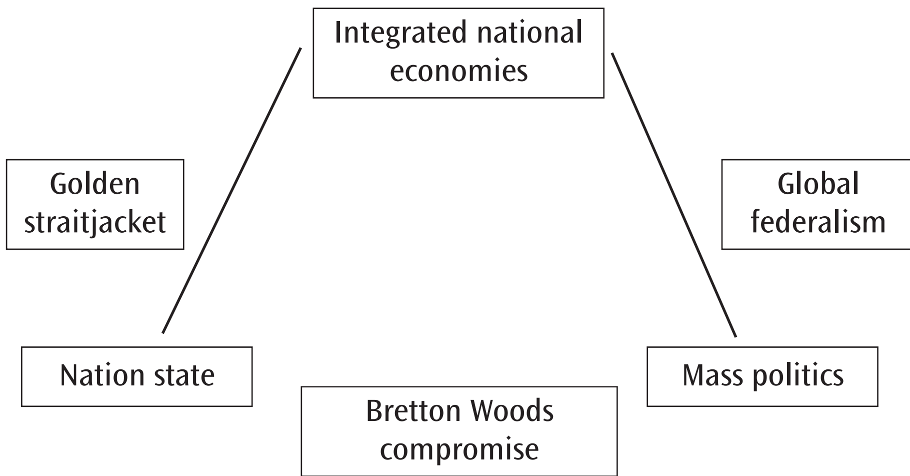
4

Welfare States and Globalisation

The issue of domestic policy response to globalisation appears in Rodrik's (1997; 2000; 2005) discussion of what he terms the 'political trilemma of the world economy' which, although not cast in terms of small economies, has resonance.

Figure 4.1. Augmented trilemma



The three nodes of the trilemma are international economic integration, the nation state and mass politics. The term 'nation state', as used here, refers to territorial-jurisdictional entities with independent powers of making and administering the law. 'Mass politics' refers to political systems where: (a) the franchise is unrestricted; (b) there is a high degree of political mobilisation; and (c) political institutions are responsive to mobilised groups.

The implied claim of the trilemma is that one can have at most two of these three things. If we want true international integration, we have to go either with the nation state, in which case the domain of national politics will have to be significantly restricted, or else with mass politics, in which case we will have to give up the nation state in favour of global federalism. If we want highly participatory political regimes, we have to choose between the nation state and international economic integration. If we want to keep the nation state, we have to choose between mass politics and international economic integration. …

The essential point is this: once the rules of the game are set by the requirements of the global economy, the ability of mobilised popular groups to access and influence national economic policymaking has to be restricted. … The price of maintaining

> national jurisdictional sovereignty while market become internationalised is that politics have to be exercised over a much narrower domain. Rodrik, 2000: 180

In an earlier work, Rodrik (1997: Appendix 1) argued that in a globalising world the bargaining power of labour in each country would fall, due to the ability of capital to move to locations which offered low wages with high productivity. This increase in the elasticity of demand for labour would reduce not only the ability of workers to organise to improve their conditions, but equally the ability of their national governments to intervene in their favour, since 'footloose' transnational capital can always move its operations to other, competing, jurisdictions. This reasoning drove Rodrik to conclude that the role of the state in a globalised economy becomes defensive and compensatory, refraining from confronting transnational capital in any proactive sense, but acting to top up low wages by increased provision of transfer benefits in cash and kind. An expanding welfare state, in short, is conceived of as a reflection of weakness and dependency in the face of global forces which are beyond the local jurisdiction's power to control, once the fateful choice of openness has been made.

Rodrik has a frame of reference which does not really extend to very small jurisdictions. He is thinking of political units of such a size that the labour force is fixed in place, while capital and goods flow increasingly freely across the borders of the state. As labour conditions are then depressed by the shift of relative power from labour to capital, domestic redistributive policies become inescapable if national government is politically accountable to the local 'losers' from globalisation. From here, the logic of Rodrik's analysis leads him to an argument for global federalism, on the basis that only at global level can the balance between popular forces and capital be made more equal again.

