

THE WELFARE STATE IN EMERGING-MARKET ECONOMIES

WITH CASE STUDIES FROM LATIN AMERICA,
EASTERN-CENTRAL EUROPE, AND ASIA

Edited by
CHRISTIAN ASPALTER

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Acknowledgments

While responding to changes in the world's economic systems due to a greater degree of globalization of the world's financial and production markets, this book sets out to fulfill three major functions. First, it attempts to explore new terrains of social policy in order to strengthen our theoretical understanding of welfare state development in general and, second, to bring together otherwise only very marginally connected parts of the world. Lastly, the book also studies the impacts on the social system that derive from economic, societal, and political changes of fast-developing—i.e., newly emerging—market economies, in the context of democratization, economic liberalization, and globaliation. A bulk of information and scientific evidence is the result of a long and extensive search for the best articles on the subject, over a period of two and a half years. *Voilà*—here they are, ten country studies from true experts in each particular field of study!

Of course, again I owe my deepest gratitude to the authors of book, especially for their patience and cooperation, which eased the process of copy-editing a great

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deal. Further, I would like to take this opportunity to thank my dear friend Praveen Priyadarshi in India, without whom I might have been rather lost in New Dehli. He was, at once, ready to lend me a hand, and pointed me out a number of key addresses without which I would not have been able to collect the information I needed for my study on India, part of which is being displayed in Chapter 7 of this book. Of course, I am also deeply indebted to all the wonderful people that I met in India, many of whom helped me a great deal. I apologize for not naming now the one or other person. My special thanks go to Pratap Shankar, Saurav Sinha, Sanjay Visen from the University of Dehli; Urmila Sharma from the Library of the Election Commission of India; Sanjay Kumar from the Center for the Study of Developing Societies; Dr. R.V. Rao from the Ministry of Health and Welfare; Professor B. Vivekenandan from Jawaharlal Nehru University; Ms. Aurora from the Parliament Library, and many others.

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Marco Polo and the Future of Welfare State Analysis: An Introduction

CHRISTIAN ASPALTER

In our time, the global economic system is restructuring, mixing and distributing the cards anew, with newly emerging comparative advantages and disadvantages across different countries worldwide. While businessmen and –women responded quickly to the changing economic realities created by now highly globalized capital and production markets, the academic circles in charge of analyzing, or at least documenting, such gigantic changes have been—that is, in comparison to the global business community—relatively slow in shifting its research foci or in adding new ones to their particular research agendas.

The *Research Center on Societal and Social Policy* (www.rcssp.org) has set out initially with the aim of promoting and strengthening new research activities especially on and in Asia due to the fast-rising salience of Asian societies and economies in today's world, and the rapid changes these societies undergo. Within short time, it has become possible for the *Research Center on Societal and Social Policy* to include other relatively less well-known, i.e. less well-researched, areas into its research agenda.

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This book is the outcome of such efforts to extend the scope and the depth of welfare state analysis to new shores (cf also Aspalter, 2003), in the way of Marco Polo who—seen from the perspective of the future—brought back an ample harvest of knowledge, a sheer incredible bulk of information from a new world that, profoundly indeed, challenged traditional world views and history. Slowly, but surely, then, traditional thoughts and theories had to give way to new ones that emerged as a reflection of one's own from new angles.

A still widespread believe (or should we say notion or myth), e.g., that Asia is an exotic place where everything has to do with apparently completely different cultures or ethics (cf e.g. Jones, 1993), the notion of which we construct from our emotional, subjective view of a distant onlooker, may become obsolete; and slowly facts of economic development, societal change, and democratization come to replace the theoretical house made up of particular, exotic notions on strange countries, with even more strange cultures. The obscure curtain created by the persisting idea that culture explains everything in Asia, to be sure, has to be lifted, and true facts—with the help of statistical, as well as qualitative, analyses—to be revealed. With new studies on the horizon, the putative (culturally interpreted) distinctiveness of Asia, and other less-explored countries, loses its ground (cf e.g. Kwon, 1998; Ramesh, 2000; Aspalter, 2001a, 2002a, b).

In short, places like Asia are not special anymore, not strange, but increasingly familiar—i.e., former “exceptions” have become today's “standard cases.” Asian countries, e.g., come to be understood as modern economies, with modern societies, with people whose eating habits, languages, operas, and family ties do not lay under an obscure layer of mist anymore. Now, the West ever more understands that the East is made of not much more than it is itself, i.e. modern democracies, modern economies, and modern people eating sandwiches, speaking English, listening to Andrea Bocelli and Amadeus Mozart, and, increasingly having modern-style nuclear families, living in high-rise buildings, voting for their presidents, and working for the same companies like people do in Europe and America—being members of a middle class in modern, wealthy, and democratic societies (cf e.g. Linz, 1989; Brown and Liu, 1992; Hsiao, 1993, 1999; Robison and Goodman, 1996; Hsiao and Koo, 1997; Aspalter, 2001b).

Other parts of the world, such as Latin America, have been romanticized as well. Brazil e.g. is famous for its music, coffee, barbeque, and the Carnival. But the modern Brazil with its high-rise buildings, new government policies and economic achievements continues to stay at the sidelines of international social research (cf e.g. Font, 1990; Tandler, 1997; Eakin, 2001). Chile, an even more vital economy, political entity and society, did not make it into mainstream social science circles either. Eastern-Central Europe, on the contrary, has—but only very recently—been able to attract more attention from its closest Western neighbors, and increasingly will so, due to the eastward extension of the European Union (cf e.g. Haller and Richter, 1994; Parnreiter *et al.*, 1999; Jaeger *et al.*, 2001; Volek, 2002).

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All three regions in concern here have one thing in common, that is relative neglect. Welfare state analyses and comparison, in Europe, North America, or the Antipodes, still miss out on current and past developments in Asia, Latin America and Eastern-Central Europe. Mainstream analysts still heavily concentrate on welfare state systems like those of the United States, the United Kingdom, Sweden, Germany, and Australia. And this is, perhaps, the main reason why theory building in welfare state analysis has been progressing so slowly and new, theoretical insights still hinge on every aspect of Reaganomics, Thatcherism, and Tony Blair's now so-called Third-Way policies.

This book is a small contribution indeed in attempting to spread the mainstream focus of international welfare state analysis to other, new, and certainly promising, countries. Emerging-market economies in Latin America, Eastern-Central Europe and Asia have set the stage for a new era in world economic (and political) history and, certainly soon, also a new era in applied and theoretical social sciences, such as the field of social policy and welfare state analysis.

In this volume, authors from three continents investigate the rise and the changes of welfare state systems in ten countries—these are Chile, Brazil, Czech Republic, Poland, Hungary, India, China, Malaysia, Taiwan, and South Korea. Chapter 2 written by David E. Hojman exemplifies the case of Chile. By dividing the Chilean welfare state experience into three periods that were accession to and the retreat from power of General Pinochet. Hojman delivers a more critical account of the history and current state of affairs of welfare provision in Chile. First, he reassesses the glory of the 1945-1973 period and, as a European, finds that the original welfare state settlement was not so shiny as it has been commented by others who were more displeased with the subsequent reforms of General Pinochet. Furthermore, he gives a rather positive, though in essence still modestly so, an account of the Pinochet years with regard to social reform and the alleviation of extreme poverty. The reforms of the 1990s, so Hojman, were extremely expensive and not cost-effective and resulted from the old historical connections (friendship economy) of government officials and those administrators and clientele that belong to parties participating in each government coalition. By the end of the chapter, Hojman has dealt with developments and the critique of labor market, poverty and inequality, health care, housing, and education in Chile.

Being also critical in nature, Chapter 3 elaborates the evolution, the problems, and the current developments in Brazilian social policy. Pedro Cesar Lima de Farias introduces in detail the Brazilian welfare state from its early onset in the late 1880s, to the reforms induced by the 1988 Federal Constitution, and to the most recent reforms that responded to economic globalization of the 1990s. Farias extensively concentrates on the universalistic character of the Brazilian welfare state system set up in the late 1980s, and the implementation of universal programs in the particular political and constitutional context of Brazil. The central message of the truly informative account of social security in one of the earth's largest countries is that

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the ongoing process of modernization (i.e., competitiveness-introducing reforms and the increased emphasis on growth-generating aspects of the system) will contribute to long-term economic growth and prosperity. Farias highlights the fact that in the second half of the 1990s Brazil—though not standing often in the spotlight of international attention—has managed the formerly unthinkable: a combination of stable democracy, stable economy, fiscal balance, administrative continuity, and growing social expenditures.

In chapter 4, Vojtech Krebs depicts welfare state development in, before, and after the fundamental regime shift from socialism/communism to capitalism and democracy. In doing so, Krebs seems to be less critical and more positive in his analysis, commenting on the success and achievements of social policy in a new democracy and newly liberalized economy. However, he does not abstain to proclaim the need for a new social program for the Czech Republic as a whole to foster social stability in the context of economic change and to encourage social policies that affect wide and varying groups of the population. Krebs sees social policy as a chief instrument to facilitate economic growth and restructuring, directly via social provisions, and indirectly via bolstering political support for the implementation of capitalism—that causes a great deal of new social hardships—on the one hand, and the accession to the European Union on the other.

In chapter 5, Stanislaw Kluza and Krzysztof Ostaszewski explore the recent Polish experience of reshaping its national pension system. After the regime change and President Lech Walesa's inauguration in the year 1990, insurance contributions began to sore and triggered a fiscal crisis of the state. By the mid-1990s, the financial crisis of the pension system has grown into a full-out pension crisis. Finally, in 1999, the Polish government succeeded in implementing major reforms that put an end to state socialism, and the unexpected vestiges of long-standing (communist) bureaucracy. Kluza and Ostaszewski draw the conclusion that the new system had now positively addressed and done away with the flaws of the old system—thus, encouraging incentives to work and save, stabilizing public finances, and lowering exorbitant replacement ratios without endangering the government's aim of alleviating poverty. Both authors see Poland as a model for other developing countries.

Chapter 6 presents the case of Hungary, and this, again, in a slightly less optimistic light than that of the last two chapters. In the first part of the analysis, Zoltan Karpati and Zsuzsa Széman provide a full analysis of Hungarian welfare state development, including employment policy, public health-care system, family provisions, the pension system and its reforms, and education. The authors then go on to examine the historical development and the status quo of social welfare provision by the civil sector. It is concluded that—which runs against the mainstream belief of welfare state experts in the Western Europe and the Anglo-Saxon world who specialize in third sector analyses—the civil sector “definitely cannot act as a substitute for a role by macro-level state policy.” Further, Karpati

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and Széman conclude that the present Hungarian welfare system is unable to counteract to the inequality-generating effects of the new market economy, which led to a wide dispersion of poverty among the populace and the formation of regional “getthos”—that is, highly underdeveloped regions in the Hungarian hinterland.

Chapter 7 depicts welfare state development in a truly mystical country, India. Christian Aspalter sketches different essential aspects of welfare state development, starting from the time of British colonial rule. In his analysis, Aspalter integrates a number of historical sociopolitical factors that, when put together, can fully explain the relative absence, the delayed and sluggish development, as well as particular successes of public policy in India, especially social policy. Aspalter examines the impact of a great number of social reforms and social movements, the unrelenting caste system, the political history, and the decisive Constitutional compromise laid down at the founding of the Indian Republic. He goes on to review welfare state development in India, paying special attention to the policy implementation process of the Indian State and Central Governments. Drawing a conclusion, Aspalter rejects the validity of so-called functional welfare state theories, in favor of conflict theories that focus on social and political conditions and constraints in the rationalization of welfare state formation and extension.

