

# The Welfare State and The Market Economy: The Austrian experience as a Social Market Economy (SME)

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## Abstract

*This paper concentrates on the recent development of the welfare state and social wage in Austria. Our empirical review is concerned with the net benefits or net social wage received by the Austrian working population. Net social wage is defined as the difference between the social benefits received and taxes paid by the working class. This measurement will enable us to find out whether the working population has received a net gain (or net social wage) and whether this net gain has expanded over time. The paper offers a study of the trends of the “social wage” in France in the last decades before the Great Recession. It addresses two major questions. The first question is whether the expansion of social expenditures has posed any drag on capital accumulation and economic growth in this country. The second question is whether the increasing ideological challenges from the right and the competitive pressures of globalization have led to the retrenchment of the French welfare states in the recent decades.*

**Keywords:** *Welfare State, Social Wage, Economic Growth, Government Expenditures, Taxes*

**JEL classification:** *B55, C88, E01, E24, E69, H50, H53*

This study<sup>3</sup> concentrates on the development of the welfare state and social wage in the last decades before the Great Recession of 2008. The Great Recession may have caused some disruption on the trends of social expenditures. Given that welfare expenses constitute a large proportion of all state expenditures, reducing government spending means a reduction in welfare programs expenditures. On the other hand, social protection programs, in particular unemployment insurance benefits and minimum income support, has significantly reduced the harsh effect of the crisis on millions of individuals. Austria has a small, yet open, economy with exports of goods and services accounting for 47 percent of the gross domestic product (GDP). Austria is one of the 14 richest countries in the world in terms of GDP (Gross domestic product) per capita; it has a well-developed social market economy, and a high standard of living (IMF 2010). The GDP (purchasing power parity) was around \$323.1 billion in 2009, down from a slightly higher \$335.2 billion in 2008. The per capita GDP (PPP value) of the country was about \$39,400 in 2009 (Economy Watch 2010). This number has increased to \$55,510 in 2018 (World Bank 2018). The economy is built on a strong infrastructure with well-developed industry, banking, transportation, services, and commercial facilities. While the majority of Austria's industrial and commercial enterprises are small, there are a

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number of large industrial employers having thousands of people on their payroll, mainly in iron and steel works and chemical plants.

The industry accounts for slightly above 25 percent of gross domestic product with an average growth rate of nearly 3 percent. (Statista 2019 and Encyclopedia of the Nations 2010) Though forming a relatively small component of the GDP, 1.7 percent in 2009 and 1.2 percent in 2017 (Statista 2019), agriculture still plays a vital role in the Austrian economy, producing about 80 percent of the domestic food consumption of the country and contributing to some export earnings with processed food items.

Historically, her trading partner has been Germany, making it vulnerable to rapid changes in the German economy. However, as a member state of the European Union, it has gained closer ties to other EU economies, reducing its economic dependence on Germany. In addition, membership in the EU has drawn an influx of foreign investment to Austria, leading to a higher growth rate of GDP. Growth in GDP accelerated in recent years and reached 3.3% of growth rate in 2006. With a GDP of \$55,510 (PPP value) ranked 18<sup>th</sup> in the world in 2018 (International Monetary Fund 2018), she was the fourth richest country within the European Union, with Luxembourg, Ireland, and Netherlands leading the list.

