

### CHAPTER 3

## THE RISE OF DEMOCRACY, LIBERALISM (OR CAPITALISM) AND THE WELFARE STATE TO ABOUT 1950

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### 3.1 THE THREE ASPECTS OF MODERN POLITICAL AND ECONOMIC SYSTEMS <sup>2</sup>

In any modern state the citizens are structurally linked to the state's authority in *three* different ways:

- (i) citizens are jointly the sovereign creators of the state's authority;
- (ii) citizens are potentially threatened by state-organised power and force and must be protected against this danger; and
- (iii) citizens are dependent on the services and other provisions organised and offered by the state.<sup>1</sup>

This tripartite link between citizens and state authority crystallised in the course of time into what we may call our modern *democratic capitalist welfare state*, which has three essential aspects:

#### (a) *Democracy and parliamentarism*

The procedures and institutions in terms of which the citizens jointly "create" the state and, as it were, "transfer" true power and legitimacy to the state are known as *representative democracy*. This "transfer" of authority by the citizens (electorate) to the rulers (of the state) is done through periodic general elections in which a parliament with legal authority is elected. During an election the electorate chose between different political parties or elite groups and the elite group(s) that gains a majority of votes is invested with the responsibility of ruling the country for a certain amount of time.

#### (b) *Liberalism, the rechtstaat and capitalism*

<sup>1</sup> Chapters 3 and 4 are to a large extent based on Claus Offe, *Modernity and the State - East and West*, MIT Press, 1996, David Held, *Models of Democracy*, Polity Press, 1987, Gösta Esping-Anderson, *The Three Worlds of Welfare Capitalism*, 1996, and Robert Heilbroner and W. Milberg, *The Crisis of Vision in Modern Economic Thought*, Cambridge, 1996.

The laws and traditions whereby citizens are protected against the *potential* threat of state-organised power and force and whereby FREEDOM and (juridical) SECURITY are created for the citizen and protected are referred to as the rule of law or the liberal *rechtstaat*. The *rechtstaat* also includes property and contract rights and thereby lays the foundation for the market-orientated (or capitalist) economic system. While state power is indispensable to prevent chaos and to create ORDER, the kind of order created predominantly in the Western world after a long and difficult evolution is the liberal *rechtstaat* and the capitalist system - in other words, a system that permits a high degree of FREEDOM and initiative to individuals and private organisations (in the private sector).

(c) *The welfare system and "social rights"*

Before the rise of the modern economy (i.e. before the year 1800), individuals and households often practised an isolated subsistence economy, and the extended and/or paternalistic family formed a "welfare community" in miniature which offered security and a minimum standard of living to all members of the extended family. The processes of modernisation, urbanisation and the rise of the modern labour market destroyed the economic independence and the paternalistic "welfare community" to such an extent that in the 20th century the apparatus of the "warfare state" must not only provide "military security", but the "welfare state" must also provide *civilian security* to civil society and in particular to those members of civil society which run the risk of declining into poverty and misery after the breakdown of the paternalistic (or family) "welfare community". In all modern states in the 20th century the state therefore accepts the responsibility of creating and maintaining not only the *rechtstaat* but also a welfare state or *sozialstaat*.

Representative DEMOCRACY, the liberal RECHTSTAAT and the caring SOZIALSTAAT thus form the three (structured) aspects (spheres) that arrange that mutual relations between the citizenry and the state - they are the three indispensable cornerstones upon which the modern state, economy and society rest:

- (i) Through representative democracy the citizenry "create" the authority of the state and, as it were, "give" legitimacy and power to the state - this is the *political* system.
- (ii) Through the liberal *rechtstaat* (liberalism) the authorities "create" a *legal order* which ensures juridical, social and economic FREEDOM for citizens and which led to the rise of capitalism - this is the *juridical* and the *economic* system.
- (iii) The caring welfare state represents those parts of the state's activities which offer a variety of (social) services - education, health, welfare, housing; etc. - to citizens, and which are financed partially or wholly from the state coffers (i.e. by taxpayers) and which are calculated to ensure a minimum of *social rights* for every citizen. This is the *social* system that assumes a particular kind of political system and has important economic implications.

The mutual relationships between DEMOCRACY, LIBERALISM and the WELFARE STATE are not *fixed*, but are subject to continuous changes and adaptations. In our dynamic world characterised by continuous technological, organisational and ideological changes, the POWER (or space) of (say) the *rechtstaat* could become greater at the expense of the other two spheres and hence disturb the BALANCE OF POWER (spatial balance) which might have been maintained for a long time. Consequently the whole of society is continuously faced with the challenge of "repackaging" POWER (all forms of POWER) to maintain a sound balance in the distribution of POWER (or space) and FREEDOM between the three spheres.

All three spheres of modern society - democracy, liberalism and the welfare state - had long histories of development before they attained their present forms. The roots of democracy lie in the city state of Athens in the 4th and 5th centuries before Christ. Representative democracy reached maturity only at the beginning of the 20th century. Liberalism, however,

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is a product of the 17th and 18th centuries. Although it has a much shorter history than democracy, it reached maturity far more rapidly. The welfare state took shape only at the end of the 19th century. Before the state took responsibility for "social services" and/or "charity", churches and other charitable organisations fulfilled this role.

Liberalism (the *rechtstaat*) is concerned with *juridical* and *economic* rights, democracy with *political* rights and the welfare state with *social* rights. It is interesting to note that these three rights became fully realized in Western countries in the 18th, 19th and 20th centuries, respectively. The 17th and 18th centuries saw long struggles in Western countries for (equal) *juridical rights* for all citizens. This struggle had largely been won by 1800. During the 19th century there was a struggle in Western countries for equal *political rights* for all citizens. In 1918 - after the First World War - democracy triumphed. The 20th century is characterised by the rise of the welfare state (*sozialstaat*) in terms of which a certain *minimum* number of *social rights* are given to all citizens. The welfare state flourished during the third quarter of the 20th century.

It is disturbing to note that before 1990/1994 South Africa still did not have a system of full representative democracy, nor a liberal *rechtstaat* and (true) capitalist economy, nor a fully fledged welfare state. While these three institutions were developed and reasonably perfected over a period of 300 years in most Western countries, South Africa is still in the *transformation process* in which all three institutions are being created and *sound mutual relationships between them being developed*. Before 1994 only "non-Africans" had the vote, while Coloureds and Indians had the vote only in the inferior second and third "parliaments" in the tricameral Parliament. Before 1990 South Africa was not in any sense a liberal *rechtstaat* with a true market economy, as black people (75% of the population) did not enjoy equality before the law, could not own land (with few exceptions) and could not for various reasons participate as equals in many economic activities because of several constraints (especially on freedom of movement). Before 1990 South Africa was not a full welfare state as the "social rights" provided by the government to the four population groups were extremely unequal. If one placed per capita social expenditure (on education, health, welfare and housing) on whites in 1990 on an index of 100, then per capita social expenditure on Indians, Coloureds and Blacks was 85, 62 and 27 respectively! The fact that many black households in South Africa were (and still are) extended families and in this capacity constituted "welfare communities" providing a minimum of "family security" to all members of the household made the heavy burden of poverty among black people under apartheid only slightly more tolerable.

## 6 3.2 THE HISTORY OF THE ORIGIN OF DEMOCRACY AND LIBERALISM

We will deal with the history of the origins of democracy and liberalism (*rechtstaat*) simultaneously because their development was sometimes complementary and sometimes conflictual. In the next section the rise of capitalism - within the framework of the *rechtstaat* - is dealt with briefly.

Democracy has become *the* positive buzzword of the 20th century. It is enveloped in an aura of legitimacy. But this was not always the case. The writer Lijphart rightly says that "democracy is a recent and rare phenomenon". David Held states that "democracy is a remarkably difficult form of government to create and to sustain". Although not a single country in the world had a fully fledged system of "one man, one vote" (i.e. representative) democracy before the First World War, there are few countries in the world today which do not have one or other form of democracy. Although capitalism is the economic system that is in full swing just about everywhere, the political system of democracy that is linked to capitalism in the 20th century has important implications. The joint political and economic system operating at the end of the 20th century is called *democratic capitalism*. The lifespan of this political-economic system has been a mere 80 years. Yet it is accepted as so "natural" that it is easy to assume that it will remain the predominant political-economic system for the next 500 years. Will this be the case? Apparently not.

### The role of civil society, elections and the rule of law in contemporary democracy, liberalism and capitalism

In the modern democracies of the 20th century the voters (citizens) do not give the governing elite group (party) carte blanche to do entirely as it sees fit. Civil society, which may be organised (and activated) in many ways, retains the right to keep a watchful and critical eye on the way that the government and all its state organs use and/or abuse the authority with which they are invested. The importance of the *controlling* role that civil society *must* play between elections - and also during elections - cannot easily be over-emphasised. A

*democratic society in which civil society does not play the critical role of watchdog effectively can easily turn into a country that is democratic only in name, but is in fact a party political dictatorship.*

There is reason for concern that civil society in South Africa is still too disorganised and fragmented to play an effective controlling role. During the Struggle there was a relatively well organised civil society among the liberation organisations. But this "civil society" was geared towards the abolition of apartheid. It is debatable whether this "civil society" has been able to transform itself from being a destructive opposition into a constructive role-player. Furthermore, it still has to be integrated with elements of the old establishment before it can become an authentic civil society. Important elements of the (potential) civil society are still vested in the (old) white establishment, e.g. the universities and the media. Unfortunately a section of the media is not engaged in constructive opposition but in hate speech. It will unfortunately take a long time before a well developed and responsible civil society will be established. Only once such a civil society is in place will we be able to feel comfortable about South Africa's system of representative democracy.

As indicated above, representative democracy is a 20th-century phenomenon. One often hears the idea that democracy is a miracle system better than any other system. But this is not necessarily the case. Churchill once said that all political systems are bad and democracy is the best of them. In 1988 the philosopher Karl Popper wrote an interesting article in which he asks whether democracies will always provide a country with a good government. His answer is that there is absolutely no guarantee that democracies will produce good governments. Yet he concludes in his article that democracy is a meritorious system because at least every 4 or 5 years it offers the voters an opportunity to get rid of a *bad* government in a *bloodless* way before it has the chance to cause *too much* damage. Seen in this way, it probably is the best of all the bad systems of government. It seems that the development of democracy is a process that will never be completed. During his speech in Cape Town on 26 March 1998, President Clinton said: "We know that democracy is always a work still in the making".

The power and authority concentrated in the hands of the government and its state organs (regardless of the political system) are usually so great and so dangerous that they remain a *potential* threat to the lives, property, freedom, and cultural and religious identity of the

subjects of the state. (Lord Acton rightly said: "Power corrupts and absolute power corrupts absolutely".) This confronts us once again with the dilemma of having a private and a public sector: if the state (regardless of the political system) does not have sufficient POWER and authority at its disposal, it will not be able to enforce (legal) ORDER effectively and will thus also not be able to counter the multiplicity of centrifugal or chaotic forces (always present) in an effective way. But the POWER that the state needs to create ORDER is usually so great that, if it were to be abused, it would constitute a great danger to the state's subjects. In order to try and create the desired balance between (collective) ORDER and (individual) FREEDOM, several Western countries already began to develop *liberal* and/or *rechtstaat* traditions and practices during the 18th and 19th centuries. In terms of these traditions and customs the state must use its authority not only to create ORDER, but also, as it were, to "create" and maintain *property rights* (in many different forms), *individual freedom* and a *market-orientated economy*. In most countries the rule of law is entrenched in a constitution which can be amended only with a two-thirds majority. The interpretation of the principles of the rule of law is thus also not dependent on parliament, but on a high court and/or a constitutional court. (This also applies to South Africa's new constitution.) In this way the *boundaries* of the state's POWER are clearly indicated by the "space" allowed for the *rechtstaat*, and the *rechtstaat* is *protected* against unnecessary and injudicious state interference. Strong guarantees are built into the German constitution, for example, which will prevent a take-over such as the one executed by Hitler in 1933 from ever happening again.

