The German Welfare State After National Unification

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The basic features of the welfare state in the Federal Republic of Germany

From an institutional point of view, the German welfare state rests on five pillars:

A. the public and semi-public insurance systems against vital risks (old age / invalidity, sickness, temporary unemployment)

B. direct and indirect tax-financed income subsidies for persons with insufficient own means

C. mandatory social expenses of employers (most notably important: almost full wage payment for sick employees for six weeks)

D. free education including university for all residents

E. subsidies and tax exemptions for large segments of the population (families with children, savers, buyers of homes, and others).

To these visible pillars a disguised one has to be added: the subsidies granted to various economic activities which by themselves would not survive in the market (in particular in agriculture and coal mining). As far as the amount of finance is concerned, the first pillar is by far the mightiest (see table 1).

Table 1: Financial volumes of the various subsystems of the German welfare state (1995)

Subsystem	Expenses (billion DM)	% of GDP
social insurances	886	26
old age / invalidity	(473)	(14)
sickness	(284)	(8)
unemployment	(129)	(4)
direct subsidies to the needy	59	2
mandatory payments of employers	60	2
public education	104	3
subsidies to non-needy groups	164	5
direct	(86)	(2.5)
tax exemptions	(78)	(2.3)
sum	1273	38

A large part of the German welfare state expenditure follows the logic of insurance: Benefits are proportional to contributions, only the financial risk of becoming dependent on benefits is borne by the whole community of contributors. This way, those who become dependent (e.g. because they lose their job or because they live long) are subsidized by those who do not (i.e. who stay employed or die early), but who also pay the insurance. The public pension system (social security) and unemployment insurance, which together account for almost half of the German welfare state, function this way and do not imply any major redistribution apart from the spreading of the risk. There are, however, minor implicit subsidies, e.g. in favor of women who interrupt their paid work due to maternity, and hence their contributions to the pension system, or in favor of those who, due to a long education, enter work life late.

Public health insurance, in turn, implies a significant redistribution. Everybody who earns a salary (except those with very high salaries) contributes according to his/her income but receives benefits according to his/her health needs. This way, subsidies do not only flow from the healthier contributors to the less healthy ones, but also from the richer to the poorer contributors. Moreover, dependent children and spouses are fully insured without an extra contribution. It is estimated that about a quarter of all expenditure by the public health insurances benefits those dependents who are insured for free together with their family's money earner. Total redistribution implied in the public health system is highlighted by the fact that the highest monthly contributions are 45 % above average contributions and thus above the pure insurance costs (i.e. discounting implicit redistribution).

Of course, all the subsidies granted to those without insufficient means constitute a net redistribution from the richer to the poorer citizens. The most important one of these subsidies is the so-called social aid, a tax-financed income subsidy designed to guarantee a minimum income for all resident households. But, as table 1 shows, these payments (welfare in the narrow meaning of the word) are the smallest part of the German welfare state, amounting to only 2 % of gross domestic product. On the other hand, the various direct and indirect subsidies which are granted to persons whose income is not very low (including lower and upper middle-class people) add up to almost three times as much. The most important group of beneficiaries here is parents with children - and, naturally, the children themselves. Obviously this applies to gratuitous public education as well.

In Germany, like in many other European countries, the welfare state is closely linked to salaried work. The public insurances against vital risks are basically an institution for salary-earners and their families. For the large majority of employees these public insurances are mandatory. The public health insurances offer also voluntary membership, an option taken up by many earners of higher incomes. Half of the contributions to the public insurance systems are being paid by the employees themselves and half by their employers. This linkage of social security to dependent work has important consequences.

The system protects citizens only to the extent that they in fact are employed.

The system's finances depend on the number of employed persons and suffer in times of mass unemployment.

The costs of social security affect companies' labor costs and, hence, the prices of the products they sell and affect companies decisions on hiring German labor or investing in Germany.

This last aspect is all the more important as the volume of the employers' social contributions is not considered part of the gross salary. Thus, it is not the result of wage negotiations but is determined largely autonomously by the financial needs of the various insurances (reflecting the aging of society, the increase in unemployment and the development of medical technologies). That is to say, labor costs might go up, even if the unions do not claim any wage increases, for instance because the pension system is short of cash.