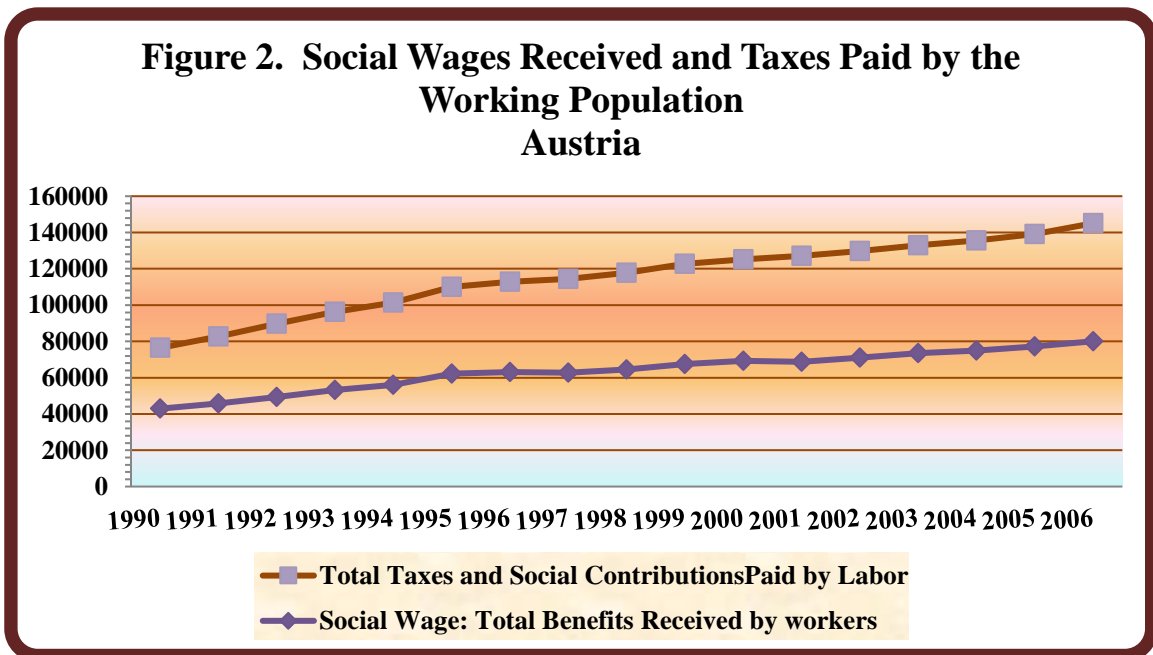
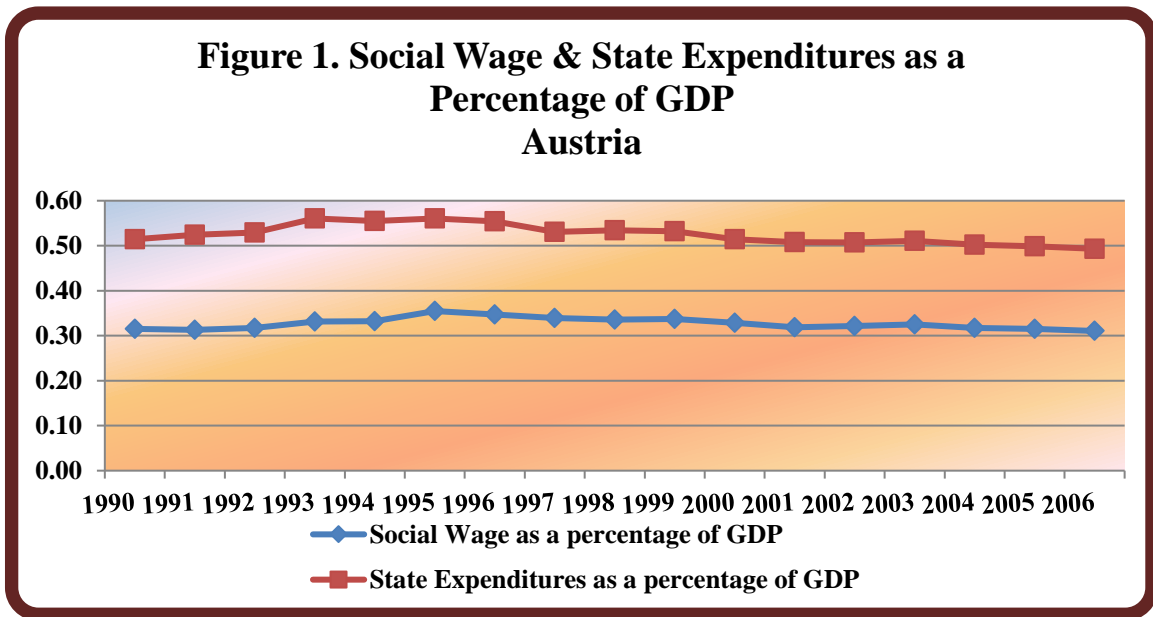
Austria is among the countries with one of the highest contribution of knowledge in the economy, the service sector accounting for 65.8 percent of GDP in 2009. (Encyclopedia of the Nations 2010 and Economy Watch 2010) Austrian labor force has become increasingly diversified in the recent decades. Between 1985 and 2001, over 254,000 foreigners were naturalized in the country. Austria's proportion of foreign-born residents in 2001 was even higher than that of the United States, reaching a level of 12.5 percent. (Jandl, Michael and Albert Kraler 2003)

Austria is among the countries whose state spends a high proportion of GDP as the government expenditures. In 2015, this ratio for Austria was 51 percent. This ratio was 57 percent for Finland that had the highest general government spending as a percentage of GDP. The second in the rank was France with 56.8 percent of GDP (OECD 2015). Our study shows that during the period of this empirical study, 1990-2006, both state expenditures and social wage have remained stable relative to GDP with a noticeable increase up to around 1995 and a slight decline thereafter. The state Expenditures have stayed at about 50 percent of GDP from 1990 to 2006, while social wage expenditures have remained at about 30 percent of GDP in this period. (See Figure 1) Social Expenditures, which has a more limited coverage than social wage, has been about 27 percent of GDP in the period of this study and recent years. Austria has been allocating a higher percentage of GDP on social expenditures, compared to all Continental social market economies, except for France. France's share of social expenditures in GDP has been around 32 percent in recent years, which is higher than all OECD countries, even higher than Northern Social Market Economies such as Sweden, Norway, and Finland.

Austria provides a comprehensive system of social security and welfare schemes. The population is either covered through the principle of insurance, which provides coverage for all gainfully employed persons and their dependents; or "public welfare benefits made available by the federal, provincial and municipal authorities to all citizens in need, who are not covered by the insurance system." One of the outstanding features of the Austrian welfare state is its provision of long-term care for the population. "All persons in need of (nursing) care are eligible for long-term care benefits. The amount of long-term care

benefits will depend exclusively on the extent of care needed. Long-term care benefits are funded from tax revenue.” (Austria .org 2019)

As reflected in Figure 1, the initial increase of more than 5 percent of GDP can be explained mainly by the economic slow-down during the period of 1992 to 1996.



