"The state has less and less room for maneuver"

As Director at the **Max Planck Institute for the Study of Societies** in Cologne, **Wolfgang Streeck's** research focuses on the tension between democratic politics and the capitalist economy. In this interview, he speaks about the consequences of fiscal policy decisions, such as the establishment of a debt brake, the cutbacks required as a result and the shared liability for debt in the eurozone.

INTERVIEW **RALF GRÖTKER**

In one of your essays, you speak about how politics in democratic countries is finding itself increasingly in a straitjacket. How did it come to this?

WOLFGANG STREECK: Governments have fewer opportunities to be proactive. This is related to the fact that the share of public budgets available for discretionary spending has long been decreasing. On the income side, it is particularly noticeable that tax receipts have been stagnating in the wealthy democracies since the late 1980s. This is because there is ever greater competition between states for lower tax rates, particularly when it comes to high incomes. On the expenditure side, the governments of developed societies are faced with increasing demands for social investment and social repairs in many areas. Here in Germany, for example, it was agreed a few years ago that kindergarten places will be made available for all children from the age of one. Initiatives like this cost money!

Elsewhere, you have noted how the maturing of social security systems is cutting deeper and deeper into budgets.

The longer social security systems exist, especially pension funds, the more something like a compound interest effect becomes noticeable. Initially, the system has only contributors, but as time goes on, the number of recipients increases. Over the long term, the aggregate claims of beneficiaries become bigger and bigger. The entire system has a sort of built-in dynamic: the older it gets, the more expensive it becomes.

Could this effect not have been foreseen?

It's easy to ask this kind of question in retrospect. In the 1970s, however, when the social-liberal coalition agreed on the final shape of the German pension scheme, an annual growth rate of 5 percent was assumed for the following 20 or 30 years. Hardly anyone doubted this figure. It wasn't until the end of the 1980s that it became clear that the economy wouldn't continue to grow at this rate. If the rate of growth is miscalculated by even half a percent over such a long period, this makes a fundamental difference to overall expenses.

Is the compound interest effect underlying the pension system the biggest problem for our social security system and the federal budget?

People like to harp on the rising fiscal burden caused by pensions in order to create conflict between the generations and distract attention from the real problems. A whole raft of drastic pension reforms has been implemented in Germany since the 1980s. As a result, the standard pension, as it is known, that an average earner receives at pension age after decades of paying contributions is now verging dangerously close to the social assistance rate. >

Photo: Jürgen Bauer for the MPI for the Study of Societies

Wolfgang Streeck is interested in how the welfare state and the world of work are changing. These changes also affect the political attitudes of citizens.

» If it's true that the future of the rich societies depends on such factors as education, social integration and the ability to learn, then key investments must be made in precisely these areas.

On top of this, the statutory – and in recent years the actual – working life of citizens has increased significantly, even though current pensions are based on political negotiations that were carried out mainly in the 1970s, when the prevailing concern was how to convince employees to exercise wage restraint. This was an existential issue for companies: it was their way to generate the profits they believed they needed. The solution was often that unions accepted wages that were lower than what they actually could have achieved in negotiations had they used their market power to the fullest. In return, their members were promised higher pensions in the future.

As a result, a high proportion of current pensions are actually deferred wages, especially in Germany, where wage inflation has been relatively low. This, among other things, has given rise to a historical sense of moral entitlement that makes it difficult to cut pensions even more than they already have been. Not to mention the other problem looming on the horizon: In an increasing number of cases, interrupted or marginal employment histories are leading to pension entitlements that are below the poverty line.

You also described another issue that has been part of the overall trend since the post-war era: the growing influence of special interests – the increase in lobbying. Is there any empirical evidence for this trend?