The overall aim of the modern welfare state - at least in the continental European understanding - is to ensure "prosperity for all", to make sure that all citizens participate in the material wealth the national economy produces. If one takes this goal as the yardstick for judging the German welfare state, one cannot but conclude that all the policies summed up in table 1 are at present insufficient. Indeed, that „prosperity for all" has been achieved to a large extent in the 1960s and 70s was not primarily the result of the elaborate system of insurances, subsidies and public goods, which constitutes the German welfare state. It was basically a consequence of full employment at „decent" wages. Since the mid-70s open and disguised unemployment has come to affect a growing minority of the population. And the formal welfare-state institutions have not been able to prevent this minority's living standard from falling significantly below the average level, even though basic necessities (health care, food, education, in part housing) are covered.

The evolution of the last 20 years has shown the limits of what the German welfare state can achieve. It is only in combination with full employment at "acceptable" wages that it had been able to guarantee to (almost) all citizens during their whole life cycle a material standard of living which corresponded to the strength of the national economy. To the extent that the welfare state was confronted with an increasing number of "casualties" of the market economy, its effectiveness was reduced more and more to two functions: (a) protecting the poor against outright misery and (b) making sure that the economic status acquired during work-life would be maintained during retirement.

The impact of German unification

When the two German states were united in 1990, East Germans obtained the right to participate immediately - if not in each case fully - in the various systems of the Federal Republic's welfare state. As a consequence, the expenditure of theses systems increased dramatically while their revenues from the "New States" turned out completely insufficient to pay for this rise. The remaining gaps were financed by higher contribution rates (measured as percentage of gross salaries) as well as by government subsidies. The corresponding rise in the government budget was financed in part by an increase in public debts and in part by higher taxes.

The big gap between additional expenses and revenues of the welfare state is for the most part due to the dramatic loss of jobs in East Germany. Its economy was exposed essentially from one day to the next to West German, European and global competition within the straitjacket of monetary union with West Germany and without being able to devaluate its currency in order to defend its competitiveness. All who lost their jobs became clients of the welfare state. Many of them were taken out of the labor market and put on early retirement. That way the unemployment statistics looked less alarming, but the public pension system was put under heavy strain. Even so, those who stayed in the active work force without a real job were numerous enough to put financial pressure on the unemployment insurance as well. Some were not declared officially unemployed with a corresponding entitlement to unemployment benefits, but stayed in their job officially receiving salaries but without working for them (the term was "zero-level short working hours"). For many other unemployed temporary government jobs with reduced salaries were created (work creation schemes). Still others were put into retraining programs while receiving income. All these rather unorthodox types of expenses were and are still shouldered by the unemployment insurance (the Federal Labor Institution).

At the same time, the decline of employment in East Germany meant that East German contributions to the social insurances were very modest indeed. It was Western contributions which had to pay for most of the new expenses. West-East transfers reached a magnitude of 19 billion DM (about 11 billion US dollars) in the public pension schemes for employees and workers (1996), a sum which corresponded to 5 % of total expenditures of these schemes, and of 38 billion DM (about 22 billion US dollars) in the unemployment insurance, where it accounted for almost half of total expenditure.

One could agree that the brutal de-industrialization which the New States had to endure was compensated for by the victims' incorporation into the structures of the West German welfare state - to such an extent that for the overwhelming majority of East Germans unification meant a significant rise in their consumption level as compared with the preceding period of full employment under the old East German regime. During the first years after unification West German transfers paid for almost half of East German consumption. Even in 1996, East German production would provide for only two thirds of the region's expenditure on consumption and investment. The missing third was still financed by Western transfers.

The welfare-state institutions of the Federal Republic of Germany have coped successfully with the gigantic task of incorporating the 17 million new citizens who lacked an even remotely adequate economic base. Incorporating them, the welfare state lowered its standard but marginally. German society mobilized the necessary financial resources. Objectively, this constituted an amazing act of solidarity though it did not spring entirely out of a feeling of solidarity on the part of the West German population. In large part, it was the merit of the skillful political handling by Chancellor Helmut Kohl, who confronted the West German people with the accomplished fact of the new financial burdens.

These new burdens did not cause a crisis of the German welfare state, but they did contribute to the emergence of a crisis which had its own, more profound roots.

The cost crisis of the German welfare state

Long before German unification the welfare state in the Federal Republic - like the one in other Western countries - became subject to increasing criticism. The critics focused on two aspects:

1. The welfare state makes people passive, it discourages initiative and economic effort because it guarantees an elevated standard of living essentially as a gift from society to the individual. This seriously weakens the engine of ecnomic prosperity.

