The 100-year Welfare State?

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Clichés notwithstanding, the demise of the welfare state has been greatly exaggerated. Despite diverse interests, groups of capital and labor in rich countries, and other social actors have cohered in proclaiming that forces of globalization have undermined the viability of government social programs. The rub is that the actual effect of increased trade on social spending is not clear-cut. In fact, if the historical record is any indication, deeper trade integration and enhanced social policy have gone hand-in-hand.

Globalization is the handmaiden of the welfare state

To fix ideas, consider the so-called great wave of globalization before 1914. To many, the period was a prelude to the current wave of globalization. Set off by a sharp decline in transport costs—the steamship being the predecessor of large containerships and the telegraph the precursor of modern telecommunications—the decades before the Great War saw unprecedented movements in goods and capital. Indeed, by some measures, like the movements of peoples, the period before 1914 was more global than that of today. There was an inevitable protectionist backlash to insulate domestic markets and employment in both New and Old Worlds, although there were exceptions, like Belgium, the Netherlands, and the United Kingdom. Nonetheless, the fall in trade costs was so steep, that imports even in the most highly protectionist countries, for instance Spain and Italy, continued to mount.

It was no coincidence that many countries, especially in Europe, sought to offer increased employment protection in ways other than by closing the door to trade. States intervened in labor markets, adopting a wide variety of legislation on children and women's employment, and hours of work, and they initiated support for pensions, accident compensation, and unemployment insurance. These reforms lay the basis of the expansion of the welfare state in the mid-twentieth century.

The relation between the effects of the decline in trade barriers on wages and employment were the same as today. The increase in trade raised the degree of uncertainty faced by workers in sectors of the economy exposed to international competition. Competition was most intense in sectors like textiles, since most countries had a domestic industry that manufactured standard or undifferentiated items being shipped over increasingly long-distances as trade costs collapsed. Moreover, paralleling developments today, low and high-wage countries had access to the same basic technologies to produce standardized goods. In rich countries, the demand for government intervention was greatest in these types of activities due to the high degree of substitution between domestic goods and imports. Labor realized many of its objectives where it joined a wide coalition, a big tent of domestic and international reform groups pushing for improved working conditions for women and children. This type of coalition building was essential in the Belgian case, which I expand on below. The trouble was that, in the competitive environment of the late nineteenth century, states acting alone to improve working conditions faced the risk of 'social dumping' or a 'race to the bottom' caused by their rivals' weaker labor laws.

The response of states is illuminating because it foreshadows today's concerns regarding the impact of migrant workers on social entitlements in host and destination countries. States had made commitments to their constituents on the degree of social protection that they would offer. More broadly, states conceived of the social contract as part of the wider movement to inculcate citizenship. In this regard, the nation state before 1914 was the creation of globalization, and not antithetical to it. The concept of citizenship was also extended to migrant workers who were eventually integrated in the grand bargain.

The French experience illustrates the evolution of the state's engagement in upholding its side of the social contract. Initially, Italian migrant workers in the French textile industries were the victims of much hostility. Immigrants were perceived as a threat to domestic workers because they undermined wages and employment conditions. In order to protect its commitments to its own workers, the French state sought a means to improve labor conditions in Italy. This would alleviate pressures on the French social contract. To this end, shortly after the turn of the twentieth century, France and Italy signed a trade agreement. In an appended social clause, the French provided the Italians with larger market access in the hexagon; in return, the Italians agreed to adopt improved employment legislation, thereby reducing pressures on the French social contract. In the decade before the war, these types of social clauses were common in commercial treaties. Because these agreements were in the main between two parties, the appended social clauses had much lower negotiation costs than today's attempts at fixing labor standards in international treaties that require the signatures of multiple parties.

Attempts by the WTO in the early twenty-first century to attach social clauses to trade agreements have not been as successful, in part because of the lack of consensus between rich and poor countries. Emerging countries, like India, view attempts by richer countries, like the U.S., to impose labor standards as a strategy to close off their markets—the equivalent of increased tariff protection—because it makes goods produced in poorer regions more expensive. The bilateral agreements of the first wave of globalization serve as a template to address this problem. The virtue of these agreements was that countries retained control over the policy agenda, regulating the type of labor conditions best suited to their competitive advantages. In the example I have given, Italy had the ability to negotiate the type and scope of social policy adopted. In this regard, domestic concerns were complementary to external pressures. The bottom line was that the nation state and globalization were partners and not antagonists.