While in prior two decades, Austria had enjoyed higher economic growth and lower unemployment than many European countries, this trend did not continue during the first half of the 1990s. In 1990, the economic upswing in Austria continued. Real GDP grew by 4.6 percent. In the course of this year, foreign demand, particularly from Germany replaced domestic demand as the driving force of the upswing. Despite the high rate of economic activity and large employment gains, unemployment increased as a result of the huge inflow of foreign labor from the Eastern European countries. Inflation was modest in 1990. The early 1990s recession led to a decline of annual GDP growth, from 4.2 percent in 1990 to 0.4 percent in

1994. Economic slowdown and rising unemployment (See Figure 8) required a higher level of social and state expenditure. Thus, as Figure 2 shows, the share of both social and state expenditures in GDP increased in this period.

Since 1995, however, due to positive merchandise export and higher investment rate due to the membership in the European Union, the economy experienced fairly constant growth, with annual GDP growth rates for 1998, 1999, and 2000 of 3.3 percent, 2.8 percent, and 2.7 percent respectively. (See Austria 2010)

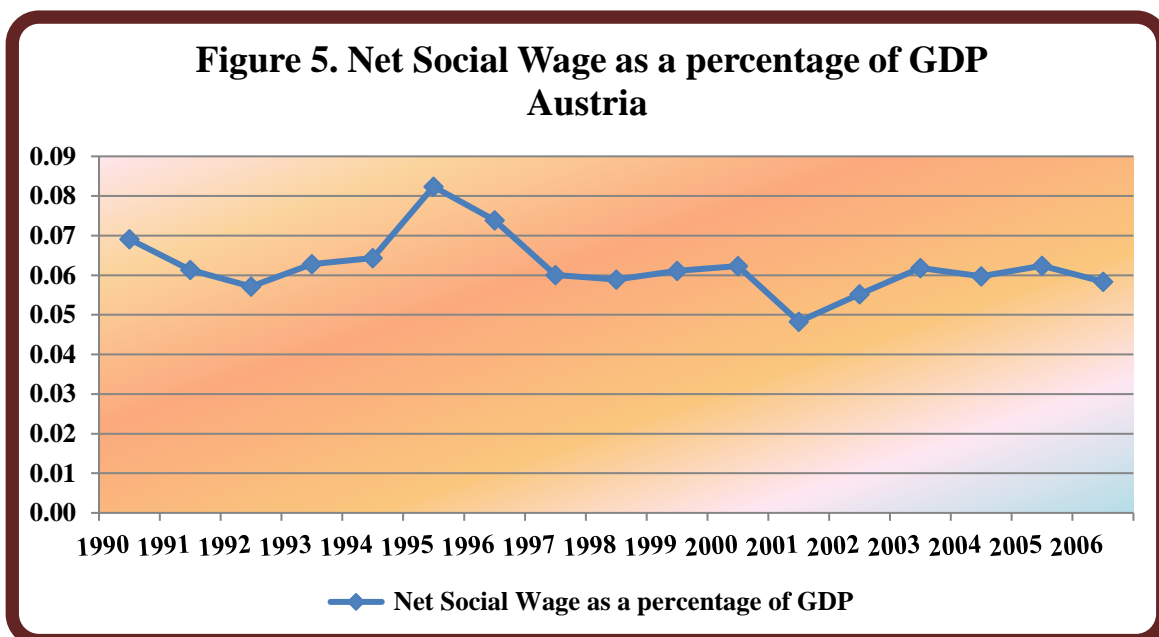
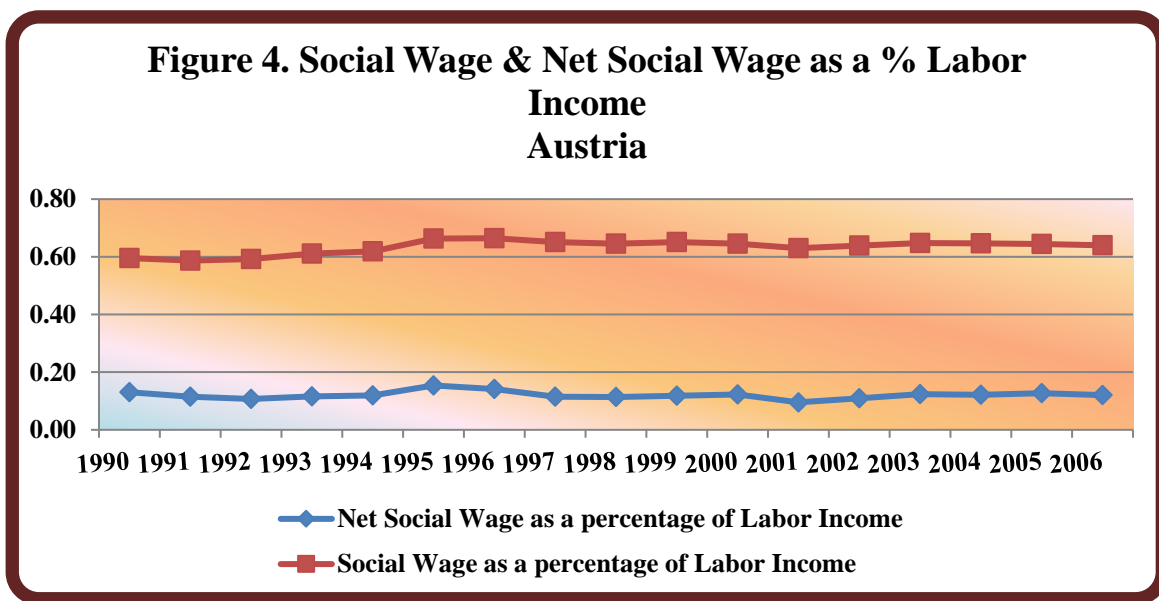
Figure 2 shows that social wage and the taxes paid by labor have increased between 1990 and 2006 in a relatively slow rate-somewhat faster between 1990 and 1995 and slower afterwards. (Figure 2) The gap between social wage and labor taxes has increased in the more recent years. (Figure 3) But the significance of this change can be evaluated better when we look at Figure 3, demonstrating these values as a proportion of GDP. This figure shows that social wage and labor taxes relative to GDP have both increased with a mild increase in their gap between 1990 and 1995 (social wage ratio from 30 percent to 35 percent and labor tax ratio 25 percent to 27 percent), implying that the net social wage has increased slightly over this period. Both social wage ratio and labor tax ratio have declined to their initial values in the subsequent years in Austria. The net social wage ratio has declined to 6 percent of GDP in 2006. (See also Figure 5 for the trend of the net social wage ratio.) This been smaller than that of Germany, and definitely much less than the net social wage ratio in the United Kingdom, the most egalitarian liberal market economy, 11 percent in 1993 and close to 10 percent again in 2003.