2. The welfare state costs too much. The financial burden it imposes has become insupportable, it jeopardizes national competitiveness, particularly the competitiveness of national labor, it discourages entrepreneurial activity as well as the work effort of highly qualified labor.

It is the second topic which has become the salient one in the German political debate and which is underpinning ever stronger demands for welfare state retrenchment. In fact, mandatory contributions of employees and employers to the three social security schemes (old age, health and unemployment) increased from 26.5 % of average gross salaries in 1970 to 39.2 % in 1994. And if one takes total costs of a working hour as the point of reference, in 1972 44 % corresponded to social costs (social security contributions, wage paid for work-free time, subsidies and others). In 1994 this percentage amounted to 56 %.

But at the same time poverty increased in Germany, showing clearly that the welfare state has become less effective - despite its increasing financial volume.

Even though opinions differ very much as to the kind and depth of desirable welfare state reform, there is a broad consensus on the fact that reform is indeed needed. This raises various avenues of questions such as

- the causes for the rise in welfare state costs and the declining effectiveness in preventing poverty
- the consequences of unchecked cost increases
- the options on how to respond to the new conditions.

Why have the costs of the German welfare state gone up so much? The costs of national unification are but *one* factor. Unification only exacerbated three other factors which had been in effect for a long time. They are

- the adverse demographic dynamics
- the development of ever more costly methods of combating disease
- the gradual increase in unemployment, which had begun in the mid-70s and accelerated in the 90s.

But it also has to be considered that these three factors worked to increase costs in the context of the social reforms created by the social democratic administrations in the 60s and 70s.

Old-age pension costs go up continuously because the number of contributors who have to pay for one retired person is steadily decreasing. In 1970, 100 contributors paid for 37 pensioners, in 1993 for 45 and in 2000 it will be for 52. Retired people live ever longer, while the number of contributors is not increasing because the population growth is close to zero and lately also because the number of full-time employed persons has decreased.

The aging of society also pushes up the costs of health insurance. But the more important factor here is the difficulty of putting expense limits on something which is considered a basic human right: health. The public health insurance is based on the principle that it should not be purchasing power which determines a person′s chances of restoring his/her health and of protecting his/her life. All the possibilities offered by the art and technology of medicine should be at the disposition of the poor as well as the rich. But then how to control the costs of the public health system, when ever more sophisticated and expensive methods of fighting disease are developed? Although there is no way around setting limits, these can only be conceived of as brakes on the continuous expansion of costs rather then as fixed ceilings.

The third factor which has been driving up German welfare-state costs, mass unemployment, has had effects much beyond draining resources from the unemployment insurance. Many of those who lost their jobs in Germany, have stayed unemployed much longer than the entitlement to unemployment benefits lasts. Eventually they turn into cases for "social aid", increasing the pressure on municipal budgets. Moreover, the unemployed drop out as contributors to the public pension and health care insurances, so that the remaining contributors′ quotas - the ones of employees as well as the ones of employers - have to be increased, too. Ultimately, the lack of „adequately" paid jobs has been the principal cause of the rise in poverty.

Responding to the cost crisis of the welfare state

There is nearly a consensus in Germany that welfare state costs are too high and that they should be reduced somehow. But how? One solution, which quickly comes to mind, has only spurious effects: cutting income subsidies for the poor. For, as we have seen, these subsidies account for only a very small part of overall welfare-state costs in Germany. To make effective cuts in the expenses of the welfare state, those segments which benefit the average citizen need to be reconsidered

The correspondence between contributions and benefits is not always a direct and immediately visible one. Thus, cost-cutting appeals to many who do not associate it with the scaling-down of benefits. On the other hand, many appreciate the benefits of the welfare state without being aware how much they pay for it. However, the real German debate on the costs of the welfare state is not predominantly about value for money, but about the harm done to the economy. If this is the issue, the question whether citizens like their welfare state or not is secondary. Of primary importance then is the way the welfare state is being financed.

But the debate is diffuse. Several things which ought to be considered separately are being put into one and the same basket. The notion that the excessive welfare-state jeopardizes the economy goes hand in hand with the notions (a) that the average citizen is charged too much for redistribution to some low-income groups and that welfare-state retrenchment would leave him/her more income for individual consumption; (b) that the welfare state makes it too easy for the people, that they should be more self-reliant rather than relying on that big anonymous institution to resolve their problems. The common conclusion this triple notion leads to is: reduce welfare state entitlements and expenses.

