An Chomhairle Náisiúnta Eacnamaíoch agus Shóisialta
National Economic & Social Council

Challenges Facing the Welfare State

Background Paper

(151/9)

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Dr Anne Marie McGauran

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This background paper was agreed by the Council in December 2019. The Council also asked for additional empirical and analytical material on the challenges facing the welfare state to be developed. This material can in found in Chapter 3 of the main Council report, *The Future of the Irish Social Welfare State: Participation and Protection.*

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1. Introduction

This background paper outlines key challenges facing welfare states in Europe and other developed countries, as well as ways in which these difficulties have been grappled with to date. The challenges include changes in the economy and society, with several ongoing since the 1970s. There are also new challenges, associated with climate change, immigration and financial crises. There are challenges too inherent within the welfare system. However, the welfare state to date has been very resilient, surviving a number of economic and social difficulties. This has occurred through changes to the structure of, and services provided by, the welfare state. As new challenges arise, a number of authors have outlined ways in which these can be grappled with. A summary of the challenges, and ways in which some have been addressed, are presented below.

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2. The Post-World War Two Period

The welfare state in Europe developed mainly over the course of the twentieth century, at a time when full-time jobs in industry were the norm for many men, and unemployment was low. At home in Ireland, fertility rates were high, and care and household management was typically carried out by a full-time female carer. During the 30 year post-World War Two period, now considered the golden age of the welfare state in developed countries, economic growth was very high and this allowed a generous welfare state to be supported. During this period, nation states also had significant capacity to control national economic and social life, including welfare. However, many of these conditions have changed, giving a rise to a number of challenges for the welfare state, which are outlined below.

2.1 Economic Changes

The first crisis to hit the welfare state came with the 1970s oil crisis, which triggered a significant recession leading to low growth and high unemployment. This led to decreased contributions to social welfare funds, coupled with increased outgoings in the form of unemployment benefits. The more recent recession from 2008 to 2013 saw similar patterns occur once more, again putting pressure on the finances of the welfare state.

Since the 1970s, there have also been many changes in the economic structure of developed countries, and so in the types of employment available. A number of companies in the West, seeking lower costs, have out-sourced manufacturing jobs to newly industrialising countries. This has led to a decline in jobs in industry in Western countries, while the proportion of jobs in services has grown. The services sector has many more 'atypical' jobs, which are temporary, part-time, etc., compared to manufacturing. There has also been growth in casualised employment, sometimes in sectors which were previously characterised by more secure working conditions. These changes create challenges for social welfare. In areas substantially affected by out-sourcing, there are fewer jobs, thus reducing contributions to welfare while increasing payments out. The contributions paid to social welfare funds are also lower for those in short-term and part-time jobs. In addition, many rising states have a form of capitalism which is not burdened by welfare costs, that erodes the competitiveness of developed countries with expensive welfare states, and puts pressure on them to reduce welfare coverage (Gamble, 2016).

A changing balance of power internationally may intensify the latter issue. Gamble (2016) argues that in the last 100 years, the West had a privileged structural position in the international economy which it used to build and entrench its wealth. Now, however, Glennerster (2007) sees Asia, particularly China and India, dominating the future world economy. He argues that this will entail change for the West, and social disruption, which will impact Western welfare states. Trade wars between the US and China will also influence the balance of world power. All of these factors will be important for Ireland, for welfare and other policies, as it has one of the most open economies in the world (see Van Kesbergen & Vis, 2014).

Growth in the West since the 1980s has also been increasingly polarised, with a decline in middle-income jobs in several countries, and an increase in wealth at the

top of the income and wealth spectrum. This has led to more pressure on welfare states, which have been spending more on transfers since the 1980s in order to reduce market income inequalities.

