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World Economic Crisis and the Welfare State

Possible solutions to reduce the economic and social imbalances in the world economy, Europe and Germany

■ There are many arguments in favour of the thesis that the world economy will not find it easy to return to the high growth rates of the pre-crisis era, in the wake of the dual crisis.

■ The crisis and the subsequent weaker growth are putting welfare states in both the industrialised and developing countries under pressure. In Europe, cuts in services, as well as tax and contribution increases, are further entrenching the process of recommodification which has characterised the reform of European welfare states for years. The situation in the developing countries is more varied: in low income countries primarily under threat are informal social security systems and the first attempts at cash transfer systems. In middle income countries, in contrast, better growth prospects mean that the building up and expansion of social security systems can continue.

■ Fundamental reforms at the international, European and national levels could both reduce the economic and social imbalances in the world economy and improve the conditions for growth. Only by means of such far-reaching reforms will the world economy be able to return to more balanced and crisis-resistant growth.

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Content

Introduction

By autumn 2009, the worst seemed to be over: in many countries, the recession had bottomed out, some people were already talking of a V-shaped crisis and world stock markets were experiencing a strong recovery. In contrast to the last great global economic crisis, in 1929, this time the crisis seemed to be of only short duration and a speedy return to the status quo ante was possible.

This article does not share this optimistic view. Instead, it seeks to substantiate the thesis that fundamental economic and social imbalances in the world economy are the causes of this crisis. These imbalances can be put right only if current account differentials between the United States, on the one hand, and China, Japan and Germany on the other are reduced; world financial markets are re-regulated; a new global monetary order is established; distortions of competition are reduced in the Eurozone; income and asset distribution in many countries of the world is recalibrated; and growth models become more domestically oriented, above all in China, Japan and Germany, but also in Central and Eastern Europe and in many developing countries. Only in this way can the negative effects on social security systems, which have been undermined by increased unemployment and rampant public debt, be sustainably avoided. All of this is possible only if the neoliberal deregulatory state is transformed into a strong and globally cooperating interventional state.

The text is divided into three parts. In the first part, ten arguments are presented which suggest that, if things remain as they are, the world economy will not revert to the high growth rates of the pre-crisis era after the crisis has been overcome, but rather undergo a period of significantly weaker growth. The second part focuses on the consequences of the crisis for the welfare state or social security systems in Europe and in the developing countries. First, the substantial changes experienced by welfare states since the mid-1990s are addressed, in order, against this background, to discuss the effects of the world economic crisis on social security systems. This is followed by a presentation of the various social security systems in the developing countries, which are mainly informal in nature and, in low income countries, partly consist of cash transfer systems, taking on the form of public social protection systems only in some middle income countries. The crisis will only further intensify these differences among the developing countries. Part three analyses the many steps which must be taken on the way towards a balanced, more crisis-resistant growth of the world economy and to the preservation and expansion of social security systems. The necessary reforms in relation to the international, European and German levels will be presented in separate subsections.

1 After the World Economic Crisis: Ten Reasons for Weaker Growth in the World Economy

Currently, the main topic of discussion with regard to the world economy is how quickly the crisis will be overcome and what course the recovery will take. Many observers expect a rapid V-form recovery, others a somewhat more leisurely U-form one. A third group consider it probable that, after a first brief recovery, there will be another downturn before the crisis is finally over, yielding, therefore, a W-form pattern. Yet others, finally, see a danger that, after this crisis, there will be a longer period of stagnation, similar to the global economic crisis after 1929, forming an L-shaped pattern. In what follows I shall give ten reasons which speak in favour of a more cautious consideration of the chances of rapid recovery for the world economy.

(i) Problems of the US Economy

The growth model of the US economy in the period after the dot-com crash in 2000/2001 was in no small measure responsible for the current global economic crisis. After the bursting of the share bubble, the policy of cheap money under Alan Greenspan, chairman of the Federal Reserve, together with the extreme deregulation of financial markets, was the starting point for the development of the crisis on the US real estate market due to overspeculation (Krugman 2008: 170ff). Generally speaking, an expansive monetary policy, together with an expansive fiscal policy led to high growth rates in the United States. Against this background, the United States, given its enormous weight in the world economy (20 per cent of global GDP in 2008), was the decisive motor of growth in the period before the crisis. The United States lived far beyond its means during this time: internal absorption consisting of private and public consumption, as well as investments was much higher than domestic production of goods and services, so that imports far exceeded exports. The world (China, Japan, Germany and the OPEC countries) invested their savings in the United States, bought US government bonds, shares and other securities. Up until the crash, this exchange formed the basis of the boom in the world economy and everything seemed fine. China, Japan, the OPEC countries and Germany fed the United States with their goods and services, thereby recording high export surpluses, and gave the US, in the form of savings exports, the credit it needed to finance private and public excesses. Growth here created growth there, financed on the never-never, and drove the world economy to ever higher levels.

In the meantime, we know the end of the story and now we need to go into reverse. Heavily indebted US consumers have to reduce their debts – in the form of credit card debts, car loan debts and mortgage debts – that is, they have to save. The US state, after its stimulus packages for the economy and the financial sector, also has to begin to reduce its debts (in other words, to save). It is therefore clear that two important engines of growth for the United States and the world economy will be underpowered for the foreseeable future. It is also clear that the United States will no longer function as a stomach which is able to swallow an oversized portion of the exports of the rest of the world.

(ii) Reduction of Global Economic Imbalances

As already mentioned, very large imbalances have developed in the world economy over the past 15 years. The United States has registered ever larger current account deficits, while China, Germany, Japan and the OPEC countries, by contrast, have recorded ever greater current account surpluses. This was possible only because, on the one hand, the rest of the world had faith in the United States as a debtor and was ready to invest ever larger capital sums there, while, on the other hand, many states, above all China, prevented their currency from appreciating by intervening in foreign exchange markets. In 2008, Chinese currency reserves amounted to 2.1 trillion US dollars (almost one-third of the world's currency reserves), a large proportion of these funds being pumped into the US by China buying securities (Bofinger 2009: 72ff). It should be mentioned in passing that the overspeculation on world financial markets can also be traced back to these huge international capital flows (Münchau 2008: 155ff).

It should be clear that such imbalances cannot go on forever. Debts (US) must be repaid some time; the currency of indebted nations (dollar) can come under strong pressure in foreign exchange markets; and benefits gained from an undervalued currency (China) will sooner or later provoke counterreactions (competitive devaluations, protectionism). In the immediate future, the US must reduce its deficits, a process which has already begun due to the recession there, but must also be sustained. At the same time, the countries running surpluses must reduce their export dependency through stronger domestic growth, thereby relieving the strain on the USA. Furthermore, a re-orientation of currencies is also required, with further devaluation of the dollar, as well as the yen and the euro, but above all with a revaluation of the Chinese currency.

These necessary currency adjustments will slow the pace of globalisation, promote growth in the USA, subdue growth in China, Japan and the Eurozone, but also confer more stability on the world economy and the global financial system.

(iii) Rising Unemployment and the Strain on Consumption

Since the beginning of the recession in December 2007, seven million jobs have been lost in the USA, more than in any other recession since the Second World War. The unemployment rate had risen to 10.2 per cent in October 2009, the highest since 1983, and for the whole of 2010 a rate of more than 10 per cent is expected (IMF 2009: 65). Unemployment puts a strain on private consumption, which in the USA accounts for around 70 per cent of GDP.

There are also negative expectations in Japan with regard to domestic demand as a result of rising unemployment. For the Eurozone, the IMF expects an unemployment rate of 11.5 per cent for 2010 (IMF 2009: 65). The general assumption with regard to the industrialised countries is that unemployment rates will peak in 2010, before gradually falling back over the next few years. This means that private consumption will rather hold back economic recovery than support it after the crisis (Roubini 2009a).

(iv) Budget Policy and the Reduction of Public Debt

In order to avoid the collapse of the financial sector, governments in the USA, Japan and the EU have invested billions in rescue plans, and in many parts of the world economic stimulus programmes have been adopted to combat severe recession, although they differ considerably in size – not to mention economic policy uncertainties.

