

I. Political Systems

Collectivism vs. Individualism

Democracy vs. Totalitarianism

Collectivism vs. Individualism

Collectivism

- **State manages economic activities if they are to benefit society**
 - **Social Democrats (vs. Liberals)**
 - **Communists**

Individualism

- **Individual freedom and self-expression**
- **Self-interest = public interest**

Country risk and development policy strategy

- Behind economic policy measures, there is often a « model » of economic development that policymakers try to implement, to adopt or to enforce!
- Ex.: Chavez in Venezuela, Putin in Russia, Morales in Bolivia, George Bush in the US, Thaksin in Thailand, Ben Ali in Tunisia, Hamas in Palestine, Castro in Cuba...

The neoclassical liberal school

- **Economic development is rooted in market-driven economic policies, in cautious monetary management, and in trade liberalization:**

Low taxes and minimum public sector budget deficit!

Adam Smith

- Adam Smith heavily influenced economic thought throughout the Victorian Era. Generally considered the "father of modern economics".
- Competition, the market's *invisible hand*,
- Opposed to any government intervention into business affairs. Trade restrictions, minimum wage laws, and product regulation are detrimental to a nation's economic health.

Milton Friedman's approach to economic growth and development

Economic development's roots?

☞ **free-market economy +
minimum state intervention + cautious
monetary management =
non-inflationary economic growth**



Walter Eucken



Walter Eucken
(1891 – 1950)
German
Economist

- German economist and father of “ordo-liberalism” (*German variant of neo-liberalism*)
- claims that the state has the task to provide the political framework for economic freedom, in contrast to laissez-faire
- originated the idea of a legal and institutional framework for a market economy

Post war Germany

The Social market economy

Alfred Müller Armack:

“A system which allowed business and finance to operate under the conditions of free market trading yet which worked within the legislative framework of industrial democracy at plant, company and industry level and within a statutory social security scheme seemed to enjoy the best of both worlds.”

(Nigel Reeves, 1995,)

The Social Market Economy

Die soziale Marktwirtschaft

- Free market trading
- The industrial harmony
 - Laws of Codetermination
 - *Mitbestimmungsgesetz* 1951
 - *Betriebsverfassungsgesetz* 1952
- Monetary policy of the Bundesbank (Federal Bank of Germany)
- Extensive social security scheme

Post War Germany - The Economic Miracle

- 1957 Pension reform (*Rentenreformgesetz*)
 - Pay-as-you-go principle
 - Pension adjustments linked to gross wages
- Characteristics of the welfare system:
 - Based on traditional role models:
Women as mothers and carers,
male breadwinner, “family wage” / splitting of income
full-employment, standard employments
 - Core aim: securing the achieved standard of living of families