The rise of participative democracy as well as the welfare state in the 20th century has meant that the "space" available for the liberalism (i.e. the *rechtstaat*) has been considerably decreased. This is not to say that there is no place for liberalism, the *rechtstaat* and the market economy in the 20th century. On the contrary. Liberalism has been "packaged" differently in the 20th century and certainly has less "space" than before, but with democracy and the welfare state it remains one of the three most important aspects of modern social patterns. (See next chapter.) (Apart from liberalism (*rechtstaat*) as an institution, liberalism as an *ideology* remains very - perhaps too - powerful.)

It is important to emphasise that the public sector (incorporating democracy and the welfare state) and the *private* sector (incorporating the *rechtstaat* and capitalism) are based on conflicting principles. Democracy is based on the principle of *equal* political participation and equal civil rights. A democratic state has accepted the responsibility of giving concrete embodiment to the *ideal of equality* for the sake of the nation state and of common loyalties and the sound “organisational” functioning of society.

The *rechtstaat* is also based on the principles of equality before the law. But the *rechtstaat* maintains *inequalities* in the distribution of property rights and opportunities in the capitalist economy. The “logic” of capitalism - given the guaranteed (unequal) freedoms and (unequal) rights upon which it is based - goes against the grain of the logic upon which democratic principles of equality are based. Capitalism attempts to maximise efficiency and profits through merciless competition in which the strong and the “sly” win and the weaker and less “cunning” lose. It tends to become *supranational* in that the “global economy” becomes ever more important and often goes against the grain of democratic national interests (see section 3.4 below).

While democracy emphasises joint interests and loyalties, capitalism is based on self-seeking and conflicting group (class) interests. The task of reconciling the conflicting “logics” of democracy (based on the *principle of equality*) and capitalism (which necessarily produces inequalities and, as it were, feeds on these inequalities for its success) is the great challenging facing the modern industrial state. In the process of “packaging” and “repackaging” the three spheres of a modern state, difficult trade-offs are necessary between the principle of equality associated with the system of democracy and the principle of inequality associated with capitalism.

### 3.3 THE RECHTSTAAT AND THE RISE OF CAPITALISM

#### (a) Four characteristic features of capitalism

The rise of capitalism from about the 16th century was very closely linked to the rise of the nation states and the rise of the *rechtstaat*, which was characterised by a clear differentiation between the *public* and the *private* sectors. Capitalism is a complicated system of social, political and juridical relations which jointly determine the nature and dynamics of capitalism as an economic system. Capitalism is a *unique* system with at least four *institutional* characteristics which are common to all capitalist systems and distinguish them from other kinds of economic systems.<sup>3</sup> The four institutional characteristics are:

- (i) The property principle that assumes a certain kind of juridical system and that plays an indispensable role in the successful mobilisation of production factors;
- (ii) The political aim of capital accumulation for the sake of sustained economic growth and job creation. Capital accumulation is the aim not only of private entrepreneurs but most certainly also of the dominant social and political classes. Capitalism became a dynamic system only once the political rulers of nation states created conditions favourable for capital accumulation. This is a *political* aim as it occurs successfully only when and where the political authorities support it directly and indirectly.
- (iii) The organisational role of the *market mechanism* in the allocation of scarce resources, in the remuneration of production factors and in the distribution of the national income is also unique to capitalism.
- (iv) The administrative distribution of activities (functions) between a *public* sector and *private* sector is also not found in any other system. While the public sector is the political sector, it also has the task of creating and maintaining the rule of law. It is due to this “rule of law” created and administered by the public sector that “space” is

<sup>3</sup> See R Heilbroner and W Milberg, *The Crisis of Vision in Modern Economic Thought*, Cambridge, 1996.  
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created for the private sector within which the capitalist economy can develop to the full.

The four distinctive features of capitalism are thus:

- (i) the *juridical* principles upon which *property* is based;
- (ii) The *socio-political* structures that create the conditions favourable to the promotion of *capital accumulation*;
- (iii) The *organisational* system in which the *allocation* and *distribution functions* are left predominantly to the market mechanism; and
- (iv) The *administrative* arrangements whereby certain functions are left to the *public sector* and others to the *private sector*, and in terms of which these two sectors - which in certain respects represent conflicting aims - function in a *complementary* way.

Some economists (especially those in the classical and neoclassical school) are often inclined to regard the modern (capitalist) economy as if its were something *natural* - a "natural construct" - in which laws of nature operate and can be scientifically revealed. This is a dangerous misconception. If one takes the four characteristics of capitalism mentioned above into consideration, it immediately becomes clear that capitalism is not a "natural construct" but a "social construct". Capitalism is a system devised and delicately constructed by human beings. As a "mechanism" produced by human beings it must be maintained by human beings and adapted to changing circumstances. If capitalism does not function as desired on a national and/or global level, it is the task of the authorities to correct it, "refashion" it, reorganise it.

- (b) The institutional constraints that give capitalism its structure

Before the four above-mentioned characterising features of capitalism are discussed, we first need to devote attention briefly to the way that *institutional constraints* give a structure to capitalism and, as it were, keeps the behaviour of those participating in the economy in check and channels it in the desired directions.

Douglas North rightly claims that the multitude of political, economic and juridical institutions that *jointly* make up the economic and political system act as "humanly devised constraints" that must provide a pattern and direction for individual and group action. These institutions, as it were, lay down the rules according to which the economic game must be played. North makes the point as follows:

"Institutions are humanly devised constraints that structure human interaction. They are made up of *formal* constraints (e.g. rules, law, constitutions), *informal* constraints (e.g. norms of behaviour, conventions, self-imposed codes of conduct) and their *enforcement* characteristics ... It is the interactions between *institutions* and *organisations* [e.g. firms, trade unions, family farms, cooperation] that shape the institutional evolutions of [a capitalist] economy. If *institutions* are the rules of the game, *organisations* and their entrepreneurs are the players ... The organisations that come into existence will reflect the opportunities provided by the institutional matrix [of capitalism] ... Economic change [of and within the capitalist system] is a ubiquitous, ongoing, incremental process that is a consequence of the choices individual actors and entrepreneurs of organisations (i.e. corporations) are making every day. The vast majority of these decisions are routine. Some involve altering 'contracts' between individuals and organisations ... Sometimes these new 'contracts' require an *alteration* of the rules concerning property rights and political rules [i.e. this requires an alteration to the institutional structure of capitalism] ... Politics significantly shapes economic performance because it defines and enforces the economic rules.<sup>4</sup>

This modern description of the (humanly devised) institutional framework of capitalism reminds one of the institutional *constraints* Adam Smith laid down before individual (economic players) can be permitted to pursue their own self-interest. His four institutional constraints were: (i) the psychological condition that human beings were born with instinctual self-interest as well as a sense of common humanity; (ii) a well organised society which would inculcate the (informal) moral norms in all the individual "players to pursue

them subject to other conditions. Seen in this light, property has a dynamic character. (Since 1994 the new government in South Africa has been redefining the "contents" of property rights in a variety of different ways and giving them a different "content".) Potentially new forms of "property" are continuously being created because of technological advances. This property needs to be "empowered" and protected. Douglas North (awarded the Nobel Prize for Economics) claims that those countries which have best protected property rights have experienced the greatest capitalist progress through the ages. One method of securing property rights on *new knowledge* is through patent rights. But to whom must the property rights on new knowledge gained through government research be allocated? How must property rights on new knowledge be protected internationally? (Study GOES, pp. 192-195.)

(ii) The politically-inspired objective of capital accumulation

The political objectives chosen by the rulers of a state or country and the influential social and political classes may differ widely. In the city state of Athens it was the promotion of the *bonum commune* (common good). In the Roman Empire and the late middle ages it was the expansion of territory and/or the subjugation of competing centres of territorial power. In the late middle ages Florence and Venice began to accumulate capital, but this was done by urban, not private, enterprises. In the 16th century Spain and Portugal also began to accumulate capital, but this was also done by state enterprises. From the 17th century the rulers of Holland, England and France gave direct and indirect support in all kinds of ways to *private* enterprises in their moves to accumulate capital. We have already referred to the EEIC and the VOC. From 1661 to 1683 Colbert modernised the manual labourers' industry and gave it great financial support to increase its ability to accumulate capital. Over the past four centuries the governments of all countries have increased the ability of private enterprises to accumulate capital by means of legislation, subsidies, research and infrastructural facilities. In the 20th century all governments spent enormous amounts of money to keep the labour force healthy and well trained for the sake of greater productivity and greater capital accumulation. In the 20th century a great (and growing) part of this

capital accumulation - in the public as well as the private sector - takes the form of *investment in human capital formation*. No one can have any doubt that *capital accumulation* has become an important *political aim*.

It is interesting to distinguish between the different kinds of capital accumulation. In the 17th and 18th centuries capital accumulation took the form of *capital formation* - i.e. through the increase of capital per labourer. In the 19th century and the early 20th century it took the form predominantly of *capital modernisation* - new capital always embodies technological and organisational innovation. In the later part of the 20th century capital accumulation mainly takes the form of investment in human capital formation and in research for new knowledge. It is estimated that the latter two forms of capital accumulation are responsible for at least 75 percent of the rise in labour productivity.

(iii) Allocation and distribution through the organisational operation of the market mechanism

The organisational role of the market mechanism in capitalism is familiar and does not have to be set out in detail here. The market - like any other economic institution, in fact - is not something "natural" or "naturalistic", as many people seem to think. It is a social institution made by human beings, which has developed over many centuries and is always shaped and refined by government action. The organisational role of the market in capitalism is unique. In other systems *tradition* or *government decree* has played this role.

In some respects the role played by the market mechanism is becoming ever greater, as is clear from its geographical spread with the rise of the global economy. The operation of the market mechanism is now usually synchronised with the process of capital accumulation. The market can naturally fail in all kinds of ways or function in structurally flawed ways, in which case the authorities have an important compensating or corrective function to fulfil. Although the market for consumer goods usually functions fairly well, this is not the case

with the factor markets. It has rightly been said that, if there is an Invisible Hand working on the factor markets, then it is a hand that is all thumbs!

(iv) The administrative separation between the public and private sectors

The administrative *division* into a public sector and a private sector is a feature that is not found in any other system. The public sector (which has now been democratised) is the political sector that is responsible for the making and application of laws and for the maintenance of the rule of law (*rechtstaat*). The private sector, on the other hand, is the sector in which most "economic" activities occur and in which individuals have a great deal of personal freedom. This sector may also not under any circumstances claim the right to make laws or to punish offenders.

The division into public and private sectors has a long history. As indicated above, the ideas of Hobbes and Locke on a social contract played an important role in giving this division its shape and rationale. The question about the *dividing line* between the public sector and the private sector, however, is extremely controversial. Heilbroner and Milberg rightly state:

"This bifurcation of realms [into a public and private sector] not only vastly enhances the dynamic properties of capitalism, but also sets the stage for the tense relationship between the two sectors that poses a constant problem for the design of effective economic policy ... [In the future] ... public intervention [will have to be expanded] to protect the capitalist order from the difficulties and dangers with which it will have to contend" (pp. 108, 120).

In the following chapter we shall devote more attention to this dividing line between the public sector and the private sector.

### 3.4 THE RISE OF THE WELFARE STATE AND "SOCIAL RIGHTS" FOR CITIZENS

The early origins of the welfare state lie in Bismarck's social legislation of the 1880s, but it is essentially a 20th-century phenomenon. In the first half of the century it grew relatively slowly. In the third quarter of the century - i.e. during the so-called golden era of high economic growth - it expanded extensively in the highly industrialised countries. The growth of the welfare state was accompanied by a sharp increase in government spending and government participation in economic activities. (See Table 5.3.) Total government expenditure as a percentage of GNP of 15 industrialised countries rose from 30 percent in 1950 to 40,3 percent in 1991. It has since declined to  $\pm$  39,9 percent.