However, we come right back to the fact that any really cost-effective welfare-state retrenchment leaves the majority of citizens with less protection for the standard risks of life. They would have to buy this protection in the market. And it is not at all obvious that they would get a better deal there than with the present welfare-state arrangements. Some high-income contributors would, but they are a minority. Thus, citizens′ interests and the claims made on behalf of the economy do not necessarily coincide. It is warranted, therefore, to look one by one at the various objectives which can be pursued with cost-cutting, identifying for each one the policy responses which might serve it. Maybe there are solutions which reduce the welfare-state burden on the economy without diminishing the citizens′ social protection.

The case for liberating the economy of the excessive welfare-state has two main components: high tax quota and social security contributions, and high non-wage labor costs imposed on enterprises. Both have to be considered separately, as they imply different policy responses.

Altogether we have three different objectives for cost-cutting:

- lower non-wage labor costs for enterprises,
- a lower ratio of taxes and contributions to national income,
- lower expenses of citizens on social protection.

Reducing welfare-state costs for enterprises

As mentioned above, contributions to the three public schemes of social protection are divided evenly between employees and employers. In addition, employers have to pay - since 1996 with a small rebate - the full salary to sick employees for six weeks. Other "social costs" of companies are the result of collective bargaining with organized labor. The total social cost is one of the highest in the world. In combination with high gross salaries non-wage labor costs have made the average German working hour the most expensive in the world. Even if we take into account the high productivity of labor in the German manufacturing sector, labor costs per product unit are still extremely high in international comparison. Many economists attribute this to the appreciation of the German currency at the beginning of the 1990s. Still, this explanation does not help the competitiveness of German industry. In the present context of persisting high unemployment, whatever its causes may be, it is difficult to turn a deaf ear to the request to make German labor more cost competitive - vis-à-vis foreign labor, vis-à-vis the production factor capital and vis-à-vis "do-it-yourself" work. And it is welfare-state-induced costs which appear as the appropriate cost component to concentrate the cutting on.

There are two ways to liberate companies entirely of these costs. One is that employees pay all social security contributions themselves and that salaries for sick employees are taken over by an insurance which is financed by employee contributions. The other way is to finance social protection (including salaries to sick employees) out of the state budgets, i.e. through taxes instead of specific contributions. The second option would constitute the most clear-cut solution for enterprises, as long as the additional taxes needed to replace the present social security contributions are not levied on enterprises but on consumers (in form of income, value-added or of specific consumption taxes, as for instance an energy or a carbon tax). The first option would amount to a significant reduction of real salaries if the transition to the new system were not accompanied by an equivalent increase in salaries. However, in this case the change would not immediately improve the situation for enterprises. But future increases in social security contributions would no longer automatically push up labor costs, as is the case now. Nevertheless, the unions could respond to higher social security contributions with demands for higher wages in order to defend the workers′ purchasing power. In view of this possibility the tax option would seem to be more effective as far as the reduction of labor costs is concerned.

If companies no longer paid half of the contributions to the various welfare-state schemes that would not diminish social protection. But at whose expense would it ultimately be? If it is the employees who pay all the social security contributions without obtaining a compensatory salary increase, it is they who suffer. They would have less income available for consumption. But this is only the most immediate effect. Real salaries are determined in both the labor market and the markets for consumer products. A significant reduction of labor costs should - if there is competition - show in the price level, so that real disposable wages would not be affected as much as nominal wages. To the extent that lower costs improve the German workers′ international competitiveness unemployment would be reduced and the negotiating power of labor vis-à-vis capital would be improved. Moreover, higher employment would improve the financial situation of all three social insurance systems, thus alleviating the pressure towards ever higher contributions. In addition, it would reduce the number of those dependent on tax-financed "social aid".

If social security is financed the Danish way completely out of the state budgets, it will be most likely the consumers who will have to pay. But on the other hand, they would also benefit from the lower product prices made possible by diminished non-wage labor costs. Besides, here we would have, too, the positive employment effect with all its reduction of welfare-state costs. It could well be that in the final instance everybody wins - a classic positive-sum game. However, depending on the kind of taxes which are raised to replace the old social security contributions, certain sectors could be affected much more than others (for instance, in the case of higher energy or carbon taxes). But then, sectoral costs are by their nature temporary costs, which disappear after structural adjustment has been accomplished.

Partial solutions are also conceivable. Instead of replacing employers′ social security contributions completely, one could diminish the quotas, thereby reducing the corresponding benefits to the level of a „basic protection". In order to maintain the full level of protection, people would have to buy additional private insurance then. This would, of course, reduce real wages if there were no compensatory wage increase at the moment of transition to the new system. But in case there were, employers′ overall labor costs would remain the same, only the relation of wages and non-wage costs would change.