The case of the second demographic billionaire in Asia, China, is put forward in the following chapter (Chapter 8) by Nelson W.S. Chow and Christian Aspalter who deliver a rather critical account of the development of the communist welfare state system in the first place, as well as its current and future prospects. The authors are giving emphasis to the difficult time of the Great Cultural Revolution in accounting for the delayed development of the welfare state system in China, which is, as a result, still unfinished and highly uneven. In coping with the great burdens of financial difficulties, an fast-aging society (especially in the cities, due to its one-child-per-couple policy), and millions of laid-off former State-sector employees, the Chinese government began to erect an insurance-based social security system, to facilitate a greater pooling of risks, and to extend the coverage of the system, and prepare a gradual transition from a pay-as-you-go system to a fully- or partially-funded system. Chow and Aspalter conclude that the Chinese welfare state system is still one of protecting the strong and neglecting the weak, as only permanent workers in the cities are covered by the social security system.

In Chapter 9 on the welfare state system in Malaysia it is concluded, again, that emphasis on economic growth alone could not adequately deal with the social imbalances, which for a long time characterized Malaysian society. John Doling and Roziah Omar pay attention to different periods and areas of social policy in Malaysia. The welfare state system in Malaysia is based on economic growth—that is, full and continuous employment. Its Employees’ Provident Fund is a fully funded scheme resting on contributions from employers and employees alone. Besides recent macroeconomic changes that affected the welfare state system there

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are also threads arising from changes in the nature of the family and the role of women. Malaysia, as it is put forward, is not an exception but it reflects a great deal the very same economic and societal challenges of the welfare state systems such as in Europe and North America, with rapidly-aging societies, fast-dropping birthrates, a shrinking average size of the family, and, last but not least, a hefty increase in the female labor force participation rate.

The case of Taiwan is reviewed by Yeun-wen Ku (Chapter 10) who also stresses the importance of the social dimension in economic development and vice versa. Even though Taiwan was relatively immune to the economic crisis that affected most of East and Southeast Asia in the late 1990s, the economic turmoil still triggered a significant political crisis of legitimacy, since the government did not (so the author) pay enough attention to the problems of the people. After studying the Taiwanese economic performance during the time of the crisis, Ku looks closely at the social conditions and policy responses of the government. The rather limited scope of the government's response—despite the fact that the Democratic Progressive Party's policy agenda, so Ku, features characteristics of a social democratic party—has to be explained by the institutional constraints of democratic capitalism. Taiwan, certainly, continues to represent an attention-grabbing case for testing welfare state theory.

As revealed in Chapter 11, the South Korean welfare state system emerged even stronger out of the Asian financial crisis that hit Korea in December 1997. In his analysis, Soonman Kwon points out major improvements of the welfare state system, but, at the same time, he also criticizes several aspects of the Korean welfare settlement, with too high pensions that led to fiscal shortcomings of the pension system, high welfare benefits that do not address the problems of work disincentives, inadequate protection against income loss arising from illness, and the welfare system has yet failed to protect the very poor due to stringent eligibility criteria and limited benefits. Soonman Kwon calls for an expanded role of social policy to counteract the outcomes of an aging society, to look after weak members of society, and those who find themselves unemployed or in increasingly irregular jobs, and, of course, those completely out of work.

The future of Asia does not resemble an empty sheet of paper (this, though, has been suggested by e.g. some of my colleagues at a recent expert seminar held at UC Berkeley). On the contrary, it is increasingly visible, measurable, and an already incontestable fact that Asia is following the footsteps of earlier-developed countries pertaining to economic and social transformations—and the problems that emerge out of those very changes (cf e.g. Aspalter, 2000; Phillips, 2000; Vivekanandan, forthcoming). Welfare state systems in Latin America and Eastern-Central Europe were among the first countries in the world to set up national insurance systems, and, thus, must not be regarded as late-developers. Long-term political determinants in Latin America and Eastern-Central Europe, by and large, stand in contrast to fast—

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and very recent—political developments in Asia (especially in the case of Taiwan, South Korea, and China).

But with regard to globalization, we see in the case studies below that all three regions under scrutiny suffer from the same impacts, and that governments, as well as academicians, have addressed the issue by proposing an increasing role of the State in the realm of social policy, to counteract peace- and equity-disturbing economic factors that arise out of increased global competition and insecurity on the one hand, and breathtaking social and political changes on the other.

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2

The Welfare State in Chile

DAVID E. HOJMAN

The development of Chile's welfare state since 1945 is examined by dividing the period into three phases, corresponding to the years before, during and after the Pinochet military dictatorship (1973 to 1990). A welfare state was, and is, required because of serious problems of poverty and inequality, which predate 1945. Poverty was largely caused until the 1990s by a dualistic, Lewis-style, 'unlimited' supply labor market. Inequality has centuries-old historical and institutional roots. Current problems with health care and education are at least partly provoked by income and other inequalities, whereas current housing problems are related to more recent policy mistakes. The last section summarizes key conclusions and perspectives.

The development of a welfare state in Chile after World War II has both characteristics that are common to most emerging market economies, alongside unique features, which are specific to the Chilean case. Chile still has the most successful economy in Latin America, despite the considerable damage that the Asian crisis inflicted upon exports in 1997 and 1998. The facts and interpretations offered here are new. However, to some extent they also constitute an update on materials introduced previously by Hojman (1993) and Hiscock and Hojman (1997).¹ As we shall see, and in line with parallel analyses by other observers, the present assessment is less optimistic than the views prevailing among analysts in the mid 1990s.

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A convenient way of dealing with a long historical period is to divide it into shorter ones. The following discussion divides the post-1945 years into three phases, which coincide with the periods before, during and after the Pinochet military dictatorship (1973 to 1990). But it is also a fundamental assumption of the discussion presented in the following pages, that a satisfactory macroeconomic performance is a necessary (but not sufficient) condition for a decent welfare state. It does not make sense to expect adequate social conditions, supported by credible government guarantees, in backward and stagnant economies. In Chile, to a large extent poverty results from long-term and cyclical problems in the operation of the labor market. High inequality has been present in the country for centuries. Both past and present problems in the Chilean welfare state are largely provoked by this inequality. This is the reason why we look successively at the labor market, poverty, and inequality, before examining health care, housing, and education. The last section is devoted to summarize key conclusions and perspectives.²

The Three Periods

The “Lumpen” Welfare State: 1945 to 1973

The first period under consideration is 1945 to 1973. The origins of the welfare state in Chile predate 1945. The first manifestations of a welfare state go back to the 1920s, or even before (Mamalakis, 1976; Diamond and Valdes-Prieto, 1994; Raczynski, 2000). However, the post-1945 years differ from previous periods in that: (1) Chilean exports were becoming more stable following the ending of wartime disruptions to international trade; (2) tariff- and non-tariff-protected manufacturing for the domestic market was making gradual but steady progress; (3) internally there was political stability; and iv) social policies were stable. The country's governments during the period either were center-left coalitions or, with few exceptions, their social policies could not be distinguished from those of center-left coalitions. To a large extent, welfare expenditure during this period was financed either by taxation of export activities (largely copper) or by inflation (Mamalakis, 1976).

There has been some glorification of the quality of the social services in the 1945-1973 period. Observers have argued that during that period Chile enjoyed a welfare state, which was one of the most progressive in Latin America (which is possibly true, but then this does not mean very much), offering universal access to all of its citizens. This view is misleading, and it may have been, deliberately or not, largely generated by, or at least linked to the attempts to express opposition to, and rejection and repudiation of the economic and social policies implemented by the Pinochet military dictatorship after 1973.

Possibly a more accurate description of Chile's welfare state during the 1945-1973 period would be as a “lumpen,” or “proto-” welfare state. The quality of the social services on offer was so poor that anyone who could afford to pay for private

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provision did so. This applies to education, health care, housing and old-age pensions (or more accurately, personal arrangements towards retirement).³ Possibly the only exception was the use of accident and emergency units in public hospitals, for which there was no alternative, but even here users who could afford it were expected to make an out-of-pocket payment. The belief that provision was universal is a myth. For example, pension schemes, if present at all, were wildly differing, offering immensely better terms to the most successful among very diverse groups of rent seekers. Rural laborers were not allowed to join unions, and their overall wages (including non-monetary conditions and entitlements) were substantially lower than those of unskilled urban workers. Access to the state universities was free of charge, but in practice this represented a subsidy from the poor to the rich.

Some authors have chosen to give to the period's institutions the rather grandiose title of "*estado benefactor*" (welfare state). However, what was on offer could possibly be described more precisely as partial social assistance of very low standards, which was available to those who could not afford private provision. Clearly social conditions improved between 1950 and 1970 (the infant mortality rate fell from 129 to 82, life expectancy rose from 53 to 58 in men and from 57 to 64 in women, illiteracy fell from 20 to 11 percent (cf Table 2.1). However, the rate of improvement was not sufficiently fast to compensate for the very low starting point at the beginning of the period.⁴

Table 2.1
Chile: Social Indicators

	1950	1970	1990	1995
Infant mortality rate (per thousand live births)	129.0	82.0	16.0	11.1
Life expectancy at birth, years (men ; women)	53 ; 57	58 ; 64	71 ; 77	
Illiteracy rate (%)	19.8	11.0	5.4	4.6
Basic school enrollment in respective age group (%)		94.4	89.2	87.1
Secondary school enrollment in respective age group (%)		37.9	75.5	68.5
Higher education enrollment in respective age group (%)		7.8	11.3	18.0
Schooling of population economically active (years)		4.3	8.6	9.6
Urban access to drinking water (%)		66.5	98.0	
Urban access to sewer systems (%)		31.1	80.9	
Housing deficit (thousand units)		508	1095*	

Note: * Year 1986.

Source: Raczynski (2000).

The Free-Market "Solution": 1973 to 1990

The Pinochet military dictatorship introduced free-market, open-economy policies that represented a drastic change in relation to the state-fostered model of industrialization, which had been in force since the 1930s. Policy mistakes, negative external conditions and slow responses by economic agents combined to generate

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serious economic crises in the mid-1970s and again in 1982, with extremely negative labor market and social outcomes (see Table 2.2 for real wages and unemployment rates). Eventually the economy recovered in the mid 1980s and actually boomed towards the late 1980s and during most of the 1990s. Already by the beginning of the 1980s, the Pinochet regime was experimenting with and introducing new approaches to health, education, housing, retirement pensions, and extreme poverty. Thus, in both the economic and social areas, the role of the state became “subsidiary” (as opposed to the hegemonic role it had been playing in the economy previously).

The Pinochet social schemes will be examined in the following sections. However, some of the outcomes have been summarized in Table 2.1. In several areas (and although there were exceptions), social indicators improved much more dramatically in the 20-year period 1970 to 1990, than they had in the previous 20-year period, 1950 to 1970. For example, between 1970 and 1990 infant mortality fell from 82 to 16, life expectancy increased from 58 to 71 in men and from 64 to 77 in women, and illiteracy fell from 11.0 to 5.4 percent. Access to drinking water among the urban population increased from two thirds to practically universal, and access to sewerage increased from 31 to 81 percent. On the other hand, not everything improved. Enrollment in basic education, as a share of the respective age group, fell from 94.4 percent in 1970 to 89.2 percent in 1990, and the housing deficit doubled between 1970 and 1986 to over one million units (cf Table 2.1).⁵

The comparison between the periods before and after 1973, in terms of social policies and their effects, is difficult because the country’s main economic activities, demographic profile, rural-urban composition, social structure and political institutions changed (Hojman, 1993; Villablanca-Zurita, 1996; Jocelyn-Holt, 1998, 2000; Koch, 1999). But at least we know that, thanks to the development of a healthy financial sector and appropriate institutions, those middle and higher income families, who before 1973 used to rely on out-of-pocket payments for their health care needs and on their own personal arrangements towards retirement, now benefit from specific health insurance and fully funded private pension systems (however, these advantages did not become available to the poor and the very poor). Because of increased competition between suppliers, the quality of education available both to those who can afford to pay for at least part of it, and to those who cannot, has improved. The Pinochet dictatorship also developed highly effective systems of extreme poverty alleviation, although it could be argued that poverty and extreme poverty had been worsened, at least in the short and medium terms, by the dictatorship’s own policies.