Growth of the government sector from the 60s to mid 70s

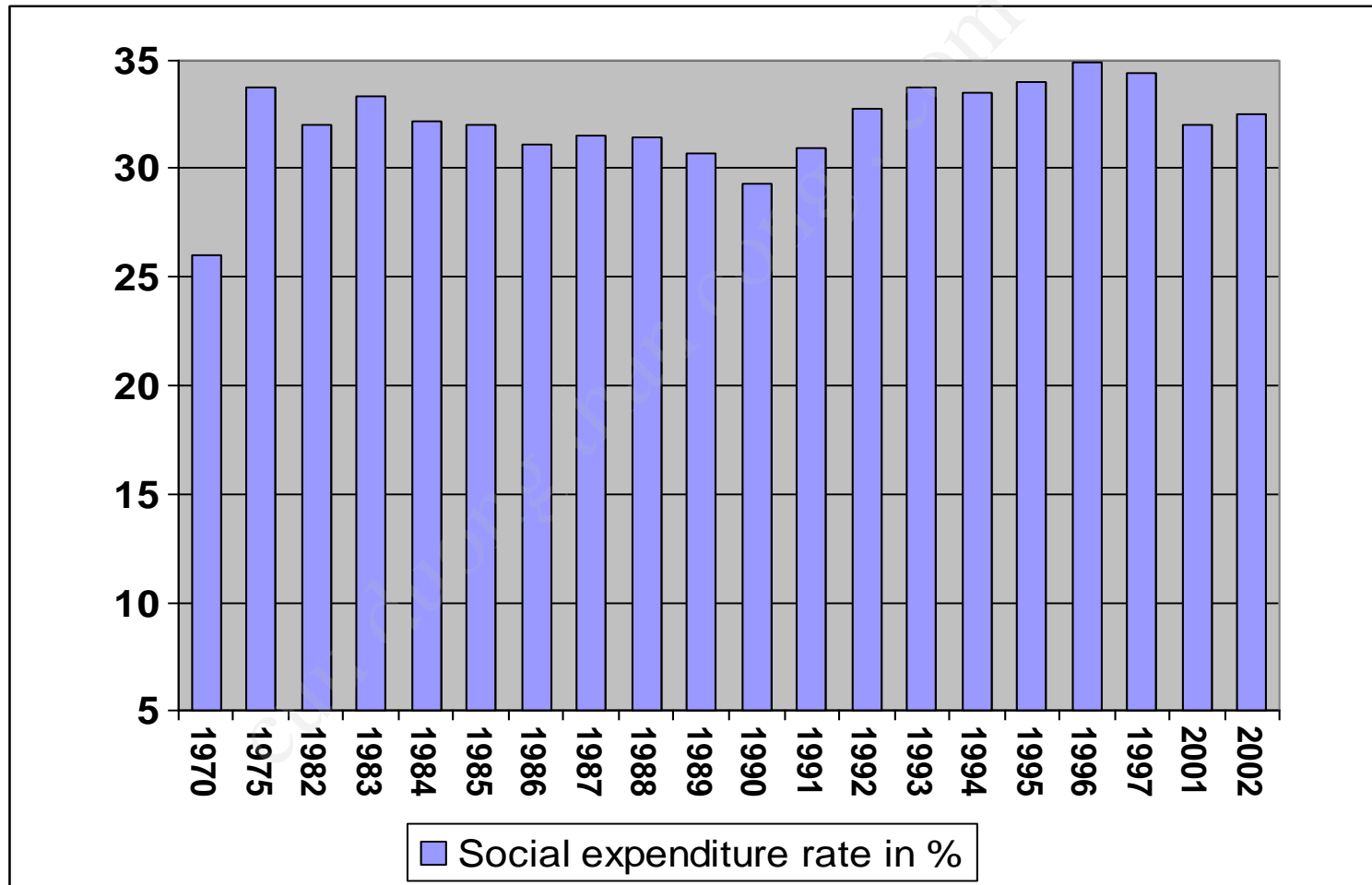
- 1966 / 67 Recession: government investment programme (7.5 billion DM)
- 1967 Stability Law (Law for the Promotion of Economic Stability and Growth)
- Public sector grew about 1.3 million employees between 1960-1973 (~60%)
- 1968 Average unemployment benefit: 68% of prior net wage
- 1972 Pension reform law: age of entitlement 63

Strength of job-guarantee, A comparison of OECD countries: liberal vs coordinated

	France	Germany	Netherlands	UK	USA	Japan
Inconvenience of layoff procedure	2.8	3.5	5.0	1.0	0.0	2.0
Advance announcement term and allowance of layoff	1.5	1.3	1.0	1.1	0.0	1.8
Difficulty of layoff	2.8	3.5	3.3	0.3	0.5	4.3
Total strength of job-guarantee	2.3	2.8	3.1	0.8	0.2	2.7

The Social Expenditure Rate

Sozialleistungsquote



Source: Wewer, G. (1998), Bilanz der Ära Kohl, p. 348,
Statistisches Bundesamt

Rolling back the welfare state in the 80s?

Helmut Kohl (1982 – 1998), CDU

- 1992 Pension reform: pension adjustments linked to the net wage, age of entitlement 65
- 1992 Social expenditure rate: ~70% in the former GDR
- 1995 Long-term / nursery care insurance, pay-as-you-go (*Pflegeversicherung*)

The Situation of today – Reforms

Gerhard Schröder (1998-2005), SPD

- „In an ageing society it is fair to expect people to take more responsibility for themselves, especially concerning health care and pensions. It is fair not to cripple citizens' willingness to work by excessive non-labour costs“ (Agenda 2010,p.4)
- 2002: Gesetz zur Reform der Rentenversicherung („Riester“-pension):
 - Promotion of capital-covered private pensions,
 - Times of child-raising taken into account
 - no adjustments of pensions in 2004
- 2004: Reform of Health Care:
 - quarterly fee of 10 €

DER SPIEGEL

Nr. 2/5.1.04
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DER LETZTE DEUTSCHE

Auf dem Weg
zur Greisen-
Republik

www.spiegel.de

Definition

„Retrenchment means the reduction in expenditures – in our case welfare expenditures“

...to retrenchment (I/II)

U.K. with Margret Thatcher



1979:

Conservatives promise

„new direction for economic management“

Favorable political environment:

- British politics is distinguished by the concentration of power in the executive
- The opposition Labour Party was extensively weakened
- The union movement was weakened by new legislation and very high unemployment

U.S. with Ronald Reagan



1980:

Reagan advocates

„a major retreat from government activism“

(Favorable) political environment:

- Weakened Democrats
- Political clout of an already anemic union movement continued to deteriorate
- Fragmentation of the American political system confers fewer resources on a triumphant party

...to retrenchment (II/II)

„For the first time since before WW2, political executives in Britain and U. S. were now **openly critical of central features of social policy.**”

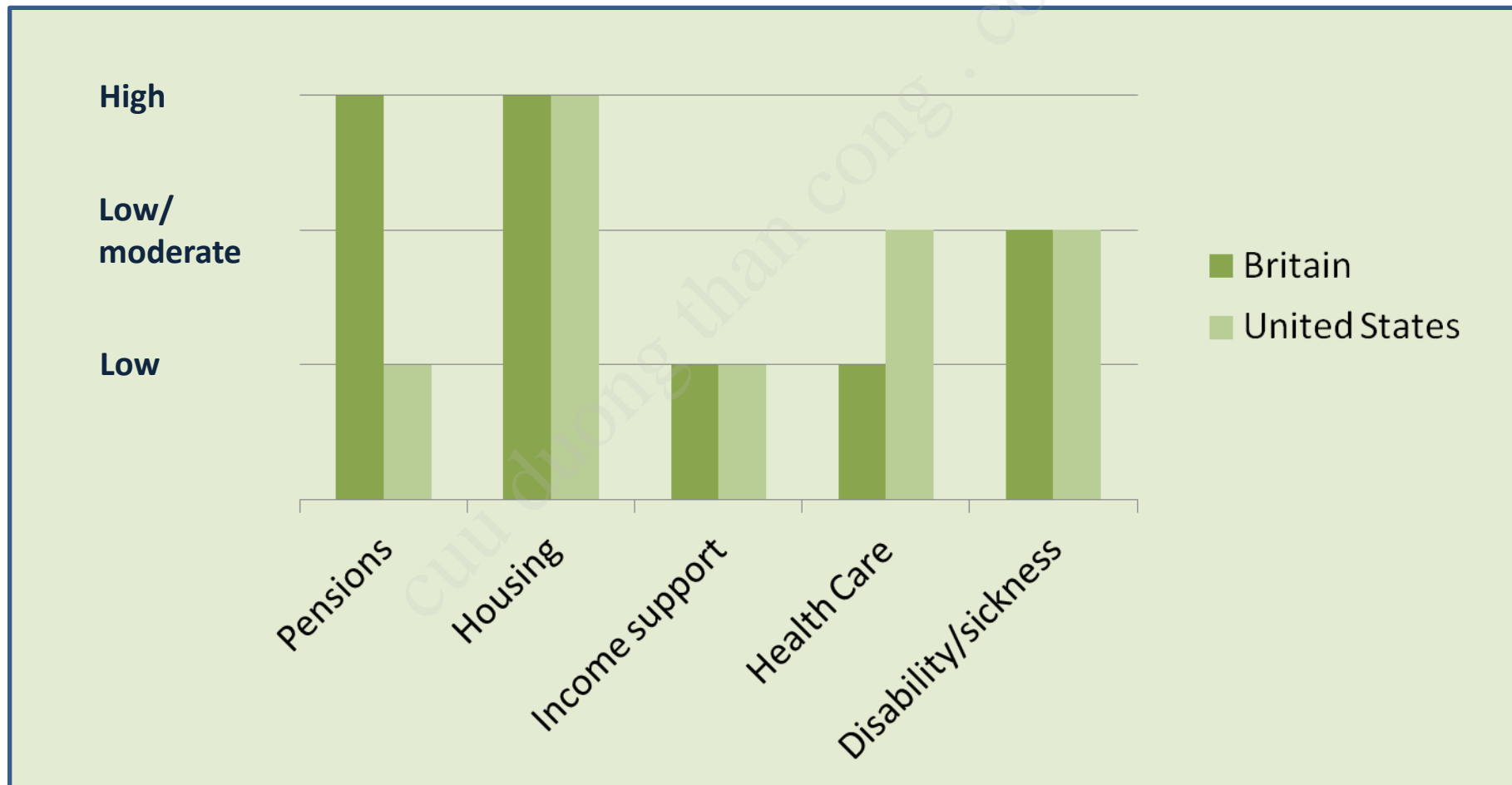
Main arguments against the welfare state

- Welfare state was not only a victim of **poor economic performance** but one of its principal causes.
- High tax requirements of mature welfare states **discourage work and investment.**
- Countercyclical consequences of social expenditures were seen as **inflationary** rather than reflationary, destabilizing rather than stabilizing.