A partial privatization of social protection could have serious redistributive effects among the protected ones, leaving some with much higher expenses - or else with less protection - than they have within the present welfare-state schemes. We shall come back to this point later on.

Another partial solution to excessive non-wage labor costs would consist in liberating only the low salaries from mandatory social security contributions, replacing them with payments out of the state budgets. This way, the competitiveness of less qualified labor is enhanced, something which would have positive effects on employment and hence on the finances of the welfare state.

Naturally, every policy which succeeds in reducing unemployment and in increasing population growth would also help diminish non-wage labor costs, because it would allow social security contributions per employee to fall (more contributors, less expenses on unemployment benefits).

Reducing the ratio of taxes and contributions to national income

The share of national income which is claimed by government or by the public systems of social protection has much significance in the neo-liberal discourse. As the public sector is not subject to the permanent efficiency pressure coming from competition in the market this sector is considered as something like a dead-weight on the economy. This axiomatic view makes the conclusion inevitable that a tax and contribution ratio of close to 50 % is excessive and must be urgently reduced.

Now, as far as the German welfare state is concerned, the most effective way of achieving this would be total privatization of the public pension system and possibly also of the public health insurance system, because these two constitute by far the biggest chunk of overall welfare-state expenses. What now counts as public expenditure would turn into private expenditure. In order to prevent negligence people could be obliged to take private insurance, very much the same way as car owners or house owners are obliged to take a liability or fire insurance.

Such a radical reform of the welfare state would result in various problems, the most difficult being the transition from the current pay-as-you-go pension system to a private capital-based system, because the present active generation would have to pay for the pensions of the currently retired generation (be it with contributions, be it with taxes) and at the same time accumulate the capital which pays for its own future pensions. But perhaps one could solve this problem with a gradual transition: If the public pension system is not abandoned entirely from one day to the next but only reduced in coverage, the old-age income of those who did not have the opportunity to save enough capital would be paid for with taxes (i.e. a burden on the present generation) and with public debts (burdening future generations).

Privatization of welfare-state protection against the risks of life does not need to imply less protection for anybody. However, provisions would have to be made to replace the implicit subsidies in the present system (as we have seen, most of all in the public health insurance system) through explicit ones. For example, the government could pay to persons with low income or with dependent family members the difference between their present health insurance quota and the price of a private (maybe cooperative) insurance. Such a subsidy could be granted in the form of a tax rebate. This way, nothing would really change in substance, but the appearance would be starkly different. The tax ratio would include only the subsidies which are implicit in the present system, but not the total volume of the insurance costs. To the extent the subsidies are given as a tax credit, not even they would show in the tax ratio - the new welfare state façade would look even more beautiful to neo-liberal eyes.

Of course, everything else which reduces the financial volume of the welfare state (or stops its expansion) would also show in the share of taxes and contributions in the national income. This refers to

- a higher efficiency of the welfare state services, including a clamp-down on waste and misuse
- the scaling-down of programs which do not follow an insurance logic and cannot be purchased privately („social aid“, housing subsidies)
- a decrease in welfare-state dependency (less unemployment, faster demographic growth).

To some of these points we shall give a closer look in the next sections.

Reducing the welfare-state costs for the average citizen

The simplest way to alleviate the financial burden the welfare state imposes on citizens would be to diminish the level of social protection. However, this protection ranks very high in the preference scale of most Germans. Any loss of welfare-state protection would be replaced by private protection. The high expenditure of the average German household for private insurance coverage in addition to the insurance offered by the welfare state corroborates this hypothesis. Therefore, the case for a lower level of welfare-state protection can only be based on the postulate that private substitutes are cheaper. For this to be the case for the average citizen, private protection would have to be more efficient than public welfare-state protection or it would have to contain less implicit subsidies for minorities..

As we shall see in the next section, there are in fact some cost advantages of a private pension system in place of the current pay-as-you-go system of the compulsory German old-age insurance. However, it is highly questionable whether these advantages will hold under the adverse demographic conditions which are one of the important sources of ever-rising welfare-state costs. As far as health insurance is concerned, it would seem that the German system of semi-public insurances, which negotiate the fees on behalf of their members, i.e. from a position of high bargaining power, with doctors, hospitals, laboratories etc., is more cost-efficient than a private insurance which reimburses its clients for their payments to doctors, pharmacies etc. without trying to bring these costs down. Nonetheless, there would probably be less waste in the health system if the public insurances offered their members the option of trading in a higher participation in costs for a lower contribution quota. Such methods of mobilizing the patients′ self-interest in cost reduction are not alien to the principle of public insurance with their built-in solidarity.