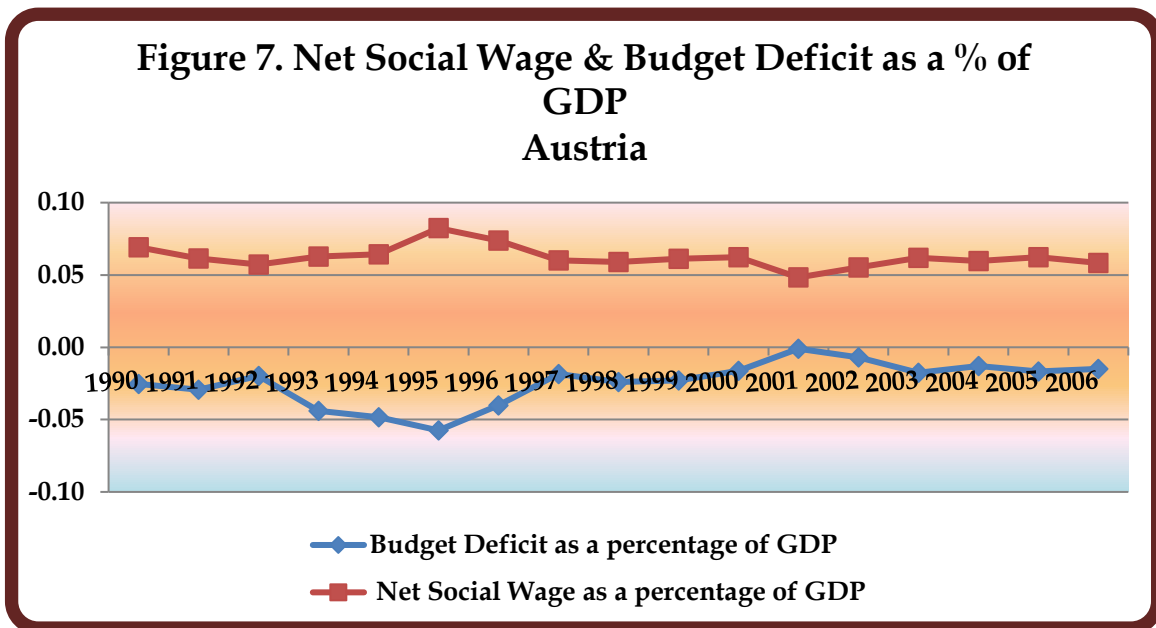
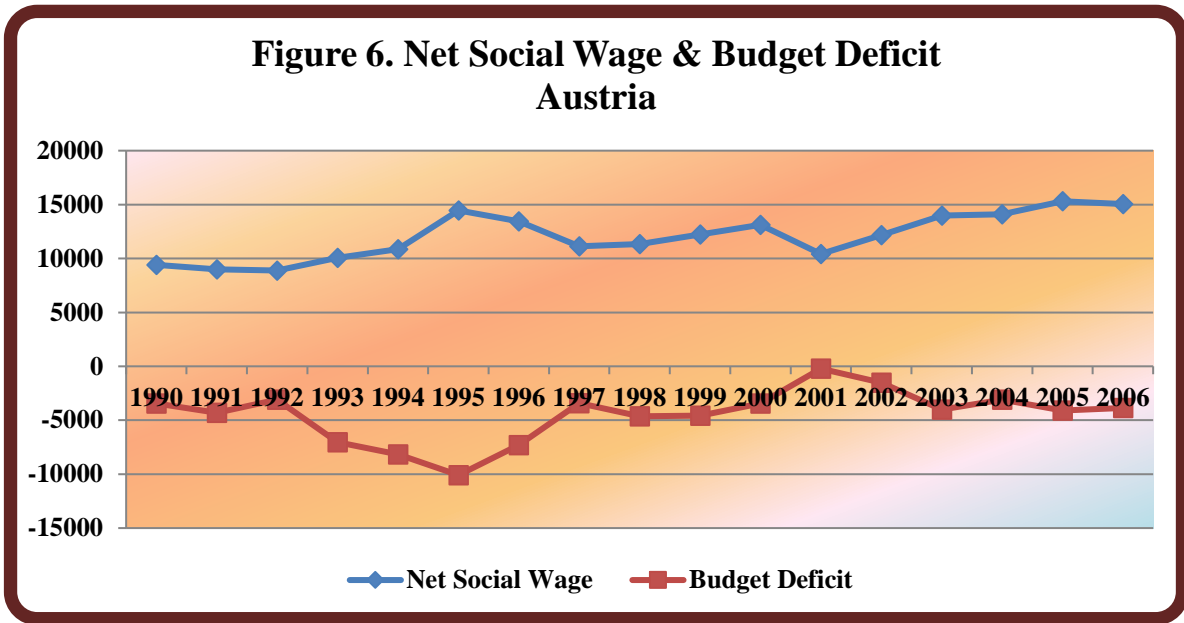