In sum, there are a number of highly influential studies arguing that social corporatism and centrality of welfare state provision (whether conservative, liberal or social-democratic in Esping-Andersen's (1990) typology) are most prominently encountered in smaller states for which globalisation presents the greatest instability and uncertainties, and where a political premium consequently attaches to social security in the face of adverse economic shocks.

However, these writings on small states, which limit their case studies to countries well above the 1 million mark (and generally focus on countries with populations of between 5 million and 10 million), suffer from a lack of engagement with the experience of the large number of small states which lie around or below that threshold.

The traditional welfare state works with disembodied aggregates and is designed to affect large homogeneous aggregates of citizens. As it emerged in its various forms in Europe and North America, it was a formal sector set of institutions and practices applied in the context of broad impersonal forces – industrialisation, proletarianisation, commodification of labour, alienation and anomie.[3] The welfare state provided a substitute for the security that individuals had previously experienced through the informal mechanisms of family, clan and community in pre-industrial society.

Because of economies of scale and scope, industrialisation has historically proceeded most dramatically in economies with populations above a threshold somewhere between 5 and 10 million. At these population sizes, impersonal statistical measures of welfare become relevant[4] and depersonalised policy interventions such as universal benefit entitlements become an efficient policy response. Similarly, as population size increases, economies of scale in the provision of public goods such as health and education become more obvious and it is efficient to install specialised facilities to cater for these needs, with the citizenry enjoying access as of right (with or without payment of user fees).

In contrast, in some small states, poverty and its consequences are expressed individually, and often confronted and resolved at the level of the village community. The need for the state to deal impersonally with large aggregates is reduced, meaning that universal benefits may be less effective than well-targeted individual support measures, while at the same time diseconomies of scale in providing specialised health and education facilities make it uneconomic to sustain a complete portfolio of services locally. For specialised health problems, transporting the patient to a larger country's facilities is the rational course of action, and giving local students scholarships to pursue advanced studies in larger countries makes more sense than trying to sustain world-class educational facilities at home. The increasing international mobility of people reinforces these considerations.

Considerations such as the above suggest that the welfare state as an institutional construct in its traditional form is likely to be less, not more, prominent in very small than in larger polities, because:

- The informal networks and personal support mechanisms for which the formal welfare state is a substitute are both more widespread and more likely to persist in very small states;
- Industrialisation and commodification of labour power tend to be limited in very small economies because of the absence of economies of scope and scale in production and because of the incomplete proletarianisation of the labour force (which encompasses retention of membership in networks of kin, clan, village and community, and the successful reproduction of informal support networks within society to provide the first line of social security protection);
- Public goods provision by the state becomes narrower in scope in very small communities because services requiring highly-specialised facilities (e.g. universities and research institutes) and that are subject to large economies of scope and scale (for example hospitals or specialist surgery) are more 'footloose' (apt to locate in higher-yielding locations in larger countries, with the client base becoming internationally mobile in order to access the services – the service itself, in other words, is outsourced). Note here the funder-provider split issue: insofar as it is the willingness to fund health and education that distinguishes the welfare state, rather

than the direct provision of the services in kind, it is problematic to insist that provision of the service must take place within the home territory as a defining part of the definition of a welfare state.

Since it seems that population size correlates positively with some forces that favour the welfare state but negatively with others, it is unlikely that a linear inverse relationship will exist between population size and prevalence of formal state welfarism across the whole size spectrum. The need for social security mechanisms may increase as population size falls, but the endogenous ability of a society to respond to that need by informal bottom-up mechanisms based on family, community and personal relationships rises sharply at some point on the descending size scale, reversing the trend towards greater state provision of welfare and substituting away from such formal mechanisms towards a greater reliance on social networks and personal relationships.