These inevitable interventions have left gaping holes in state budgets. Many states, in particular in the EU, on the basis of the strong economic upswing since 2004, were on the point of reducing state indebtedness, but were forced into an abrupt policy about-turn by the crisis. The IMF assumes that the net debt ratio from 2007 to 2014 in the USA will almost double, rising from 43 to 83 per cent. For the Eurozone, the IMF expects, for the same period, an increase from 52 to 75 per cent, and for Germany from 57 to 83 per cent. Japan's net debt ratio is to increase from 80 to 136 per cent and the UK's from 38 to 83 per cent. Net new debt in the USA is estimated at 9.7 per cent for 2010, at 6.1 per cent for Germany and the Eurozone, 10.9 per cent for the UK and 9.8 per cent for Japan (IMF 2009: 203, Table A8). Regardless of the controversial issue of how quickly and to what extent governments will switch from an expansive fiscal policy to a cost-cutting policy, there is general agreement that the consolidation of state budgets must be tackled after the crisis has come to an end. As far as economic growth is concerned, this undoubtedly means that, during this period, the state will seek to keep a tight rein, whether by means of tax and contribution increases or spending cuts.

(v) Monetary Policy Problems

Central banks have lowered base rates in order to combat the economic crisis and have provided the banking system with more liquidity by diverse means. Critics of this monetary policy fear that the increased money supply may lead to higher inflation, in particular if the central banks, as the economy picks up, commence their exit strategies too late.

With regard to potential problems for economic growth which might arise from future monetary policy after the end of the crisis, two issues are relevant. On the one hand, it is being discussed whether in future central banks should not concentrate only on fighting inflation, but should also be encouraged to terminate bubbles in financial markets in good time. If this happens, it can influence economic growth if central banks perform this task very restrictively and intervene rapidly with regard to emerging excesses in stock and real estate markets.

Another problem can arise if the central banks commence their exit strategies too late and, to begin with, tolerate higher inflation rates which they later try to get a grip of by means of a tough monetary policy. Akerlof and Shiller rightly point out that money is not neutral and money illusion really exists (Akerlof and Shiller 2009: 157ff). They argue that workers, when inflation is falling, find even nominal wage reductions which are neutral in real terms to be unfair, if they suffer from money illusion. Therefore, it must be assumed that there will be a trade-off between inflation and unemployment, even in the long term. A tough anti-inflation policy which over a longer period costs growth and jobs is therefore a bad economic policy.

On the whole, as result of the crisis, monetary policy has not been made any easier. The possible extension of its tasks to the combating of financial market bubbles could impose difficult decisions on it, which might have the effect of dampening growth and employment. Similarly, the exit strategy might lead at first to more inflation and then to substantially lower growth, if the so-called »animal spirits« are not taken into consideration.

(vi) Wage Policy and Distortions of Competition in the Eurozone

At the beginning of the 1980s, a new phase commenced with regard to wage policy in European countries, which has continued until today. As a result of far-reaching socio-economic changes, since that time the trade unions have not been able to ensure that, on average, real wages keep pace with labour productivity (cf. Baum-Ceisig, Busch and Nospickel 2007: 218ff).

For the European integration process it is particularly problematic that this process of declining real unit wage costs has taken place very unevenly, as a result of which distortions of competition have arisen, especially in the Eurozone. While countries with their own currencies can balance longer lasting imbalances in unit wage cost development by means of exchange rate adjustments (re- and devaluations), this is by definition no longer possible in a common currency area. In the Eurozone, as a result of the above-average fall in real unit wage costs in Germany in recent years, tensions have been heightened. Germany has been able to consolidate its leading export position in the Eurozone on the basis of distortions of competition arising from wage policy. As a result, it has put its main competitor, France, but also Greece, Italy, Portugal and Spain under significant pressure (Fritsche 2009). These imbalances have exposed the stability of the Eurozone to considerable strain. If EMU's internal stability is to be safeguarded, wage policy must urgently be adjusted to national figures on productivity and inflation.

Like the reduction of global current account imbalances (see point ii above), this correction in wage policy in the Eurozone would also force Germany to bid farewell to its excessively export-oriented growth model and direct its efforts towards the domestic economy. In the transition period between these two growth models economic growth in Germany would slow down.

(vii) The Crisis in Central and Eastern Europe

The less developed states in Central and Eastern Europe which have acceded to the EU (CEE-10) have experienced a strong economic upturn since overcoming their transformation crises and have been able to reduce the development gap with the EU-15 considerably. The catch-up process, in textbook fashion, has been co-financed by high capital imports, resulting from large current account deficits in the CEE-10. This catch-up model, supported by a high foreign debt, remains feasible as long as foreign creditors have confidence in the economic development of the emerging countries. The experience of many Asian countries in the 1990s and of many Latin American countries in the 1980s, however, shows that this model is extremely fragile. If current account deficits reach high levels in relation to GDP, internal public debt, which is usually linked to foreign debt, grows to an extraordinary size and these double deficits, in combination with domestic political turbulence or exogenous economic shocks, can lead to a currency crisis. A proportion of foreign capital flows out of these countries, new foreign capital is hard to obtain and even some domestic capital flows abroad, thereby intensifying the currency crisis. This is exactly the situation in many CEE-10 countries as a result of the global financial market crisis. On top of this, the economic downturn in the EU-15 has further weakened the strongly export-oriented economies among the CEE-10 and increased their current account deficits. Overall, the question arises of whether, in light of these experiences, the economic model of the CEE-10 is not too foreign-, that is, especially EU-oriented. A stronger domestic market orientation and a lower dependence on capital imports may lead to lower growth rates, but the catch-up process would acquire a lot more stability. The particular severity of the crisis in some CEE-10 countries has negative consequences for the exports of EU-15 countries, especially Germany. Any eventual restructuring of these countries' growth models would have a depressive effect on economic growth in Germany.

(viii) Uncertainty on the World Oil Market

In 2008, the OPEC countries exported oil to the value of more than 1 trillion dollars. This was an increase of 35 per cent on 2007, attributable primarily to the strong increase in the oil price to 147 dollars a barrel. As a result of the global recession, the oil price then plunged to a mere 30 dollars a barrel in February 2009, recovering somewhat to reach 70 dollars a barrel by September 2009.

The further development of the world economy will depend strongly on the evolution of the oil price. The prognosis is uncertain, but world oil reserves are fast running out. At the same time, demand is rising, due to economic catch-up in the emerging countries (above all, China and India). The estimated reduction in investment in development and production in 2009 of between 15 and 20 per cent – according to the International Energy Agency (IEA) – is counterproductive.

At present, further developments in the world oil market are difficult to assess. It is unclear whether stricter regulation of futures markets can be effected on an international basis. The development of reserves, production and demand is also difficult to predict. However, it must be assumed that the world oil price is on an upward trend, and will act as a brake on the world economy.

(ix) The Significance of the Credit Crunch

A credit crunch occurs when investors cannot obtain loans – or only under onerous conditions – to finance their projects. Whether the current crisis involves a credit crunch in the true sense is controversial. The current willingness of the banks to lend is hampered by, basically, three factors. First, toxic securities continue to lie dormant in banks' balance sheets, leading to an increased need for write-downs and so narrowing the banks' capital base. Second, as a result of the crisis, more and more enterprises will become distressed and no longer be able to repay their loans. This too will increase the banks' need for write-downs. Finally, the international Basel II Treaty requires that banks set aside more equity capital to cover problematic loans, thereby reducing the banks' basis for loan allocation.

The upturn of the world economy could be adversely affected if the banks still have large write-downs in store and more and more borrowers lose creditworthiness due to the crisis. In any case, governments in principle have sufficient means at their disposal to avoid a credit crunch.