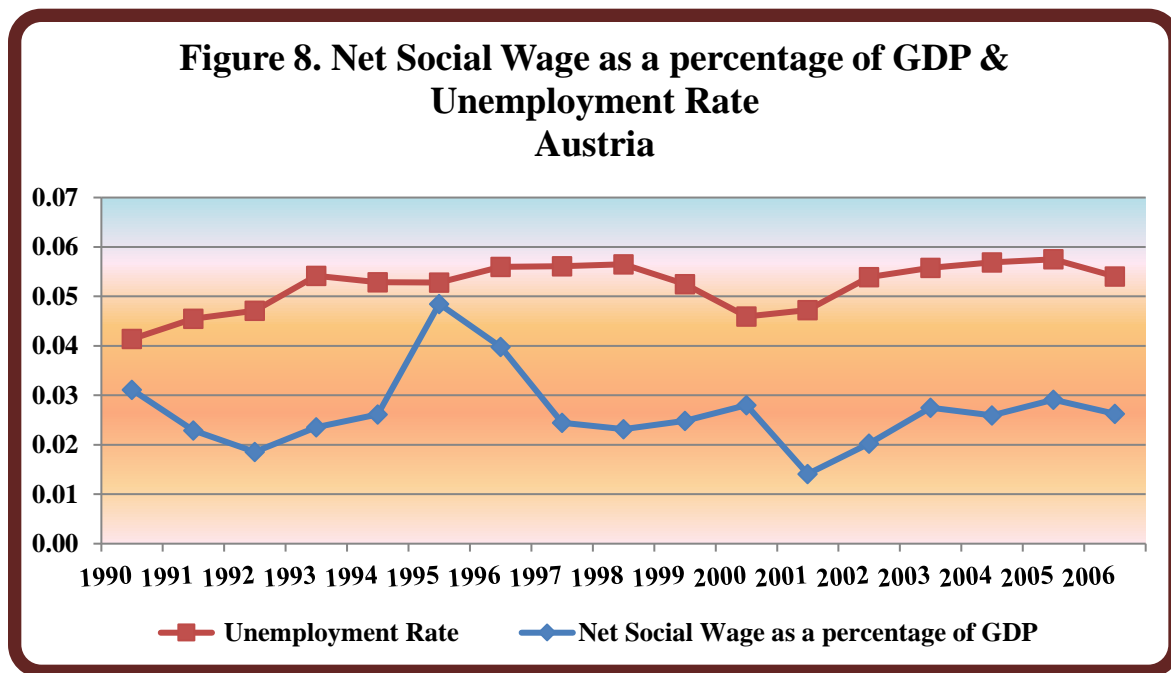
These numbers do not, however, indicate a lower role for the welfare state in Austria. The ratio of social wage to GDP has varied between 30 percent and 35 percent of GDP. (See Figure 3) This is a significant share of GDP and larger than those of Germany (ranging from 28 percent to 33 percent) and the United Kingdom (ranging from 22 percent to 27 percent). The prominent role of the social wage in the life of the working population becomes even more evident when we look at share of social wage in the

labor income. This ratio has varied between 59 percent and 64 percent and shows a high degree of the reliance of the working population on social wage rather than their wage earning in the market. This ratio has also been high for Germany (ranging from 52 percent to 64 percent), but not as high as the comparable values for Austria. The comparable ratio for the United Kingdom has been between 40 percent and 49 percent, a significant figure, but much lower than the same ratio for Austria and Germany.

In the entire period, the fluctuations of the net social wage ratio have not been that large. Even during the recession of early 1990s, the net social wage stayed at 6 percent of GDP from 1991 to 1994, increasing to 8 percent in 1995. While social wage was increasing at a modest rate from 1991 to 1994, with a relatively sharp increase in 1995, net social wage ratio remained stable, since the ratio of labor taxes to GDP was also increasing at a smooth rate. This trend was consistent with the trend of unemployment rate that remained stable at 5 percent.