We can see very clearly how the funding and staffing of interest groups grew continuously in the 1970s and 1980s. However, the criteria that we used in investigating interest groups during these decades already fail to work for the 1990s. The reason for this is a rising individualization in the pursuit of interests. In the past, every respectable interest association had an office in Brussels. Now, every large company has one. There is therefore less willingness to pay large contributions into the coffers of collective associations. At the same time, the structures that interest groups had established and that often resembled those of public bureaucracies have given way to a more flexible type of representation. More and more services are now purchased. These days, Brussels is the domain of American law firms working on behalf of interest groups and companies.

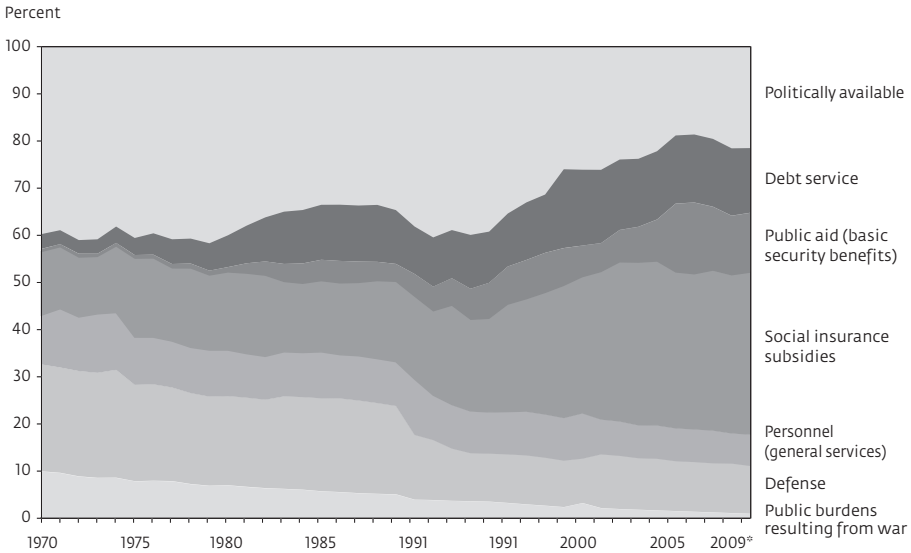
When will the effect of the straitjacket be seen?

Rising expenditures and declining revenues mean that states have less and less room for maneuver in their budgets – at least when they want to reduce public debt. And they have to try this at some stage, otherwise lenders get nervous. If a state then enters the consolidation stage, a large proportion of what it can still spend is already committed for fixed obligations. If a public budget is cut, its less flexible proportion increases. The question is whether the state can even respond to new demands with the remaining fiscal leeway.

A budget deficit doesn't necessarily mean lower expenditures in the future. Cutbacks need to be politically institutionalized – in an "austerity scheme," as you call it.

A lot depends on the institutions. The "debt brake," based on the German model, will be part of the European landscape in the future. States impose rules on them-

Share of politically available resources in the federal budget



(Source: Federal finance reports (Bundesfinanzberichte) 1970–2010, tables 2, 4) * Target