In the quarter century after the Second World War the ideological climate as well as the high economic growth rates in the Western world and Japan were particularly favourable for the rise of welfare state capitalism. The rise of welfare state capitalism meant that the relationship between the public and private sectors had to be "structured" differently. The Keynesian macro-economic approach had a decisive influence on this restructuring. While the task of the private sector in industrialised countries is still (since 1950) to produce the greatest amount of goods and services, it has been the task of the welfare state (and all the institutions that form part of it) since 1950 to be involved in the "*production*" and the *distribution* of the *social welfare* of society. "To study the welfare state is therefore a means to *understand* a *novel* [i.e. 20th-century] phenomenon in the history of capitalist societies."<sup>7</sup> Because of the higher taxes that had to be levied to finance the welfare state, the rise of the welfare state implied from the very beginning that "space" for capitalism had to be limited for the sake of providing "social rights" to all other citizens.

Since 1950 social expenditure (i.e. expenditure on education, health, welfare and housing) in OESO countries has made up about half of total government spending. From 1960 to 1958 the average social expenditure of 21 OESO countries rose from 12,3 percent of GNP to 24,6 percent of GNP! Since then it has declined somewhat to an average of  $\pm$  22 percent of GNP.



Before we can discuss the reasons for the rise of the welfare state, we must compare in detail the nature of the social structure before the rise of industrialism with the nature of the social structure after countries became industrialised and capitalist.

Before the rise of industrialism and capitalism (i.e. before about 1750), there were various "networks" in Western countries to ensure that no one fell into a state of complete poverty and misery. This was so in spite of the fact that countries were still fairly poor and material standards of living were still relatively low. These "social networks", which took responsibility for the fate of the economically vulnerable part of the population, included the extended family structures, the charitable organisations of the various churches, the idea of *noblesse oblige* whereby the nobility regularly gave alms to the poor for the sake of the salvation of their souls, and a number of guilds that pooled their resources in mutual solidarity to ensure that their members did not fall into poverty. At the end of the 16th century Queen Elizabeth I (called "Bloody Bess" by some) placed a number of poor laws on the statute books in terms of which all local authorities (municipalities) were obliged to see to the needs of the indigent in their town or city. Such poverty relief was necessary in England after Elizabeth's father, Henry VIII, severed ties with the Roman Catholic Church and established the Anglican Church. In Catholic countries such poor laws were not necessary as the Church (and all its associated bodies) accepted responsibility for charitable services.

The rise of industrialism and capitalism since about 1750 destroyed the existing "benevolence networks". The processes of modernisation and urbanisation as well as the greater emphasis on individualism wrenched many individuals out of their protective social environments. To survive in the industrial world individuals now had to sell the labour on labour markets at whatever the prevailing market rate happened to be. In the midst of cyclical instability large numbers of labourers were often unemployed for long periods without having any kind of unemployment insurance. In the early phase of industrialisation the families of factory workers ended up living in appalling conditions in slums. The 19th century saw the flourishing of the freedom of property rights for the bourgeoisie (20 percent

of the population), while the civil and/or "social" rights of the broad lower classes were neglected and even trampled on.

The extremely poor living conditions of the slums provided fertile soil for socialist ideas. When Karl Marx published his *Das Kapital* in 1867 - in which he pointed out the abuses of laissez-faire capitalism - he claimed, among other things, that in the system of industrial capitalism the labourer was reduced to a *commodity*. One of his sharpest reproaches against capitalism was that it led to the *commodification* of labour and hence *deprived human beings of their humanity*. On the labour market the fate of labour is decided by impersonal and conscienceless forces of supply and demand, just as the fate (or price) of pumpkins is determined by supply and demand on the pumpkin market. If pumpkins are not given a price, they rot. Pumpkins have a fairly long shelf life - human beings do not. If a labourer (with a family to support) cannot find employment, then he and his family become "pumpkinified" and decline into a state of misery. It goes against the grain of being human, says Marx, to be "pumpkinified", or commodified, in this way.

### Possible questions on Chapter 3

1. Write an essay in which you indicate that Democracy, Liberalism (or the Rechtstaat) and the Welfare state (or the Sozialstaat) are the essential aspects of a modern state. Indicate also which role each one of the three aspects are playing.
  2. Write an essay on the Rechtstaat and the rise of capitalism. Indicate in your answer what are the four institutional characteristics of a capitalist system and discuss each one.
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## DEMOCRATIC CAPITALISM

Democratic capitalism is a dual politico-economic system that reached maturity, after centuries of organisational development, in the first half of the 20<sup>th</sup> century, notably in developed western countries. The 'logic' of democracy and capitalism is contradictory: while democracy emphasises joint interests, equality, and common loyalties, capitalism is based on self-seeking inequality and conflicting individual and group interests. The legal system that protects both democracy and capitalism is based on the principle of equality before the law, but maintains inequalities in the distribution of property rights and opportunities in the capitalist system.

## DEMOCRATIC CAPITALISM (continues)

The 'logic' of capitalism -- given the unequal freedoms and unequal rights upon which it is based -- thus goes against the grain of the 'logic' of democracy. Capitalism attempts to maximise efficiency and profit through merciless competition in a free market system in which the strong, skilful, and property owners win, and the weaker and less 'cunning' lose. It is the task of a democratically elected government to reconcile not only the conflicting 'logics' of democracy and capitalism, but also the 'power' with which they exert themselves in the dual system of democratic capitalism. South Africa's democratically elected government must try to bring about reconciliations that will promote the welfare of society at large. It must also rectify the unacceptable inequalities produced by capitalism.

## DEMOCRATIC CAPITALISM (continues)

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While emphasising the conflicting 'logics' of democracy and capitalism, we are not denying the complementary relationship between them. The strength and sustainability of the system of democratic capitalism depends on the mutual inter-dependence of democracy and capitalism. Democracy cannot survive without the material and/or monetary assistance of capitalism, and capitalism cannot survive without the legal and bureaucratic support of the democratic state. They also need one another in the sense that the power each exerts needs to be curtailed or 'counteracted' by that of the other in order to prevent its misuse. It is therefore important that none of the two parts is too powerful in relation to the other.

## DEMOCRATIC CAPITALISM (continues)

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Democracy is based on the equality of rights and privileges maintained and supplied by state power, while capitalism is based on the unequal distribution of property and assets and on the state-guaranteed freedom of everyone to use his/her assets and property as he/she pleases within the prescriptions of the law.

## CHAPTER 4

### **THE MUTUAL RELATIONSHIP BETWEEN DEMOCRACY, LIBERALISM AND THE WELFARE STATE SINCE 1870 AND THE PERIODIC "REPACKAGING" OF THE THREE ASPECTS**

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#### 4.1 THE IDEOLOGICAL DEBATE SINCE 1870 BETWEEN THE PROPONENTS OF DEMOCRACY, LIBERALISM AND THE WELFARE STATE

In the previous chapter we claimed that the three essential aspects of the modern political-economic system were:

- (i) Democracy and parliamentarianism
- (ii) Liberalism and capitalism as based on the rule of law or the *rechtstaat*
- (iii) The welfare state or *sozialstaat* for the sake of social rights.

We also showed in the previous chapter that the relationship between democracy, liberalism (capitalism) and the welfare state is not *fixed*, but subject to continual changes and adaptations.

The success of the total system depends to a large extent on the degree of *complementarity* or *conflict* between the *three* aspects of the total system. In the dynamic world in which we live there are constant (ideological) debates on how much “*space*” and how much POWER must be allocated to each one of the three aspects (democracy, liberalism and the welfare state); on how the *complementarity* (the mutually reinforcing interaction) between them may be strengthened, and how the *conflicts* (negative mutual relationships) between them may be eliminated.

This debate is predominantly an *ideological* debate:

- (i) The champions of democracy constantly put forward arguments as to why the greatest amount of POWER should be vested in the hands of the democratically elected government, because such an elected government represents the general will and only such a government can take the measures necessary to promote the common interest or the social welfare of society *as a whole*.

- (ii) We could describe liberalism as the ideology adopted by the champions of the *rechtstaat* and (unbridled) capitalism to advocate that the greatest possible amount of “*space*” should be allocated to individuals and private (capitalist) corporations, because such “*space*” and freedom are a prerequisite for the development of creativity, initiative and entrepreneurship without which a sustained rise in living standards would not be possible. Dogmatic liberals are proponents of an unbridled free market system.
- (iii) The champions of a great and growing welfare state advocate greater social expenditure - mostly on the basis of the social democratic ideology - for the sake of greater *human development*, for the sake of greater socio-economic *justice* and for the sake of the elimination of the worst forms of *poverty*. According to the social democrats high social expenditure is also necessary for sound social development which, according to them, is a prerequisite for sustained economic, cultural and human development over the long term.

#### 4.2 FOUR “IDEOLOGICAL” PERIODS SINCE 1870

In a survey of 20th-century history it can be demonstrated clearly how democracy, liberalism and the welfare state have been “packaged” differently in succeeding periods to give relatively more “*space*” to one of the three aspects at the cost of the other two. For our purposes the first period of the 20th century begins not in 1900 but in 1870.

(a) The first period: 1870-1914; the flourishing of liberalism

During this period the idea of liberalism and the *rechtstaat* flourished. It was also the time of *laissez-faire* capitalism, when economic and political POWER were concentrated in the hands of the property class or bourgeoisie.

During this period there was no talk of representative democracy or the welfare state. It is true that the political system was a system of parliamentary democracy, but only people who could meet certain property and/or other franchise qualifications could vote. Seeing that political POWER was mainly concentrated in the hands of the bourgeoisie, it was used predominantly to promote and protect the property rights and other economic rights and privileges of this class. The *rechtstaat* and the protection it afforded the property classes thus enjoyed a high priority.

During this period the welfare state was still in its infancy. Bismarck began a welfare state system in Germany in the 1880s, but its aim was not to bring about greater socio-economic equality and/or fairness. The aim was rather to stabilise the obsolete (or reactionary) German political system - the Second German Empire - and entrench it in the face of social uprisings. In 1909 the British government - at that time in the hands of the Liberal Party (that was ruling in a coalition with the newly established Labour Party) - adopted important social legislation. This legislation unleashed a political storm because the property class (who interpreted the notion of property in an absolute way) regarded the higher taxes they would have to pay as a serious violation of the property rights. An ideological debate thus waged on the important issue of whether, and to what extent, the *property rights* of the property class should be "limited" to provide a *minimum* of *social rights* to all citizens. The property class was negatively disposed [ideologically] towards the welfare state at that time (and again these days). Is it admissible for the property class to advocate such a total priority of *property rights* over *social rights*? (See the relationship between the *rechtstaat* and the *sozialstaat* below.)

(A particularly topical question at the moment in the new South Africa is the extent to which the (predominantly white) property class should make great sacrifices for the sake of the promotion of the social rights of the (predominantly black) lower class.)

The economic theory (or ideology) generally accepted in the late 19th century was the neoclassical theory. It was believed in terms of this theory that, if all market participants were given maximum freedom, the *self-regulating operation of the market mechanism* would see to it that every individual market would achieve a state of equilibrium and that the equilibrium on all markets would ensure a macro-economic equilibrium or full employment. According to the free market ideology an Invisible Hand would ensure that all economic activity would be channelled in such a way that the general interest would be *spontaneously* promoted and that political and/or welfare state intervention in capitalism would not only be unnecessary or superfluous, but that it would in fact disrupt and damage the self-regulating operation of the market economy and harm the general interest.

(b) The second period: 1914-1950; full democracy takes final shape

During this period *representative democracy* came to full maturity in Western countries and democratically elected governments used their parliamentary power to curtail the "space" of the *rechtstaat* considerably. After the First World War the American President, Woodrow Wilson, said that the Great War had been fought for the sake of democracy. In terms of the Treaty of Versailles (1918/19) a number of newly created states received democratic constitutions.

The period 1914 to 1950 was also a period of relatively low economic growth, which was the result of the disruption caused by the two world wars and the instability of the inter-war years. During this period the ideology of *laissez-faire* capitalism and theories of the neoclassical school proved to be inadequate to "diagnose" the crisis brought about by the Great Depression. Keynes introduced his new macro-economic theories in 1936 and showed why a condition of *under-employment equilibrium* had arisen in industrialised countries and

he put forward a strong case that the state *must* play an *active* role in the economy to restore a condition of full employment and to distribute incomes *more equally* to some extent.