(x) The Inadequate Re-regulation of World Financial Markets

After the collapse of Lehman Brothers in September 2008, the world financial crisis peaked. During this period, when people were in shock in the face of the unthinkable, calls for the re-regulation of financial markets were ubiquitous. Many sensible proposals were made (cf. Bofinger 2009; Krugman 2008; Otte 2009; Münchau 2008; Schäfer 2009), although the various institutions and authors focused on different things. The most important demands included:

- destruction of the shadow banking system in order to subject the entire banking system to state control;
- introduction of counter-cyclical rules in the Basel II Treaty;
- abolition of mark-to-market accounting;
- takeover of credit rating agencies by the state;
- control of hedge funds;
- regulation of private equity investments;
- controls and transparency with regard to all financial products;
- a ban on particularly risky collateralised debt obligations (CDOs);
- introduction of a state-controlled exchange for credit default swaps (CDSs);
- limitation and control of bonus payments in the financial sector;
- an end to all tax havens, including in the industrialised countries;
- lifting of bank secrecy in all countries;
- introduction of a global supervisory authority for world financial markets.

The G-20 has addressed this topic several times and adopted principles for a new set of regulations for international financial markets at its Pittsburgh summit at the end of September 2009. It is foreseen that, by the end of 2010, new rules will be developed at international level for the increase and improvement of banks' equity capital, which would then be introduced gradually by the end of 2012. The banks are to hold more and higher quality equity capital, while there will be stricter rules for collateralised debt obligations (CDOs). All the G-20 countries – in other words, including the USA – want to implement the stricter Basel II equity capital rules by 2011. For derivatives, exchanges or electronic trading platforms are to be introduced by the end of 2012; by mid-2011, uniform accounting standards will be developed. Major banks of systemic importance must develop strategies to cover the event of their bankruptcy (»wills«). Tax havens are to be actively combated. Management bonus systems are to be more strictly regulated and restricted.

These resolutions sound promising, but are difficult to assess since everything depends on the final proposals and resolutions which, with regard to the most important issues, are due only in 2011 and 2012. Some scepticism is warranted because, in the wake of the partial recovery of world financial markets and the world economy in the summer of 2009, the zeal for reform has waned somewhat (Hoffmann 2009; Wolf 2009). In particular with regard to the dismantling of the shadow banking system, the control of rating agencies, hedge funds and private equity companies, the restriction of CDOs and the supervision of CDS markets, strong resistance is to be expected. An international supervisory authority with real competences will, in all probability, not materialise. Ultimately, a great deal will remain within the jurisdiction of nation-states.

It is therefore apparent that the danger of a repetition of the international financial crisis will not be averted.

Provisional Conclusions

The arguments presented here should serve as a warning that a rapid V-shaped recovery of the world economy or a speedy return to the high growth rates of the pre-crisis era are not to be expected. Instead, all indications are that the world economy will recover slowly and growth will be weak in the post-crisis period. This sceptical view of things is shared by many critics, such as Krugman (2009), Rodrik (2009), Rogoff (2009), Roubini (2009b), Shiller (2009) and Stiglitz (2009), to mention only some of the most important. Although the analyses differ in detail, there is general agreement that without the elimination of the global imbalances between the USA, on the one hand, and China, Japan and Germany on the other; without a correction of the unequal distribution of wealth and incomes, both nationally and internationally; without a new architecture for world financial markets;

and without strong state intervention at the level of nation-states and the world economy, a transition to stable and balanced growth across the world will scarcely be possible.

Some of the reform measures already touched on in this section, and to be presented in more detail in section 3, entail lower growth in individual countries; for example, the coordination of European wage policy in Germany. Overall, however, the implementation of international, European and national reform packages would eliminate global economic and social imbalances and lead to balanced and more crisis-resistant growth for the world economy, as well as for Europe and individual nation-states.

2 Economic Stagnation and Social Security Systems in Europe and the Developing Countries

Weaker economic growth will also adversely affect social security systems in the various regions of the world. In many **industrialised countries**, the welfare state has come under pressure since the 1990s as a result of demographic change, high public debt and low employment rates, triggering a host of reforms. While the economic boom of 2004–2008 provided some relief, now the steep increase in public debt, higher unemployment and prospective lower growth rates means that a new set of burdens lies in store. In many **developing countries**, the process of building extensive social security systems is far from complete. Particularly in developing countries, which have been adversely affected by the fall in commodity prices, these reform processes have been stymied and traditional systems of social protection (the family and the local community) have come under greater strain due to increasing poverty. Things are otherwise in **emerging countries** which have large domestic markets and are likely to grow at a high rate, despite the weakness of the world economy. Here the economic foundations for the establishment and expansion of social security systems will continue to improve.

In what follows, the various problems of individual groups of countries will be examined in more detail.

2.1 Welfare States in the EU-27

In the European welfare states reform pressure arose over the past two decades from a combination of explanatory variables, including demographic change, employment crises, public debt and the system of »market states«. The evolution of social security benefits since the mid-1990s illustrates that in many EU countries (Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, the Netherlands, Slovakia, Spain, Sweden and the UK) the dismantling of the welfare state is already discernible in macro-data. The main driver of these trends is the reforms of pension and health care systems, which account for 70 to 80 per cent of all welfare state expenditure.

Finally, as a result of the unequal development of economic and social catch-up processes, social dumping may well emerge in the system of market states. While in Greece, Hungary and Portugal the economic catch-up process has gone hand in hand with both an absolute and a relative expansion of the welfare state, in Estonia, Ireland, Latvia, Lithuania, Slovakia and Spain the welfare state has been cut back in relative terms, despite economic advance.

This shows that, without political intervention, the close link between economic and social progress, which existed in the EU until the mid-1990s, cannot be maintained. Belief in almost automatic interaction in the functionalist sense is not borne out by experience.

Reforms of social security systems in the past two decades display a high degree of convergence. Similarities with regard to reform policy and system evolution are particularly marked in pension and labour market policy, in both Western and Eastern Europe. Change in these sectors has tended to be radical, with existing structures often being cast by the wayside (cf. Baum-Ceisig, Busch, Hacker and Nospickel 2008).

In **pension policy**, this finds expression in the introduction of the three-pillar model, in the transition from defined benefit schemes to defined contribution schemes, a relative cutback in services (recommodification) and a tendency towards mixed financing (taxes/contributions).

Such change, which has characterised all European states, is more marked in the Central and Eastern European countries than in many of the EU-15. The stigmatisation of socialism in the wake of the transformation from real socialism to the capitalist market economy has meant that neoliberalism has made greater inroads in many CEE countries than in the old EU. The »new« Europe has tended to take its bearings from the USA and the UK – in other words, the homelands of liberalism. »Social policy« is associated with »socialism« by many political strands in the CEE. It is not surprising, therefore, that in the CEE – with the exception of the Czech Republic and Slovenia – pension reforms have taken on a more pronouncedly neoliberal bent than in Western European countries.

A similar tendency is to be noted in the development of **unemployment insurance**. In both West and East Europe entitlement conditions have been tightened up, entitlement periods cut and wage replacement ratios reduced. The social safety net allows more people to slip through it. As in pension policy in Western and Eastern Europe, the re-commodification trend here is unmistakeable. As in the pension sector, unemployment insurance reforms are often more radical in the East than in the West.

In the **health care sector**, the picture so far is more differentiated. Although the reforms are driven by the same demographic and financial constraints in both East and West, in contrast to what has happened with regard to pension and unemployment insurance, they have taken place in a more path-dependent manner, remain more strongly attached to existing structures and are less radical overall.

To summarise, we can say that reforms of the welfare state in the EU exhibit considerable convergence in the East and the West. Given the common objective problems (demographic change, public debt, unemployment) and the common socio-political ideal-model (neoliberalism), this is not surprising. However, there are national differences and diverging political constellations at the level of the member states, which in the system of market states could reinforce the danger of dumping and downward spirals (cf. Section 3.2).

