anglo-Saxon enterprises the past decade has been witnessing a strong reform movement in the search for high-commitment, low-conflict labour relations.²⁷ In part, this movement has been imbedded in the business sector's wider effort to free itself of the old burdensome influence of organized labour. But it also deliberately introduced new elements of welfare statism, in particular more firm-guaranteed employment security and increased employee participation on various levels of firm decision-making – steps in the direction of "corporate citizenship" analogous to the economic citizenship which always has been a central (though not the only) motive of the welfare state movement.

Communality of Interests

It is highly significant that such new elements are not only being introduced as a concession to the bargaining power of organized labour but also as an offer to non-organized workforces in the union-free settings of the American south-west. This indicates that from the point of view of micro-economic efficiency the best of all (realistic) worlds is not the unabashed rule of labour market discipline. Since the intra-firm principle of coordination is not the market but pre-designed ("planned") cooperation, incentive patterns are superior which provide for a broad communality of interests rather than stressing only the exchange of effort against pay. In the absence of such communality, welfare statism has helped to undermine the exchange-based discipline because it has tended to secure pay without corresponding effort. But the principles of welfare statism are also the ones which can establish the broad communality of interests and thus overcome the limits of the pure individualistic exchange logic.

High-commitment labour relations do not eliminate the exchange principle, creating entitlements independent of performance. Rather, they combine the two principles, supplementing the discipline of

conditional rewards with the motivational source of common purpose. It seems that the balance between the two is not always an easy one. Besides, there can be trade-offs with allocative efficiency, as the maintenance of communality may require a certain mitigation of adjustment pressures. If the balance cannot be achieved, the question as to the second best solution becomes relevant. And here, the discipline which arises out of a weak market position of labour might well render a better performance than purely voluntary cooperation under freedom from sanctions. This would be more likely if welfare statism entitlements appear to be a conquest of the labour movement within a basically antagonistic class conflict setting.

Thus, for welfare states to remain internationally competitive it is important that they overcome the political culture of class antagonism and establish strong elements of an economic community. Otherwise they are liable to lose out in productive efficiency to countries where discipline is imposed with the help of economic pressure on a politically weakened labour force.²⁸

The Politics of Welfare State Adjustment

Welfare statism is highly ambivalent with regard to the three central aspects of international competitiveness which we have considered. It can and does hamper the formation of capital but it does not need to at all if properly designed. It can and does interfere with allocative flexibility and with labour performance. But it can and does also help to promote competitive virtues. Whether the one or the other is the case depends in part on mere technicalities like tax structures. But in part it depends on the political and economic circumstances which determined the historical evolution of welfare statism in the individual countries. The economic disfunctionality of certain welfare state patterns became typically apparent when economic conditions

²⁵ Cf. M. K a l e c k i: Political aspects of full employment, in: *Political Quarterly* 1943.

²⁶ Cf. R. E d w a r d s: *Contested Terrain. The Transformation of the Workplace in the Twentieth Century*, New York 1979, D. G o r d o n, R. E d w a r d s, M. R e i c h: *Segmented Work, Divided Workers. The historical transformation of labor in the United States*, Cambridge/Mass. 1982; M. N a p l e s: *Labor Militance and the End of the Postwar Truce*, in: *American Economic Review, Papers and Proceedings*, May 1984; or for a case study D. F l a h e r t y: *Labor Control in the British Boot and Shoe Industry*, in: *Industrial Relations*, Vol. 24, No. 3, Fall 1985.

²⁷ Cf. D. Q. M i l l s, M. R. L o v e l l, Jr.: *Enhancing Competitiveness The Contribution of Employee Relations*, in: B. S c o t t, G. L o d g e (eds.): *U.S. Competitiveness*, op. cit.; and J. S i m m o n s, W. M a r e s: *Working Together*, New York 1983.

²⁸ See also Streeck's hypothesis on the superiority of market-enforced discipline vis-à-vis relatively expensive corporatist consensus in times of general unemployment. W. S t r e e c k: *Neo-korporatistische Kooperation und weltwirtschaftliche Konkurrenz*, in: *Pluralismus unter Konkurrenzdruck*, op. cit.

underwent fundamental changes while old practices could not easily be adjusted.