During this period of economic *stagnation, unemployment and exchange rate instability* ideological speculations on the most desirable economic system were rife. The question of the way that liberalism, democracy and the welfare state should be “packaged” became the focal point of intense ideological debates in Western countries, while the Soviet Union saw the rise of communism, and Italy and later Germany saw the rise of fascism. Because of the Great Depression and massive unemployment, the survival of capitalism (and liberalism) was hanging on a thin thread at the beginning of the 1930s. Economic systems that did not depend on the co-ordinated operation of the market mechanism but on one or other form of central *planning* seemed more attractive at the time, such as fascism in Italy, state capitalism in Nazi Germany and the centralised command economy of the Soviet Union, for example. In 1942 Schumpeter claimed in his interesting book, *Socialism, Capitalism and Democracy*, that capitalism would not be able to survive its own success and would be succeeded in some 50 or 100 years by a system of democratic socialism. According to him, democratic capitalism and the welfare state were simply “halfway houses” on the inevitable path towards democratic socialism. (Schumpeter’s prediction has not been realized to date. If he were still alive, he would probably say that his prediction would come true within 50 or 70 years.)

During this period a whole new relationship between democracy and liberalism - between the public and the private sector - came into being. Not only did the public sector become considerably larger (partially as a result of the gradual growth of the welfare state), but the state also interfered more actively in the economy (it became more *interventionist*) in an attempt to find solutions for the instability, unemployment and gathering social conflict (or class struggle). (See Table 5.1 on the growth of government expenditure as a percentage of GDP.)

In Western Europe the role of the state grew enormously after the First World War and never declined to the levels of the period before 1914. Government expenditure rose from about 10

percent of GDP before 1914 to over 40 percent of GDP at present. In the USA President Roosevelt introduced his New Deal 1933 in an attempt to soften the blow of poverty and unemployment caused by the Great Depression. His New Deal policy was deliberately calculated to set up a *new dispensation* between the *economic* (or liberal) sphere and the *political* (or democratic) sphere. Although the New Deal policy did not achieve all its short-term goals, it *permanently* “packaged” the mutual relations between democracy, liberalism and the welfare state in a different way to what had been the case for the previous 150 years in the USA. The New Deal also represents the beginning of the welfare state in America, but on a more limited scale than in Europe.

(c) The third period: 1950-1973: the golden era of economic growth and the flourishing of the welfare state

During this period the welfare state took on its final shape and also experienced its greatest growth.<sup>1</sup> This meant that the mutual relationships between democracy, liberalism and the welfare state were “packaged” anew in such a way that considerably greater “space” was allocated to the welfare state vis-à-vis the capitalist sector. This meant that the state had become more involved than ever before in the “production” and “provision” of goods and services. Although the welfare state had already had an early start in the Germany of the 1880s, and gradually grew after the First World War, it was still relatively small by 1945. During the inter-war years its growth was retarded by low economic growth rates (and by the still relatively low tax capacities of most countries) as well as by the strong resistance from the property class (on the basis of their liberal or free market ideology) to the growth of a welfare state. The Beveridge report was published in Britain in 1944; together with Keynes’s social democratic arguments, it made out a strong (and ideologically persuasive) case for the greater social expenditure. When Attlee’s Labour Party came into power unexpectedly in 1945, the recommendations of the Beveridge report were implemented. During the next

<sup>1</sup> We showed in the previous chapter that the social expenditure of 21 OECD countries rose from 12.3% of GDP in 1960 to 24.6% of GDP in 1985. Even after the decline of GDP after 1973 social expenditure continued to rise primarily because of the higher unemployment insurance that had to be paid out. Although social expenditure (as a % of GDP) reached a peak in 1985, the idea of the welfare state peaked in the mid-1970s.



decade the British welfare state became the model for welfare states in several European countries.

The period of 1950 to 1973 was also the golden era of exceptionally high economic growth (see Table 4.1). During this period all the socio-economic objectives of the industrialised countries improved *simultaneously*. Living standards increased dramatically, incomes were more equally distributed, poverty was to a large extent eliminated, full employment was maintained, exchange rate stability was effected within the Bretton Woods system and there was also a relative degree of price and social stability.

**TABLE 4.1**  
**Growth rate in gross domestic product (1820-1987)**

	1870-1913	1913-1950	1950-1973	1973-1987	1820-1979	
Britain	1,9	1,3	3,0	1,7	2,0	Liberal
USA	4,1	2,8	3,7	2,4	3,8	capitalist
Germany	2,8	1,3	6,0	2,4	2,6	Social
France	1,7	1,0	5,1	2,1	2,0	capitalist
Sweden	2,3	2,8	3,8	1,5	-	Social
						democratic
Japan	2,5	1,8	9,7	3,8	2,7	Corporate
						capitalist
Average:						
15	2,5	1,9	4,9	3,0	2,5	
industrialised						
countries						

Source: Adapted from A. Maddison, *Phases of Capitalist Development*, p. 45 and IMF International Finance Statistics

Because of the success of democratic or welfare state capitalism as well as because of the Keynesian social democratic approach, the ideological debate on what the most desirable economic system should be, came to an end for all practical purposes in this period in Western countries. The ideological debate (which had been so intense during the 1930s) came to an end because people in Western countries became convinced during this period (i.e. from 1950 to 1973) that they had found the correct "packaging" or "mix" of liberalism,

democracy and the welfare state. People thought they had now found how to organise the *political, economic and social* life of a modern country. Because of the Cold War the dictatorial command economy of the USSR was regarded with abhorrence and *a remarkable consensus was achieved in Western countries on the merits of democratic capitalism as a system of "mixed capitalism"*. The crux of Keynes's and Beveridge's arguments was that the welfare state and the Keynesian anti-cyclic fiscal policy had become indispensable to compensate not only for market "failures", but also for structural flaws, uncertainties, the cyclical instability and unequal power relations in capitalism.

Because of the "great consensus" that prevailed in industrialised countries in the third quarter of the century on the mechanics of an industrialised economy as well as on the role of a democratically elected government and the welfare state, political parties to the left and the right of the political spectrum now *agreed* with one another to such an extent that they made themselves guilty of "*me-too-ism*"! In the 1960s some writers even claimed that the West had now reached the end of the period of *ideology*.

(d) The fourth period: since 1973: the revival of (neo-)liberalism and the "crisis" of the welfare state

For industrialised countries the period since 1973 has been one of lower economic growth, higher inflation rates (especially from 1974 to 1984) and relatively widespread unemployment - especially in Continental countries. The economic *crisis* that developed after the 1973 Oil Crisis brought the "great consensus" and general acceptance of the Keynesian social democratic approach to a sudden end. This crisis led to the *revival* of neoclassical orthodoxy and the belief in the merits of a relatively unbridled *free market economy*. The neo-conservative or liberal-capitalist or New Right approach "diagnoses" the crisis of stagflation as *too much* government intervention in the economy - in the form of, among other things, an "*over-developed*" welfare state. They advocate a drastic curtailment of government expenditure as well as government intervention in the economy. This approach has enjoyed great support in the British-American world in particular, but also has

the support of the Continental countries. During the period of Reaganomics and Thatcherism this approach enjoyed unprecedented popularity in the British-American world.

The social democratic or post-Keynesian and/or New Left approach, on the other hand, "diagnosed" the *crisis* of 1973 as a *structural* problem that arose because of serious *imbalances of power* that had become entrenched in the structures of democracy and capitalism. Hence, for example, the New Left blamed the excessive power and influence of the well organised and well integrated "managerial elite" of the large corporations for the imbalances of power because *too much POWER* had become concentrated in their hands. According to the New Left, this imbalance of power causes of *crisis of legitimacy* that can only be resolved through significant *structural reform* in the political, economic and social spheres in order to create a new (and better) *balance of power* ("packaging") between pluralist power groups. In contrast to the approach of the neo-conservatives in the USA (or neo-liberalism in Europe), the social democratic ("New Left") approach is by no means convinced that the welfare state should be blamed for the crisis of stagflation nor that government expenditure should be cut.

In a situation of lower economic growth rates, widespread unemployment and new political alliances, the issue of the "space" which *ought to be* allocated to democracy, liberalism and the welfare state has unleashed a new ideological struggle that has been waging uninterrupted and with undiminished intensity since the end of the 1970s. It has also led to the three aspects of the total system once again being "packaged" differently in most countries to what they were in the third quarter of the century. We could sum up the legal and ideological *shifts* that have occurred over the past 25 years in the following way:

- The "space" of *rechtstaat* (free market) is increasing vis-à-vis democracy;
- The "space" of the *rechtstaat* is increasing vis-à-vis the *sozialstaat*;
- Since 1973 democracy has been used to reduce the "space" of the welfare state.

## OECD COUNTRIES

High-water mark of liberalism	Full democracy takes shape	The golden era of high growth rate and the welfare state	Revival of neo-liberalism	
	The unstable inter-war period	Rapid expansion of the welfare state	The period of stagflation and lower growth	
<i>Laissez-faire</i> capitalism	Representative democracy	The Keynesian social democratic synthesis	Polarisation between the New Right and the New Left	
High-water mark of the <i>rechtstaat</i>	Gradual development of the welfare state	4,9%	3%	
Neoclassical doctrines	1,9%	Ideological consensus	<i>Rechtstaat</i> vs democracy	
	The Great Depression	Higher standards of living	<i>Rechtstaat</i> vs <i>sozialstaat</i>	
	Massive unemployment	Greater equality	Democracy vs the welfare state	
Welfare state only in Germany	New Deal policies	Consistent stability	"Jobless" growth in especially Continental countries	
1870	1914	1950	1973	1997
GDP ± 10%	20-30%	35%		42-45%
		12,5%		± 23%

#### POSSIBLE QUESTIONS ON CHAPTER 4

1. Write an essay on the ideological debate since 1870 between the proponents of democracy, liberalism and the welfare state and indicate how these three aspects have been "packaged" differently in the succeeding periods after 1870.
2. Write an essay in which you discuss the merits (or otherwise) of the greater "space" allocated to the *rechistaat* since 1973 vis-à-vis democracy and the *sozialstaat*, with special reference to the British-American world. In your answer you should also devote attention to the existence of a pluralist equilibrium (or otherwise) in the modern political-economic system.

## A COMPARISON BETWEEN THE TRADE-OFFS MADE IN SWEDEN, GERMANY AND THE UNITED STATES

S J Terreblanche  
University of Stellenbosch

### 1. THE FOUR WORLDS OF CAPITALISM

We can make a relatively clear distinction between four worlds (or models) of capitalism in the OECD countries. Each one of these forms is organised around a different *ideological* principle, while the social stratification and integration in the four worlds are strikingly different<sup>1</sup>. The four forms have their origins in different historical patterns and follow qualitatively different development paths. The four worlds of capitalism are the following:

- (i) Free market capitalism in the British-American world, obviously based on the ideology of *liberal capitalism*;
- (ii) Social democratic capitalism in the Scandinavian and Benelux countries, mainly based on the ideology of *social democracy*;
- (iii) Social market capitalism in Continental countries such as Germany, France and Italy. In contrast to the liberal capitalist countries, these countries do not claim to have a system of *free* market economies, but *social* market economies;
- (iv) Familistic capitalism or corporate capitalism in Japan. We could say that, because Japan is an island with a homogeneous population with a long common history based on a strong unifying ethos, Japanese capitalism is based on a "familistic" and/or "corporatist" ideology.

In this paper I want to concentrate on only two aspects of the four worlds of capitalism.

- (i) Firstly, on the kind of welfare state system in the first three worlds and the extent (degree) of *decommodification* of labour that has been achieved by each of these worlds' welfare state system;
- (ii) Secondly, on the ways in which, and the terms upon which, the *trade-off* between *social rights*, (*social security*) *full employment*, *price stability* and *economic growth* occurred in

Sweden, Germany and the United States as representative countries of the first three worlds of capitalism. The *trade-off problem* became much more difficult in all OECD countries after 1973 in comparison to the situation during the golden age of high economic growth from 1950 until 1973 (see section 4 below).