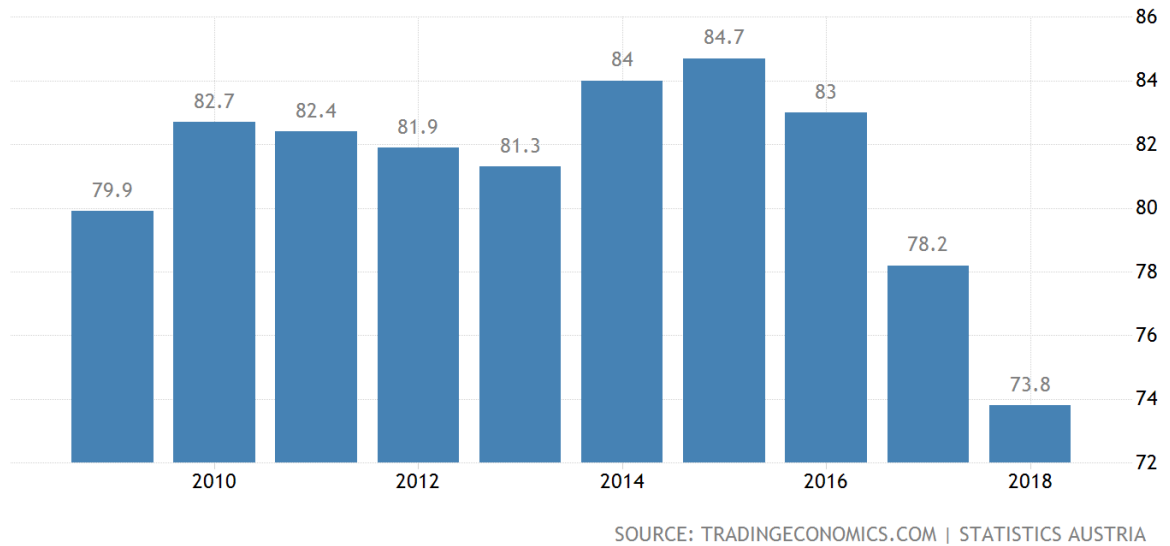




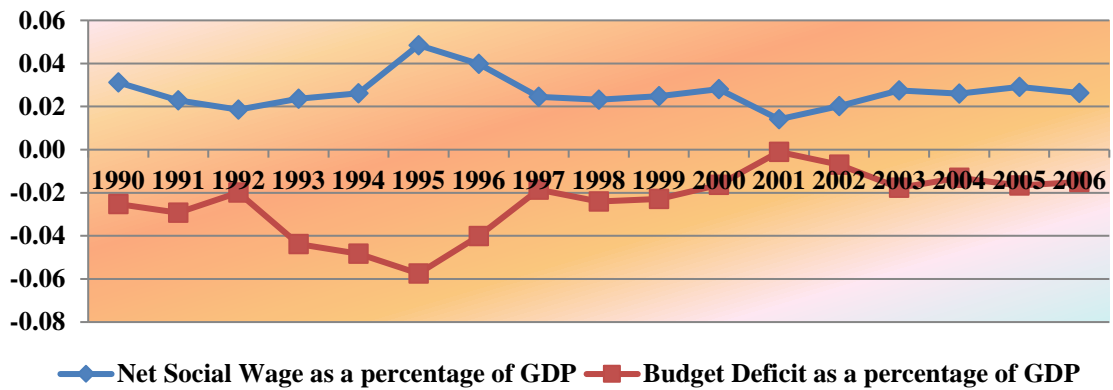
The net social wage declined to 7 percent of GDP in 1996 and stayed at 6 percent in all subsequent years except for one year, 2001, during which it declined to 5 percent. Once again, this trend is consistent with trend of unemployment rate, which stayed at 5 percent in all subsequent years except for 1996 and 1997 during which it increased to 6 percent. Let us add that the trend of net social wage estimated with the assumption of an incidence for consumption taxes would lead to a similar conclusion in terms of close association between net social wage ratio variation and unemployment rate trend. (See Figures 8 & 10)

There is also a close association between the trend of net social wage as the percentage of GDP and the ups and downs of the share of budget deficit in GDP. This ratio steadily increased from 1992 to 1995. The budget deficit was 2 percent of GDP and increased to 6 percent in 1995 and returned to 2 percent in 1997. Budget deficit remained mostly at about 2 percent of GDP except for 3 years in which it decreased to 1 percent and one year, 2001, in which it was reduce to 0.0 percent. This is well within the range set by the European Union.

Austrian public debt has fluctuated between 59 percent and 68 percent of GDP in the last 10 years. In the more recent year (2010), her public debt was \$67 billion or 61 percent of her GDP. (Austria Public Debt 2010) Under the EU's Stability and Growth Pact, euro-zone members are bound to maintain public deficits below 3.0 percent of GDP and public debt at less than 60 percent of GDP. They are also expected to work towards balanced budgets and even surpluses in times of economic growth. The debt to GDP ratio stayed within the 65 to 70% range right up to the global financial crisis of 2008. That event caused the Austrian national debt to rise quickly for two years. Under post-crisis conditions, this range has been higher at between 80 and 85% up to 2016. This ratio has, however, declined to 73.8% in 2018 (see [tradingeconomics.com/austria/government-debt-to-gdp](http://tradingeconomics.com/austria/government-debt-to-gdp))