Slow Progress and New Forms of Rent Seeking After 1990

Restoration of democracy in 1990 led to three successive civilian governments between 1990 and 2001, all by the *Concertacion*, a center-left coalition headed by

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Christian Democrats and moderate socialists. The free-market, open-economy model has been preserved, but some initiatives have been introduced in order to improve social conditions, and several others are under consideration or discussion in Congress.⁶ Again, these will be examined more carefully in following sections, but Table 2.1 offers a general summary of outcomes. Between 1990 and 1995, both infant mortality and illiteracy continued to fall, infant mortality from 16 to 11, and illiteracy from 5.4 to 4.6 percent. Enrollment in higher education as a share of the respective age group rose from 11 to 18 percent, and the average schooling of the labor force rose from 8.6 to 9.6 years. On the negative side, enrollment in basic education fell again, from 89 percent in 1990 to 87 percent in 1995. This is shocking in that almost one in seven children is being denied basic education, by governments which claim that their most important social aim is to fight poverty. Of course, enrollment is no guarantee of quality, and as we shall see, poverty and inequality are being perpetuated by the educational system, even among those enrolled.⁷

Elsewhere (Hojman, 1996a) we have argued that the Concertacion's anti-poverty policies are extremely expensive and not cost-effective. This is because each anti-poverty initiative is designed, discussed, implemented, publicized and assessed by huge armies of middle-class, middle-income "experts" of very low productivity. These are government bureaucrats or independent consultants whose main claim to their jobs is that they belong to one of the political parties in the government coalition, or that they have relatives or friends in powerful official positions. This is part of a more general pattern of rent seeking in Chilean society, which to some extent has very old historical roots, but which also developed new forms during the 1990s (Paredes-Molina, 1995; Paredes-Molina and Ramamurti, 1996; Hojman, 1996b; Pena-Torres, 1997; Rojas, 1998; Ortiz, 1999, 2000).

The Labor Market

Traditionally, the Chilean labor market was always unable to offer good, reasonably productive, and reasonably well-paid jobs to all those looking for them. This is true both before and after the beginning of the industrialization push in the 1930s (Mamalakis, 1976; Jocelyn-Holt, 2000). The country's labor market was always a dualistic case of "surplus" labor, or Lewis-style "unlimited" supply of labor. The only brief exception was 1971 to 1972, when an artificial "full-employment" bubble was engineered under macro and microeconomic policies, which were unsustainable in the medium term. This is why the labor market boom during the second half of the 1980s and the first half of the 1990s looks so spectacular (Table 2.2; cf also Hojman, 1996a). Between 1987 and 1994, the real wage rose by one third, and the number of those with jobs by 25 percent. By the mid 1990s the Chilean economy was no longer a dualistic one *a la* Lewis. Unfortunately, the labor market situation deteriorated with the 1997 Asian financial

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crisis, which damaged both prices and volumes of Chilean exports. Since then, real wage growth has stagnated and unemployment remains close to 10 percent.

These very favorable 1987-1994 results (which were in fact sustained for a longer period, of about ten to twelve years) came together with increases in the minimum wage, in the number of unions, in union membership, and in the number of workers covered by collective bargaining (Table 2.2). The Pinochet regime had introduced several measures to liberalize the labor market and make it more flexible, in areas such as dismissals, dismissal compensation, number of hours, and extent of applicability of the minimum wage legislation (Bronstein, 1997; Cortazar, 1997). Several of these measures were reversed, or at least qualified and their impacts mellowed, after 1990. However, most observers believe that in contemporary Chile improvement in real wages and increases in job numbers depend largely on macroeconomic expansion, rather than a favorable legal environment. Differently from other Latin American countries (or from Chile in the 1960s and 1970s), the educational standards of the labor force are largely appropriate to the demands of employers, and there are no serious problems of ethnic or geographical isolation. Thus, as the economy expands the labor market becomes tighter and wages and living standards improve.

Table 2.2
Chile: Evolution of Labor Market Indicators

Variable / indicator	1970	1983	1987	1994
Real wage, index, 1989=100	109	94	92	120
Minimum wage, index, 1989=100	237	114	84	132
Labor force, thousands	2890	4032	4315	5187
Employed, thousands	2720	3284	3912	4878
Unemployed, thousands	170	748	403	310
Unemployment rate, percent	5.9	18.5 27.0*	9.3 10.2*	6.0
Unions	4758	4401	5883	12109
Union members, thousands	628	321	422	662
Collective bargaining, workers covered, thousands	316	224	270	532

Note: * Includes emergency employment program (*Programa de Empleo de Emergencia*).

Source: Cortazar (1997).

It has been argued that both long-standing historical traditions and the legacy of the dictatorship in the 1970s and 1980s constitute serious obstacles to the

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modernization of labor relations (Albuquerque, 1998; Stillerman, 1998). While this is true, it should be seen in a long-term context. Cultural attitudes of employers towards employees have evolved very gradually, from for all practical purposes viciously genocidal immediately after the Spanish Conquest in the sixteenth century, to contemptuously patronizing in the mid and late twentieth century.⁸ Montero (1996, 1997) has shown that employer attitudes are changing but at different speeds, from very slowly (or not at all) in traditional activities such as clothing manufacturing, to much faster in more dynamic activities such as supermarket retailing.

Over the very long term, as labor becomes gradually more expensive, the cultural and psychological attitudes of employers towards their employees tend to become more 'civilized'. This process has been present in Chile's economic history for centuries, and it may have been accelerating since the mid 1980s. Unfortunately, a reversal has probably been experienced following the 1997 Asian crisis. Despite the fact that a moderate amount of mild rigidities or inflexibilities were re-introduced into the labor market after 1990, double-digit unemployment rates are possibly far above the country's natural unemployment rate, or "non-accelerating inflation rate of unemployment" (NAIRU). The modernization of labor relations is inevitable, but a depressed labor market means that, when this modernization eventually comes, it will have taken much longer than otherwise.

Poverty

Poverty may be defined in terms of income and in terms of access to goods and services capable of satisfying basic needs. When defined in terms of income, poverty, after increasing in the 1970s, had been falling in Chile during the late 1980s and early 1990s, in direct proportion to the extent to which the labor market became tighter (there are some figures for the 1960s but they are not as reliable as more recent ones). The poverty line is usually defined as twice the cost of a basket of essential foods. According to this standard, the poverty rate fell from 41 to 23 percent between 1987 and 1994 (Table 2.3). Extreme poverty (or indigence or destitution, equivalent to an income lower than one half the poverty line) fell from 13 to 5 percent during the same period.⁹ During the Pinochet years, the emphasis went towards state subsidies targeted to the very poor, in health care, nutritional supplements, housing, pre-basic education, pensions, and cash transfers. Among the main components of the dictatorship's approach, Huber (1996: 167) highlights "the emergency employment program, which in 1983 provided temporary employment to 13.5 percent of the labor force, health and nutritional programs for poor mothers and infants before and after birth, a means-tested school lunch program, and pre-school day care centers for poor children with nutritional and other health problems." This approach had some spectacular successes, for example in health

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and nutritional outcomes, but it was also criticized as expensive, stigmatizing and dependency-inducing.

Table 2.3
Chile: Income Distribution and Poverty, 1987 to 1994

	1987	1994	Change (%)
Gini coefficient*	0.547	0.530	
<i>Income Decile 10</i> (Pesos 1994)*	299,726	402,089	34
<i>Income Decile 9</i> (Pesos 1994)*	105,610	148,113	40
<i>Income Decile 7</i> (Pesos 1994)*	51,488	74,523	45
<i>Income Decile 4</i> (Pesos 1994)*	26,701	39,266	47
<i>Income Decile 2</i> (Pesos 1994)*	16,205	24,127	49
<i>Income Decile 1</i> (Pesos 1994)*	9,036	13,469	49
Ratio <i>Deciles 10 to 1</i>	33	30	
Ratio <i>Deciles 9 to 1</i>	12	11	
Ratio <i>Deciles 10 to 2</i>	18	17	
Poverty, headcount (%)**	41 47	23 29	
Indigence (%)	13	5	

Notes: * Real household income corrected for family composition and including all subsidies;

** Respectively, with low (defined as twice the indigence line) and high poverty lines.

Source: Ferreira and Litchfield (1998).

A continuation of this pattern, namely, the incidence of poverty evolving both with the labor market and with special anti-poverty policies, should be expected towards the beginning of the twenty first century and beyond. As macroeconomic expansion has become slower since 1997, the speed of decline in the poverty rate also diminished. Special programs for the very poor will continue to play an important role. However, some negative signs have already been appearing during the mid and late 1990s, in, for example, the increase in the number of children excluded from basic school enrollment (Table 2.1), the fall in the share of those insured by private health insurance companies in the lowest quintile (Table 2.4), and the increase in some types of crime (Table 2.5). In addition to the already mentioned rent-seeking activities in the poverty-alleviation industry (Hojman, 1996a, b), policy mistakes have also damaged the anti-poverty effort in areas such as housing.¹⁰

Table 2.4
Chile: The Private and State Health Subsystems (ISAPRES and FONASA)

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	1984	1990	1994	1997
ISAPRES (run by the private sector)				
Beneficiaries (as % of population)	3.1	16.0	26.2	26.5
Contribution by member (thousand Pesos, 1997)	356	310	287	317
Expenditure by beneficiary (thousand Pesos, 1997)	134	129	125	143
Subsystem budget (as % of GDP)	0.4	1.4	1.8	1.7
Members as % of quintile population, Q5		41	51	55*
Members as % of quintile population, Q4		22	34	35*
Members as % of quintile population, Q3		11	22	23*
Members as % of quintile population, Q2		6	14	15*
Members as % of quintile population, Q1		3	6	5*
FONASA (run by the state)				
Contribution by member (thousand Pesos, 1997)	26	45	68	85
Expenditure by beneficiary (thousand Pesos, 1997)	38	44	79	93
Subsystem budget (as % of GDP)	2.9	2.1	2.7	2.7
Fiscal contribution (as % of budget)	43	38	47	49
Members' contributions (as % of budget)	33	43	32	32
Out-of-pocket payment (as % of budget)	12	8	6	7

Note: * Year 1996.

Source: Titelman (1999).

Table 2.5
Chile: Crime, Index Numbers

Year	Theft	Murder	Theft with murder	Theft with violence
1977	100			
1980		100	100	100
1981		117		
1982				94
1983			35	183
1986	226			
1989	187			125
1991	242	87	108	206
1992		88	94	166
1993	215			

Source: Fruhling and Sandoval (1997).

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Inequality

Differently from the poverty rate, which experienced dramatic fluctuations in recent decades, but with a long-term trend, which suggests the possibility of gradual decline in the future, the pattern of income distribution has remained remarkably stable. The ratio between average incomes of the top quintile and the lowest quintile (Q5/Q1) was exactly the same during the Alessandri government, 1959 to 1964, and the Aylwin government, 1990 to 1993—that is, 18.1 (Marcel and Solimano, 1994: 219; Raczynski, 2000: 129).¹¹ Ferreira and Litchfield (1998) believe that there are very good reasons for the stability of inequality between 1987 and 1994 (cf Table 2.3), related to equilibrium between the supply and demand for labor. A thorough examination of the impact of policy, with emphasis on the period after 1973, has been provided by Scott (1996; cf also Gindling and Robbins, 2001). In any case, regardless of how this stability of inequality is explained, the fact is that income inequality in Chile is excessive. In the early 1990s, the Q5/Q1 ratio was estimated by the World Bank at 5.6 for France, 5.1 for Italy, 5.4 for Spain, and 5.6 for the United Kingdom.¹² Chile's income distribution is worse than the Latin American average. However, if the top decile is excluded from the calculation, the country's distribution becomes the best in the region (Mizala and Romaguera, 2000: 398; cf also Table 2.3).