### 2. THE RISE OF THE WELFARE STATE, "SOCIAL RIGHTS" AND "SOCIAL PROTECTION" FOR CITIZENS

The early origins of the welfare state lie in Bismarck's social legislation of the 1880s, but it is essentially a 20th-century phenomenon. In the first half of the century it grew relatively slowly. In the third quarter of the century - i.e. during the so-called golden era of high economic growth - it expanded extensively in the highly industrialised countries.

Before the rise of industrialism and capitalism (i.e. before about 1750), there were various "social networks" in Western countries to ensure that no one fell into a state of complete poverty and misery. This was so in spite of the fact that countries were still fairly poor and material standards of living were still relatively low. These "social networks", which took responsibility for the fate of the economically vulnerable part of the population, included the extended family structures, the charitable organisations of the various churches, the idea of *noblesse oblige* whereby the nobility regularly gave alms to the poor for the sake of the salvation of their souls, and a number of guilds that pooled their resources in mutual solidarity to ensure that their members did not fall into poverty. The rise of industrialism and capitalism since about 1750 destroyed the existing "benevolence networks". The processes of modernisation and urbanisation as well as the greater emphasis on individualism wrenched many individuals out of their protective social environments. To survive in the industrial world individuals now had to sell the labour on labour markets at whatever the prevailing market rate happened to be. In the midst of cyclical instability large numbers of labourers were often unemployed for long periods without having any kind of unemployment insurance. In the early phase of industrialisation the families of factory workers ended up living in appalling conditions in slums.

<sup>1</sup> This paper is to a large extent based on Esping-Andersen, G., *The Three Worlds of Welfare Capitalism*, Princeton, Princeton University Press, 1990 and on Esping-Andersen, G., (ed.) *Welfare States in Transition*, SAGE Publications, London, 1996.

The extremely poor living conditions of the slums provided fertile soil for socialist ideas. When Karl Marx published his *Das Kapital* in 1867 - in which he pointed out the abuses of *laissez-faire* capitalism - he claimed, among other things, that in the system of industrial capitalism the labourer was reduced to a *commodity*. One of his sharpest reproaches against capitalism was that it led to the *commodification* of labour and hence *deprived human beings of their humanity*. One of the main purposes of social security legislation was to bring about a *decommodification* of labour in a deliberate attempt to humanise capitalism. The rise of the welfare state undoubtedly played an important role in preventing Proletarian Revolutions and in the perpetuation of capitalism.

In 1950 TH Marshall published a seminal article in which he claimed that every person is entitled to a minimum of *social rights or social protection* and that it is the state's responsibility to see to it, by means of the welfare state, that every citizen is adequately provided with these *social rights*. Marshall's argument is that during the 18th century a battle waged in Western countries on the issue of equal *juridical rights* for all citizens, and in the 19th century the struggle was for equal *political rights* for all citizens. According to him the 20th-century struggle has been for reasonable minimum of *social rights* for all citizens. *Consequently to him every single person has an inalienable claim to a minimum of social rights for no other reason than that he or she is a human being*. According to this argument the state (or society as whole) has the *moral* responsibility to counter the excessive individualism, greed and abuse of power which sustain capitalism, by taxing the "winners" (who often win undeservedly) and providing the "losers" (who often lose undeservedly) with a minimum of "social rights" and social security in an attempt to achieve greater *social justice*.

Since 1950 social expenditure (i.e. expenditure on education, health, welfare and housing) in OECD countries has made up about half of total government spending. From 1960 to 1988 the average social expenditure of 21 OECD countries rose from 12,3 per cent of GNP to 24,6 per cent of GNP! Since then it has declined somewhat to an average of  $\pm 22$  per cent of GNP.

### 3.1 The conservative welfare state model of countries such as Germany, France and Italy

When these countries began to introduce a welfare state system at the end of the 19th century, their societies - as remnants of feudal period - were still clearly stratified into narrowly defined and hierarchical socio-economic classes. The intention of the *conservative* model was not to bring about greater *equality* and/or levelling of the socio-economic stratification. On the contrary, the *conservative* model was designed to retain the *traditional* socio-economic stratification and to give it a permanent basis by introducing a compulsory and distinctive social insurance system for each of the socio-economic strata, e.g. one for blue-collar workers, one for agricultural workers, one for office workers, one for teachers, etc.<sup>2</sup> The intention was that all employees (or heads of families) should be insured in order to shield themselves against unexpected economic disasters. The amount a family received as unemployment, accident or life insurance depended on what that individual concerned contributed monthly. Benefits were thus dependent on contributions.

The reason why these countries initiated welfare state systems at such an early stage was that, at the end of the 19th century, they feared that the *social disruption* caused by industrialism would jeopardise the *conservative* (traditionalist) *political systems* in the countries concerned (i.e. the German, French, Italian and Austrian empires). The *conservative* welfare state model of Continental countries was built on conceptions of *society* and the *state* that had deep roots in these countries, namely the *corporatist* (or organic) view of *society* and the "*etatistic*" (or paternalistic) view of the *state*. The corporatist approach sees society (the inhabitants of a country) as a kind of "organism" and/or corporate whole. In this view, the individual is a subordinate component of the organic whole and the well-being of each individual is dependent on the well-being/health of the whole or the "organism". If the "body" or organism is not healthy, its members (individuals) can also not experience permanent well-being.

In the *etatistic* approach the task of finding a solution for the *social problems* caused by industrialism and urbanisation is entrusted in the first instance to the state (hence *etatism*). The

<sup>2</sup> "Bismarck's social policy ... was the creation of conservative elites who abhorred *laissez-faire* almost as much as the socialist menace, and who sought to reserve the old order with moral discipline, social participation and nation-building. Bismarck's aim was not a welfare state, but a welfare monarchy ... The early architects of social policy on the Continent were authoritarian, etatist and corporativistic", Esping-Andersen, G., "Welfare States without work: the Impasse of Labour Shedding and Familialism in Continental European Social Policy" in Esping-Andersen, (Ed.), *Welfare States in Transition*. SAGE Publications 1996 p.66

#### 4. ZERO-SUM TRADE-OFFS IN SWEDEN, GERMANY AND THE USA AFTER 1973

##### 4.1 Zero-Sum trade-offs after 1973

One of the most remarkable features of the golden era (1950-1973) was that all OECD countries succeeded in making *positive-sum trade-offs* during this period: the growth rate was high, price stability was maintained, there was also reasonable exchange rate stability, full employment was achieved, and incomes were distributed much more equally. In almost all the OECD countries, there existed a remarkable ideological consensus about the Keynesian Social Democracy, about the government's responsibility in supplying social rights and social security and about the government's role to complement and to correct the deficiencies of the market mechanism.

In sharp contrast to the golden era, the period after 1973 was a time of *stagflation* (to the mid-1980s), growing unemployment, wild fluctuations in exchange rates, a sharp rise in government spending, while the net tax burden (up to about 1988) increased sharply. The most important factor responsible for the "crisis" was the sharp rise in oil prices from the OPEC cartel. The *trade-off* between the different socio-economic and political objectives became a *zero-sum game*. The ideological consensus was replaced with an ideological polarisation (or war) between the New Right and the New Left that is still raging to this day.

While the growth of the Gross World Product (GWP) was 5,0 per cent in the 1960s, it was 3,6 per cent in the 1970s, 2,8 per cent in the 1980s, and 2,0 per cent per year from 1990 to 1995. According to Lester Thurow the world lost 60 per cent of its growth momentum in two decades<sup>10</sup>. The implication of this is that all governments had continuously had to make difficult choices between *policy priorities*.

<sup>10</sup> Thurow, L., *The Future of Capitalism*, Nicholas Brealey, London, 1996. p 1.

After 1973 it seemed that the *bargaining power* of the working class was much greater than it was in, say, 1950. The number of labourers who had unemployment insurance rose sharply. In several European countries contracts on joint decision-making ("mitbestimmung" or "codetermination") were concluded between capital and labour<sup>11</sup>.

The transition of the so-called *industrial* to the *post-industrial society* in highly industrialised countries that took place from 1960 onwards, also complicated the trade-off problem. With the rise of post-industrial society and the changing nature of job opportunities, the fear has arisen "that high-technology economics can satisfy our *wants*, but not our *need* to work". Two important questions have come to the fore in the transition to post-industrial society. *Firstly*, whether the *additional* job opportunities that are going to be created in the *services sector* (or tertiary sector) of the post-industrial economy are going to be sufficient to *compensate* for the large number of jobs that is going to be lost in the (old) *industrial sector* (secondary sector), and, *secondly*, whether the productivity and the remuneration of job opportunities in the *services sector* are going to be as high as the productivity and remuneration of the (old) industrial job opportunities<sup>12</sup>.

Over the past 20 years perhaps the most important influence on individual countries' ability to implement social security policies independently, is the rise of the Global Economy. It narrows the field of domestic policy changes quite considerable due to the fact that global competition mercilessly punished profligate governments and uncompetitive economies. Openness inevitably restricts nations' capacity to autonomously design their own social policy and their own political economy. We have reason to fear that openness will drive out countries towards a "lowest" common welfare denominator.

Another factor that contributed towards the welfare state crisis in the period from 1973, is the view – rather popular in the British-American world – that the welfare state *per se* is to be

<sup>11</sup> In some European countries wage increases were "indexed" so that wages would be adjusted automatically to price rises. All this meant that labour's ability to withstand unemployment and/or wage decreases had become considerably greater. The sharp rise in social spending in especially the 1970s and the beginning of the 1980s must be ascribed particularly to the increased unemployment benefits that had to be paid by governments to the unemployed in this period of stagflation.

<sup>12</sup> "The idea of *post-industrial society* emerged in the 1960s, provoked by contemporary revolutions in technology, management, consumption and employment. It portrays a *new world* where technicians, professionals and managers predominate; where old-fashioned manual labour disappears; where consumers' appetites are driven towards services ... The burning question [since the 1960s] concerns the *employment consequences* of post-industrial change ... Under post-industrialism lies a real process of *fundamental employment change*: new occupations are emerging; [manual] jobs that once were scarce are becoming abundant; physical and manual labour is a dying breed, and *mind-labour* ... is becoming the norm", Esping-Andersen, 1990, pp. 191-192.

blamed for the trade-off problems. The argument is that the rise of the welfare state brought about "market-distortion" that stifles the market and erodes incentives to work. On the strength of this argument, social spending – and special spendings on social protection and on poverty relief – was retrenched quite severely in British-American countries<sup>13</sup>.

Since 1973 the governments of OECD countries have been struggling with the problem of *job creation* on the one hand, and maintaining satisfactory levels of *social rights* on the other hand. Despite fundamental differences in *institutional* accommodation (i.e. the type of welfare states and ideological orientation in different countries) none of the prevailing institutional models – of which Sweden, Germany and the USA are representative – has been capable of furnishing full employment and adequate levels of social security. While the challenge facing Sweden and Germany is to create *more* jobs, the challenge facing the USA is to create *better* jobs. But the other side of the same coin is that the USA are faced with the problem of increasing inequality while the European countries are faced with the task to modernise the welfare state system.

#### 4.2 Trade-offs in Sweden

Since the 1930s strong, comprehensive and centralised trade unions have developed in Sweden which were prepared to hold *round-table talks* - in close collaboration with the social-democratic government - on wages, full employment and on social rights. This highly organised *negotiation system* in Sweden succeeded right until the end of the 1970s in producing *positive-sum trade-offs* through bargaining and in maintaining a surprisingly high level of employment. Sweden maintained a growth rate of 3,8 per cent from 1950 to 1973. Since then it has declined to 1,5 per cent.