Faced with economic challenges, many states have increasingly supported individuals and families to provide their own housing, pensions, health insurance and education, through e.g. mortgages, private pensions, insurance and student loans (Gamble, 2016; Lee & Woodward, 2012). However, while this can move costs away from the state towards individuals, it can also transfer costs back to the state when the risk taken on by individuals and families is too high and/or when there are regulation failures. In these cases, high mortgage arrears, homelessness, pension funds without adequate capital, default on repayment of education loans, etc., can occur, with the state often facing pressure to absorb some of these costs.

2.2 Social Changes

As well as changes in the economy, there have also been changes in society since the post-World War Two period. Lifecycle patterns are different, with people spending a longer period in education, and giving birth later. Fertility rates are lower, families smaller, and many more women are in the labour force. There are fewer 'traditional' families, and more lone parent families. There are also more dual-income, highly educated couples, and at the same time low rates of employment among those with lower skills (Van Kesbergen & Vis, 2014). All of these changes have led to demands for welfare to cover new social risks, including the cost of eldercare and childcare for working families, combating poverty among lone parents and jobless households, and higher spending on education.

Another change in society is greatly increased longevity. However, although people are living longer at one end of the life cycle, this is being met by falling fertility rates, and so the proportion of those at work compared to older people is falling rapidly. Therefore, the pay-as-you-go model of social insurance, which relied on a steady stream of workers taking the place of those reaching retirement, is argued to face great difficulty in paying the costs of the current pension system (Gamble, 2016). There is, however, disagreement over the extent of this future difficulty, with some arguing that the population and economy assumptions used in the models are unduly pessimistic, and that the models assume no future tax rises (see e.g. Spies-Butcher, 2014). In addition, smaller families with more women at work means less people available to provide unpaid care for older people at home.

Some argue that there is now also more individualism, with the collective organisations which underpinned the welfare state as it developed (churches, trade unions, extended families) much weaker now. Many citizens want to pay less on tax and instead have more opportunities (or need) to spend on personal consumption (Gamble, 2016). People may feel less solidarity with others, and be less attentive to their needs. Where Governments have found it difficult to cut services which are targeted at all of the population (education, pensions, and health in some countries) (Gamble, 2014), they have at times found it easier to cut benefits which go to minorities, such as those who are unemployed and low income families. In Ireland, for example, social housing has become much more residualised than it was 30

years ago, and those living in it much more disadvantaged. These patterns can reduce support for the redistributive element of the welfare state.

All of these patterns can mean less desire to support the costs of the welfare system.

2.3 Challenges within the Welfare System

There are also challenges within the welfare system. As welfare services were developed during the mass industrialisation era, they display several characteristics typical of that era. For example, they are typically collectivised, top-down, and with little possibility for citizen involvement, participation or choice. Power is concentrated in the hands of managers, professionals and experts, with an emphasis on hierarchy, discipline and efficiency (Gamble, 2016; Page, 2012). However, this is counter to how many other areas of economic and social life are organised now. Service users want more choice, there is a focus on individual needs, and a tendency to distrust experts. This gap between how welfare services are typically delivered and the desires of those receiving them risks the electorate having declining confidence and faith in these services.

In addition, ironically, those who need most protection in the labour market (precarious workers) often find it hardest to qualify for assistance in the current social protection systems (Van Kesbergen & Vis, 2014). This again risks citizens becoming disenchanted with the welfare system. On the other hand, some of those most impacted by precarious jobs, education loans, and high housing costs might support a return to more state support with these costs, thus boosting support for the welfare state.

During the 1970s, there was also a lot of debate on whether or not the welfare state structure provided 'incentives' for people to withdraw from the labour force. Such debates continue still, and the view of welfare recipients as 'deserving' or 'undeserving' can weaken support for redistribution through the welfare state (Van Oorschot *et al*, 2017).

2.4 New Challenges—Climate Change, Immigration and Changes in Political Alignment

A number of new challenges now arise for the welfare state. Among these is climate change. At the very least, it is likely to lead to calls for new welfare spending, on insurance, housing, flood protection, management of natural disasters, and climate mitigation. It may displace spending on social policy issues, by capturing the political imagination and weakening the traditional concerns of social justice.