Private insurance would be cheaper for all those who now subsidize with their high contributions the coverage of others who contribute less or even nothing. As mentioned, in the old-age pension system such implicit subsidies are not all that significant. But the decisive question here is whether the subsidies which do exist (e.g. in favor of mothers who do not earn an own income) are politically endorsed by the majority of the citizens. If this is the case, then a transition to an insurance system without implicit subsidies would have to be accompanied by the creation of explicit schemes to subsidize the pensions of those mothers etc. What the majority saves in contributions to the pension system will have to be spent on higher taxes. The burden would be distributed in a different way, though. On the other hand, if the political support for such subsidies is missing, they can be eliminated out of the present public insurance system as well.

The issue of subsidies is much more significant in the health insurance system. But the political logic is the same. If the principle is being upheld that a person′s chance of protecting and restoring his/her health should not depend on the person′s income or wealth it is indispensable to impose the burden of solidarity on the citizens with a relatively high income. But of course, one could gradually reduce the compulsory solidarity of today′s system, increasing patients′ financial participation in doctor, hospital and medication costs. This would allow to reduce, or at least stabilize, the contributions to the health insurance.

But there is another point to be made. In the health insurance it is not the majority which subsidizes a minority. It is rather the richer half of the insured which subsidizes the poorer half. Superimposed on this division are the subsidies in favor of the dependent family members of all income classes. Thus, it is doubtful whether the majority would really benefit from a reduction of health insurance quota.

Altogether, the private option makes things appear very different, but it hardly reduces the costs of provision for the risks of life for the average citizen - with the exception of certain possibilities in the pension system, which will be discussed in the next section. Besides these possibilities, four ways can be imagined to make the welfare state cheaper for the majority of the German people.

- The first way consists in the reduction of waste and misuse in the health insurance system. But even in the optimal case its effect will not amount to much cost cutting.

- The second way consists in the political decision to reduce subsidies for minorities. Even though there are some subsidies which benefit certain middle class groups (e.g. home buyers), the most important target of subsidy cutting would be social aid and other programs in favor of the most needy groups of the population. This would be a direct move against that basic solidarity which has been almost a defining feature of the Federal Republic of Germany from its very beginning. The economic situation of the affected groups would deteriorate considerably. But the benefit for the majority would be a very modest one indeed because the transfer payments to the needy groups constitute - as shown above - a rather small, albeit growing, part of the German welfare state.

- The third way consists in broadening the eroding basis of contributors to the compulsory welfare state insurances. For example, one could incorporate the self-employed. The most radical broadening would result from the transition to a completely tax-financed (as opposed to a contribution-financed) system, as it exists in Denmark.

- The most attractive way would doubtless be the one of stronger economic and demographic growth. This double growth would improve the financial balance of the welfare state by reducing its expenses (less unemployment) and increasing its revenues (more employed contributors, better relation between active and retired persons).

Excursus: the specific problems of the old-age pension system

Provision for old age is the most expensive part of the German welfare state. Therefore, any financial improvement which could be achieved in the pension system would have a larger effect on overall welfare-state costs than progress in any of the other schemes. But the problem here is somewhat more complex. Everybody wants an adequate provision for the time after retirement. But the contributions to the welfare-state pension system, which are becoming ever higher, do not truly guarantee this provision because they finance the pensions of the present generation of retired workers. The pensions of the present contributors, however, depend on the contributions of a future generation of economically active residents. Since their contributions will have to be even higher than the current ones (due to the aging of society) it is doubtful whether they will in fact be paid. A system in which every one finances his/her own pensions, accumulating a sum of capital during active life and liquidating it thereafter, seems more appropriate for such a situation. The risk that one lives longer than foreseen can be covered by an insurance which is bought with the accumulated capital and which guarantees a life-long monthly income in relation to the capital paid in. With such a system, the sum to be put aside every month in order to provide for a certain guaranteed income during retirement is actually lower than the contributions to the present pay-as-you-go system. For a significant part of the final amount of capital consists of the interests generated by the sum already saved, and not just of the sum of monthly contributions. Altogether this way of providing for retirement seems to be more secure and cheaper at the same time. As an additional advantage the national savings-ratio will go up, which favors investment and hence economic growth.