This pattern of unchanging income inequality over time (constant or almost constant Gini coefficient; the same Q5/Q1 ratio) has very important negative implications. The gap in absolute incomes between the top and the bottom of the income distribution pyramid becomes larger and larger. This is evident from Table 2.3. Despite the fact that there was a marginal fall in inequality between 1987 and 1994, as measured by Gini or Q5/Q1, the gap in absolute incomes between *Decile 10* and *Decile 1* increased, from about 290,000 to about 390,000 Pesos of constant purchasing power. By the end of this seven-year period, *Decile 10* was better off by over 100,000 Pesos, whereas *Decile 1* was better off by about 4,500 Pesos. This is arithmetically straightforward, or even trivial, but its negative consequences in terms of alienation, disappointment, feelings of exclusion, damage to the social fabric and to social capital, and increase in crime, may not have been sufficiently understood.¹³

Health Care

In the early 1980s, the traditional system of health care, as described above, was replaced by the introduction of compulsory health insurance for all wage and salary earners. The provision of health insurance and health care was explicitly divided into private and state suppliers. All employees pay 7 percent of their wages or salaries to a health insurer of their choice. If they go for the private subsystem

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(ISAPRES), they must also choose an individual health insurance company, or ISAPRE. Even if they go for the state subsystem (FONASA), they may choose between different consultants, provided that they make out-of-pocket payments to meet any fee differentials. Further details of the system operation are described in Hiscock and Hojman (1997) and references there. The system was preserved after 1990, with only very minor changes. Since the economy grew at a rate of about 7 percent per year between the mid 1980s and 1997, and wages and salaries grew even faster, the real resources available for health care increased by at least a factor of four. As mentioned before, there was substantial progress in, for example, infant mortality and life expectancy (cf Table 2.1). However, a stage of diminishing returns may have been reached, even after taking into account the fact that the first *Concertacion* government increased real wages in the health sector substantially in the early 1990s.

Between 1984 and the mid 1990s, the membership of ISAPRES grew from 3 to 26 percent of the population (Table 2.4). Both the average contribution by member and the average expenditure by beneficiary, in money of constant value, remained approximately constant (the member is typically the breadwinner, and all the family are beneficiaries). However, this stability is hiding the fact that the variance in both contribution and expenditure increased dramatically. ISAPRE membership expanded not only among the rich, but also among middle-income groups. In 1990, ISAPRE membership was equally divided between the top quintile and the rest of society. But by 1997, membership consisted of two top quintile families for every three families from *Quintiles 1 to 4*. Since middle and lower income groups could only afford less comprehensive health insurance plans than the rich, the same average amounts of contribution and expenditure in 1984 and 1997 mean that the respective variances boomed, with some plans becoming much more comprehensive than in the mid 1980s, whereas other plans became much less comprehensive.¹⁴ According to Titelman (1999), by the late 1990s the ISAPRES subsystem was offering up to 8,000 different health insurance plans. In this particular way, the ISAPRES subsystem is reflecting the pattern of high-income inequality of Chilean society.

In contrast, in the state subsystem (FONASA), both contribution per member and expenditure per beneficiary expanded substantially. Expenditure per FONASA beneficiary rose from about a quarter of that in the ISAPRES subsystem in 1984, to about two thirds in 1997 (although it has been argued, to some extent misleadingly, that the extra money in FONASA went to wages and salaries rather than better health care). As a share of the state subsystem's budget, FONASA members' contributions remained approximately constant, representing about one third of this budget, with almost half of the budget coming from fiscal resources, and less than ten percent of it, from out-of-pocket payments (cf Table 2.4).

For all its merits, the current system is plagued by efficiency and equity problems (Fischer *et al.*, 1998; Sapelli and Torche, 1998; Sapelli and Vial, 1998;

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Titelman, 1999; Torche and Williamson, 1999; Bruce, 2000). There is a problem of asymmetric information, in that the sellers of health insurance and suppliers of health care are better informed about the respective markets, than the buyers. The powers and duties of the regulator (the *Superintendencia de ISAPRES*) are insufficiently defined by the law. The resources available to the regulator are insufficient. Many of the problems (but not all of them) arise from the extreme inequality in incomes. The amount of health insurance that can be bought with 7 percent of the typical income of the top decile is excessive, whereas that which can be bought with 7 percent of the typical income of the lowest decile is insufficient.¹⁵ Recent attempts at introducing some solidarity into the system have been challenged, successfully so far, both by those who claim that it would amount to an increase in taxes by the back door, and by those who oppose health subsidies (for example, to lone parents or to AIDS patients) on the grounds of defending traditional lifestyles. The ISAPRES discriminate against the elderly, pregnant women, and those with chronic or expensive illnesses.

The best proof that FONASA in the 1990s was offering a better service than the old state system in the 1960s is the fact that, each time they could get away with it, ISAPRE members have been using FONASA services and facilities, in order to avoid losing the no-claim bonuses in their private insurance contracts (Hiscock and Hojman, 1997: 360). This is, of course, another example of the poor subsidizing the rich.¹⁶

Housing

Traditionally, the housing deficit has been the subject of confusion and controversy. Then suddenly, by the end of the 1990s, it was officially announced that the housing deficit would finally be over, in the immediate future, at the latest by the first years of the first decade of the 21st century. It is true that by the 1990s the big waves of rural urban migration were already over, thanks to the demise of the large traditional rural estates (the *latifundia*), the modernization of agriculture, especially for export markets, and demographic change. This alleged end to the housing deficit, which has been hailed in some quarters as a big success, possibly should be described more realistically as one of the most disastrous failures among the social policies of the Chilean model (Richards, 1995; Ducci, 2000).

Whereas it is true that there are no illegal urban land invasions any longer, and that the policies of “basic housing” and “progressive housing” effectively reach many among the poorest, on the other hand these policies have had immensely negative effects, and even worse outcomes may be expected for the foreseeable future. “Basic” and “progressive” housing consist of, respectively, very small units (typically, 40 square meters) of completed houses, and plots of land connected to the water and electricity networks, with a completed bathroom. Parallel systems are run by the public and private sectors, and access can be obtained after savings as

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small as US\$ 100 to 300, or even without savings provided that other conditions are met. Unfortunately, the system results in isolation and segregation. The new developments are far away from jobs. There is no public transport, or green areas and communal spaces, or new school and primary health care facilities.¹⁷ The construction quality is very low and the new houses deteriorate at fast rates. Because the housing units are very small, and there is no physical space or financial and technical support for expansion, extended families break down, social networks are destroyed, and children are forced out to the street, gangs and drugs. Social capital declines. Resale values are minimal. Many “beneficiaries” feel cheated and betrayed and stop paying back their mortgages. What for many poor families should have been the first step into modern society has become a trap.

Crime statistics are notoriously unreliable. Rates of under-reporting may differ from year to year depending on many factors. However, the series in Table 2.5 show beyond any reasonable doubt that during the 1980s (or the longer period 1977 to 1993), whereas murder and theft with murder remained stable or even fell, both theft and theft with violence doubled. It is highly likely that these crime increases were at least partly provoked by the failure of economic expansion to diminish income and other inequalities, and that a disproportionately large share of the new criminals were youngsters from “basic housing” and “progressive housing” ghettos (Rodriguez and Winchester, 1996; Fruhling and Sandoval, 1997; Tedesco, 2000, forthcoming a; Hojman, forthcoming b).

Education

The most important development in basic and secondary education during the 1980s was “decentralization,” that is, the transfer of responsibility for state schools, from the Ministry of Education, to the respective local authorities. During the 1990s, this reform was reinforced by introducing in some schools a system of partial payment by parents, to supplement the vouchers paid by the central government to the school. Thus, the system has now three different types of school: municipal schools, which are free; subsidized fee-paying schools; and private schools, which are not subsidized and where therefore the full fee is paid by the parents. Another important development during the 1990s was the allocation of special resources and support to schools and schoolchildren in the most deprived areas of the country. This three-level school system is supposed to give freedom of choice to parents and to encourage competition between schools. In higher education, the Pinochet dictatorship encouraged the creation of many new private universities, which after 1990 came under increasing supervision by the government (Muga and Brunner, 1996).

According to Table 2.6, families in the top decile tend to send their children to fee-paying private schools, and families in the lower and middle deciles (*Deciles 1 to 6*) tend to send their children to free municipal schools (although, as mentioned

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before, in 1995 about 13 percent of children had no access to school at all, a situation that was worse than in 1990, which was itself worse than in 1970, cf Table 2.1). The SIMCE (*Sistema de Medicion de la Calidad de la Enseñanza*, “Measurement System of Teaching Quality”) test has been used to measure children’s performances in reading, writing and arithmetic, in the fourth and the eighth grades. Although there has been substantial improvement between 1988/1989 and 1996/1997, the performance gap between fee-paying private and free municipal schools has been diminishing only very gradually, and it is still about 20 percent. On the other hand, considering the huge gaps in the amounts of resources available to schools of different types, and the effects of a pupil’s home environment, the performance gaps detected by the SIMCE test can hardly be blamed on the schools (Mizala and Romaguera, 2000).

Moreover, the SIMCE test gaps between school types are very small, when compared with the income gaps between adults (cf Table 2.3). Even without going to the extremes of the income distribution, the gaps in earnings are much larger than the gaps in school performance. Compare, for example, *Deciles 4 and 7*. The average income in *Decile 7* is double that in *Decile 4*, both in 1987 and in 1994 (cf Table 2.3). But in terms of SIMCE test performance (Table 2.6), that of the average child in *Decile 7* (with a municipal/subsidized/fee-paying profile equal to 47/47/6) is less than 120 percent of the average child performance in *Quintile 4* (with a profile equal to 62/35/3). On the strength of these data, it would be difficult to argue that income inequality in Chile is largely or entirely provoked by inequalities in the school system. On the other hand, and to put it mildly, inequalities in education do not help to address income and other inequities in Chilean society.¹⁸

Table 2.6
Chile: School Enrollment by School Type and Income Class
(1996, percent) and School Performance

	Municipal	Subsidized private	Fee-paying private	Total
<i>Decile 10</i>	12	24	64	100
<i>Decile 9</i>	28	41	31	100
<i>Decile 7</i>	47	47	6	100
<i>Decile 4</i>	62	35	3	100
<i>Decile 1</i>	76	23	1	100
SIMCE test* 4 th grade, 1988	49	56	76	
SIMCE test 4 th grade, 1996	68	74	86	
SIMCE test 8 th grade, 1989	52	58	76	
SIMCE test 8 th grade, 1997	60	66	80	

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Note: * Maximum performance: 100.
Source: Mizala and Romaguera (2000).

Before it can fulfill its promises, the Chilean educational system still needs substantial additional resources to deal with, for example, those school children in the most deprived regions and urban neighborhoods, and those children who are excluded from school altogether. Also, drastic institutional and attitudinal change is required to deal with problems such as monopolistic suppliers of local school services, rigidities in the market for teachers, bureaucratic inflexibility in both central and local government, inadequate or perverse incentives, and insufficient resources to invest in both supply and purchasing of education (Parry, 1997; Jimenez-Saldana, 1998; Vial, 1998; Arellano and Braun, 1999; Coloma, 1999).