**Figure 9. Net Social Wage & Budget Deficit as a % of GDP  
Austria (Counting Cons. Taxes)**





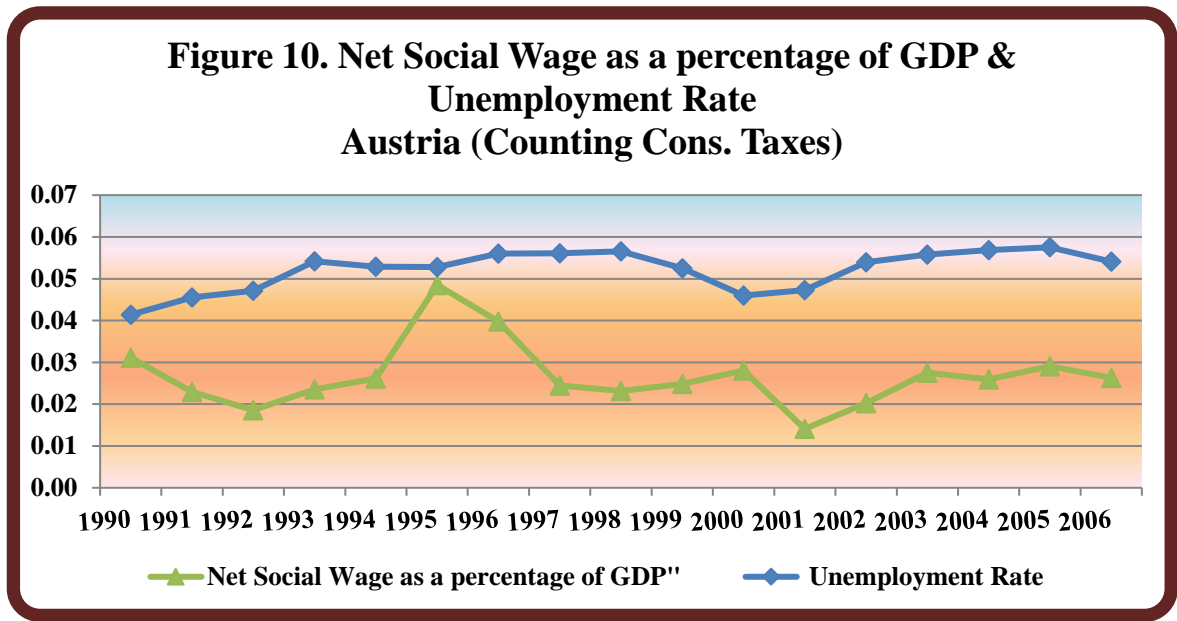
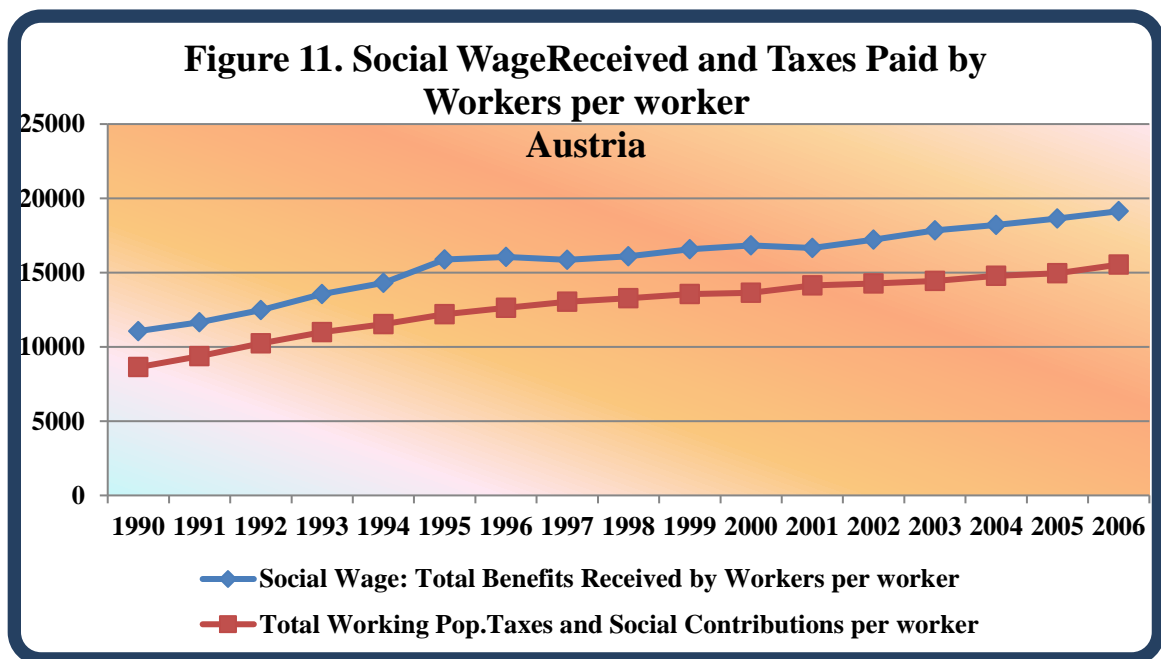


Figure 9 displays the association between the net social wage ratio and budget deficit and Figure 10 between net social wage ratio and unemployment rate. These two figures are based on the second assumption of production tax incidence. Figures 9 and 10 confirm our earlier discussion based on Figures 7 and 8 assuming no production tax incidence for the working population.