2.2 Effects of the Global Economic Crisis on the Welfare States of the EU-27

The global economic crisis affects the funding of social security systems essentially via two channels: on the one hand, due to the higher unemployment, the expenditure of social insurance funds and the state is increasing, while on the other hand, their tax and contribution revenues are falling as a result of lower economic growth or lower wage increases. In this way, funding gaps generally appear in state social security systems. Since most European states have put together larger credit-financed rescue packages in response to the economic crisis and to bale out the financial sector, cumulatively larger deficits are emerging in state budgets and in the budgets of the social insurance funds. If the crisis is overcome soon and the economy returns to high growth, the indebtedness of the state as a whole as a result of the crisis can be remedied without difficulty. Things will be different, however, if growth in the post-crisis period is weaker than before the crisis. In Section 1, it was argued that it is precisely this that is to be expected after the great dual crisis of the world economy. If growth rates remain below earlier rates of potential growth and unemployment, therefore, remains high for an extended period the public coffers will experience prolonged difficulties. Spending and benefit cuts, as well as tax and contribution increases could then quickly become the order of the day.

The European Commission presented the state of the public budgets of EU members as a result of the crisis in a recent Communication to the European Parliament and the Council (Commission of the European Communities 2009). This picks up from its report of 2006 on the long-term sustainability of public finances in the EU (European Commission 2007). In 2006, nine states were deemed to be in the low-risk group: now there are only four (Denmark, Estonia, Finland and Sweden), together with a new EU state, Bulgaria. In the medium-risk group in 2009 are Austria, Belgium, France, Germany, Hungary, Italy, Luxembourg, Poland and Portugal. Twice as many countries as in 2006 are now in the high-risk group: Cyprus, the Czech Republic, Greece, Ireland, Latvia, Lithuania, Malta, the Netherlands, Slovakia, Slovenia, Spain, the UK and new member state Romania.

From its analysis of the mounting debt situation with regard to public budgets, the Commission derives three demands: (i) the reduction of deficit and debt ratios; (ii) an increase in employment rates; and (iii) social security reforms, especially of pension and health care systems.

It is therefore clear that the EU states, as a result of the effects of the world economic crisis on the labour market, social insurance funds and state budgets, will intensify the reforms of the welfare state which they have already been pursuing for a number of years. Benefit cuts and/or tax or contribution increases are on the agenda, if things remain the same, especially in the group of high-risk countries, which in any case includes half of all EU states.

In the market states system this process of dismantling the welfare state could give rise to multiplier effects, which ultimately even the medium- and low-risk countries will not be able to elude.

2.3 Social Security in the Developing Countries

While in the industrialised countries social security is, in the main, guaranteed via public systems and private insurance companies, the situation in the developing countries is much more complex. Here the traditional forms of social security afforded by mutual support groups (family, relatives, neighbours), and by membership of organisations and associations (cooperatives, churches, benevolent funds) still play a larger role. Often, these are the most significant social security mechanisms.

The tables in the annex present data – if available – on the development of public expenditure on social security in a large number of states throughout the world. The stark contrast between the developed industrialised countries of Europe and the developing countries in Latin America, Africa and Asia is immediately striking, as are the great differences within the group of developing countries. While many states still spend only 1 or 2 per cent of GDP on state social security (including India, Pakistan, Indonesia and the Philippines), others have sometimes made significant efforts to increase spending between 1995 and 2005/2006 or at least to maintain it at a comparatively high level (including Tunisia, South Africa, China, South Korea, Mauritius, the Seychelles and some Latin American countries), with values of between 5 and 20 per cent.

The most important target groups of comprehensive social security in many developing countries are still state employees (armed forces, state officials and employees) – in other words, the key pillars of the regime.

An extremely interesting development is taking place in the welfare states of East Asia, including Indonesia, Malaysia, the Philippines, Singapore, South Korea and Thailand. Here, the social situation of the population in the decades preceding the Asian crisis in 1998/99 improved considerably. This was due primarily to the high GDP growth rates and the high (male) labour market participation. Poverty rates decreased significantly and life expectancy grew strongly.

These countries suffered a major setback as a result of the Asian crisis, however, with negative growth rates and rising unemployment as a consequence of the outflow of international capital. The countries in this group responded to this crisis in two different ways. In Singapore, Malaysia, the Philippines and Indonesia the governments have relied on the traditional adjustment strategies of their welfare regimes and have basically shifted the social burden onto the family. In contrast, after the crisis South Korea, Taiwan and Thailand began to expand their state social security systems (IMF 2009: database). In these young democracies, the political parties became aware of the potential of social policy for political mobilisation (Tangcharoensathien et al. 2009).

The different consequences which the welfare regimes of East Asia have derived from the Asian crisis, and the great differences between relative spending on social security in developing countries with a similar level of development raises the general question of whether less developed countries would be better off building up their social security systems or devoting all their resources to the pursuit of economic growth, since this may lead quasi-automatically, via the so-called »trickle down effect«, to the reduction of poverty there. This question was recently addressed by Michael Cichon and Wolfgang Scholz in an econometric investigation (Cichon and Scholz 2009). The authors examined for 22 OECD countries in the year 2000 the relationship between per capita income and the poverty rate or between the social expenditure ratio and the poverty rate. The results show that with an increase in either per capita income or the social expenditure ratio, poverty rates fall, but the connection between the reduction in the poverty rate and the increase in the social expenditure ratio is significantly stronger than between the poverty rate and per capital income. Cichon and Scholz conclude from this that a higher per capita income can reduce the poverty rate, but that this effect is uncertain. In contrast, the probability is much higher that poverty rates will fall in the event of an increase in the social expenditure ratio (Cichon and Scholz 2009: 83f).

These results are confirmed by studies on the impact of social security systems on poverty rates in the European Union (Cantillon 2009). In the EU member states social security systems contribute to a considerable reduction in poverty rates and, vice versa, no EU member state – with the exception of Slovakia – has managed to achieve below average poverty rates with below average expenditure on social security (Cantillon 2009: 220ff). The following reflections are intended to show that the low income countries could make good use of the positive experiences of the developed industrialised countries, in particular the EU member states.

The following data show clearly how essential it is to develop strategies to reduce poverty in the developing countries. According to the recent UN report on the achievement of the Millennium Goals, between 1990 and 2005 the number of people living below the poverty line of 1.25 dollars a day was reduced from 1.8 billion to 1.4 billion. While in 1990 almost half the population of the Third World was living below the poverty line, by 2005 this had fallen to one quarter. This is in large part due to economic growth in China where, during the period in question, 475 million people were raised above the poverty line (United Nations 2009: 7). While, on the one hand, this outlines the absolute and relative dimensions of the problem of poverty in the Third World and, on the other hand, shows that poverty rates could be sharply reduced by expanding public social security systems – and better than by a strategy which concentrates exclusively on economic growth – the question arises whether the developing countries can afford this expansion of their social security systems and what the costs would be of building up a basic, but comprehensive platform for social security in poor countries.

Christina Behrendt and Krzysztof Hagemejer addressed this issue in a recent study (Behrendt and Hagemejer 2009). They first define a basic social security package for poor countries, consisting of four components:

»1. universal basic old age and disability pension; 2. basic child benefit, either universal or limited to orphans only; 3. targeted cash transfer for the most vulnerable households; 4. universal access to essential health care« (Berendt and Hagemejer 2009: 101).

The costs of such a programme were worked out for seven African countries (Burkina Faso, Cameroon, Ethiopia, Guinea, Kenya, Senegal and Tanzania) and five Asian countries (Bangladesh, India, Nepal, Pakistan and Vietnam). Benefits in this package are oriented towards the poverty line defined by the World Bank, which amounts to 1 US dollar a day per person in PPP. Old age pension and disabled benefits are assumed to be 0.5 US dollars a day per person and child benefits 0.25 US dollars. The health care package is based on the work of a WHO commission and includes 49 medical interventions for the population of developing countries (Commission on Macroeconomics and Health 2001).

The financial burden of the total social security package for the countries examined amounts to 6.4 to 17.3 per cent of GDP in 2010, with a range of 6.4 to 11.4 per cent in eight countries, and 14.7 to 17.3 in the other four countries. The bulk of the burden derives from the health care package (Berendt and Hagemejer 2009: 109f).