More profoundly, climate change and the environmental destruction underlying it may challenge economic growth and therefore welfare states' past dependence on this growth. The 'golden age' of the welfare state occurred during the economic

growth of the twentieth century,[1] and a number of authors wonder if it depends on this growth. If so, climate change will challenge this. While many argue that it is possible to invest in alternative technologies that can achieve growing production and consumption while at the same time cutting carbon emissions, others are not as optimistic, and question if it is possible for growth to be maintained in the West whilst moving to a sustainable low carbon world (Wurzel, 2012). If growth in the West is curbed, richer countries would lose out, and the welfare state would have to transform (see Gough & Therborn, 2010). Climate change is also likely to increase migration from affected countries, putting more pressure on Western welfare states.

In a number of countries, immigration has already put stress on welfare states (Glennerester, 2007). While data show that immigrants are net contributors to the state (as they are typically young, healthy and already educated) (see Gamble, 2016), they are not always viewed as net contributors. Alesina *et al.* (2019) show that indigenous respondents are less supportive of redistribution when there is a higher share of immigrants in their region. This pattern is more common in countries with relatively large welfare states,[2] and among respondents who are politically centre, or centre-right. As a result, large-scale immigration, where immigrants are not well absorbed into society, could reduce people's willingness to see welfare services as universal, and to pay for welfare services which are used by a more disadvantaged minority.[3]

As well as pressure to spend more to adapt to, or mitigate, climate change, other areas of spending may demand more resources. For example, there may be increased pressure to spend more on defence in Europe. This can be linked to the increase in terrorist attacks, the Russian annexation of Crimea, and US pressure for NATO members in Europe to augment their defence funding. More spending on defence might occur to the detriment of welfare spending.

Gamble (2016) also argues that increased investment in education and training will be needed, as to be competitive, Western economies will need to move up the value chain, using skills, networks and accumulated capital to develop new products and services which cannot be replicated by cheap labour in other parts of the world. This will require state investment.

In addition, the rising cost of housing is leading to lower levels of homeownership among young people, and this may have implications for their housing costs and pension needs in old age. In Ireland, and a number of liberal welfare states, high levels of home ownership amongst older people has meant that state pensions did not need to cover housing costs (Stebbing & Spies-Butcher, 2016). If pensioners need more financial support to cover housing costs, this will increase pressure on

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[1] Although during this time many groups were not covered by social insurance, such as married women.

[2] The effects are also stronger when immigrants originate from Middle-Eastern countries, are less skilled than the indigenous population, and experience more residential segregation.

[3] As noted above, there can also be reluctance to pay welfare to disadvantaged minorities who are natives of a country.

governments to raise pensions and/or to support home ownership at earlier stages of the lifecycle.

Glennerester (2010) also argues that financial crises may become more common due to the lack of effective international regulatory regimes for banking. As financial crises usually lead to slow growth and high unemployment, this would raise more financial challenges for welfare states. The aftermath of the financial crisis in 2008, for example, poses a challenge for existing welfare states. If growth is feeble, debt repayment levels are high, and rates of personal consumption decline, so that this narrows the scope for expenditure on traditional social programmes (Gough & Therborn, 2010). The impact of Brexit in Ireland may also lead to increased pressure on the welfare state, if it leads to job losses.

2.5 However, the Welfare State has Survived Previous Challenges

It is, however, useful to remember that the welfare state has survived previous challenges. For example, the recession of the 1970s led many to predict that the welfare state would decline significantly. Nonetheless, the welfare state has proven extremely resilient—but there have been many changes in the structure of welfare states, and how they operate.

Welfare state resilience

In terms of welfare state resilience, many Western states have increased spending on welfare, and are doing much more work to redistribute market income, than in the 1970s. This can be linked to the increase in market income inequality which has arisen from neo-liberal growth since the 1980s. The fact that states are carrying out extensive redistribution, to a greater degree than in the past, also suggests that the trend towards individualism may have been somewhat exaggerated. However, in some countries, supports for some more marginalised people have been reduced (e.g. social housing) suggesting that support for groups who are seen as 'undeserving' is not as strong. Countering this, Glennerester (2010) has argued that there are instead new groups mobilising around different issues, such as care and disability.