The central welfare state principle of economic solidarity within a national society does not need to be restricted for the sake of international competitiveness. On the contrary, its generalization should even improve the conditions for allocative flexibility and human performance. Society has to compromise, however, on certain non-economic objectives which interfere with basic conditions of economic dynamism. Essential is further that the costs of welfare state solidarity are allocated in an explicit and transparent way and not thoughtlessly burdened onto enterprises.

Even though international competition does not restrict the institutionalization of economic solidarity it does impose on all countries the priority of productivity vis-à-vis enjoyment of life and to some degree the priority of business interests vis-à-vis the interests of all other segments of society.²⁹ And in fact, the pressure of international competition has begun to induce adjustments in this direction. However, the anti-welfare-state backlash which can be observed in various countries cannot simply be interpreted as a rational attempt to optimize the trade-off between welfare statism and productivity. Politics and ideology are heavily involved.

It was in the functional context of domestic market oriented Keynesian macro-economics that welfare statism provided a means to accommodate the redistributive aspirations of organized labour. And there is a tendency – in some countries more than in others – to defend and consolidate the redistributive “conquests” in this context. And not only redistributive labour demands, but interest group pressure of all sorts, has shaped the reality of Western welfare statism and is set to defend the plethora of entitlements it has created.

Conflict over Distribution

Attempts to adjust welfare statism to the requirements of international competitiveness are therefore almost inevitably drawn away from the level of a purely functional discussion to the conflict over distribution. The resistance of vested interests against adjustments brings welfare statism itself under fire from the modernizers, because it is seen as the institutional and ideological base of the recalcitrant rent-seekers. In particular, the cause of organized labour loses legitimacy as it gets associated with the defence of anti-

productive rigidities. This has become especially accentuated in Britain and the USA. But the tendency can also be observed in Germany, for instance.

Of course, a generalized confrontation pattern “welfare statism versus efficiency” offers a free ride to the distributive interests of business as well as of the upper income strata who are net contributors to the welfare state.³⁰ Therefore, the movement to cut back on welfare statism is liable to gain momentum well beyond that which would be warranted on efficiency grounds. Such cut-backs are felt most quickly and often most severely at the fringes of welfare statism where political resistance is weakest, whereas the centre pieces of social security are left untouched. Again, in the UK and the USA this has become most obvious. But the dismissal of increasing segments of the population from the welfare-state protected sector of the economy into the non-protected zones of unemployment, part-time work, subcontracting etc. also reflects the uneven distribution of power rather than the functional necessities of economic efficiency.

On the other hand, international competition increases the interest of business and national governments in the efficiency-enhancing elements of welfare statism mentioned earlier. In the Anglo-Saxon countries initiatives in this direction have largely come from outside the labour movement and taken it more or less off-guard. Elsewhere organized labour has stayed more in control of new developments, in part because the patterns of welfare statism were much more compatible with efficiency to start with. Even there, however, it is not certain that labour has not become an accomplice to solutions which give extended “corporate citizenship” to the permanently employed while neglecting the outsiders.³¹ The requirements of international competitiveness do not make such a development mandatory. But it is questionable whether labour or any other political force has the will and the strength to veto it and enforce economic solidarity nationwide.³²

²⁹ This is also the ideological climate for the tendency towards a “colonization” of the welfare state. Cf. R. Rosenbrock: *Die Kolonialisierung des Sozialstaats*, in: *Soziale Sicherheit*, Zeitschrift für Sozialpolitik, Vol. 34, No. 11, 1985.

³¹ On the difficulties German unions have in coping with the changed situation, see e.g. J. Esser, W. Flach, W. Vöth: *Krisenregulierung. Zur politischen Durchsetzung ökonomischer Zwänge*, Frankfurt/M. 1983.

³² On the interplay of power relations, ideology and alternative futures of welfare statism see also J. Goldthorpe: *The end of convergence: corporatist and dualist tendencies in modern Western societies*, in: B. Roberts, R. Finnegan, D. Gallie (eds.): *New Approaches to Economic Life. Economic Restructuring, Unemployment and the Social Division of Labour*, Manchester 1985; and W. Korpi: *The Democratic Class Struggle*, London 1983.

²⁹ Cf. the basic notion of Lindblom that the distributive interests of capital coincide to a considerable degree with the efficiency requirements of the capitalist economy. C. Lindblom: *Politics and Markets. The World's Political-Economic Systems*, New York 1977.