The welfare state as a driver of globalization

The relationship between trade and social spending was two-sided. Restrictions on the hours and the ages of women and children effectively reduced the potential labor supply available to firms. In this way, limitations of supply raised the wages of those working or able to work, especially at the low end of the wage distribution, because this segment of the labor force replaced women and children directly affected by the new laws. Labor regulation was therefore a type of income distribution. From employers' perspective, regulation raised the price of labor relative to that of capital, giving firms the incentive to replace labor with machines. In this fashion, it became viable for countries abundant in labor to adopt the best practice techniques of industrial leaders where labor was relatively scarce. The new techniques were operated by skilled labor. The implication was that in the process of adopting new labor laws, countries manufactured and traded more high-valued goods.

The Belgian experience provides an example of the effects of labor regulations on the type of goods produced, and industrial structure more largely. The country was a laggard in the adoption of labor laws, but it also experienced a trade boom, mainly in cheap textile products. Because of growing domestic and international pressures, beginning in the late nineteenth century, the Belgian government adopted a package of social reforms. The effect of the labor laws was manifested in the mix of export products. The country began exporting high-end and complicated goods, like tramways. Even in textiles, firms moved up the product ladder, selling specialized goods in niche markets to faraway destinations. By 1900, Belgium sold tramways to 40 destinations and textiles to as many as 60. The increase in trade in differentiated goods had implications for the effects of globalization on wages, because workers in these sectors were more insulated from international competition than workers who produced standardized goods. There was an added feature of increased exports of specialized goods. Since competition was attenuated in these types of markets, firms had more leeway in pricing. In essence, the export of high-end and specialized goods meant that consumers and producers everywhere assumed some of the costs of social policy because they paid higher prices. As a result, even a small, open economy like Belgium could have a large and successful welfare state.

The feedback mechanism between trade in specialized goods and social policy has been a neglected aspect in the long history of the relationship between globalization and the welfare state. To achieve the benefits of economies of scale, firms specializing in differentiated goods required larger markets. At the same time, heightened product differentiation reduced the risks and uncertainty faced by workers exposed to increased economic integration. More trade begat more social spending which begat more trade. Tellingly, in contrast to the latest wave of globalization, in the decades before 1914 international groups of social reformers and organized labor were less skeptical about the benefits of trade. Indeed, in certain contexts, they became ardent supporters of free trade, the presence of countries isolated from trade actually increasing and not reducing the threat of a race to the bottom.

The complementarity between trade in specialized goods and social spending was most evident in the European core since trade in these types of goods was well developed on the continent. The relationship was much weaker in North and South America since trade in resources was dominant in the region. In this regard, the rise of the welfare state before 1914 was very much an Old World affair. The New World chose tariff protectionism and immigration restrictions to isolate workers from the risks of globalization.

Does the welfare state have a future?

The trend in specialized trade mirrors the history of the welfare state. On the continent, social spending swelled as trade in differentiated goods surged. Because the European Union and its predecessors actually diverted trade, which meant that trade among members intensified and that between Europe and other regions diminished, the relationship between trade and social spending was actually strengthened. The story in North America was similar. As Canadian exports of specialized goods to the U.S. increased, so did the commitment of Canadian governments to social spending.

After one hundred years, the epoch of trade in differentiated goods appears to be drawing to a close. Ever more fragmented globally, manufacturing in poor countries has increased at the expense of the old industrial core. Some, like Paul Krugman, have predicted the (re)ascendancy of factor-endowment trade, that is trade based on the abundance of labor, natural resources, and capital, like that which existed before the adoption of labor laws.[1] In this scenario, the exports of low-wage countries have detrimental effects on the distribution of employment and income of its commercial partners. From the perspective of rich countries, the future of welfare states would appear dire. The inevitable demands for unemployment insurance and other forms of social protection will prove difficult to meet since, in the new global trading regime, the opportunity of shifting of the costs of increased social spending onto consumers and producers around the globe will diminish.

Taking a historical lens, however, fears of the end of the welfare state may be overblown. To begin, a rise in unionization in poor countries has accompanied the shift toward manufacturing. Domestic pressures for better worker protection have been buttressed by international reform groups, exactly as transpired in the first wave of globalization. It may be the case that industrial relations in Asia and Africa do not look like the western ideal, and that welfare states in developing regions will not mimic those of Belgium, France, or even that of the U.S. But there was never a one-size-fits-all model even in the heyday of the welfare state. Perhaps the deeper historical lesson is that cutting off newly industrialized regions from richer markets only delays the progress of social reform across the globe. Increased integration, and not less, would appear the best antidote to secure and preserve welfare states everywhere.

Further reading

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[1] Krugman, P. “Trade and Wages Reconsidered”, *Brookings Papers on Economic Activity*, spring 2008, p. 103-49.