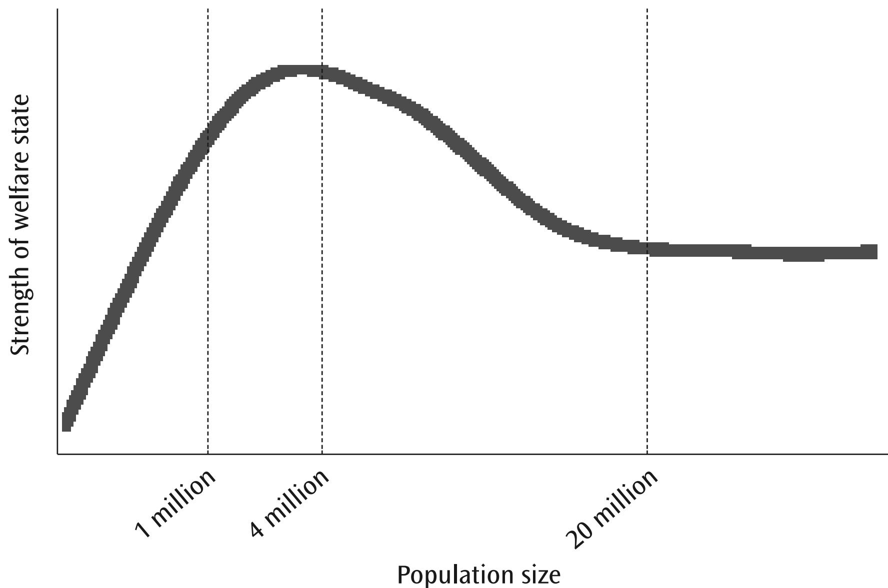
This suggests the relationship between the prominence of welfare state institutions and population size shown in Figure 4.2.

The population thresholds in Figure 4.2 are impressionistic at this stage. Four million is the smallest country in Cameron's (1978) sample from which he derived a linear relationship between 'openness' (the ratio of trade to GDP) and the share of tax revenues in GDP. Katzenstein's (1985) book similarly makes the case for smaller states to exhibit greater social cohesion and welfare state corporatism on the basis of a survey of countries with populations above 3–4 million. Hence in Figure 4.2, over the range from 3–4 million to an arbitrary 20 million, I have drawn the Cameron–Katzenstein relationship, with welfare statism rising as population falls. But to the left of 3–4 million I have hypothesised that this relationship cannot be extrapolated out of the sample into the population size range below 1 million, because in this size bracket the countervailing advantages of informality and non-governmental social networks provide an increasingly efficient and cost-effective substitute for the welfare state.

In the extreme case at the left-hand end (Pitcairn Island with its population of around 50), a welfare state may not be necessary since Pitcairn Islanders routinely travel to Australia, New Zealand or the USA to access most government-provided services, and the means by which budgetary grants from New Zealand and the UK are disbursed to enable island residents to purchase the imported goods and services which underpin living standards on the island are not the formal benefits or social security provisions of the welfare state, but highly personalised payments for services provided.

If the extreme case is accepted as an anchor at the left-hand side of Figure 4.2, it is obvious that the Cameron–Katzenstein relationship must have a maximum at some point – I have put it at around the 3–4 million population mark in the figure. A number of small states around the one million population mark have elements of a partial welfare state about them (Mauritius, Fiji Islands), but they are less clear-cut than countries around the four million mark.

Figure 4.2



Of the eight states in the world that have populations of between 1.8 million and 3.1 million population only two – Slovenia (2 million) and Armenia (3 million) – come close to the levels of industrialisation and economic development generally associated with the welfare state, and neither would qualify as a leader in terms of state welfarism. (Uruguay, a well-established welfare state from the early twentieth century, has 3.5 million; New Zealand and Ireland – both of which have stronger welfare states than Uruguay, though they are similarly exposed to Katzenstein's external instability – have 4.1 million each.)