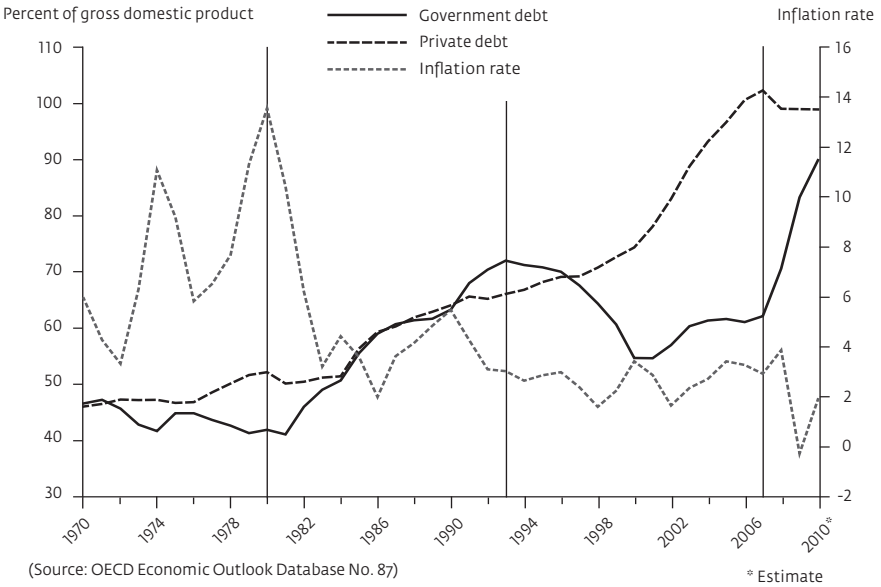
Increasing subsidies to the social security systems, rising costs associated with supporting the long-term unemployed, and interest payments on public debt are continuously reducing the German federal government's political discretion.
After the collapse of the Eastern bloc in the early 1990s, with the accrual of the "peace dividend," the budgetary room for maneuver expanded temporarily. After 2005, the Hartz reforms of the Red-Green federal governments and the consolidation efforts of the Grand Coalition began to have an effect. With the onset of the financial crisis, the leeway in the federal budget shrank again.

Graphic: MPI for the Study of Societies

selves by changing their constitutions, and future majorities will have very little power to do anything about it as they will need the agreement of the opposition. In Germany, in the coming years – when tax receipts are lower than they are today – we will be facing a situation in which the government will be acting unconstitutionally if it doesn't make further cutbacks. Constitutional debt ceilings have existed in the past, albeit in a less rigorous form, and the European Treaty on Monetary Union includes something akin to a constitutional debt ceiling. These were often not complied with. In principle, unconstitutional budgets are not a new phenomenon, including those formally declared unconstitutional by the German Federal Constitutional Court, but ultimately, no one can do anything about them. You can't jail the entire parliament.

If the proportion of the budget available for discretionary spending is getting smaller and smaller, this raises the question of where cutbacks can still be made. You examined how welfare spending is changing under the pressure of cutbacks ...

Crises of democratic capitalism based on the example of the US



(Source: OECD Economic Outlook Database No. 87)

* Estimate

Up until the early 1980s, increases in income and government revenues were achieved partly through inflation in countries like the US. Once inflation was curbed, public sector debt increased, also as a result of tax cuts. Later, when public debt became a political problem, the government deregulated the financial markets, allowing private sector debt to increase as a substitute for government debt. This ultimately led to the financial crisis in 2008, as a consequence of which public sector debt rapidly increased again.

Graphic: MPI for the Study of Societies; photo: MPI for the Study of Societies – Matthias Jung

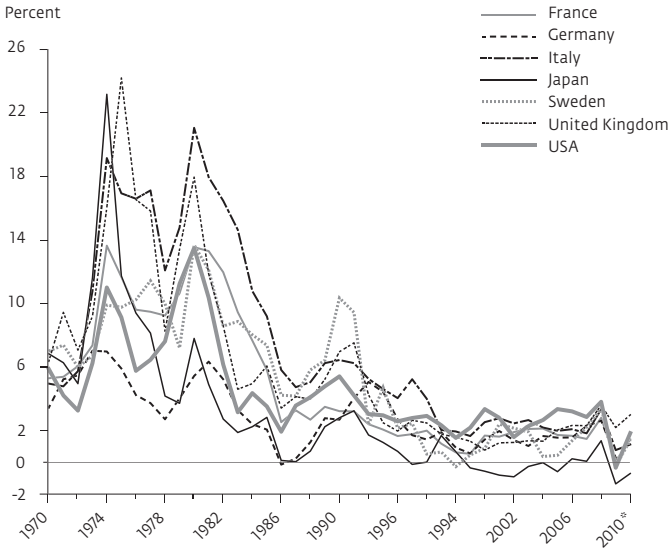
Not welfare spending, but social investment: spending on education, family policy, active labor market policy, and research and development. We are talking here about "soft" investments, in contrast to "hard" physical infrastructure such as roads and public buildings. In rich countries, a further expansion of hard infrastructure won't be able to contribute significantly to their economic potential. To date, however, the national accounts have included only these hard investments.