Another reason for the survival of the welfare state, is that, contrary to the welfare state being a drag on Western economies, a number of researchers have argued that instead it provides the conditions for successful international competition. The welfare state helps create conditions under which businesses can thrive, such as education, infrastructure, housing, etc. It corrects some of the downsides of innovation and competition that come from capitalist growth. In reality, there is evidence of welfare being both a cost, and a pre-condition, in international competitiveness.

Another possible reason for the expansion of welfare spending is that market solutions do not work well for many aspects of welfare (Glennerster, 2007; Van Kesbergen & Vis, 2014). For example, if workers self-select into private illness insurance schemes, then those who are more likely to need them will join over those who do not, leading to an unsustainable business model. Many private pensions ran into serious difficulties during the 2008 financial crash, to the extent

that Argentina closed its private pension scheme and merged it with the public one, while Chile changed its pension system to be more universal and equitable (Rys, 2010). The state has much greater power to both require people to join insurance schemes, and to bear the cost of them, than the private sector, and so is better placed to organise social welfare coverage.

Politicians have also come under intense pressure from voters to retain the welfare state (Gamble, 2016; Gough & Therborn, 2010; Van Kesbergen & Vis, 2014), particularly universal benefits such as pensions, education, children's allowances, etc. Other interest groups which benefit from the welfare state, such as private companies dependent on public welfare contracts, have also pressured politicians not to cut these.

All of these factors have contributed to the survival and growth of the welfare state despite the challenges it faces.

Changes in the structure of, and services provided by, the welfare state

A number of researchers have argued that solving the affordability of welfare state commitments takes the shape of: 1) increased borrowing; 2) increased taxes; or 3) reduced services. In an era of increased austerity, along with the EU Stability and Growth Pact, increased borrowing became less and less possible, in EU member states at least. Instead, there was evidence of both increased taxes, and changes (rather than outright reductions) in services, to help maintain the welfare state.

In terms of taxes, in 2007, Glennerester argued that the sources and types of revenue used to fund the welfare state would change. For example, he foresaw more 'quasi-taxes', such as enforced contributions to health care and personal pension insurance, and income-related deferred fees for higher education. He also saw more user charges. Such contributions and charges have been introduced in a number of countries, and Ireland, for example, is planning an auto-enrolment savings scheme to contribute to pension costs. Rys (2010) also suggested the build-up of reserves to be used to fund welfare during hard times—an option that Ireland exercised with the Pension Reserve Fund during the 2000s, followed more recently by the National Surplus (Exceptional Contingencies) Reserve Fund.

In terms of the services provided, Van Kesbergen & Vis (2014) argue that states have responded to the financial risks to the welfare state by re-commodification of schemes (e.g. tightening eligibility, restricting benefits, changing the duration of payments); by cost containment (e.g. setting a limit on spending on some programmes); and recalibration, which involves making welfare payments more consistent with contemporary goals and demands for social provision. Some changes affect only one group and, in effect, dualise service provision, with current beneficiaries typically receiving superior services to new users. Elements of these can be seen in reforms in Ireland also.

To cope with the increasing costs associated with ageing and pensions, many states have reduced pension promises, and extended working lives (Glennerester, 2010), changes which display elements of re-commodification and recalibration. These are important changes, as too often states failed to relate benefits to costs (O'Sullivan, 2012). For example, they did not change the age at which a pension could be drawn

down in line with increases in life expectancy. When first introduced, retired workers lived only a few years post-retirement, whereas now the average life expectancy in the EU is 81 years, leading to approximately 15 years of state pension after retirement. Welfare states, in some cases, contributed to the prospect of a long period of pension payments, by, for example, establishing early retirement schemes supported by the state during recessions, in order to reduce unemployment figures.