Up to 1986 Sweden had succeeded in keeping unemployment below 3 per cent. A factor that made an important contribution to the relatively high level of employment was the large number of job opportunities (especially for women) created in the public sector (as part of the growing post-industrial service sector). In this way the Swedes compensated for the decline in industrial job opportunities with an extension of job opportunities in the large welfare sector. Since 1981

<sup>13</sup> Esping-Andersen summarised the present problem in welfare capitalism as follows: "On the one hand, many of the difficulties the welfare states today face are caused by *market failure*: that is, badly functioning labour markets produce an overload on existing social programmes ... on the other hand, there are possibly also *welfare state failures*: that is, the edifice of social protection in many countries is 'frozen' in a past socio-economic order that no longer obtains, rendering it incapable of responding adequately to new risks and needs". See Esping-Andersen, 1996, pp 2-9.

government expenditure as a percentage of the GDP has been higher than 62 per cent! (See table 2).

As indicated in table 5, the degree of means testing, private pensions and private health spending is very low in Sweden compared with both Germany and the USA.

Another characteristic of the Swedish model is the active labour market programmes to train people in the kinds of skills that post-industrial society demands<sup>14</sup>. The stress on human capital investment, in the form of "productive social policy" has been part of the Swedish strategy for decades (table 3).

During the latter part of the 1980s, Sweden encountered a series of problems which made it impossible to maintain high levels of growth and employment together with high levels of social spending. Following liberalisation (as demanded by the Global Economy) in the early 1980s, the Swedish economy suffered heavy capital leakage's abroad. Consequently, the level of domestic investment declined and with it the level of the growth rate and job creation<sup>15</sup>. In these circumstances the strong "consensus-building institutions" – that played such a pivotal role in creating social harmony – started to break down.

TABLE 3  
SOCIAL INVESTMENT POLICIES

	Percentage of labour force involved in public training and employment measures <sup>a)</sup>	Percentage of 18-year olds attending full-time education and training, 1990-1991
Sweden	6,3	56
Germany	4,9	81
USA	2,6	55

a) These figures exclude general education and private training programmes

Source: OECD, Employment Outlook, 1994, Table 1.18 and Table 1.B.3

<sup>14</sup> Henry Milner describes the Swedish economy as a system approximating the *solidaristic* market economy: "The solidaristic market economy associated with a socio-democratic social system may be conceptualised as a system of economic relations that reduced *uncertainty* by channelling market competition to those spheres of activity where they are seen to contribute to aggregate *productivity*, while fostering relations of *solidarity* in other spheres complementary to *productivity* ... Solidaristic market relations make economic sense since they bring down *information and transaction costs* to a considerable degree". Milner, H., *Sweden, Social Democracy in Practice*, Oxford University Press, 19, p 37.

<sup>15</sup> Stephens, JD, "The Scandinavian Welfare State: Achievements, Crisis and Prospects" in Esping-Andersen, (ed.), *Welfare States in Transition*, 1996, pp 32-62.

In the early 1990s Sweden experienced a negative economic growth while unemployment increased to almost 10 per cent<sup>16</sup>. In these circumstances Swedish governments – both Social and Democratic and Conservative – had no choice but to cut back on social spending. During the period of high rates of productivity growth, Sweden was in a position to maintain both the high level of social spending and the creation of additional jobs in the public sector. But with the decline in investment and a decline in labour productivity, its smaller fiscal capacity made it impossible to continue with both the high levels of social spending and job creation in the public sector. It remained, however, on high levels compared to Germany and the USA. See table 4.

**TABLE 4**  
**PUBLIC SOCIAL SECURITY AND HEALTH EXPENDITURE**  
**AS OF PERCENTAGE OF GROSS DOMESTIC PRODUCT IN SELECTED**  
**COUNTRIES**

	1980	1990
Sweden	32,4	33,1
Germany	25,4	23,5
USA	14,1	14,6
Japan	8,9	12,2
Hungary	14,9	16,2
Brazil	5,2	5,0

Source: Esping-Andersen, 1996, p 11.

The relentless discipline of the Global Economy and the breakdown of Sweden's celebrated consensus-building institution, are mainly responsible for the fact that Sweden can no longer maximise *both* the welfare and efficiency. Some authors allege that the Swedish crisis is mainly induced by the welfare state's negative effects on work, savings and investment – i.e. the so-called entitlement problem other authors rejected this analysis. Esping-Andersen is of the opinion that the real issue has more to do with rebuilding consensus-building institutions rather than a further dismantling of the welfare state due to its disincentive effect on labour<sup>17</sup>.

But apart from improving negotiating institutions, the Swedish government should not spend less, but rather more on retraining and human capital development in an attempt to restore its levels of productivity in the Global Economy.

**TABLE 5**  
**DEGREE OF MEANS TESTING, PRIVATE PENSIONS AND PRIVATE HEALTH**  
**SPENDING 1980**

<sup>16</sup> *Ibid.*, p 45.

<sup>17</sup> *Op.cit.* 1996, p 15.

	Means tested poor relief (as % of total public social expenditure)	Private Pensions (as % of total pensions)	Private health spending (as % of total health spending)
Sweden	1,1	6	7
Germany	4,9	11	20
USA	18,2	21	57
18 OECD countries		13	22

Source: Esping-Andersen, 1990, p 70.

#### 4.3 Trade-offs in Germany

After the Second World War Germany (or rather West Germany) developed its renowned "social market economy" (social capitalism). This left a great deal of space for the free market, but the government accepted responsibility for a relatively comprehensive (social) welfare system. For a long time Germany managed to sustain a high economic growth rate, high levels of social spending, full employment and price stability. From 1950 to 1973 the average growth rate was 6 per cent per year. Three factors made a favourable contribution towards a positive-sum trade-off: the autonomy of the German Central Bank (Bundesbank) which adopted a restrictive monetary policy, and the government, which ensured that state debt did not increase more rapidly than the GDP rose; the trade unions were relatively weak and consequently the pressure for redistribution was also relatively weak; the great influx of migrant workers from East European countries kept wages relatively low<sup>18</sup>.

**TABLE 6**  
**SOCIAL EXPENDITURE AS PERCENTAGE OF GDP**

Sweden	not available
Denmark (1991)	29,8
Germany (West – 1991)	26,6
USA (1986)	18,0
18 OECD countries (1986)	25

Source: Esping-Andersen, 1996, pp 71 and 122

<sup>18</sup> "As long as labour supply outpaced industrial job expansion, the German 'economic miracle' could proceed without inflationary and without political claims for major social reform" (Esping-Andersen, 1990, p. 169)



In the period after 1973 Germany persisted with a strict fiscal and monetary policy. Consequently unemployment increased to 8 per cent in 1983 and to more than 12 per cent in 1997<sup>19</sup>. The growth rate in Germany for the period 1973 to 1998 was a mere 2,5 per cent. As opposed to Sweden, Germany did not use the public sector to create additional job opportunities. Social spending was cut back, but not as drastically as in the USA (see table 6). In order to soften the unemployment problem, labourers were encouraged to take early retirement from the age of 55. Steps have also been taken to reduce the number of migrant labourers and, where possible, to repatriate them<sup>20</sup>.

It is also not surprising that the *employed* population rate has declined in Germany (and other EEC countries) while the employment rate has risen in both the USA and Sweden<sup>21</sup>. While Sweden has managed the surplus of "deindustrialised" workers with retraining and job creation in the public sector, and while the Americans managed the surplus with very low wages, Germany has opted to subsidise their exit, especially through early retirement. In contrast to both Sweden and the USA, Germany is not experiencing a noteworthy growth in the post-industrial service sector<sup>22</sup>.

To make matters even more complicated, a policy of low wages has been prohibited in Germany and job opportunities at low wages (in "junk-job" employment as in the USA) cannot be created. European social legislation makes it also very expensive, and almost impossible, to fire workers. The German welfare state since the time of Bismarck has been designed in such a way that women do not have to form part of the labour force. Consequently the labour supply is relatively low and wages of men (especially in the industrial sector) particularly high<sup>23</sup>. The assumption in Germany is that men must be paid particularly high wages in order to enable them to support a

<sup>19</sup> Thurow, *op.cit.*, p 37.

<sup>20</sup> According to Lester Thurow, the unemployment figure in Germany (and in other EU countries) is at least 20 per cent if one takes into account the labourers removed from the labour market through early retirement and repatriation. This means that one fifth of Germany's *potential* labour force does not form part of the *active* labour force.

<sup>21</sup> In 1960 the overall employment ratios were basically identical in Scandinavia, North America and Continental Europe at an average of 65 per cent of the working-age population. Since then, the *employed* population rate has risen to more than 75 per cent in the USA and almost 80 per cent in Sweden, while the EEC average has fallen to below 60 per cent. Esping-Andersen, 1996, p 18.

<sup>22</sup> Almost 42 per cent of Germany's labour force was in the middle 1980s still employed in the *industrial* sector in comparison with 28,8 in Sweden and 25,1 in the USA. Esping-Andersen claims that "the German employment trajectory is ... the oddest. Services and post-industrial occupations are not booming as they are elsewhere. Instead, there is a decline in employment as such, and Germany remains a largely traditional industrial society with a relatively underdeveloped private- and public-service sector" *Op.cit.*, 1990, p 214.

<sup>23</sup> Germany tops the charts of hourly wages. Its wages are more than \$30 if fringe benefits are included. Including social costs, manufacturing labour costs in Germany are more than two thirds higher than those of the USA. Thurow, *op.cit.*, p 36.

family (in which the wife does not work) and to be able to pay high taxes for the sake of the well developed welfare state. Fortunately most German labourers are usually very skilled, efficient and hard-working and justify the usually high wages they are paid. It, nonetheless, seems as if the "mix" of high productivity, of low employment, high wages costs and high social spendings becomes a too heavy burden to compete effectively in the Global Economy.

The problem of unemployment and productivity in Germany has been seriously aggravated by the unification of East and West Germany. It also appears as if Germany's ability to adapt to the post-industrial economy is relatively weak while its industrialism is accompanied with "jobless growth"<sup>24</sup>.

While of the 35 per cent of the labour force in Sweden and the USA was employed in the post industrial sector in 1985, only 21 per cent was employed in this sector in Germany<sup>25</sup>.

The high level of unemployment in Germany and other EU countries indicates that the EU is facing a very difficult *trade-off* between job opportunities and the maintenance of *social rights*. The fact that the EU countries have created no additional job opportunities since 1973 (while the USA created 38 million additional job opportunities) is an indication of how seriously the EU's ability to *create jobs* has weakened in the post-industrial period. In spite of this lack of job creation, the GDP of EU countries was in 1994 some 80 per cent higher than it was in 1973<sup>26</sup>. This must be ascribed particularly to the high productivity of those workers who are employed. The high level of productivity maintained by labour is also linked to the sound education system in Europe, good in-service training and sustained technological advances.

In contrast to the USA, the EU countries are not prepared to adjust *wages*, or *social rights* or the *welfare state* in a downward direction in exchange for greater job creation and a higher growth rate<sup>27</sup>. Public social security and health expenditure in West-Germany as a percentage of GDP

<sup>24</sup> "Western Europe, with its much more comprehensive industrial relations system, welfare states, and also powerful trade unions [compared with the USA] has maintained equality and avoided growing poverty, but at the price of heavy (especially youth and long-term) unemployment and swelling armies of welfare dependants, the combination of which overburdens social security finances", Esping Andersen, 1996, p 4.

<sup>25</sup> Esping Andersen, *op.cit.*, 1990, p 204.

<sup>26</sup> Thurow, *op.cit.*, p 37.

<sup>27</sup> Social security expenditure declined only marginally in Germany from 28.7 per cent of GDP in 1980 to 26.6 per cent in 1990. Esping-Andersen, *op.cit.*, 1996, p 71.

has decreased only from 25,4% in 1980 to 23,5% in 1990 compared to less than 15 per cent in the USA (see table 4)<sup>28</sup>.