Since these burdens cannot be borne by many of the countries under examination, measured against current expenditure, the authors calculated the domestic resources needed based on the assumption that these states devote 20 per cent of their budgets to social security. On this basis, the cost burdens come out at between 2.4 and 5.8 per cent of GDP in 2010. By deploying these resources, India would be able to cover 90 per cent of the basic package already in 2010, while Pakistan, Cameroon, Vietnam and Senegal would be able to cover between 90 and 100 per cent by 2030. In many countries, however, even by 2030, the level of coverage would only be between 20 and 50 per cent (Berendt and Hagemejer 2009: 113f). Without aid from the international community, therefore, a basic social security package cannot be achieved.

Social security systems are not only the most suitable strategies for reducing poverty in low income countries; they are also a basic requirement for economic development. Only by means of basic health care can the population's ability to work be maintained in developing countries. Only through cash transfers for children and old people do families have sufficient resources to send their children to school rather than to work, thereby making it possible to improve young people's qualifications. Only by means of a basic social security package can the strain be alleviated to such an extent that women can increasingly pursue gainful employment (Barrientos 2009; Lund 2009; Samson 2009).

Many underdeveloped countries have now introduced various cash transfer schemes for the poor and basic health care services, although most such schemes do not have anywhere near 100 per cent coverage. India, China, Brazil, Mauritius, the Seychelles and South Africa can be cited as examples.

To summarise, the following can be said about social security systems in the developing countries:

1. Social security systems can be found in poor countries to varying degrees. Almost half the world's population, according to ILO calculations, are excluded from public social protection in any form. In South Asia and Subsaharan Africa, the figure is around 90 per cent. In middle income developing countries this still applies to

between 20 and 60 per cent of the population (Townsend 2009b: 250).

2. Since the problem of poverty in the developing countries remains exceptionally serious and social security systems contribute to a greater extent to the reduction of poverty than pure economic growth, the introduction and expansion of public social security systems in the developing countries is of the highest priority.
3. Public social security systems are associated with a higher financial burden (more than 10 per cent of GDP) for the developing countries than pure cash transfer systems for the poorest sections of the population (around 3 per cent of GDP). In low income countries, therefore, cash transfer programmes are more widespread, while many middle income countries have already begun to set up and expand public social security systems.
4. Basic social security packages are fundable by many developing countries, but in many other cases they must be supported by aid from the international community. This obligation on the part of the richer countries can only increase on the basis of the negative consequences of the global economic crisis, for which the poor countries are not responsible.

2.4 Effects of the Crisis on the Social Situation in the Developing Countries

Given that in the developing countries millions of people live on the margins of or below the subsistence minimum the effects of the global economic crisis are more dramatic in these states than in the industrialised countries. However, the picture is extremely differentiated in the developing countries, too. Hardest hit are the low income countries, which have suffered disproportionately from the decline in world trade and world commodity prices.

Falling and negative growth rates in many regions of the Third World mean a fall in income for millions of people below the UN poverty line of 1.25 US dollars per day. It also means that the proportion of employees who earn less than 1.25 US dollars per day will increase. With regard to the effects of the global economic crisis the UN estimates that, in 2009, between 55 and 90 million more people will be forced below the threshold of 1.25 US dollars per day (United Nations 2009: 6).

UN data also make it clear that, as a result of the most recent economic developments, the share of the population in the developing countries suffering from hunger in 2008 will either remain the same in comparison to 2004–2006 (South Asia, not including India, South East Asia, Latin America and the Caribbean, North Africa) or increase (Subsaharan Africa, East Asia, not including China, Oceania). In developing countries as a whole, the proportion of people suffering from hunger has increased from 16 to 17 per cent, after witnessing a fall of 4 percentage points between 1990–1992 and 2004–2006 (United Nations 2009: 11).

Just as many low income countries have been less successful than many middle income countries in setting up public social security systems, the effects of the global economic crisis are also very different between the two groups. The **low income countries** have been harder hit, in particular if they are more integrated into the world economy. Poverty rates have risen as a result of the crisis, as has the proportion of the population affected by hunger, while the share of employees earning more than 1.25 US dollars a day has fallen. Informal social safety nets have been exposed to heavier burdens and cash transfer systems, if they exist, are becoming more expensive and threaten to overwhelm the domestic resources of many countries. If growth remains weak in the world economy over the long term, which appears probable, the problems of this group of countries will intensify.

The consequences for the **middle income countries** are different. In particular in the most populous states, such as China, India, Indonesia and Brazil, although growth rates are currently falling, there is considerable potential for stronger domestic oriented growth. Here there is every chance that growth rates, even under new conditions in the world economy, will pick up again and therefore the material basis for the establishment and expansion of public social security systems will improve. Since East Asia, with China, will in future become the new centre of growth of the world economy, after the crisis the circumstances of countries such as South Korea, Taiwan and Thailand will also improve, enabling them to continue the successful expansion of their public social security systems.

While the situation in the developing countries is becoming more and more diverse as a result of the crisis, in the group as a whole the achievement of the Millennium Development Goals by 2015 is under threat. That applies in particular to the goals related to poverty reduction, malnutrition and decent work. But this only increases the obligation of the rich countries to develop new strategies to support low income countries.

3 Alternatives to the Status Quo in the World Economy, the EU and Germany

The analysis so far has shown that, if policy as usual is maintained, growth rates in the world economy, in particular in the industrialised countries and the low income countries, will be very low and the economic imbalances, both between the United States, Japan, China and Germany and within the Eurozone will be sustained or be reduced only very slowly. Besides that, the status quo scenario harbours a major risk that the world economy will soon be shaken once again by regional or global financial market crises. Public debt and unemployment will remain very high in the industrialised countries under these conditions and, as a result of stagnation, no new sources of taxation can be tapped into. The welfare states in these countries will experience contribution increases and/or cuts in services. In the low income countries weak growth and higher unemployment will drive poverty rates even higher and traditional social security systems – families, relatives, neighbours, local communities – will be subject to additional, almost unbearable burdens.

In light of these prospects the discussion of alternative solutions should be much more intensive. The alternatives can be identified on **three levels**:

At the **global level**, a new global monetary system should be established, a new architecture for world financial markets should be developed and a financial instrument should be created to promote the establishment and expansion of public social security systems in the low income countries.

In the **European Union**, a new economic policy regime should be introduced which includes both a European economic government and rules for the avoidance of distortions of competition within the Eurozone.

At the **national level**, for export-oriented countries, such as China, Japan, Germany, Ireland, many Central and Eastern European countries and many low income countries, a strengthening of domestic economic forces is on the agenda in order to find a new balance between the global and the domestic market.

3.1 Reform of the World Economic Order

New Monetary System

If the global imbalances in current accounts and currency reserves are to be corrected, first of all the world monetary system must be reformed. A system of fixed, but adjustable exchange rates should be re-introduced. Instead of the dollar or some other national currency, special drawing rights should be installed as reserve currency. In order to avoid delayed adjustments and so distortions of competition, as well as speculative movements, additional rules should be introduced in accordance with which, at a certain level of current account imbalances in relation to GDP, exchange rate corrections should be implemented. These rules would be monitored by the IMF, which would also be responsible for the allocation of international foreign currency loans, as well as the issuing and adjustment of special drawing rights. It should also be debated whether or not the IMF should be given the authority to impose economic-policy conditions on countries with large imbalances and in relation to exchange rate corrections. Only a regime of this kind, in connection with a re-ordering of world financial markets, can cut global imbalances and prevent the emergence of new distortions. Its introduction is, of course, conditional on the willingness of the most important global trading nations to submit their economic policy to such new »rules of the game«.

New World Financial Market Architecture

Alongside reform of the world monetary system, the second important element of a re-organisation of the world economy is a new architecture for world financial markets. In order to avoid crises on world financial markets, as far as possible, first, the main causes of the present crisis should be eliminated: first, the reduction of global current account imbalances and the high international capital flows connected to them – in other words, the abolition of the »Chimerica« system (see above) – and second, a drastic correction of the unequal distribution of incomes and assets within nation-states (see below). Besides these two decisive steps, the re-regulation of markets is necessary. A restructuring of world financial markets should basically include the elements listed under point (x) in Section 1.