Significant reform of the welfare states was a high priority for both administrations !

The Thatcher and Reagan Records of Programmatic Retrenchment (I/III)

Programmatic retrenchment outcomes



A Closer Look at Programmatic Retrenchment in Health Care

General prospects for retrenchment in these arenas

Health Care

- Heated debates due to involvement of life and death issues
- Concentration of economic activity
- Private alternatives to public options

Sickness and Disability

- Generally agreed that these groups in particular are deserving of public support.

Programmatic Retrenchment in Health Care

– United States (I/III)



Backdrop

- Tradition of mainly private health care system
- **US Hybrid health care system**
 - **Components** of Hybrid system:
 - Extensive private care provision
 - Medicare & Medicaid
 - **Weakness** of system: Out of control costs

Political System:

**Liberals who
want more
public care**



**Conservatives
who want a
more market
oriented system**



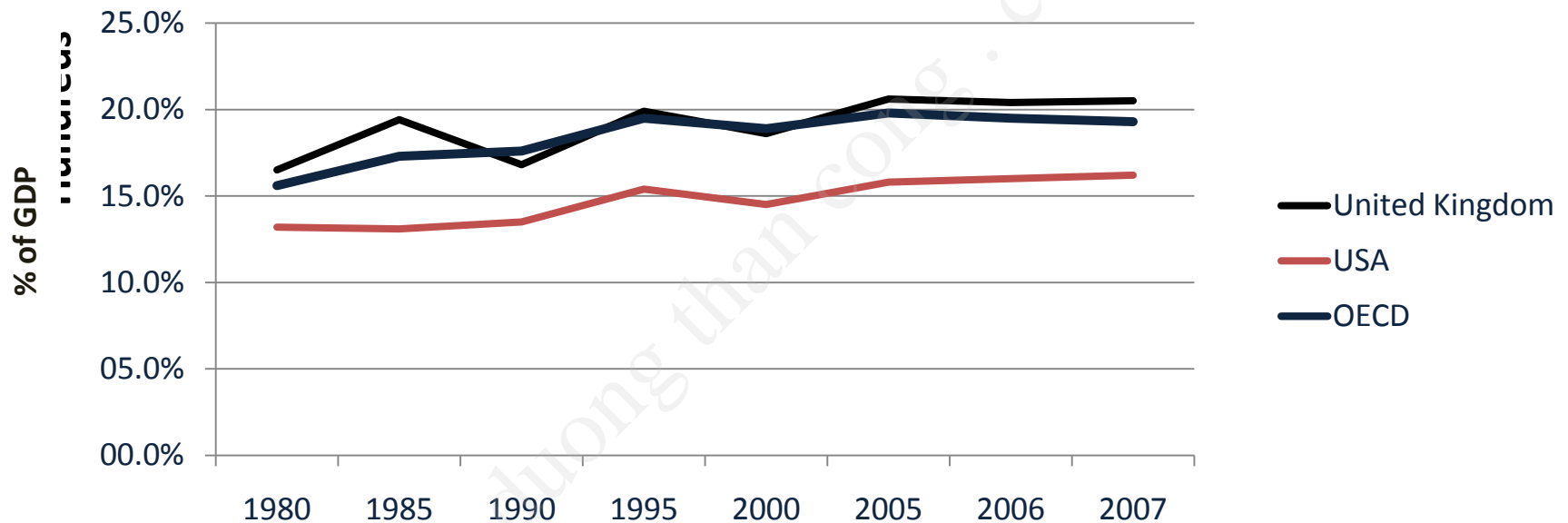
**US Hybrid
health care
system**

- **Price issues** in both public and private sector
- **Demographic** and **technological pressures**
- Design of the US health care system
- **Extensive public spending** in health care but lack of cost control
- Scattered third party payers making payments after costs incurred

**Cost Catastrophe
exacerbated by**

Public health spending development

Public health spending as % of GDP



	1980	1985	1990	1995	2000	2005	2006	2007
United Kingdom	16,5	19,4	16,8	19,9	18,6	20,6	20,4	20,5
United States	13,2	13,1	13,5	15,4	14,5	15,8	16	16,2
OECD - Total	15,6	17,3	17,6	19,5	18,9	19,8	19,5	19,3