A special characteristic of the German welfare state is its combination of highly (if not overly) developed social insurance (inordinately orientated towards the pension of the breadwinner) with underdeveloped social services that are not family connected. The necessity of a long uninterrupted career results in a very flexible labour market for breadwinners. Any reform of the German welfare system should – according to Esping-Andersen – concentrate on a decrease of its built-in market rigidities and its orientation towards familistic transfers. But to reform a system that has been established in its familistic pattern for over a century, will not be easy<sup>29</sup>.

As in Sweden, so Germany (and the other EU countries) are grappling with the problem of *entitlement*. The high level of social security spendings have to some extent spoilt the broader labour force in EU countries so that they claim ever more *social rights* (i.e. they have developed a kind of mentality that expects free handouts), while they are no longer prepared to accept their *social responsibilities* as hard-working and productive labourers as before<sup>30</sup>.

Seeing that the EU countries are not prepared to accept the *crude* form of American capitalism, on the one hand, and seeing that they will not be able to maintain the present form of welfare state capitalism in the midst of growing unemployment, on the other hand, the EU countries are at present seeking a middle way or a "third way": "... between the flexible but relatively *ruthless* capitalism of the United States and the more *caring* but *costly* European model of social welfare and workers' rights"<sup>31</sup>. In terms of these programmes, young people between 18 and 25 are given

<sup>28</sup> "Europeans remain convinced that the welfare state is the *right path* for them. Europeans are not about to trade in their hard-won model of social justice for the hazards and inequalities of the US-style free market. Andreas Schockenhoff, a member of the German Bundestag says, 'Nobody in Germany would seriously propose abolishing the welfare state. This is a model not of our economy, but of our very *society*. We don't want to abolish it; we want to *bring it up to date*' ... The problem is, while Americans are used to performing with the flimsiest of social safety nets, Europeans have grown accustomed to - and some argue, unhealthily dependent on - the providential hand of government" (*Time*, 8 December 1997).

<sup>29</sup> Esping-Andersen summarises it as follows: "The problem ... is that the welfare of individuals and families depends on precisely those elements that cause rigidities in the first place: job security, high wages and expensive social contributions". *Op.cit.*, 1996, p 20.

<sup>30</sup> "Low growth and high unemployment are twin strands of a vicious economic circle. In Europe the high level of benefits paid the jobless not only strains government coffers, but *discourages* the unemployment from seeking work. In addition, the working age population is declining in relation to the number of people entering retirement. The result: governments are financing more and more welfare services from ever dwindling resources" (*Time*, 8 December 1997).

<sup>31</sup> Many European countries are experimenting with innovative ways to trim the welfare budget and share the essentials more equally among governments, businesses and individuals - while getting more people into work. Giving individuals not only the *right* but also the *responsibility* to work would be an important first step on the road to the Third Way. Some European governments are doing just that by exploring *active labour market policies*,

training for 18 months in some countries. Those who refuse to undergo the training, forfeit their unemployment benefits. Good results have been attained in this way. In terms of other programmes, the government pays half of the salary of the unemployment for several months if the private sector employs them. Other programmes are calculated to stimulate entrepreneurship.

While Germany and other EU countries realise that the glorious days of high growth, extravagant welfare benefits and lifelong jobs are probably gone for good, they do not necessarily regard the American model ("with its economic brutalities and social fractures") as their fate. Because of the EU countries' more human view of labour, they regard the low wages and poor conditions under which Americans must do their "junk jobs" as undignified.

#### 4.4 Trade-offs in the USA

In the first thirty years after the Second World War the USA found it relatively easy to make a *positive-sum* trade-off - especially because social expenditure in the USA rose more slowly than it did in the European countries. In 1965 President Johnson began his Great Society policy and social spending began to rise moderately. In the stagflation after 1973, social expenditure (especially unemployment spending) rose much more rapidly than taxes and social security contributions. Given the lower economic growth rate and the lower tax capacity, the tax burden increased very quickly and led to the "tax resistance" of the end of the decade<sup>32</sup>.

Since Reagan the USA managed economic decline and domestic unemployment with greater labour market and wage flexibility. This has involved the reduction of minimum wages and of social security benefits. In 1989 the minimum wage dropped to only 38 per cent of average earnings and the real value of social assistance benefits (aid to families with dependent children) to 24 per cent of average earnings. The percentage of the unemployed receiving insurance benefits declined from about 70 per cent in the mid-1970s to 33 per cent in 1989. Consequently

programmes in which the state makes unemployment benefits *conditional* on the recipient's willingness to accept training and work" (*Time*, 8 December 1997).

<sup>32</sup> In order to bring the inflationary pressure under control, President Jimmy Carter introduced strong fiscal and monetary measures and caused a "political business cycle downswing" which led to his election defeat in 1980. In the depression of 1982 and 1983 unemployment rose to above 10 per cent, primarily because of President Carter's restrictive policy. Reagan won the election of 1980 on the back of the tax resistance. On the one hand, he reduced taxes and, on the other, sharply increased expenditure on defence (for the sake of military preparedness against the "evil empire"). The budget deficit of the federal government rose from 1,4 per cent of GDP in 1980 to 5 per cent in 1983. In the 12 years of Republican government from 1980 to 1992 American state debt more than quadrupled. While the USA was the greatest credit country in 1980 that the world had ever known, by 1992 it had become the greatest debit country that the world had ever known!

the already weak social safety net was allowed to become even weaker<sup>33</sup>. (Compare the low level of welfare related spendings in the USA with those of Sweden and Germany in Tables 1 and 2-6).

The American model is built on the basic assumption that the market should supply the public safety net. This implies negotiated occupational plans in the private sector<sup>34</sup>. An increasing share of the labour force is employed in firms and sectors with traditionally low coverage. At the same time private coverage in health and pensions has declined steadily since 1980<sup>35</sup>. The shift of job opportunities from manufacturing towards services jobs, brought about a lowering in the social coverage of many workers.

Ninety per cent of the new job opportunities created in the USA since 1970 are in the post-industrial *service sector*. While 50 per cent of the labour force were employed in the industrial sector in the USA in 1950, this has declined to the current 20 per cent. Since 1960 job opportunities in the *service sector* (the private as well as public service sector) in the USA grew by on average 4,7 per cent per year, as opposed to the 2,4 per cent per year in Sweden and 0,2 per cent per year in Germany. In contrast to Sweden, growth in the USA took place mainly in the *private service sector*.

The higher growth in job opportunities in the USA has its darker side. The USA "bought" job creation with lower wages, lower social expenditure and growing inequalities in the distribution of income. Much of the job growth appears in service jobs with lower wages. The low wages are especially acute among unskilled, non-unionised workers and among those entering the labour market. According to Esping-Andersen, "the burning issue is whether these jobs (with low wages) become dead-end traps; that is, whether the low wage strategy fosters a new kind of chronically impoverished post-industrial proletariat<sup>36</sup>. We have indeed reason to allege that the low social expenditure and the flexible labour market has already caused a reappearance of the *commodification* of labour in the USA. Many of the job opportunities created in the USA's rapidly growing "fun services" are "lousy jobs" or "junk jobs". A large number of African-Americans, women and children do in fact find job opportunities, but the pay is low and the

<sup>33</sup> Esping-Andersen, 1996, p 16. Despite the fact that the USA spends almost 13 per cent of GDP on health care the number of persons without adequate protection is very high – an estimated 40 million.

<sup>34</sup> The typical company in the USA pays 11 per cent of wages to legislated social contributions, and another 12 per cent towards fringe welfare benefits. This compares with the EC average of 24 per cent to the former and 5 per cent to the latter. Esping-Andersen, 1996, p 28.

<sup>35</sup> *Ibid*, 1996, p 16.

working conditions very bad. A full-time, all-year employment often results in below-poverty income.

There can be little doubt that America's positive employment performance was attained through the dogmatic return to unbridled freemarkets in which winners are rewarded and losers are punished severely. An important result of the retrenchment of social security and the flexible labour market, is the sharp increase in the unequal distribution of income. From 1973 to 1995 the per capita GDP in the USA rose by 36 per cent (or an average of 2,4 per cent per year) and 38 million additional job opportunities were created. But during this same period the *real* hourly wages of the bottom 60 per cent of the labour force declined by 14 per cent! ("Never before have a majority of American workers suffered real wage reductions while the real per capita GDP was advancing")<sup>37</sup>. Lester Thurow predicts that the wages of the bottom 60 to 70 per cent of the labour force will decline further and that their real wages in 2000 will be at the same level as they were in 1950, in spite of the fact that the per capita GDP in 2000 will be more than double what it was in 1950.

The puzzle we must try to solve is why the decline in real wages of the bottom 60 to 70 per cent of the labour force must be ascribed to an economy where the real economic growth rate has been 2,4 per cent per year since 1973. President Kennedy was fond of quoting the phrase that "a rising tide lifts all boats", but since the beginning of the 1970s this has no longer been the case. This could be ascribed to several factors. A first possible reason is that the collaboration between the Reagan/Bush/Clinton administration, on the one hand, and the well organised managerial elite of the large corporations, on the other, has succeeded in once again neutralising the greater bargaining power that the working class has gained during the golden era. A second possible reason could be that the USA (i.e. the administration and the corporate sector) used the rising global economy and increased international competition skilfully to undermine the bargaining power of the working class. In this respect the cheaper products imported from Japan and other Asian countries played an important role in enabling employers in the USA to force down wages. A third possible reason could be that the productivity of the bottom 60 to 70 per cent of the American labour force did not keep pace with that of the USA's trading partners. If it

<sup>36</sup> *Ibid*, 1996, p 17.

<sup>37</sup> "While the real per capita GDP has risen in 18 out the past 20 years, real weekly wages have fallen relentlessly in 15 of the same 20 years", Thurow, *op.cit.* p. 24.

is true that the relative labour productivity in America is on the decline, this must probably be ascribed to deficiencies in the American education system<sup>38</sup>.

While the real wages of the bottom 60 per cent of individual workers declined by 14 per cent from 1973 to 1995, the *household* incomes did not decline so sharply because of the greater participation of women and the higher wages of women. According to Thurow, women's participation in the economy of the USA is thus no longer voluntary, but essential to protect the living standards of the majority of households - in a growing economy - against being scaled down. The mad rush for success in the materialistic and consumer-driven civilisation, however, leads to the disintegration of the family and of society at large. Crime rates in the USA are much higher than in Europe. It is alleged, with a considerable degree of justification, that the cost involved in the prison population in the USA is the American equivalent to Europe's high unemployment<sup>39</sup>. Lester Thurow asked the following question about the USA economy: "How far can inequalities [in the USA] rise before the system cracks?"

Trade-Off Since 1870	Economic Growth	Employment	Price Stability	Exchange Rate Stability	Quality of level of Social Rights
<b>SWEDEN</b> (Social Democracy)	Reasonably high until 1970's. Since then much lower. Unemployment problem.	Quite high due to the consensus building institutions. Round table discussions. Retraining.	High public spending put pressure on prices.	High public spending and outflow of capital (in global capitalism) weakened exchange rate.	Income exceptionally equally distributed. Social rights enjoy preference.
<b>GERMANY</b> (Social Capitalism)	6% annually from 1950 to 1973. Only 2.3% since then. Labour productivity very high	12% unemployment since 1990. Jobless growth continuing. Unemployment insurance. Many are forced to retire at 55.	Strict monetary policy responsible for price stability. Labour productive and disciplined.	German mark was traditionally strong. Unification weakened it. Euro is weak vis-à-vis the dollar.	Reasonably equal. Germany not prepared to adapt wage, social rights and social spending downwards.
<b>USA</b> (Liberal Capitalism)	Maintain high growth since 1990. USA has a powerful position in Global Capitalism and high level of technologic progress	Unemployment insurance and minimum wages almost abolished. Flexible labour market "Junk jobs".	Maintain price stability thanks to Greenspan and Global Capitalism.	High negative balance of payment - especially with Japan. Dollar strong towards all other monies.	Income becoming more unequally distributed. USA "buys" employment with lower wages, lower social spending and growing inequality.