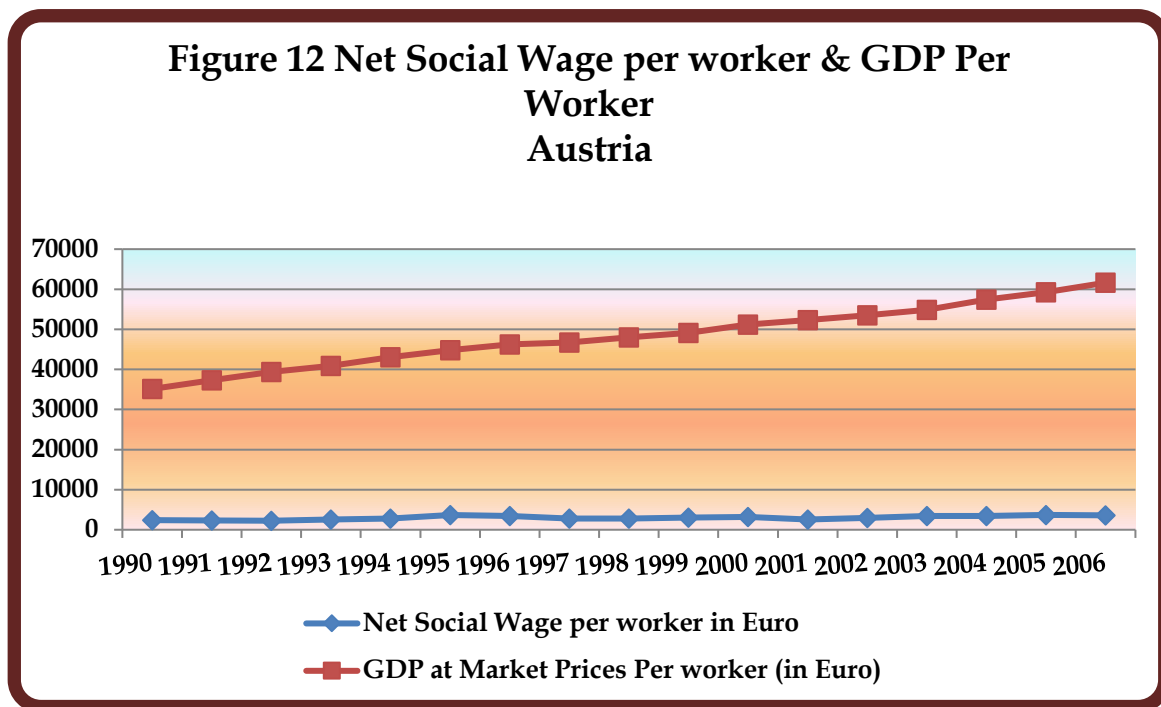


Figure 12 shows that while GDP per worker has been increasing at a reasonable rate, the net social wage per worker has remained rather stable. Thus the growth of the net social wage has remained well within the productive capacity of the Austrian economy and has not been a drag on economic growth.

In comparative analysis, the recent development of the European welfare state has been characterized as a set-back compared to the preceding decades, described as the end of ‘the golden age of the European welfare state’<sup>2</sup> and the emergence of a ‘neo-conservative turning-point’.<sup>3</sup> Jessop explains this pattern as the outcome of the economic crisis, starting from the 1970’s and the loss of social consensus on the ‘Fordist’ growth model, which had supposedly described the earlier decades after the Second World War. In his view, the recent decades can be characterized as the ‘erosion of the nation state’ and the gradual displacement of the ‘Keynesian welfare state’ by a new model that he identifies as the ‘Schumpeterian workfare regime’. (see Talos and Fink 2005: P131)

On the other hand, the evidence shows that retrenchment policies have not strongly undermined the provision of social welfare programs in Austria and other continental welfare states. The results of our study confirm that neither the conservative challenges and nor the forces of globalization have succeeded to dismantle the Austrian welfare states. We should, however, indicate that social spending as a share of GDP has stagnated or has been growing at a slower rate than the earlier decades. “Ever since the postwar economic boom ended in the early 1970s, however, social programs have faced mounting political challenges. Questions of expansion have long since given way to an acknowledgment of the limits to welfare state growth and the prospect for extended austerity.” (Pierson 1996) In reality, the politics of social policy retrenchment has not posed a major challenge to the existing welfare state programs. “International comparative research still underlines the substantial stability of the welfare state, and that earlier growth has given way to stagnation of a relatively high level of social security.” (Talos and Fink 2005: P132)

The other question is to what extent, the current and future development of the Austrian welfare state depends on the European trends of social policy. The European political system, which many scholars expected to be an incipient form of European national state, is now, yet, struggling to move beyond the postwar national state. Since European national state lacks its own well-established institutional heritage of a national state character, the European political system also tends to draw on real national states to acquire its legitimacy. Whether it can break out of such paradoxes by developing a new European 'social contract' remains to be seen.

\* Anwar Shaikh's comments and contribution has been indispensable for this and other studies by the current authors.

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