Unfortunately, the advantages are not as solid as they might appear. Firstly, the monthly quota in the capitalization system is lower only as long as real interest rates are relatively high and economic growth is modest - something which applied in Germany during the past quarter of a century but not in the boom years before. It is important to realize that in the present pay-as-you-go system a right is acquired to participate in the future national product. This right is defined in real terms, not in monetary terms. That is to say that the average level of pensions depends very much on the economic growth created by the future generation of economically active people. In the capitalization system all decisions on the amount of the monthly pension are taken as soon as retirement begins and the capital accumulated is being consumed bit by bit.

But more serious is another problem. The capital accumulation or saving phase during economically active life is being followed by the phase in which the capital saved is being liquidated. One could call it the de-saving phase. The aging of society implies that there are ever more people who liquidate their savings while the number of those who still save grows much more slowly, if at all. If the active population does not restrict its current consumption one way or the other (i.e. voluntarily or forced by taxation) the capital accumulated by the retired population might lose some of its value in terms of the consumption entitlements it is meant to carry. If the economically active private sector does not increase its savings ratio the government or foreign countries would have to save more and buy an increasing share of the assets which the pension funds must sell in order to pay out their retired clientele. However, all highly industrialized countries as well as the East Asian and Eastern European countries have more or less the same demographic problem of an aging population. Only some parts of the „Third World“ (South Asia, Africa, Latin America) would be in a position to compensate with their saving surplus the future deficit of the industrialized countries.

The problem could be aggravated if during the period in which savings abound opportunities for productive investment are insufficient (perhaps because of insufficient demand). Then the money invested by pension funds will inflate the prices of stocks, real estate etc. - with the danger of a subsequent deflation back to the "normal" level and a corresponding devaluation of pensioners′ entitlements.

As long as no contingency plans exist for the case of a generalized insolvency of pension funds it seems risky to abandon the present system and switch over to a capitalization system. The idea that a certain volume of accumulated finance has an immanent value in the products markets - the ones which matter for peoples′ standard of living - is based on a monetary illusion.

But there is a solution which can stabilize the pension system in adverse demographic circumstances: the prolongation of work life beyond present average retirement age. This could be introduced gradually (reduced working-time) and on a voluntary basis. However, the labor market would have to be adapted to the new requirements, mass unemployment would have to be brought under control.

Ways to make the welfare state more effective

Prosperity for all in post-war Germany was founded less on the welfare-state protection and redistribution schemes than on full employment at relatively high wages. Most Germans earned - and still earn - their standard of living as well as their entitlements for the time after retirement through dependent work. That (almost) everybody of working-age would find a job and that even low-paying jobs allowed a standard of living not too far below the national average, was based on the scarcity of manpower. Scarcity of manpower was the key to "prosperity for all" in those years which now are referred to as the "golden" ones. Likewise, the resurgence of poverty after that "golden" period has its roots in the growing abundance of manpower.

The central cause of this growing abundance of manpower is the slow-down of the pace of economic growth after the early 1970s - not only in Germany, but in almost all industrialized countries. This has been true ever since economic growth was no longer sufficient to keep demand for working hours sufficiently high in order to absorb the growing supply of manpower on the labor market.

There are various theories which try to explain the brusque and sustained slow-down of economic growth throughout the western world. They point at

- the monetarist policy which supposedly neglects aggregate demand

- the saturation of demand typical for a prosperous population and the corresponding increase in the propensity to save rather than to spend

- the switch of demand from the products to the assets markets, which supposedly results from the higher concentration of national income in the hands of the rich

- the inflationary effect demand expansion has in a situation characterized by a less and less flexible supply structure (due to excessive regulation and excessive power of rent-seekers)

- the diminished attractiveness of productive investment in view of high real interest rates and ample opportunities for speculation (itself due to financial deregulation).

It is not the place here to discuss these theories. But it should be noted that the long period of high economic growth in the first post-war decades is considered today as extraordinary in the history of capitalist development and as being based on a syndrome of interdependent factors which cannot be reestablished at will, once it has come apart.

The question then is, how to make the welfare-state not-dependent on rapid economic growth. Three basic strategies can be envisaged:

1. deregulating the labor market, so that job-seekers as well as job-holders adjust to the changed conditions of demand for manpower;

2. intervening in the labor market with the purpose of making manpower scarce again and thus ensuring full employment at a "decent" wage;

3. partially detaching the assignment of incomes from the labor market.