At present, such radical re-regulation of world financial markets is being called for only by some prominent academics, such as Joseph Stiglitz, Paul

Krugman and Robert Shiller. Government and central banks have so far shied away from such comprehensive regulations.

Tax for Social Security Systems in the Developing Countries

As a third element of the re-organisation of the world economy a new funding system should be created for achieving the UN's Millennium Development Goals. In the sections on the social security systems of developing countries and the effects of the world economic crisis on them we have seen that setting up public social security systems is the best way of combating poverty; that the introduction of basic systems of social protection is financially feasible, even if international aid would be necessary; and that, as a result of the crisis, in particular in the low income countries these systems have been put under enormous pressure. The world economy should therefore introduce a new funding system to promote the expansion of public social security systems in the developing countries. Given the responsibility of the rich countries for the global economic crisis, this is a moral imperative.

The international debate on additional financial resources for achieving the Millennium Development Goals, which has primarily been conducted within the framework of the UN since the turn of the millennium, should be followed up here. The main focus is the taxation of currency transactions, which James Tobin proposed as early as 1972 to reduce international currency speculation. In 1994, the UNDP took up this idea in its Human Development Report. Although the debate on the Tobin tax has been highly controversial, since the outbreak of the global financial crisis there has been renewed enthusiasm for the idea. Depending on what forms of currency transaction the tax would cover – foreign currency, spot, forward, swap and/or derivatives transactions – the funds which can be tapped with this instrument differ. For a universal tax in the amount of 0.1 per cent, which also included transactions by travellers, as early as 2002 a sum of 400 billion US dollars was calculated (Townsend 2009c: 162). In this instance, eight industrialised countries would account for 80 per cent of the funds (the UK and the USA alone would account for 50 per cent). As an alternative to the Tobin tax, an international financial market tax could be introduced which has been brought into play in the context of the current crisis as an extension of the basic notion of the Tobin tax.

With regard to the significance of public social security systems for overcoming poverty, the UN could develop a strategy on the creation and expansion of such systems in low income countries which, besides mobilising the domestic resources of the developing countries, provides for aid from the rich countries based on a Tobin tax. This would constitute a decisive contribution by the rich countries to realising the Millennium Development Goals and to assuming their responsibility for the social and economic costs imposed on the developing countries by the world economic crisis.

3.2 Reforms of the EU Economic and Social Order

In the European form of Economic and Monetary Union, in which the currency is a shared competence – in other words, it is European – but wage, social and tax policy remain expressly in the hands of the member states, dumping is a structural inevitability. In such a system of market states, nation-states compete for international investment on the basis of wage and social costs, as well as corporate tax rates. The European Economic and Monetary Union set in motion general competition in the reduction of wage costs, the cutting back of the welfare state and lowering corporate taxes. These imbalances can be avoided only if rules on competition with regard to wages, social costs and taxes are developed in the EU.

New Rules for Wage, Tax and Social Policy in the EU

With regard to **wage policy**, since the Doorn Declaration in 1998 and the adoption of coordination directives by various European branch organisations, the trade unions have been trying hard to obstruct wage dumping in the EU. These directives call on the member organisations to adjust national wage policy to the rule of thumb »inflation rate plus productivity increase«. If this directive was realised, nationally, distribution and, at European level, competition, could be kept constant. In any case, the data on the development of unit wage costs clearly show how far the European trade union movement still is from realising these aims.

Nevertheless, these efforts must be intensified considerably, since the stepping up of intra-European wage competition – which in the Eurozone has, for years, derived in particular from the reduction of unit wage costs in Germany – is leading to ever increasing external economic imbalances between the member states. At the same time, as a result of the redistribution in favour of capital the inequality of income distribution within the nation-states is becoming more and more glaring.

Besides that, all 27 member states should introduce a **minimum wage defined at European level**. This should amount to 60 per cent of the average wage in the respective EU country. As a first step, a minimum wage of 50 per cent could be set. Urgent action is also needed to clamp down on the escalating tax dumping in the EU. Besides the introduction of a common basis of assessment, agreement on **minimum corporate tax rates** is also necessary.

With regard to **social security systems**, coordination at European level is urgent in order to halt further competition-induced cutbacks in welfare states. For this purpose, a **European Social Stability Pact** should be agreed at EU level, linking the size of the welfare state to the relevant state's level of economic development. In the EU there are four or five groups of states, measured in terms of per capita income. A band or corridor of social benefit ratios should be fixed for each group. The group of richer countries should have a higher corridor than the group of poorer ones. States can move to a higher corridor from a lower one as they catch up economically.

The implementation of this kind of regulation would overcome the system of market states. In keeping with the Social Stability Pact, in the EU an economic and social policy of harmonisation while the improvement is being maintained would be pursued. Dumping strategies, of the kind followed by Ireland and Spain, and in the meantime pursued among the new member states by the three Baltic states and Slovakia, could in this way be prevented from the outset.

A New Economic Design in the EU

Not only did the Maastricht Treaty establish the system of market states, but economic policy was redesigned, within the framework of Economic and Monetary Union, along neoliberal lines. The decisive elements here are the one-sided orientation of the European Central Bank's monetary policy towards price stability, the primary responsibility of member states' financial policy to consolidate state budgets and the absence of European economic government.

While monetary policy competence within the framework of Economic and Monetary Union was transferred to the European level, financial policy is still the competence of the member states. This leaves us with an asymmetrical design, with supranational monetary policy but national financial policy. At the same time, the Maastricht Treaty and EU regulations, within the framework of the so-called Stability and Growth Pact, do subject member states' financial policy to certain rules. Despite some flexibility with regard to the Stability Pact and its recent reform, the latent effects of the Treaty and the Pact in the direction of a more restrictive financial policy cannot be overlooked.

In contrast to the Werner Plan at the beginning of the 1970s, the absence of a European economic government is another specific feature of the Maastricht Economic and Monetary Union. According to the Werner Plan: »The basic parameters of overall public budgets, in particular, changes in their volume, the size of balances and the manner of their funding or use, must be determined at the Community level«. This formulation was tantamount to the establishment of a European economic government, which would decisively shape the economic policy of the Community and determine the general orientation of national budgets within the framework of their fiscal policy responsibilities. In the Delors Plan on the preparation of the Maastricht Economic and Monetary Union, this parallelism of Europeanisation of monetary and economic policy was rejected in favour of an asymmetrical design. A price has undoubtedly been paid for this change of paradigm: in the EU, an economic policy decision-making centre is lacking, which can effectively establish and coordinate the fiscal policy of the member states and, in cooperation with the ECB, can ensure that there is an appropriate monetary and fiscal policy mix.

In the current global economic crisis, which is hitting Europe hard, the deficiencies of the EU's economic policy regime are glaringly obvious.

Both in the financial market crisis and in the economic crisis the EU states have, initially, reacted in a fragmented and uncoordinated way, sometimes at variance with one another. In particular, between France and Germany there was no uniform position on whether the crisis concerns Europe as a whole, what instruments are to be used to combat it, what the extent of the response should be and when it should be implemented. What eventually emerged were national rescue schemes for overcoming the financial market crisis, which differed considerably in terms of scope and, above all, the degree of state intervention in the banking system. National economic stimulus packages also differed widely in scope, the application of fiscal policy instruments and, especially, the time of their adoption.

The EU cannot pursue a consistent economic policy with the one-sided orientation of its monetary policy towards price stability and the existing fiscal policy structures, with the member states as decision-making centres. A crisis which affects all EU states – as the current crisis shows – will be combated too late, in a fragmented way and with too few resources. The recession will, as a result, become stronger and last longer than necessary. The following demands for reform arise from this criticism of the EU's current economic policy regime:

The European Central Bank should be equally responsible for high economic growth, full employment and high currency stability. In this way, a pro-cyclical interest rate policy and the restrictive monetary policy currently pursued by the ECB would be prevented.