To study the impact of globalisation on local politics, the small state is an ideal laboratory. At the small state level, countervailing power is exercised against the negative side of globalisation in a variety of ways that depart significantly from the defensive, redistributive welfare state paradigm of authors such as Rodrik. First, labour becomes footloose alongside capital: workers move to high-wage locations as capital moves the other way. In the process, forces are set up which should ultimately, if reproduced on a larger scale, tend to equalise working conditions across countries, not necessarily on terms wholly favourable to capital. This in essence is the outcome which Rodrik had in mind in his advocacy of global federalism, but the mechanism is the market process of migration rather than the political project of constructing a global state.

Second, the domestic tax base in small states is commonly too small to sustain internal policies of redistribution. A self-contained welfare state requires some group in the community with high taxable capacity, from whom revenue can be extracted

to pay benefits to the disadvantaged. But the essence of being small is that the entire population shares much the same set of circumstances, driven by external forces. The redistribution that is required to compensate for the negative effects of globalisation is redistribution across countries, from the 'winners' to the 'losers' – not the redistribution within the nation state that is the focus of Rodrik.

Far from being defensive, the successful small state is of necessity pro-active, seeking means of drawing from developed countries transfers to small states. The mechanisms through which this process of implicit international taxation operates are many and varied, but two are of clear salience: 'aid' and trade subsidies. These trade subsidies, which in the past were offered mainly under the European Union (EU)–African, Caribbean, Pacific (ACP) trade agreements have been eroded under the World Trade Organization's (WTO) trade liberalisation agenda.

Smallness becomes overwhelmingly important in this context. When a large country extracts economic surplus from a smaller one, the process is generally perceived, especially by the population of the territory from which surplus is being removed, as a predatory exercise of superior power and force – what used to go by the name of imperialism. When the power relationship is reversed, however, the political dynamics are entirely different. Surplus flows (if and when it does) from the large and powerful to the small and powerless by the consent of the former's governing coalitions. (However, recent data shows that aid to small states has declined.)

Cameron's (1978) sample of 18 countries was limited to OECD member states, of which the smallest was Ireland, and the same limitation of case studies to states with more than three or four million population is found in Esping-Andersen (1990; 1996). In all these states, government is funded primarily by taxes on domestic output and income. There are no major aid-recipient governments and no major royalty-earners in Cameron's sample (his data end at 1975, when Norway was only just embarking on its role as an oil economy). To extend Cameron's regression results out of the sample and down to small states is likely to involve crossing an important qualitative threshold as external revenues rise in importance.

In the data, one relevant relationship to look for is the proportion of total government expenditure that is financed from overseas grants as distinct from revenue from local taxpayers. One hypothesis to examine is whether government payments of transfers in cash and kind to the home population will be greatest in those small states which have the readiest access to overseas grant and/or royalty funding of the fiscal budget, while restrictions on such grant financing (and on other forms of rent transfers) will induce corresponding restrictions on the extent of welfare state-type expenditures. The 'financing question', long familiar in welfare state debates in large countries, moves in the small states setting from a closed economy to an open economy frame of reference.

This is not a new phenomenon: Bertram and Watters (1985) noted a longstanding pattern of 'colonial welfarism' in the Pacific since the 1940s, as colonial powers such as New Zealand and the USA sought to raise living standards in their territo-

ries as part of the transition to decolonisation. They developed a model of the 'MIRAB' economy, an acronym which refers to the dominance of an economy by four economic drivers: migration, remittances, aid and bureaucracy. A central finding of Bertram and Watters' research was the 'jaws effect' that opened up in the government finances of New Zealand-related territories from the 1940s, as expenditure on public services and public sector wages and salaries rose far above onshore revenue (see Bertram, 1993). To see whether the jaws effect has appeared elsewhere, and if so, whether it has persisted, requires further empirical work.