The first strategy requires that income support to unemployed persons be reduced. That way they will have to accept the conditions of the job market, however unattractive they may be. The "culture of dependency" among the recipients of "social aid" and other forms of income support will be replaced by the obligation to take initiatives. This strategy can create additional employment, but it will also create additional poverty among job-holders and as a consequence perhaps among the retired ones of tomorrow, because the risk grows that many people will not have acquired sufficient entitlements for a decent old-age income.

Still, one could perhaps introduce an element of social justice into the resulting highly unegalitarian society by ensuring that low-wage work is mostly a temporary experience, one which is shared by the majority of the work-force. The precondition for such a combination of pronounced inequality at any given point in time and much higher equality of life-time incomes would be a big effort at continuous education for everybody. Equality of chances would have to apply not only at the day of birth, but during the whole active life.

The second strategy, which has as objective to make manpower a scarce "commodity" again, can be based on two different types of policies:

A. distributing the working-hours demanded (and paid) by the labor market more equally among the members of the work-force,

B. tax-financed public employment which absorbs sufficient manpower to make labor scarce again on the private labor market.

The third strategy gives an additional income to those who only earn "sub-standard" wages in their jobs. This way the advantages of a flexible, supposedly efficient, labor market are combined with the normative principle of "prosperity for all". The additional income can be assigned in form of an extended earned income tax credit, a negative income tax, a basic "citizens' income" or wage subsidies to employers. Who would pay for it? The easiest would be to use directly the money of the tax-payers, who would save, however, at the same time the direct and indirect costs of mass unemployment and would enjoy the low-price goods and services produced by cheap labor. Another - very long-term - strategy would be to use continuous government surpluses for accumulating a capital stock, the yields of which are then distributed among the citizens.

The various strategies can be classified according to their effects (a) on the welfare state and (b) on economic equality.

	more inequality	less inequality
more welfare-state expenses	status quo (high unemployment, generous „social aid")	public employment, top-up income
less welfare-state expenses	deregulation of the labor market	redistribution of work

It becomes obvious that the only strategy which responds at the same time to the imperatives of cutting welfare-state costs and reestablishing „prosperity for all" is the redistribution of work through a coordinated general reduction of individual working-time. This strategy would also make it easier to prolong working life and, thus, stabilize the pension system. The last mentioned effect would apply as well to the extension of public employment and to the combination of a deregulated labor market with a top-up income for low-wage workers. The table also shows that continuing with the status quo is the worst option.

The dynamics of politics

It is easy to see that any of the strategies which would reduce inequality implies a significant redistribution either of income or of wealth. In the case of the redistribution of work it would be present job-holders who would have to give up part of their salary, even though they would be rewarded with more spare time for leisure, family and voluntary commitments. In the cases of extended public employment and of top-up income for low-wage workers it is most likely the majority of the population would have to pay higher taxes.

It is these costs which have so far made all the egalitarian options rather unattractive for politics. After all, they imply a redistribution in favor of a minority (the unemployed) at the expense of the majority (the job-holders). It is particularly difficult to justify such redistribution within the "working class" at a time which is characterized by a tremendous and long-ongoing redistribution away from wage-earners to businessmen and capital-owners.

But the first strategy, the US-style deregulation of the labor market, will not find sufficient political support either. In spite of all the rhetoric about the need for a profound reform of the welfare state we find a generalized political blockade in Germany, which does not allow bold steps in any direction. Not even the national unification with its immense costs was able to break that fortress of status-quo politics based on the quasi-corporatism of the German political system. However, status-quo politics cannot stop economic evolutions. The pressure of the problems delineated above keeps mounting. And since any profound adjustment is excluded we witness a tendency towards minor adjustments combined with the search for new window-dressing. The cumulative effect of all these minor corrections reduces the redistributive element of the German welfare state - at the expense of the most vulnerable groups. For example, various explicit subsidies are not adjusted in time to general price and income developments, or participation of patients in medication costs is increased. But taken together these measures do not amount to a "cold" abandonment of the basic institutionalized solidarity of the German welfare state. And it is unlikely that they will do so in the foreseeable future.

But at the same time the erosion of "prosperity for all" which has been an essential element of the fundamental legitimacy of the Federal Republic of Germany goes on. While the flag of the "European Social Model" is being waved, unemployment with all its material and immaterial deprivations is allowed to become the lasting destiny of more and more persons. The institutions of the welfare state are being upheld, but not much is being done to ensure their effectiveness vis-à-vis the new challenges.