The future of the welfare state

Despite the aggressive efforts of (different) retrenchment policies,
the welfare state remains largely intact in both countries

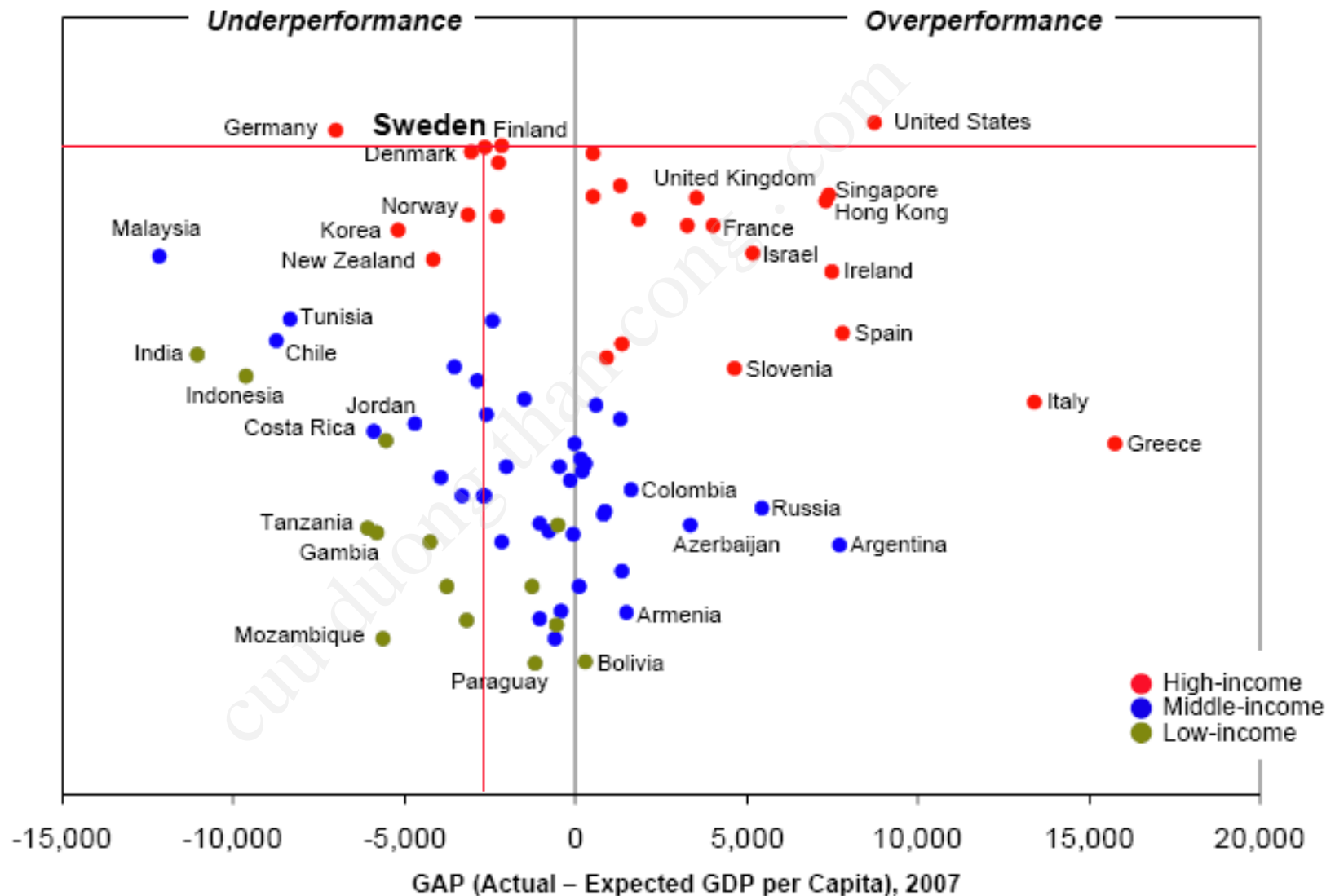
WHY?

The evolution of public opinion provides clearest sign, that, barring the onset of much serious pressures, the welfare state is unlikely to undergo radical change.

→ **Mass public remain strongly attached to the central features of modern welfare states**

Prosperity Potential and Sustainability

BCI Value, 2007



Source: Global Competitiveness Report 2007

Alternative Models for Transformation