Recalibration can also be seen in the greater emphasis on duties in relation to welfare benefits (O'Sullivan, 2012), and the emphasis on movement into employment, via workfare policies (Glennerester, 2010; Rys, 2010). Some of these changes support a move away from the perceived incentive for people to rely on welfare and so leave the labour market. Van Kesbergen & Vis (2014) point to other changes which supported employment during the 2008 financial crash—e.g. job search assistance, support for employers to take on the unemployed, changes in tax supports to help businesses, etc. As the finances of the welfare state have relied strongly in the past on full employment, it is not surprising that many of its services now are geared towards increasing employment.

Gamble (2016) also notes the drive for greater efficiency in service delivery, to cut costs, and so afford welfare provisions. This takes the shape of competition and privatisation, although the results of this are mixed. There have been some positive effects on service quality, such as better service responsiveness and extended availability of customer care; but there has also been net job losses, increases in atypical forms of employment, and deterioration of pay levels and working conditions (which causes problems for social welfare funding, as outlined above) (Loffler *et al.*, 2012).

Rys (2010) argues that the state has reduced its role in the direct running of social security schemes, but increased its regulation of private arrangements. The expansion of mortgages, private pensions and educational loans suggests that this role may continue—although the impact of the 2008 financial crash shows the challenges inherent in this change.

Sometimes governments do not make any specific changes to a welfare policy, but allow 'policy drift'—in other words, they do not change a programme, so that over time it becomes less relevant and supportive, and so its impact is lessened, just by letting it 'drift'. An example is labour law in the US (Galvin & Hacker, 2019).

Other possibilities for the State to afford the welfare state into the future

What other steps can states take to continue to afford the provision of welfare services in future? Glennerester (2007; 2010) estimates that, on average, EU member states will have to devote 4 per cent more of their GDP to welfare spending by 2050 to sustain current policies and promised benefit levels. Views are mixed on the extent to which this will be raised by taxes. Gamble (2016) considers that voters do not want pay the taxes necessary to support the welfare state, but he argues that the issue of affordability is not really one of money, as Western societies are much richer than they were when welfare states were first introduced. Instead, it will come down to political compromise. Van Kersbergen & Vis (2014)

argue that the distribution of political power among different social and political groups, and the capacity of political actors to design reform packages that function and are politically feasible, are key influences on what type of change takes place in relation to welfare. As a result, groups that do not have good political representation (e.g. young, poor) can sometimes be more adversely affected by welfare changes than those who do (older people, the well-off).

Glennerster, meanwhile, considers that paying an extra 4 per cent of GDP through increased taxes is politically feasible, especially given the costs of alternative private solutions. This links in to the arguments outlined earlier that the models used to estimate future pension needs and costs assume that there will be no tax increases (Stebbing & Spies-Butcher, 2014) - but there could be. Rys (2010) has also noted that not all employers are paying their full taxes, and that addressing this could help tackle welfare funding shortfalls. He recommends levies on excessive salaries and speculation, as a future welfare state funding mechanism.

Immigration also offers possibilities. Although it can lessen support for the welfare state, it can also offer solutions to some of the problems of ageing populations in Western states, as immigrants can boost the proportion of the population who are of working age and so contribute to social welfare funds. In several countries, migrants are also employed as care workers for the older population,[4] thus addressing the need for eldercare there.

At another level, Gough & Therborn (2010) argue that if the welfare state has to transform under pressure from reduced finances, it could be useful for it to prioritise, for example, preventative health, sustainable public services, and local support networks.

Glennerester (2010), meanwhile, has suggested that the global impact of climate change may possibly induce more collaboration between countries, to tackle climate change, improve welfare in developing countries, and even to tackle issues such as regulation of markets. This could allow an improved focus on welfare globally.

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[4] This is the case if migrants come from outside Europe, but migration also contributes to increased population ageing in Eastern Europe, as many young people migrate to Western Europe to work.

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