As a matter of fact, there is evidence that some groups may have been receiving “too much” education, or too much education of the “wrong” kind, in relation to labor market needs. Table 2.7 shows the evolution of real incomes by occupational categories in the 18-year period 1976 to 1994. As could be expected, all categories improved in absolute terms. But in relative terms, the only winners were the “unskilled lower classes.” Two out of the three most badly affected among losing groups were people with a university education: “professionals” with social science degrees, and “engineers” (specialists with a technical or natural science qualification).¹⁹

Table 2.7
Chile: Evolution of Real Income by Class/Occupational Position
(1994, US dollars)

Class/occupational position	1976	1994	Change (%)
Managers (of 10 or more employees)	996	2223	123
Small employers (less than 10 employees)	336	499	49
Professionals (with a social science degree)	298	589	98
Engineers (specialists with technical or natural science degree)	579	728	26
Skilled middle classes (commercial, services, manual)	131	289	121
Unskilled lower classes (commercial, services, manual)	76	199	162
Weighted average	156	361	131

Source: Koch (1999).

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Conclusions

It is not surprising that most analysts have become more negative or pessimistic during the late 1990s. The picture does not look good. The central conclusion of the previous analysis is that the Chilean welfare state, in all of its versions since 1945, has failed the very poor. The “lumpen” welfare state before 1973 was, and the post-1990 one is, better at helping the middle sectors than at solving the problems of the poor and the destitute. The post-1994, or more accurately post-1997 record looks particularly disappointing, considering the much more successful, in relative terms, years between 1987 and 1994 (or, between 1990 and 1994). Some policies introduced by the Pinochet military dictatorship during the 1973-1990 period contributed to alleviate extreme poverty, but these policies had other problems, and they did not help to diminish inequality. Moreover, not only were these policies unable to eliminate poverty or destitution completely before 1990, but the dictatorship also failed at creating those political and social conditions which would have made the continuation of its best anti-poverty policies possible after 1990.

Although things do not look good today, they may improve in the future. After decades of experimenting with several different systems, observers know reasonably well which policies work and which ones do not.²⁰ However, the *Concertacion* may not be able to adopt and implement the best policies. The *Concertacion* welfare state is too expensive in terms of left-wing ideology, anti-capitalist rhetoric, damage to investment and growth, and resources lost to rent seeking. For example, the May 2001 proposals to finance health care reform with a uniform-rate tax on ISAPRES contributions across the board look dangerously close to an insane vendetta. Why not make the tax rate progressive rather than punishing all ISAPRES members equally? As mentioned before, by 1997 three out of five ISAPRES members did not belong to the top quintile. As to the right-wing opposition, it has largely severed its previous links with the military dictatorship, and it put forward a very good candidate in the December 1999 presidential election. However, at this stage no one can say whether the right-wing opposition's social policies would do better, should it win the next election in December 2005. Unfortunately, there is a real danger that, in the future, the 1990s (or the years 1990 to 1997) may be remembered as a golden age by generations who cannot match that period's achievements.

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3

The Welfare State in Brazil: Evolution, Problems, and Trends of Social Policy

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All over the world, the promotion of public policies in order to reduce the inequalities and to protect the citizens in situations of social risk are already very common. In spite of having constructed, along the 20th century, one of the biggest world economies and created a large set of labor and social rights, Brazil has not achieved the reversion of a very unjust social picture.

The evolution of a welfare state in Brazil has been historically influenced by some features of Brazilian political culture. Centralism, authoritarianism, paternalism, and demagogy have contributed to generating a social protection system with chronic problems. These characteristics were present in many of the main events of recent Brazilian social and political history, since the 1930s, such as the advent of labor rights, the industrialization, the rural migration to large cities and the establishment of the authoritarian regime in 1964. The economic growing of the 1970s retained outcast masses of landless rural workers and urban workers.

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During the 1980s, the redemocratization took place, being pushed by labor and social movements that demanded more than political and civil rights. People were demanding to meet their basic needs and to reduce differences in an economy featuring one of the world's greatest income concentration.

The main political result was a new Federal Constitution, which introduced new guidelines for governmental social interventions. The increase of labor and social rights and the integration of both private and public actions were the main changes related to social policies. However, the implementation of this model has been facing several problems, especially with regards to focus, financing, management and distribution of competencies among the three tiers of government.

Fiscal crisis and social pressures have driven Brazilian government to carry out efforts to review social expenses and to stimulate and regulate the supply of social services delivered by market. Despite the recent improvement of some social indicators, the road to reduction of inequalities in Brazil is still very long. These inequalities are consequences of centuries of slavery and foreign control, in which social exclusion and exploitation were usual features of the relationship between elite and ordinary people.

Nowadays, Brazilian population is about 170 million and the country is ranked among the ten greatest economies of the world. Nevertheless, despite the economic development, nothing more than 10 percent of the population held half of Brazil's total wealth. Almost 14 percent of Brazilians over the age of 14 are illiterate. Infant mortality rate is 36 per 1,000 live births. In rural areas of the Brazilian Northeast Region, the most densely populated semiarid region in the world, the infant mortality rate is four times higher than in the urban areas of the Central South.

The analysis of how the Brazilian government has faced such problems is the subject of this article, which intends to come closer some of the main aspects that have been conditioning Brazilian social protection system. This subject takes on special importance in this country, where social policies are fundamental for promoting the integration of an enormous contingent of socially excluded people. As a methodological option, due to time and size restrictions, only some aspects will be emphasized, although the complexity of the theme embraces sociological, economic, political, cultural, and juridical variables.

The Brazilian Experience with Social Policies

Until the end of the 19th century, social initiatives in Brazil were limited to actions of social assistance promoted by civil society, mostly religious entities. Under the same cultural influence, governmental social initiatives in Brazil were marked by a historical tendency that combined paternalism with the establishment of political clientele. From the administrative point of view, the characteristics of these actions were lack of institutional consolidation, scattering of resources and overlapping in the execution of activities by different organisms and tiers of

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government.

Such practices were backed by stigmatizing view that Brazilian high and mid-society had about poverty, making it difficult to distinguish among rights, participation, assistance, and charity. Traditionally, the interest of specific social groups was opposed to the pursuit of the universality of rights based on equality.

The Building of a Social Protection System

The first formal record of governmental initiative of social protection was in 1888, when the post office employees had regulated their right to retirement. In 1919, companies became responsible for compensations in cases of labor accidents in certain activities. With regards to the health policy, a landmark was the Sanitary Reform undertaken by Carlos Chagas, during the twenties, in Rio de Janeiro.

In 1923, the “Eloi Chaves” Law created a Fund for Retirement and Pensions of the Railway Employees, following the model adopted in Germany by Bismarck. This Act is deemed the initial mark of the Brazilian social insurance policy. Up to 1931, several funds of retirements and pensions were created, as nongovernment entities, covering workers of the better-organized professional categories, like employees in ports, banks, and commercial and industrial companies. Later, in 1933, these funds were organized as Institutes of Retirements and Pensions (IAP), bringing together all the workers of a same professional category, in order to ensure a greater pooling of insurance funds.

The Getúlio Vargas Administration, 1930 to 1945, introduced significant changes in labor legislation. The more outstanding initiatives of this period were the creation of the minimum wage, the regulation of work for women and minors, the eight-hour workday limit, the right to vacations, norms about labor accidents, and the establishment of the Labor Judiciary. In the same period, many health services were taken to the interior population with the creation of federal field offices.

In 1942, former First Lady Darcy Vargas founded the Brazilian Assistance Legion (LBA) with the aim of assisting poor families. Unfortunately, during the following decades, Brazilian Assistance Legion (LBA) extended its actions to majority of Brazilian municipalities, consolidating paternalist practices, frauds, and the political use of resources. The creation of the Ministry of Health, in 1953, changed the priorities of the national health policy and turned its focus to healing medical care rather than fighting extensive diseases. Likewise, a movement of centralization took place—reserving for the State governments only responsibilities for the execution of health policy.

Gradually, the social insurance system dropped the principle of individual membership in favor of a new concept, called “regulated citizenship” (cf Santos, 1979). In the 1950s, an important group of public officers began to reform the system according to actuarial bases, defending the idea of unification of the institutes, despite resistance from labor unions, which were fearful over the loss of

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political influence and reduction of quality of the health services provided by their respective institutes.

At last, in 1960, after 13 years of discussions, a new Social Insurance Organic Law was approved, determining the uniformity of contributions and plans of benefits of all the institutes. Three years later, political pressure caused by peasants movements achieved access of rural workers to the same mechanisms of social protection available for the urban society, through the institution of Fund for Assistance to the Rural Worker (FUNRURAL). According to Wanderley Santos, the Fund for Assistance to the Rural Worker, FUNRURAL, “breaks up the contractual conception of the social insurance,” because “the rural workers don’t pay any direct contribution for the fund” and “the occupational or functional partition of the rural work linked with different rights does not exist” (Santos, 1979: 114-15).

Thus, in 1966, the definitive administrative unification of the existing institutes occurred with the creation of the National Institute of Social Insurance (INPS), which took on the responsibility for the provision of the services of medical care services, payment of benefits and collection of contributions related to all the workers linked to the old institutes. During the second half of the 1970s, the Federal Government promoted a broad restructuring of the social sector, instituting the National Social Attendance and Insurance System (SINPAS), coordinated by the Ministry of Social Assistance and Insurance (MPAS). The responsibilities were redistributed again, with the establishment of new entities and the same supervision for all the organizations of the areas of medical care, social assistance, and insurance.

In 1982, the National Health Plan, formulated with the participation of officials, representatives of the sector and civil society, presented, for the first time, official proposals for the rationalization and integration of the medical care system. However, the Ministry of Social Assistance and Insurance, the MPAS, retained the centralization of resources and, consequently, the concentration of decision power, to the loss of Ministry of the Health and the other tiers of government. Throughout the 1980s, the redemocratization process took place at the same time as the worsening of the fiscal crisis and of the living conditions of a significant portion of the Brazilian population. The increase of unemployment and concentration of income and the uncontrolled growth of the big urban centers contributed to characterize a process of “metropolization” of the national poverty. In addition to that, almost half of the national workforce was concentrated in the informal labor market and therefore excluded from the official mechanisms of social protection.

The government not only proved to be inept to solve the social crisis, but it has also contributed to exacerbate the crisis by excluding social groups from receiving benefits and allowing the deterioration of the quality of social services. Furthermore, all the tiers of government contributed to economic instability through the increase in the fiscal deficit.

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In 1986, the Federal Government instituted unemployment insurance and the National Program of Milk for Poor Children, which was ended in 1990 under accusations of political use, frauds and corruption, after having, in 1989, assisted more than 7.6 million beneficiaries. In the following year, the Program of Development of the Single and Decentralized Health System (SUDS) was created to be regulated by the MPAS and implemented with the participation of States and municipalities. Afterward, under the strong influence of organized popular mobilization, the philosophy adopted in the Program of Development of the Single and Decentralized Health System (SUDS) would be fully incorporated by the representatives and expressed in the decentralization guideline included in the new Constitutional text of 1988.

Except for some punctual and local experiences, a significant lack of effectiveness has characterized, historically, Brazilian national social programs. Several reasons for these scarce results were well addressed by Sônia Draibe: excessive centralization and bureaucracy, technocratic power, institutional dispersion, insufficient controls of costs and outcomes, lack of continuity and deviation of objectives (Draibe, 1992: 32-33). The Federal Constitution approved in 1988 tried to determine a political and conceptual revision of the guiding principles of Brazilian social policies with questionable results, as it will be shown ahead.