That is why we combed through the budgets of three countries for items that, according to a more modern interpretation, could also be described as investments, but of the "soft" kind. If the data is considered over an extended period of time, it becomes clear that our selection is reasonably close to the mark: the soft investments that we identified behave exactly like the physical investments over time. Both of them decline when budgets start to get consolidated.

You conclude from this that politics has fallen into a kind of vicious circle. If the government has to make cutbacks, it loses its power to shape policy and act as an advocate for the public interest. The legitimacy of politicians dwindles accordingly – and with it, the interest of citizens in politics. A situation tends to arise in which those who can afford it look after themselves – by taking out a private pension, for example – and everyone else is left on their own.

We have a distribution problem. In a democracy, public education must always aspire to ensuring that the next generation of citizens has an equal start in life. If a de-

Inflation rates in seven industrialized countries



(Source: OECD Economic Outlook Database No. 87)

* Estimate

Unemployment rates in seven industrialized countries

* Estimate

In most industrialized nations, inflation rose sharply until the beginning of the 1980s (left), not least because trade unions had pushed through significant wage increases in the previous decades. The end of inflation resulted in a significant increase in unemployment at the beginning of the 1980s (center). In response, trade unions accepted moderate wage increases, which, however, went hand in hand with a decline in their influence. This can be seen in the number of average strike days per 1,000 employees (right).

mocracy no longer performs that function, its legitimacy dwindles. Moreover, if it is true that the future of rich societies depends on such factors as education, social integration and the ability to learn, the key investments for the future must be made in precisely these areas. If, in the course of budget consolidation, cutbacks are made in these areas, we may perhaps restore the confidence of the financial markets in the short term, but we will damage the national economy's potential to prosper in the long term.

In a long-term analysis, you show the extent to which austerity, currently manifested in the debt brakes that have been adopted, is part of a whole series of crises in capitalism. These crises are unfolding according to more or less the same pattern in many countries.

The first crisis, or the first turning point, was the sharp increase in inflation seen in democratic countries in the 1970s. Inflation was a political response to declining economic growth – it represented a way of allowing the then-powerful trade unions to exert pressure on wages without adversely affecting profits, investments and employment in the short term. Thanks to progressive taxation, rising wages, including nominal wage increases, were accompanied by increased revenue for the government.

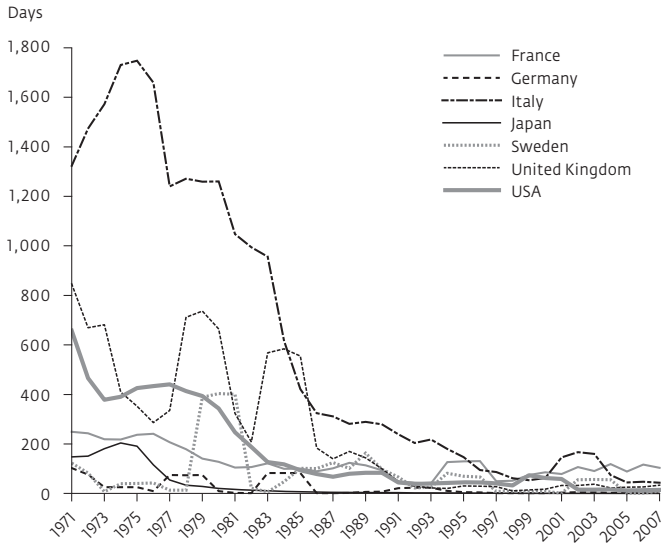
In the long term, however, inflation is a problem even for employment. That's why, in the early 1980s, it was fought and conquered worldwide. As a result, public debt increased: with the elimination of bracket creep, states now had to cover many of the claims that had previously been covered by – inflationary – wage increases. This was also only a temporary solution. When the interest payments on the public debt themselves became a major budget item, a global phase of budget consolidation began in the 1990s. In a number of countries, the fall in demand and the resultant loss of income were compensated for by deregulation of the financial markets, which facilitated rising private sector debt. Germany was a special case in this regard, partly because of reunification. It consolidated its budget only at a later stage and, as in the Anglo-Saxon world and, interestingly, in Scandinavia, the propensity to borrow is generally weaker in Germany. This development was accompanied by a change in the arenas of political conflict. Conflicts about income distribution first shifted from collective bargaining to government budget policy. The end of inflation coincided with a weakening of trade unions, and the consolidation of public budgets reduced the scope that governments had for political redistribution. Clinton's welfare reforms and our own Hartz reforms belong in this context. Today, conflicts about the extent and the limits of government policy have shifted to the financial markets and to international financial diplomacy. Trade union members and voters have a say only on the margins, if at all. Over time, government policy has been increasingly insulated from democratic pressure from below.