In the short to medium term the aim must be to coordinate national policies at the EU level in such a way that economic policy options are better utilised and proper coordination can be achieved between European monetary and European fiscal policy. For this purpose, the competence to determine the basic direction of member state fiscal policy in accordance with their respective economic circumstances (a consolidation or expansionary strategy) should be transferred to the European Commission, in cooperation with the Council of Economic and Finance Ministers (ECOFIN), in keeping with the Werner Plan. This would constitute a first step towards establishing a European economic government.

This extension of EU fiscal policy competence would, at the same time, render the Stability and Growth Pact untenable, because it is based on member state competence for budgetary policy. In this instance, the EU should develop a stabilisation concept for the state budgets of the Union as a whole. A complex overall concept should take into account both the cyclical and the structural debt situation of the whole Union, as well as of the individual member states.

Long term, it is essential to transfer the competence for economic and cyclical policy decision-making to the European level and, for this purpose, to furnish the EU with its own complementary right to levy taxes and a bigger budget. France has been calling for this under the heading of a European economic government for several decades. It wishes to set up an equal ranking fiscal policy institution alongside the strong ECB in order to create a level playing field for monetary and fiscal policy and to enable an effective European cyclical and economic policy. This demand should, generally speaking, be supported. Fiscal policy must become European, in particular for the Eurozone. This Europeanisation of fiscal policy is not an end in itself, however. It must be used to provide for growth, employment and environmental restructuring. A European economic government would be responsible for the implementation of an expansionary economic policy for qualitative growth.

3.3 Germany: More Domestic Growth Instead of Export Dependency

Associated with the elimination of the various imbalances in the world economy, already mentioned, is the need to restructure those economies which are exceptionally dependent on exports (China, Japan, Germany, numerous CEE countries and developing countries). These economies must find a new balance between exports and the domestic economy. If the global current account imbalances between the USA, on the one hand, and China, Japan and Germany, on the other hand, are to be eliminated, the surplus countries must increase their domestic absorption; that is, sell more of the goods and services they produce in the domestic market. If the distortions of competition in the Eurozone are to be removed, Germany must change its wage policy and increase domestic demand at an above-average rate. If the Central and Eastern European countries and developing countries which are particularly oriented towards the world market, and thus are strongly affected by global crises, wish to reduce this dependency, they must gear their economies more strongly towards the domestic economy.

The difficulties associated with such a restructuring of economies are different for each country. In what follows, the risks and possibilities of this strategy for Germany are examined in more detail.

At first sight, the attempt to find a new balance for Germany between the domestic economy and exports seems hopeless, while the political and social forces which are betting on a revival of the export strategy after the world economic crisis seem to be right. How an above average increase in private consumption is to be possible, given higher unemployment and the weakness of the trade unions, is not readily discernible. Support for a restructuring of the German economy seems unlikely to be forthcoming from the state, although the debt ratio, which stands at 80 per cent in 2010, is heading for 100 per cent in 2020. In this situation, it would appear, the state has only one political duty to fulfil: to reduce its debts through severe cuts. There seems little scope for above-average growth in public spending within the framework of a rebalancing of the economy.

The upshot of this is a scenario for the German economy in which exports will no longer be able to emulate the growth rates of previous years due to the reduction of imbalances in the world economy and in the Eurozone; private consumption will be constrained by unemployment and weak trade unions; and the state, because of the need to pay down its debts, will have the option only of a below-average spending increase. In this difficult environment, even private investments – as the last macroeconomic demand factor to be considered – cannot, unlike Baron Münchhausen, pull themselves out of the swamp by their own hair. The vicious circle of stagnation seems unavoidable.

An alternative strategy to break out of this stagnation scenario must once more rely on the state as key variable. A way must be found for the state to reduce the debts it has accumulated on account of the crisis and, at the same time, mobilise resources for public investment in education, health care and the environment. The point of departure for this strategy is the sharp rise in inequality of income and wealth in recent years, which critics have identified as one of the decisive causes of the world financial crisis (Schäfer 2009; Stiglitz 2009). In Germany, the wage share fell from 69 per cent in 1991 to 62 per cent in 2006. In parallel with this, the investment ratio has not increased, as might be expected, given the strong increase in the profit share: it fell from 23.25 per cent in 1991 to 17.84 per cent in 2006.

More or less the same can be said for the EU as a whole between 1975 and 2006. While the profit share rose from 24 to 35 per cent, over the same period the investment ratio in EU member states fell – with some cyclical fluctuations – from 24 per cent to 20.5 per cent (source: European Economy, in Huffschmid 2009: 107). With regard to wealth distribution in Germany, the following data are important: the share of net wealth of the top 10 per cent of households increased from 44.7 per cent in 1993 to 61.1 per cent in 2007, while the share of the lowest 10 per cent fell during the same period from –0.2 per cent to –1.6 per cent. Furthermore, as a result, the debts of the latter group rose during this period (Hirschel 2009: 93).

This increasing concentration of income and wealth, which is a worldwide feature of capitalism, has not led to strong growth in productive assets, but has been invested overwhelmingly as monetary capital. While world GDP grew approximately five-fold between 1980 and 2007 – from 10 trillion US dollars to 55.5 trillion US dollars – global financial assets during this period grew from 12 trillion US dollars to 197 trillion US dollars, a 17-fold increase (OECD, in Huffschmid 2009: 108). Global financial assets are now more than four times larger than global GDP. Given these extremely undesirable developments, corrective state intervention via the tax system is a matter of both social justice and economic rationality.

From the standpoint of social justice, further divergence within society is more unjustifiable than ever. The income and wealth of the poorest 20 per cent in society is falling, while that of the richest 20 per cent is skyrocketing. Between these two social strata there is virtually no common social bond any more. Rupture looms, with unforeseeable consequences for Germany's political and social development.

Economically, it makes no sense that a large proportion of financial resources are risked in financial markets, where they have caused a crisis, which has taken the world to the edge of the abyss, while the costs of rescuing the financial markets and the real economy have been loaded onto the state. The state should, instead, appropriate some of these resources through its tax policy in order, first, to diminish the crisis risk, second, to pay down its debts and third, to provide for a new balance between foreign trade and the domestic economy through public investment in education, health care and the environment.

Given the deficits which Germany has posted with regard to the education sector, by OECD comparison, a significant increase in public spending is urgently required in primary, secondary and higher education.

The improvement in human capital that this would bring about would increase potential growth in Germany by 0.5 to 1 per cent, so that in the longer term it would be self-financing. Investment in the health sector likely to increase long-term growth would also be beneficial, as in the education sector, necessary improvements in workplace health care have been urged for years, in the face of demographic change, in order to prolong working lives. What is needed here is, on the one hand, investment in occupational training and retraining and, on the other hand, investment in healthy workplaces, adapted to the needs of older workers. Here too the experience of many countries – for example, Sweden – indicates that, through measures of this kind, the labour force participation rate of older workers can be markedly increased, with positive effects on potential growth and the finances of social security systems.

Another sector in which public investment must be urgently increased is the environment. Given the dangers of climate change Germany should significantly increase its investment in alternative energy systems, energy efficiency measures, public transport systems, alternative propulsion systems for cars and coastal protection.

The resources available for investment programmes of this kind in education, health care and the environment, if the state had the courage for an alternative tax policy, are shown by the following comparative figures: net private assets in Germany are worth around 6 trillion euros, while GDP is around 2.5 trillion euros. This means that, even with a 1 per cent wealth tax, resources in the amount of a good 2 per cent of GDP could be collected. The 60 billion euros or so which will be lost to the state each year, until 2013, due to the crisis could be made good with only a 1 per cent wealth tax. These data show that, with a combination of fiscal intervention in the form of the re-introduction of a wealth tax, higher income tax for the top income quintile and progressive taxation of the liabilities of financial services companies – as a liability premium for the costs born by the tax payer in the event of financial crises – both sufficient resources would become available to allow the state to pay down its debts and to fund public investment programmes.