The National Constituent Assembly and the New Model of Governmental Social Action

The Federal Constitution, promulgated in 1988, brought a very important innovation: the institution of the “seguridade social,” a new Portuguese word created in order to express a new concept for governmental social intervention. This approach had clear influence of international experiences with welfare state models, mainly in several European countries, and it was spurred by the purposes of liberty and social justice, which supported that moment of Brazilian redemocratization.

The Constitutional text incorporated social participation and, mainly, the enlargement of the concept of citizenship in the country, according to the political ideas that associated that concept with equality, an essential value to the consolidation of the democratization process. The importance given to this theme is well demonstrated by the expression “Citizen Constitution,” formulated by the President of the Constitutional National Assembly, Deputy Ulysses Guimarães, during his speech in the promulgation ceremony, on October 5, 1988.

If the extension of the citizenship concept to the field of social rights were not an explicit option for a theoretical model, it was compatible with a set of sociological essays internationally diffused, since the 1940s, especially by the sociologist Thomas Marshall.

According to Marshall, an historical analysis of the citizenship concept allows its division into three parts or elements: civil, political, and social. The civil element

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is composed of the rights needed to ensure individual liberty, like freedom of movement, freedom of press, thought and faith, property right and right of concluding valid contracts, and the right to justice. Thus, the main institutions associated with civil rights would be the courts. As to the political element, there is the right to participate in the exercise of political power, as a member of an organism invested with political authority or as a voter. The corresponding institutions would be the Parliament and Local Government Councils. The social element is related to the right to a minimum of economic well-being and safety and the right to participate in the social heritage, as well as to lead a civilized life according to the prevailing standards in the society. The institutions most linked to these rights would be the educational system and social services (Marshall, 1967: 63-64).

For Marshall, it is possible to affirm that the three elements of the citizenship were formed in different centuries. Thus, with reasonable elasticity, the 18th century would correspond, essentially, to the period of formation of civil rights. The 19th century brought the extension of political rights for wide sectors of the population. Finally, in the 20th century, we had the fight to abolish inequalities with regards to the essential elements of the social well-being with incorporation of social rights to the status of citizenship and, consequently, the creation of a universal right to an income that is not proportional to the market value of the citizen.

Apart from any evaluation related to the adoption of the citizenship theory as a theoretical reference to guide public policies, it should be noted that this theory was quite convenient to the political process of Constitutional elaboration. Its big social appeal, aggregation capacity and abstraction represented an element of interesting consensus for political negotiations.

In that conjuncture, assuring the consistency of political proposals with appropriate technical support was vital, in order to guarantee the economic and operational viability of the state intervention model to be included in the Constitutional text. This support to the congressmen came from the active participation of a group of public officers linked to the Ministry of the Social Insurance and Assistance (MPAS).

Those officers advised the preparation of proposals and the decision-making process grounded in their personal knowledge and capacity of survey the models and experiences of the welfare state in European countries and North America. Their involvement with the Constitutional process began in 1986, when an inter-ministerial group developed a set of proposals that greatly influenced future congressmen in the conception of the social protection model.

The Brazilian Federal Constitution settled fundamental rights and guarantees and, in the Article 6, confirmed that “education, health, work, leisure, security, social insurance, protection of motherhood and childhood, and assistance to the destitute, are social rights, as set forth by this Constitution.” In the same chapter, a set of 34 different labor rights were ensured to urban and rural workers in order to

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improve their social conditions, including unemployment insurance, in the event of involuntary unemployment, and severance-pay fund. Several of these rights would require government actions to be organized or supported, as it will be shown ahead.

Moreover, through clauses included in Title VIII (The Social Order) and in Title VI (Taxation and Budget) of the Federal Constitution, an implicit option for the adoption of minimum social warranties was made with the institution of the “seguridade social,” hereby called social security, which comprises: “an integrated set of actions carried out by the government and society, with the purpose of ensuring the rights to health, social insurance and assistance” (FC, 2003: Art. 194). Education was described as a “right of all and duty of the [Federal] State and of the family” and free public education in official schools was declared as a principle. This duty of the Federal State should be fulfilled by ensuring:

1. mandatory and free elementary education, including the assurance of its free offer to all those who did not have access to it at the proper age;
2. progressive universalization of the free high-school education;
3. specialized assistance for the handicapped, preferably in the regular school system;
4. assistance to children of zero to six years of age, in day-care centers and pre-schools; and
5. assistance to elementary school students by means of supplementary programs providing school material, transportation, food and health assistance.”

The characteristics of the new welfare system were similar to some systems already instituted during the 20th century in European countries: wide social insurance benefits with centralized administration structure, universal medical care, unemployment-insurance and financing based on a combination of tax resources and employers and employees’ contributions. The wish to break ties with the past was so strong that a new word was created to express the concept introduced in the Constitutional text: the word “seguridade” had not existed in the Portuguese language until that time. It was a neologism coined after the Spanish “seguridad,” the French “sécurité,” and the English “security.” The organization of the system was supposed to observe as objectives:

1. universality of coverage and service,
2. uniformity and equivalence of benefits and services for urban and rural populations,
3. selectivity and distributiveness in the provision of benefits and services,
4. irreducibility of the value of the benefits,
5. equitable participation in funding,
6. diversity of the financing basis, and

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7. democratic and decentralized character of administrative management, with community's participation, especially of workers, businessmen and retired people" (FC, 2003: Art. 194).

Furthermore, several benefits were instituted to be supported by funds coming from the budgets of the Federal Union, the States, the municipalities, and the federal districts, and from the following social contributions of: (1) employers, calculated on the payroll, revenue and profits, (2) workers, and (3) lottery revenue (cf FC, 2003: Art. 195). The resources and corresponding expenses with health, social insurance and assistance policies were assigned to a specific budget, the Social Security Budget (OSS), strengthening the link between these initiatives and their earmarked sources.

As for the educational systems, a distribution of priority roles was established: the municipalities became responsible for pre-schools and elementary education, the States took on elementary education and high-school, and the Federal Union should guarantee the equalization of the educational opportunities and a minimum standard of quality of education, besides backing federal public organizations. The concerns about ensuring maintenance and development of education were so serious that application of a minimum portion of tax revenue collection was established: 18 percent for the Federal Union; and 25 percent for States, municipalities, and the federal districts.

With regards to the regulation of the Constitutional statements, in the post-1988 period, there were different approaches and results according to each one of the social security components. Concerning the health policy, that became a "right of all and a duty of the [Federal] State," with a guarantee of "universal and equal access to the actions and services," regardless of contributions (FC, 2003: Art. 196). In organizational terms, the public initiatives should "integrate a regionalized and hierarchical network and constitute a single system," following the directives of decentralization, full service, priority to preventive actions and participation of the community.

In 1990, the Health Organic Law was approved, defining the form of participation and funding of the three tiers of government and that of private service providers in the Single Health System (SUS). Since that time, a huge conjunct of legal and administrative instruments have been established in order to accomplish the difficult task of consolidating the Single Health System (SUS).

As to social assistance, for the first time it was considered a right of the poor people, regardless of contribution. Emphasis was placed on protection of the family and of maternity, integration to the labor market and assistance to the more vulnerable social groups, which are: children and adolescents, the physically disabled and elderly people. A monthly benefit of one minimum wage was guaranteed to the elderly and the handicapped without other means of support. The directives of social participation, social control and political and administrative

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decentralization were established to guide government actions.

Concerning social insurance, all the distinctions between urban and rural workers were eliminated and the guarantee that no monthly benefit could be inferior to the minimum wage was implemented. In addition to that, the required age for retirement was established as 65 years of age or 35 years of work for men. This limit was reduced in five years for women. Integral retirement for teachers and proportional retirement for other workers became allowed after 30 years of work for men and 25 years for women.

The theory concerning social insurance recommends the coverage of the workers only in situations of social risk, which are understood as events out of control that can damage, temporarily or definitively, their work capacity. Despite that, some of the benefits provided by the Brazilian system—like retirement, due to time of service—cannot be characterized as an uncontrolled event that can generate reduction of worker's means of subsistence.

From Model to Practice: The Implementation

More than 12 years after the formulation of the model, in any evaluation that can be made about the system created by the Federal Constitution, managerial and financial obstacles faced in operating the social security policies in recent years stand out. The concern of the legislators with the definition of a group of sources of revenue that, at the same time, could unburden the payroll of companies and reduce the vulnerability of the system to economic fluctuations was not enough to ensure the balance of the system. On the contrary, structural and circumstantial problems have been contributing to generation of constant instability within government and civil society. As a result, there is a progressive fiscal deficit related to the social insurance, as well as serious problems of quality of public health services.

The desired integration of actions has never been achieved. As a matter of fact, public initiatives in different areas of social security have been characterized by the weak coordination at the federal tier, and political disconnection in the relationships among the different tiers of government. In spite of the Constitutional guidelines, the system of social protection retained its characteristic of exclusion. The several social insurance benefits instituted by the Federal Constitution were fully regulated in the first years after their creation, without loss of traditional privileges, like the retirements with special legislation for some professional categories with a high influence. On the other hand, the social assistance benefits for poor people without political pressure capacity faced serious difficulties to be instituted.

Furthermore, while the benefits linked to the maintenance of formal work became a reality, the universal right to health remains seriously compromised and the assistance to families, children, adolescents, elderly and handicapped remains influenced by political use, paternalism and lack of social integration, despite advances that have occurred last years. Specifically, the social assistance has been

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relegated to a position of secondary importance. The approved laws have not met the necessary political will and the appropriate administrative resources to achieve their goals. The National Social Assistance Council was the last entity to be instituted among all the similar organisms foreseen for allowing social participation in management of the social security. In addition, the Organic Social Assistance Law (LOAS), approved in 1993, faced enormous problems in its application. These problems have occurred despite the fact that this law was a landmark for the sector due to the modernization introduced with regards to the decentralization of services, distinctions of roles for each tier of government and the regulation of concession of social assistance benefits. Today, the Organic Social Assistance Law (LOAS) ensures an official minimum wage to the elder aged 67 and over and the physically disabled people whose families do not have per-capita revenue equivalent to a quarter of minimum wage.

Another characteristic of the system is that retirement for time of service is on average three times higher than the other social insurance benefits granted based on aging and incapacity for work. Furthermore, the model of funding official labor accident insurance does not stimulate the adoption of any kind of safety measures, because the variation in the contribution brackets is determined only by the type of activity performed by each company, instead of taking into account the investment in prevention. This circumstance contributes to generate a labor accident rate almost five times higher than those recorded in many industrialized countries. The serious economic and social consequences are both personal losses and significant social insurance expenses with benefits, treatment and victim rehabilitation.

The features of Brazilian political culture and the chronic inadequacy of institutional resources allocated to carry out the social policies have strongly conditioned the process of implementation of the welfare security system. A traditional feature of Brazilian public policies has been the underestimation of issues related to the institutional capacity of the Federal State to perform the proposed actions. Among these difficulties, it is possible to distinguish several variables such as the planning and budget processes, the organizational structure, the management and control and the intergovernmental articulation.

From 1992 onwards, the social security expenditure was strongly influenced by the impressive growth of expenses with social insurance benefits. In fact, the price of increasing both the quantity and the unitary value of the benefits was the doubling of expenses in terms of percentage of GDP.

This growth has been pushed, since 1995, mainly by the payments of social assistance benefits for the elderly and the handicapped and by the minimum wage increase. Nowadays, more than 2 million of 19.8 million of benefits paid by the National Social Insurance Institute are assigned to assistance recipients. If we add other benefits without linkage to contribution, like rural retirements, the number of recipients rises to about 7.5 million, corresponding to more than 40 percent of total benefits, contributing to a significant actuarial unbalanced condition of the system.