Is it politically rational for practically all parties to be in favor of shared liability for debts in the eurozone?

Nobody knows what the right solution is. In fact, current policy in Germany is driven mostly by pressure from the export sectors – both companies and employees –

Graphics: MPI for the Study of Societies (2)

Strike volume in seven industrialized countries



(Source: ILO Labour Statistics Database, OECD Labour Force Statistics; own Force Statistics; own calculations)

which have an interest in retaining the euro to maintain the stable conditions needed by exporters. Of course, you can't say to voters: "We need to persuade the Greeks to cut the pensions of their low earners so that their high earners can continue to buy BMWs."

So, for propaganda purposes, the euro must be associated as inseparably as possible with peace and international friendship. "If the euro fails, Europe will fail!" is an enigmatic statement, and all the more enigmatic the more one thinks about it. Would our shared cultural heritage – the idea of democracy, the diversity of languages, traditions and ways of life that make Europe so unique – disappear without the euro? What we are experiencing is, on the contrary, that the divisions between the peoples of Europe are dramatically increasing with the euro. This is not surprising, given this completely nonsensical project in which Brussels or Berlin are to monitor the public budgets of Greece and Italy for decades and are expected to tell the citizens of these countries what they can and can't afford. How will that ever work without making us figures of hate forever?

In my opinion, sooner or later we are going to have to think about a new monetary system for European states that takes into account the fundamental heterogeneity of European national economies. That means restoring the option of a controlled devaluation of national currencies in cases where an economy's competitiveness can't be regained by other means. There is no example of a monetary union that is as internally heterogeneous as the eurozone, except, perhaps, the union between Lombardy and Sicily, and its disastrous consequences, both economic and political, are for everybody to inspect.

Currently, the only option available to weaker countries in the monetary union is what is referred to as internal devaluation: cuts in wages and pensions, the brutal implementation of the entire neoliberal adjustment program as rapidly as possible. To do this, a government has to virtually declare war on its people. Do we want the EU to force the governments of the affected countries to do this? And even if that worked, which I doubt, it would be followed by decades of transfer payments from the North to the South – "Marshall plans," "growth programs," "structural aid," however you want to dress it up, on which voters in the northern countries would first have to be sold – at a time of shrinking budgets due to self-imposed debt brakes. ◀

TO THE POINT

- **Governments are losing their freedom to act because more and more spending is tied up for social security systems and debt brakes further limit their available resources.**
- **Due to budget cutbacks, "soft investments" in education, family policy, training for job seekers and research and development are increasingly being axed, damaging the potential for future prosperity in rich economies.**
- **Conflicts over distribution first shifted from collective bargaining to public finances. Today, struggles over the political capacity of the state are taking place in the financial markets and in international financial diplomacy. Trade unions and voters have only a marginal role in them, if any.**

Graphic: MPI for the Study of Societies; photo: MPI for the Study of Societies – Matthias Jung