A reform policy of this kind can in no way be construed as anti-capitalist, but instead would serve to stabilise the capitalist economic and social order by diminishing its self-destructive forces. A reform policy which sets its face directly against the hitherto dominant neoliberal paradigm is necessary, not just for Germany, but for many advanced industrialised countries. Only by means of a heavier tax burden on the higher income and wealth-owning strata and on the financial sector can the state budget reduce its debts sufficiently and financial leeway be created for a domestic economy-oriented growth strategy.

4 Summary

We began by presenting ten arguments to substantiate the assertion that, after the present dual crisis has run its course, a return to the very high pre-crisis growth rates is very unlikely, and instead we should count on a period of lower growth. In the following section, the consequences of the world economic crisis for social security systems in Europe and the developing countries were discussed. While in Europe, cuts in services and/or contribution or tax increases are probable, the situation in developing countries is more diverse. In many low income countries the crisis has led to more poverty and hunger, as well as the imposition of excessive demands on traditional, informal social protection systems or the basic cash transfer systems which are being set up in many states. In contrast, middle income countries, such as Brazil, India and China, are registering above-average growth rates which are enabling them to expand their social security systems further. In a third step, numerous reforms are proposed for the world economy, Europe and Germany which could help to reduce global economic and social imbalances in order to make possible balanced and crisis-free growth in the world economy. These reforms are: a new global monetary system, a radical restructuring of world financial markets, the introduction of a Tobin or financial market tax to support social security systems in low income countries, the elimination of the internal European system of market states by regulating wage, tax and social policy at EU level, the setting up of a European economic government, the paying down of public debt through higher taxes on the top income and wealth-owning classes, as well as heavier taxation of the financial sector and significant expansion of public education, health care and environmental policy in order to bring about the restructuring of Germany's export model to a more strongly domestic oriented growth model.

By implementing this comprehensive international, European and national reform package, the stagnation threatening the world economy can be overcome and the economic and social imbalances we have analysed, which form the basis of the crisis, can be eliminated. Individual reform measures may well have a negative effect on growth in individual states, such as the reform of the world monetary system (China) and the coordination of wage policy in the Eurozone (Germany). All in all, however, the reform package will reduce economic and social tensions in the world economy, in Europe and in nation-states and so lay the foundations for a sustainable growth path.[1]

[1] After this manuscript was written, the book *Der gute Kapitalimus … und was sich dafür nach der Krise ändern müsste*, by Sebastian Dullien, Hansjörg Herr and Christian Kellermann appeared (Bielefeld: transkript, 2009; English translation: forthcoming). In this book, similar basic ideas and reform proposals are put forward as in this paper. It is strongly recommended.

Appendix

Table: Public expenditure on social security and health care as a percentage of GDP

Africa

	1995	2000	2005	2006
Burundi	3,29	-	-	-
Congo	-	-	1,17	-
Egypt	5,30	1,35	8,64	15,23
Kenya	0,12	1,50	2,14	3,01
Liberia	12,93	-	-	-
Madagascar	7,34	-	2,18	1,41
Mauritius	6,07	7,13	7,96	8,34
Morocco	3,31	-	-	-
Senegal	-	0,67	-	-
South Africa	6,25	6,88	8,83	-
Tunisia	7,50	7,99	8,83	9,08
Uganda	-	0,53	3,77	4,11
Zamibia	-	-	2,54	1,77
Zimbabwe	4,53	-	-	-

America

	1995	2000	2005	2006
Argentina	11,24	10,79	10,78	-
Bahamas	-	4,19	4,35	-
Bolivia	4,89	9,07	8,44	7,69
Canada	23.99	19,14	19,13	19,37
Chile	8,42	10,01	8,95	8,25
Costa Rica	9,09	10,40	9,26	10,03
Dominican Republic	-	3,46	-	-
Dominica	2,25	-	-	-
El Salvador	-	-	5,71	6,93
Guatemala	-	1,01	1,03	1,27
Jamaica	2,46	1,59	3,35	4,20
Mexico	3,68	3,99	-	-
Panama	11,21	9,19	-	-
Saint Vincent and the Grenadines	6,10	7,27	6,73	-
Seychelles	11,83	11,49	13,84	20,35
Trinidad and Tobago	7,59	-	5,37	4,95
Uruguay	18,95	20,98	6,15	8,83
Venezuela	-	4,66	4,06	-

Asia

	1995	2000	2005	2006
Afghanistan	-	-	1,30	1,88
Azerbaijan	6,46	-	-	-
Bahrain	3,64	3,26	3,96	-
Bangladesh	-	-	1,22	1,19
Bhutan	2,67	3,82	2,57	-
China	0,75	3,93	4,99	5,33
Cyprus	9,83	11,06	14,41	23,21
Georgia	-	4,92	7,07	6,64
Hong Kong	-	-	5,25	4,55
India	1,60	0,85	0,87	0,27
Indonesia	1,35	-	1,37	-
Iran	4,49	7,36	8,54	11,31
Israel	17,03	17,21	17,63	16,53
Japan	-	-	18,98	19,31
Jordan	-	8,44	4,06	14,32
Kazakhstan	-	8,67	6,87	6,32
Korea	1,46	3,31	2,68	4,55
Kyrgyzstan	-	5,19	-	-
Kuwait	11,12	-	7,10	5,23
Kyrgyzstan	4,41	-	-	5,86
Lebanon	3,15	-	-	-
Macau	-	4,64	3,53	2,88
Malaysia	2,65	-	-	-
Maldives	4,77	5,12	6,07	8,32
Mongolia	6,44	10,40	-	-
Myanmar	0,76	0,48	0,44	-
Nepal	0,68	1,41	1,51	1,55
Oman	-	4,30	-	-
Pakistan	-	0,27	0,15	0,20
Philippines		1,16	1,22	1,20
Qatar			2,65	2,04
Singapore	2,03	1,63	1,52	2,17
Sri Lanka		4,52	5,19	4,94
Syrian Arab Republic	1,49			
Tajikistan		3,29		
Thailand	1,92	2,57	4,06	3,29
Turkey	1,39	3,05		
Viet Nam	4,27	3,21	2,66	

Europe

	1995	2000	2005	2006
Albania	10,84	-	9,87	10,06
Austria	29,52	28,62	27,74	27,32
Belarus	16,73	16,00	18,49	18,47
Belgium	24,06	23,11	24,65	
Bulgaria	14,81	17,62	17,84	16,67
Croatia	20,19	26,66	22,09	21,47
Czech Republic	17,01	19,26	18,64	18,76
Denmark		28,10	29,27	28,44
Estonia	14,39	14,60	13,93	13,61
Finland		26,03	28,03	27,24
France	28,84	27,76	29,64	29,51
Germany		25,69	28,09	27,27
Greece	21,29	20,96	22,33	22,66
Hungary	21,11	-	22,51	23,15
Iceland	16,95	16,54	17,14	16,23
Ireland	18,17	13,48	17,47	17,53
Italy	23,62	23,51	25,01	25,22
Latvia	17,08	16,10	12,68	12,81
Lithuania		15,80	14,83	15,27
Luxembourg		19,91	31,09	29,03
Moldova		15,16	15,52	20,07
Netherlands	23,64	20,35	21,05	22,36
Norway	24,60	22,41	23,51	22,39
Poland	23,08	21,12	21,87	21,67
Portugal		18,83	23,04	23,16
Romania	12,71	14,53	13,43	13,61
Russian Federation		10,06	12,66	12,29
Slovakia		18,30	17,90	17,55
Slovenia	21,49	23,84	23,43	22,75
Spain	19,76	18,28	18,59	18,58
Sweden	22,64	29,39	30,18	29,50
Switzerland	25,28	25,39	18,16	18,57
Ukraine		17,38	23,94	23,82
United Kingdom	24,40		23,08	22,86

Source: International Monetary Fund (IWF) (2009): Social Security Expenditure Database, Washington.

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