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That is why the amount of social insurance contributions does not correspond to that of the benefits, generating a deficit equivalent to 1 percent of GDP since 1999. In addition, there are the retirements of civil servants, which have their own systems with special rights that ensure them full wages in retirement. These expenses represent more than 2.2 percent of GDP in all the tiers of government. Undoubtedly, nowadays, the deficit generated by the payment of social security benefits and public sector retirement is one of the main reasons for the current fiscal difficulties that have been hindering Brazilian development process.

From an institutional point of view, the last two decades have been characterized by lack of continuity generated by the instability of administrative structures, which have been frequently created, transformed or eliminated in the governmental areas responsible for social security activities. Although, in most of cases, these changes have not succeeded in altering the results of social policies, a retrospective look at the several organizational arrangements already adopted shows, in the Federal tier alone, that at least twelve different ministries have already had the responsibility for one of the welfare areas.

With regards to the management of services, it is possible to verify that each one of the areas of the Brazilian welfare state has distinct organizational cultures and adopts different managerial models, damaging the integration of actions. Furthermore, the fragility of work processes and the lack of government professional careers and technological resources for treatment of information facilitate the occurrence of frauds and the dispersion of scarce resources.

Specifically, the health services are guided by a reasoning in which there is a service providers interested in maximizing its revenue, a client interested in having the better service available and a third party, the Central Government, which is responsible by the payment of the services. This system discourages concerns related to costs and stimulates frauds. Furthermore, States and municipalities have few incentives to invest in the control of costs and abuses, because the Central Government is in charge of the payment of services.

The needed articulation among the different tiers of government has confronted problems related to the huge existing heterogeneity and the unclear definition of roles. There are no solutions able to cover all the different levels of social, economic and institutional development among States and municipalities. The planned decentralization of services and resources has advanced, but still faces political difficulties and resistance due to the withdrawal of power from the Central Government in favor of other tiers of government. Such problem explains why some federal public entities have remained at service of regional political interests.

The Modern Global Trends and the Brazilian Welfare State

In despite of the specific historical, cultural, institutional and economic conditions of each country, it is possible to identify in Brazil some global

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demographic, social and economic changes that are influencing the welfare state reform processes all over the world.

Firstly, the changes in labor market tend to reduce the potential for collection of the traditional social contributions on wages paid by companies. Outsourcing, new managerial techniques, the diffusion of self-employment and the flexibility of labor negotiations and rules guide the salaries participation and formal employment to a decrease. Consequently, there are serious concerns about convenience of having salaries as a base of incidence to sustain, in the long term, the social protection system. In addition, governments are suffering increasing pressures in order to provide more services previously provisioned at home, such as child and elderly care, because of the rising participation of women in the labor market.

Besides labor market changes, the costs of health care are being pushed upward by the dissemination of new scientific knowledge and technologies, overburdening public health systems. The demands introduced by globalization process emphasize the need of more competitive companies, generating continuous pressures to change pattern of funding, in order to get reduction in burden on business. Then, the need to control fiscal deficits to adjust budgetary constraints to growing expenditures in social protection has become an outstanding pressure factor that has guided government and civil society to discuss alternative reforms.

Furthermore, the improvement of effectiveness of social programs and services is a constant objective of welfare state reforms. Social control, performance measurement, partnership and flexibility in operation of systems are being used to improve quality and to reduce costs. The Fernando Henrique Cardoso Administration, inaugurated in 1995, has undertaken several initiatives designed to change some traditional characteristics of Brazilian welfare state, despite political and administrative obstacles. General measures were focused on abolishing frauds and evasion in addition to specific efforts to address structural problems.

With respect to social insurance, several legal measures were issued to restrain the mistreatment of premature retirement and the accumulation of benefits. In 1998, after three years of hard negotiations and important concessions from Executive Branch, the Congress approved a Constitutional Amendment Proposal, the 20th amendment, which established new rules related to retirements of civil servants and citizens in general.

Despite the refusal of the establishment of a minimum age for retirement and a limit to wages paid for retirement of civil servants, some changes were approved like the withdrawal of the Constitutional text of rules to calculate the value of benefits. This allowed the posterior emission of law establishing that time of contribution and age of beneficiaries will be considered to fix the amount of each benefit. Just for civil servants, the Amendment introduced age limits for retirements: 60 for men and 55 for women. These limits will be fully in force in 2003, after a five-year transition.

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In the health field, in 1996, the National Health Council, after months of negotiations, approved the Basic Operational Norm (NOB) with new rules that regulate the administration of SUS. In 1997, innovations were introduced with the creation of the Basic Assistance Minimum (PAB), which instituted “per-capita” values to be used in establishing the amounts of resources allocated to each municipality within the SUS. This measure was a first and important step to leave the “third party pays” logic in favor of a set of new rational criteria, which would give more responsibility to municipalities in the management of the system.

During the last two years, the Ministry of Health concentrated efforts on regulation of goods and services provided by private companies. Two regulatory agencies were created: the National Supplementary Health Agency, to rule health plans market, and the National Sanitary Surveillance Agency, with the mandate of regulating drugs, food and health services provision. New legal frameworks were issued aimed at improving state capacity to face the chronic problems related to the quality and price of medication and private health plans in Brazil. Nowadays, there are about 30 million people linked to health plans, especially medium-class people worried about the quality of public health system.

With regard to social assistance, the traditional approach was changed and the emphasis has been on the decentralization process. Soon after the inauguration of new administration, in 1995, the Welfare Ministry and Brazilian Legion of Assistance were closed down and the Community Solidarity Program was set up, with a new strategy grounded on partnership for dealing with poverty.

Under command of the First Lady Ruth Cardoso, Community Solidarity established a permanent connection between government projects and community responsibility, jointing government and private-sector action. Popular movements were mobilized, willing volunteers were trained, business were stimulated to give money and government actions were coordinated in order to improve life conditions in the poorest regions of country.

Also, all States and hundreds of municipalities have constituted their Social Assistance Councils and corresponding funds to receive resources from the Central Government. These councils have the participation of nongovernmental entities and are an attempt of reducing local political influence and corruption on distribution and control of resources applied in each State.

Despite some governmental efforts to approve more flexible labor rules, the adjustments of labor market regulations to demands for labor in Brazil remains a critical point. The unemployment insurance payments and withdrawals in the Job-Time Guarantee Fund reach about 2 percent of Brazilian GDP. Nevertheless, an accurate analysis of these programs shows that a small part of beneficiaries are poor people and almost half of them are not workers without occupation, because the rate of occurrence of informal labor market is very high. On the other hand, the cost of funding these and other compulsory benefits are overburdening business and

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making difficult the reduction of levels of informality and unemployment in labor market.

Conclusions

It can be maintained that an effective welfare state model was never really implemented in Brazil. More than five decades after creation of the firsts social protection mechanisms and twelve years of new system's operation, most of the original objectives have not been accomplished. The incorporation of universal rights within the Brazilian Federal Constitution, grounded on the enlargement of the citizenship concept, has not succeeded in eliminating traditional negative features and consequences of the social protection system. Even the post-1994 economic stabilization was not sufficient to support successful efforts focused on transformation of the government, in order to improve the effectiveness of Brazilian welfare state. Unfortunately, nowadays, the entire society remains funding premature benefits of a minority of the population, sustaining an apparatus of questionable efficiency and bearing a tax burden that induces the growth of the informal labor market and restrains competition capacity of national companies.

Nevertheless, in despite of the structural difficulties, the analysis of social indicators evolution unveils some significant advances that have been achieved during second half of 1990s. Such outcomes may be imputed to a combination of a lot of circumstances that had never happened simultaneously in the Brazilian history: steady democracy, stable economy, fiscal balance, administrative continuity, and growing social expenditures.

The proportion of poor and destitute people as a percentage of total population fell, respectively, from 43 and 21 percent in 1994 to 32 and 13 percent in 2000. Illiteracy and infant mortality indicators had significant improvements in the same period. In the international scenario, as previously mentioned, important changes in the social and economic conditions are motivating efforts aimed at the revision and modernization of welfare states. These countries are promoting experiences based on targeting of benefits to those most in need, decentralization, partnership with civil society and different tiers of government, managed competition and strengthening of government in the role of regulator of services provided by the private sector. Even countries whose social security system does not present the distortions of the Brazilian system are undertaking extensive reforms. For instance, there are a large segment of Brazilian medium-class workers that is represented by strong labor unions and are able to establish a balanced negotiation with employers, without regulations that can inhibit investors and consume public resources.

However, Brazil is one of the countries where a principle of universal support for people was consolidated and people do not accept putting this tradition under threat. There is no general perception that the current system of social protection is not focused in the needy and the public resources should preferentially be directed

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to the poorest people. In that context, a reform demands a mature political environment, sustainable technical proposals, capacity for negotiation with union labors and producers and popular awareness of importance of change. That is why, in Brazilian case, although the reform is urgent, changes should preferentially be made gradually to ensure popular and political support to the process, in view of the traditional role played by public policies in avoiding social tension.

Undoubtedly, the modernization of the Brazilian social security framework will have positive effects on the productive sector. Also, reforms can increase the productivity, encourage competition in social services, stimulate individual and group savings through pension plans and other savings means, and contribute to long-term growth and economic prosperity. These reforms probably will demand more attention to some institutional constraints, besides the leading concerns related to the lack of financial resources required to maintain the system. The heterogeneous development level among different regions and tiers of government still restrains possibility of having general solutions and demands a supplementary role to be played by Central Government. Managerial deficiencies and problems like the institutional fragility of a lot of States and municipalities and the debility of internal and intergovernmental articulation can damage the process of implementation of well conceived measures.

In spite of the challenges and difficulties, the recent Brazilian political experience shows the viability of undertaking important reforms, as long as people become more aware of national problems. This awareness increases the expectation of building a social protection system capable to reduce inequality and promote development and social justice in Brazil. A comparison of spending on social programs as a percentage of GDP with other countries reveal an expensive, complex and broad welfare system in Brazil: while in Chile, Mexico, and Argentina this percentage was 13.4, 13.1 and 18.6 percent respectively, in Brazil it was 20.9 percent (1995 data). This spending is higher than the worldwide average for countries at similar stage of development and even wealth nations when their economies were as developed as Brazil's today.

That is why new studies about poverty and inequality have demonstrated that Brazilian social expenditure is higher than the necessary amount to eliminate poverty, but most of the social programs are badly focused or ineffective. Such conclusion is auspicious because it points out the possibility of eradicating poverty by redesigning social policies even without further collection of resources from society.

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4

The Welfare State in the Czech Republic

VOJTECH KREBS

November 1989 in the Czech Republic originated principal changes in the life of our society. Total changes of the political environment building up a democratic society, establishing a free market economy connected not only with significant changes in property relations, but also with the different position of individuals in the professional system and society as a whole occurred. By all means, the changes could not be realized without conceptual changes in social policy without changes of previous social institutions, mechanisms, a surviving paternalistic philosophy and extensive transfers connected with the risk of increasing the budget deficit. Therefore the process of transformation occurred even in social policy in which it was not only changed but also completely newly defined.

Social Policy Since 1945

Social policy applied up to the year 1989 was found to be ineffective. It could be characterized in the following way:

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1. dominant position of the government in social policy, its paternalistic role (government interferes with citizens' decisions), its monopolistic position in the social sphere, authoritative decisions on social problems;
2. significant weakening of individuals, responsibility for their living conditions, weakening of civic subjectiveness, which resulted in the suppression of their economic and civic activity, initiative and responsibility;
3. wide, overall provision of social security benefits irrespective of a credit (e.g., leveling in pension security) and social necessity (e.g., the way of providing family allowances) which became difficult because of limited financial resources;
4. inefficient and transparent distribution mechanisms; centralization of financial sources and their distribution from the State budget led to the loss of the relation between citizens' payment to the State in the form of taxes and what a citizen got from the State (e.g., sickness benefits, pensions, etc.). The mechanism was demotivating and led to a wrong conception of free social services which were presented as a gift of a generous government to citizens;
5. such large social systems as, e.g., health and education services worked relatively well. They issued from the long and good tradition and the high level they were gradually developing and to a large extent they were observing the development in industrialized countries. But they were mainly enriched with solidarity elements and became enormously expensive and did not motivate.