THE 2007 ECONOMIC EXAMINATIONS  
EVALUATING THE FIRST INCENTIVE  
RELATIONS OF SOUTH AFRICAN DEMOCRACY

GENERAL FEATURES OF ECONOMICS

1. The multi-dimensionality of Economics
  - a) A social (human) science
  - b) Struggle between MAN and NATURE
  - c) Complex and even "impenetrable"
  - d) "Beauty in the eye of the beholder"
2. Economics and Human Beings
  - a) Who wins in the struggle between Man and Nature?
  - b) Problems related to human beings:
    - i) Economics has to do with the satisfaction of human needs - which human needs? (Consumerism)
    - ii) The problem of Wealth and Poverty
    - iii) Labour as the most important production factor

3. The dynamic nature of Economics and the Economy

- a) "Economy-in-motion" and "Economics-in-motion"
- b) "The problems and methods of Economics" are ever changing
- c) The importance of Economic History
- d) The importance of POWER - political, economic and ideological power
- e) The importance of Growth and Development
- g) Schumpeter: If we left Growth out of the economy it would be "like Hamlet without the Danish prince"

4 The theoretical or "model-oriented" character of Economics as a Subject.

## CHAPTER 2

THE INTERACTION BETWEEN ECONOMISTS AND THE ENVIRONMENT AND THE PROFESSIONALISATION OF ECONOMICS

1. How contemporary problems shaped the ideas of the Great Economists:
  - (a) Adam Smith (1776) - his aim was to break Mercantilism and the power of the Merchant monopolists - he made a plea for the market.

- (b) Ricardo (1817) - he got involved in the clash between the landed Aristocracy (Gentry) and the emerging Industrialists - took side against the Gentry.
- (c) Marx (1867) - in his time Capital (Industrialists) were in a powerful position vis-à-vis the Gentry and Labour. He took the side of Labour against Capital.
- (d) Keynes (1936) - he tried to explain the Great Depression and alleged that the markets is not always a self-regulating mechanism.

The Great Economists were all concerned with unequal and/or

5. Ideology and Revolution

- (a) When does a revolution occur?
  - ♦ all the Revolutions in France 1789, 1830, 1848, 1871, 1958, 1968.
  - ♦ Communist Revolutions 1917, 1949, 1959.
  - ♦ The role of a new "idea" and the role of socio-economic conditions - the "spark" and dry wood that must be "inflammable"

- (b) The New Left or Radical student revolution of 1968/1969

c) The Cold War as a USA-driven ideology for the consolidation of the power of the Pax Americana

Irac?

2. How the Great Economists changed the cause of History

- (a) Adam Smith: played a key role in the abolishment of Mercantilism and in the rise of market-orientated capitalism;
- (b) Ricardo: his criticism against the Gentry and against the Poor Laws resulted in
  - the Reform Act of 1832
  - the repeal of the Poor Laws (1834)
  - the repeal of the Corn Laws (1846)(Few Economists were as influential as Ricardo - the Ricardian Laissez-faire system in place in Britain until 1914)
- (c) Marx: his criticism against Capitalism played a role in:
  - German welfare legislation (1880s)
  - Lenin's criticism against Imperialism (1916)
  - the hate of the Bolshevik (Communist) against Capitalism
  - Marx exercised an enormous influence on the Social Sciences
- (d) Keynes: he played a role in:
  - the end of Laissez-faire
  - the rise of "mixed capitalism"
  - the rise of macroeconomics
  - General Theory one of the 10 most influential books of the 20th century
  - [Keynes once said: "the world was ruled by little else ... (than) economists and political philosophers)

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4. Economists: A strange species

Joan Robinson:

"The purpose of studying Economics ... is to learn how to avoid being deceived by (other) Economists"

G Meary:

"Economics is the only profession in which one can gain great eminence without ever being right"

A Marshall:

"The more I study Economic Science, the smaller appeared the knowledge I had of it, in proportion to the knowledge I needed"

Galbraith:

"One of the greatest pieces of Economic wisdom, is to know what you do not know"

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3. The Professionalism of Economists and the greater relevance of Economists

- (a) Before 1870 Political Economy was practised by non-Economists
- (b) Economics became a University discipline from 1870 onwards
- (c) Three events professionalised Economists in the 20th century:
  - the Great Depression
  - the Second World War
  - The powerstruggle between pressure groups

(d) *The ideological struggle between the New Right and the New Left since 1970.*

Will Rogers:

"The trouble isn't what people don't know; it's what they do know that isn't so"

GB Shaw:

"If all the Economists in the world were laid end to end, they would reach ... no conclusion"

AH Motley:

"If the nation's Economists were laid end to end, they would point in all directions"

Winston Churchill:

"Whenever I ask England's six leading Economists a question, I got seven answers - two from Mr Keynes"

## CHAPTER 3

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### IDEOLOGY AND REVOLUTION

1. Definition of Ideology
  - (a) With ideology we seek meaning and significance in life
  - (b) All of us believe in certain things – all of us have prejudices
  - (c) Ideologies are very much part of our lives
  - (d) Close link between ideologies and revolution – Ideology legitimizes revolution
2. The meaning of Ideology
  - (a) Ideology is a method of "deceiving" people and of "distorting" information
  - (b) Philosophy, theory and ideas vs ideology (ideology mobilize people of action)
  - (c) Ideology ... hovers in the wide gap between truth and lies
  - (d) Ideology contains the idea of a dream ... an utopian dream
  - (e) Ideology describes the consciousness of a society
  - (f) Ideology provides the set of concepts that people use to interpret and understand the world around them

## CHAPTER 4

### DEMOCRACY, LIBERALISM (CAPITALISM) AND THE WELFARE STATE

1. The three aspects of Modern political and Economic systems:
  - a) Citizens are the sovereign CREATORS of the state authority
  - b) Citizens are potentially threatened by state power and must be protected against this danger
  - c) Citizens are dependent on the services of the state
2. The tripartite link between citizens and state authority crystallised over time in the modern Democratic Capitalist Welfare State
  - a) Democracy and parliamentarism
  - b) Liberalism, the Rechtsstaat and capitalism
  - c) The welfare state and "social rights"

### 3. The Function of Ideology

- (a) To enlist group solidarity – "we" that are "right" and "they" that are "mad"
- (b) To express needs, interests and expectations
- (c) To manipulate
- (d) To unite and to legitimise an establishment
- (e) An instrument for powerful communications – especially in advertising
- (f) Ideology as meaning in the service of power

### 4. Different types of Ideology

- (a) Status quo ideologies
- (b) Revolutionary ideologies
- (c) Reformist ideologies

### 3. Mutual relationship between the citizenry and the state

- a) Through representative democracy the citizenry "create" the authority of the state, and "give" legitimacy and power to the state
- b) Through the liberal Rechtsstaat (Liberalism) the authorities "create" a legal order which ensures judicial, social and economic FREEDOM which leads to the rise of Capitalism.
- c) The caring welfare state offer a minimum of essential social services to citizens

### 4. The mutual relationship between Democracy, Liberalism (Capitalism) and the Welfare State are not fixed, but are subject to continuous change and adaptations. This is a very important POLICY issue.

5. The rise of Liberalism, Democracy and the Welfare State
  - a) 18<sup>th</sup> century witness the struggle for equal judicial rights
  - b) 19<sup>th</sup> century witness the rise of equal political rights
  - c) 20<sup>th</sup> century witness the rise of a minimum of social



## The Rechtsstaat and the rise of Capitalism

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### 1. Four characteristic features of capitalism

- The property principle (all property is created by the state)
- The political aim of capital accumulation for the sake of sustained economic growth
- The organisational role of the market mechanism
- The administrative distribution of function between the public and the private sectors.

Capitalism is not a Natural but a human construct - It is a thing made (and continually remade) by human beings

Every democratically elected government is continuously busy to "reform" the rules according to which the capitalist game is played:

- Property rights are redefined
- Political priorities change
- The state interferes with the workings of the market
- The dividing line between private and public sectors is shifted continuously

Esping-Anderson (1996) summarises the

trade-offs in the three Western worlds, as follows:

"[Continental] Europe opting for an exit strategy,

subsidizing workers to leave the labour market [at 55] North America and Britain favouring a wage deregulating strategy [and the consequential greater inequality]; and Scandinavia stressing a retraining strategy and welfare state jobs, the latter mainly a source of woman employment" (p. 258).

## CAPITALISM

is not a NATURAL construct. It is a HUMAN or a SOCIAL construct. It is a thing made by human beings and something that must be "created" and "remade" over and over.

### CHARACTERISTIC FEATURES OF CAPITALISM

- The juridical principle upon which private property is based;
- The political aim of capital accumulation for the sake of growth and job creation;
- The organisational role of the MARKET in the allocation of scarce resources;
- The administrative distribution of functions between the public and private sectors.

Mev GM Kauger

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### CHAPTER 5

#### THE MUTUAL RELATIONSHIP BETWEEN DEMOCRACY, LIBERALISM AND THE WELFARE STATE - THE PERIODIC "REPACKAGING"

- The ideological debate since 1970 between the proponents of Democracy, Liberalism and the Welfare State
  - Champions of Democracy want greatest amount of POWER to be vested in the hands of elected government (Welf Government intervene)
  - Champions of the Rechtsstaat advocate the greatest possible "space" for Capitalism in private sector
  - Champions of growing welfare state advocate greater social expenditure for the sake of greater human development, justice and the elimination of poverty
- 1870-1914: The flourishing Liberalism (laissez-faire Capitalism)
  - Middle-class (property-class) control parliament made a plea for "large" Rechtsstaat
  - Neo-classical Economists maintain a dogmatic belief in the Invisible Hand of the free market
  - Welfare State only in Germany

3. 1914-1950: Full Democracy takes final shape
  - a) FWW fought for Democracy
  - b) Instability during the interwar period harmed the confidence ~~at~~ the market
  - c) Ideological battle took place between the desired Economic system, Capitalism? Planning? Socialism? Fascism? Communism?
  - d) Government spending of percentage of GDP increased
  - e) Tax increased
4. 1950-1973: Golden Age - of the Welfare State
  - a) Bigger "space" for the Sozialstaat (Welfare state) vis-à-vis Rechtsstaat ("Rechtsstaat")
  - b) Extended Welfare State introduced by Labour government in Britain
  - c) Gold era of high growth : 4,9% in OECD countries
  - d) Time of Great Consensus over Economic system of economic policy matters
  - e) During Golden Age all economic aims promoted

## CHAPTER 6

### THE FOUR WORLDS OF CAPITALISM IN OECD COUNTRIES

1. (Free market) Capitalism in the British American world based on the ideology of liberal capitalism
2. Social-democratic Capitalism in the Scandinavian and Benelux countries based on the ideology of social democracy
3. Social-market Capitalism in Continental countries (Germany, France, Italy) based on the ideology of social market capitalism
4. Familistic Capitalism or Corporate Capitalism in Japan based on a "familistic" and/or "corporate" ideology

### THE TRADE-OFF PROBLEM

Since 1973 the trade-off problem between social rights, full employment, price stability and economic growth has become a much more difficult problem. It has become a zero-sum-game. It is the policy issue in the last quarter of the 20<sup>th</sup> century.

5. Since 1973: The revival of Neo-Liberalism and the "crisis" of the Welfare State
  - a) Oil crisis, stagflation and end of Great Consensus
  - b) Ideological polarisation between New Right and New Left
  - c) New Right blames stagflation on overgrown Welfare State
  - d) New Left blames stagflation on a too great concentration of Power in the hands of the Managerial elite of Big Business

#### Result:

"Rechtsstaat" win "space" at the cost of Democracy and the "Sozialstaat"

Why has it become a zero-sum-game?

1. Negotiating power of working class increased considerable during the Golden Age
2. Lower growth rate since 1973
3. Rise of post-industrial economy and its negative effect on job creation
4. Relentless discipline of the Global markets
5. Ageing of population and large pensions

#### Government spending as a % of GDP

	Britain	France	Germany	Japan	USA
1880	10	14	10	11	8
1929	24	19	31	19	10
1950	32	29	29	-	22
1960	32	35	32	18	28
1970	4	38	37	19	34
1984	43	50	45	33	37