Social Reform

Since the beginning of the transformation of our society it has been clear that the transformation of our economy is not possible without substantial changes in the social sphere. Otherwise, the economic reform had to be accompanied by social reform. Both reforms are interconnected, none of them can be realized separately without each other. The point is that every step in the economic reform should be socially accepted and excessive social tension or even crisis would be avoided. It has been and still is one of the basic assumptions of other gradual changes realized in economic sphere. Therefore, simultaneously with the scenario of economic reform the scenario of social reform was prepared and accepted by the government. The process of social reform in the Czech Republic could be expressed in the following process:

1. Abolition of State monopoly, support of non-government subjects in social policy, liberalization of social activities of citizens, their voluntary association and organizations;
2. Giving up State paternalism and establishing the principle of civic responsibility and participation;

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3. Diversion of the central directives and creation of democratic administration.

The scenario of the social reform was drafted and declared by the government in the year 1990. The scenario is the first step within the continuous reform activities in the social sphere. In fact, it was the social program of the federal government prepared for a two-year transformation period and at the same time the first program of the conception of our social policy after the year 1948. The scenario was understood as more than protective and the security program (which should have supported the economic reform) more than the program aimed at a complex slow-down of the whole social system. Therefore it was focused on targeting of actual risks in the following development concerning unemployment, inflation and privatization and on measures, which will suppress social tension connected with the process. The scenario played a very important role in disputing its mostly sanative and security character, because social policy itself encouraged and facilitated the beginning of the economic reform. It established a new social policy, by setting up e.g. missing social institutions (e.g., work offices), institutes (social insurance, subsistence minimum) and mechanisms (e.g., valorization mechanisms, collective bargaining). The scenario initiated the creation of protective social network.

The social network is a set of legislative standards including various both active and passive measures with which a State guarantees a certain minimum level of help to its citizens in case they are in social emergency situations. It responds to unfavorable social consequences of the economic reform and the process of transformation on the whole. The social network fulfills the following functions:

1. actively works in employment policy and creates assumptions for the labor force so that it can come back into active economic activity and be secured with necessary incomes in case of unemployment;
2. guarantees minimum wages for the economically active population;
3. guarantees minimum level of incomes to socially weak citizens (e.g., minimum level of old-age pension) and families with children;
4. guarantees certain protection of housing to socially weak citizens (specific contributions on payments of housing costs).

Objectives of the Transformation Process in the Following Period

Realization of the social reform and the new social policy is not a short-term but a long-term process. Success depends on the connection of the conceptual solution and corresponding measures (which can be realized gradually) with the measures, which should and have to solve topical problems attendant on individual periods of economic reform. It is concerned with the efficient management of long-term (conceptual) intentions with short-term topical measures. However, the main

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problem consists in the fact that long-term conceptual plans and objectives of social policy have not been developed to a necessary extent for disposal so far. If we evaluate the scenario of the social reform and the social network from the point of view of time periods, their acceptance, gradual establishment, we can say that: (1) constitution of social insurance State social support and State social help are induced among conceptual (long-term) objectives, and that (2) creation and the work of social network are short-term (operative) objectives.

What was realized in social policy after the year 1989 proves that the government does not act only in a short-term way, nevertheless, a draft of the medium to long-term program of the solution of basic social problems cannot be put off. Even satisfactory results that have been achieved in the transformation of social policy should not lead to excessive satisfaction. A solution of serious problems on the medium-term horizon must be prepared in time. The transformation process of our society opened a lot of difficult conflicts and not only socially, but also humane painful problems. These cannot be easily removed and solved in a short time. What was decided, respected and observed by the majority of people (even there is no general agreement) as general objective is possible to be articulated as the creation of a democratic society in a free market economy with high culture.

To get to it is a long-term way and even the target vision is not unperturbed. The success of creation of the society will be dependent on the corresponding solution. First, it is concerned with the problem, which could be expressed as the fear of the future, of social uncertainty. The core of the fear is the origin and the view of a continuous rise in unemployment, uncertainty of real incomes, which significantly decreased for many citizens and the danger of poverty for certain groups. Changes in life values both of society as a whole and their individual groups of citizens, individuals and their families. Adaptation to the new or changed life values is complicated in many cases and conflictual. Sometimes it is for the loss of present life values (especially for the individuals who are unable to adapt). There is the serious problem of new differentiation in incomes, property and social conditions of people and in their status. The differentiation is now at the beginning but it deeply interferes in awareness, opinions and attitudes probably of majority people. Many of them generally agree with the social changes and objectives, but they are not able to agree with the act that significant differentiation not only in the social status of individuals and their families, but also of individual forms, municipalities and regions will occur. The generational differentiation plays a role and the fact that Czechs have always tended to be egalitarian. The social reform has been realized in main social spheres namely within the framework of social security policy, employment policy, as well as health and education policy.

Social Security

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The system of social security in the Czech Republic aimed very high before 1989, particularly regarding certain groups of people. This was reflected in the easy requirements for benefits, not in the level of such benefits. Everyone in fact, was insured. Various preferences in the amount, as well as in the requirements were determined by situations not related to the pension system. However, some groups of people were discriminated again, such as self-employed people. The purpose behind the general provision toward some pension benefits came into question since such benefits stopped meeting their function. The pension insurance system was funded from the State budget; contributions to the system represented a non-defined part of taxes. The existing social security system was still overly complicated and confused, mainly due to the high number of different benefits provided (around 70 types exist). It has therefore been proposed to divide the whole social security system into three related and complementary sections:

The term Social insurance describes monetary allowances to replace loss of income and is separated into long-term allowances covered by the system of pensions insurance and short-term allowances that are covered by the sickness insurance. The social insurance also includes the unemployment insurance that tries to achieve a state of balance between supply and demand as regards work forces, to utilize them in a productive manner and to ensure the right of citizens to employment. The pension insurance fund covers payments in case of old age, full disability, partial disability, widow's, widower's and orphan's pension. The sickness insurance fund pays sickness benefits, short-term benefits for care of a family member, income support in pregnancy and maternity and maternity benefits. The main feature of the social insurance is given by the fact that citizens postpone a part of their consumption to cover their future social events.

The system of State Social Support safeguards, besides other groups of families who find themselves below a certain income level, families with children. The goal of this support is to prevent the fall of low-income families into poverty and make it possible to resolve the agreed social situations to a socially acceptable level. All allowances and grants, which are provided for this reason are covered from the State budget and are provided either as regular payments or as a lump-sum. Several of the allowances are calculated on the basis of the official personal needs amount. The provision of child, social, housing and transportation allowances is income tested, whereas parental, maintenance and foster care allowances and the birth and funeral grants are not.

By social assistance is to be understood as the aid that is provided to citizens in need to an extent ensuring basis living conditions in a case where it is impossible to ensure them by their own efforts. The given spheres are financed from taxes or from contributions. The allowances of State social support (from the State budget) and the social assistance are financed from taxes. The latter is entirely financed through the local authorities budget, which itself is funded by transfers from the State budget. The pension insurance, sickness benefits and the National employment

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policy and the health insurance are financed from contributions. The payment outside the tax system for pensions, sickness benefits and expenditures on the National employment policy were introduced in 1993. Employers and employees make insurance payments, the rates of which are set by law (cf Table 4.1).

Table 4.1
The Premiums Payable on the Premium Base in 2001

Type of insurance	Employer (%)	Paid by employee (%)	Total (%)	Self-employed (%)*
Total	35.0	12.5	47.5	47.5
Pension Insurance Fund	19.5	6.5	26.0	26.0
Sickness Insurance Fund	3.3	1.1	4.4	4.4
Employment Insurance Fund	3.2	0.4	3.6	3.6
Health Insurance	9.0	4.5	13.5	13.5

Note: * Voluntary sickness insurance.

Source: Ministry of Labor and Social Affairs.

The assessment basis for the employee is the total of his/her monthly income, as calculated by the employer. Certain incomes are excluded by law from this assessment (e.g., earnings from patents). The assessment period is one calendar month. The employer is obliged to calculate and pay the contributions on behalf of the employee. For the self-employed, contributions are paid in installments during the year on the basis of the previous year's tax returns; refunds or additional payments are then made as appropriate. The assessment period is one calendar year. The assessment basis is a sum determined by the self-employed person, which must not be not less than 35 percent of their income after the deduction of necessary expenses incurred whilst obtaining, conducting or maintaining the business. The Health Insurance only provides services, since monetary allowances are provided from the sickness insurance. The health insurance provides financial compensation for health care, which is provided to insured persons by health facilities; compensation can be fully or in part. These services include diagnostic care, therapeutic care both in-patient and outpatient, care for chronically ill, provision of drugs and technical aids, transportation of the ill and care in sanatoriums. Some performances of health care, e.g. cosmetic performances, are not covered by health insurance at all.

Financing Pension Insurance in the Czech Republic

Since the year 1989 many changes have occurred in the sphere of pension insurance aimed at gradual creation of modern system of pension insurance, whose

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financing would be separated from the State budget. Its system of benefits would be able to respond to demographic and economic development and would consider running economic transformation. At the same time it was topical to encourage and motivate the insured to take an active part in pension system. The calculation of pensions has been crucially changed in compliance with legislative changes, valorization of pensions has been adopted, conditions for providing total or partial disablement have been changed and parallelism of old-age pension and gainful revenue. The gradual raise of the age of the retinal was set up.

It is necessary to emphasize that the present pension system, although it is based on pay-as-you-go system is administered much more effectively than in other countries. That is why no crisis of the system has happened, but at the same time nobody has realized the necessity of improvements of the system. Therefore nowadays we fight a lot of problems mainly in the sphere of financing pension insurance, excessive solidarity of the whole system and insufficient development of supplementary pension insurance. The pension system based on two pillars is the result of the transformation of pension insurance in the years 1990 to 1998: first, the basic obligatory pay-as-you-go system and, second, the voluntary supplementary which includes a State financial contribution. The possibility of changing the insurance based on the capital reserve system (funded) is the topical question. Even if the principle is supported by many authors its advantage is not explicit. It is clear that there are two basic alternatives: (1) preservation of pay-as-you-go system (1st pillar), and (2) transformation into the system of pension insurance based partially on pay-as-you-go system (1st pillar) and partially on funded financing obligatory insurance (2nd pillar).

Both suggested alternatives should be completed with pension insurance (which includes a State financial contribution) (3rd pillar) and other possibilities of individual security based mostly on commercial principles (4th pillar). No model is ideal, either it is going to be according to the first or the second version, a lot of serious problems must be solved. The alternative of pay-as-you-go system (including its corrections) should not be eliminated. The system should be completed with the measures that would provide bigger expansion of supplementary pension insurance. If the guarantee of pension revenues is the objective of the pension system, then the least risky arrangement is the supplementary pension insurance. Understanding of pension reform means to express attitudes towards the two roles of a State, i.e. the State as a provider of pensions and the State as a guarantee of a pension system. It is clear that the transformation of the old-age pension scheme could be realized only as a gradual process.

However, the basis of financing pensions does not consist in a way of solving pension reform (the role of basic and supplementary system, pay-as-you-go system or funded system, restriction of back up time, stricter control over giving earlier pension etc), but above all as a politically obscure social objective in which the pension system in the Czech Republic should be targeted and as defining methods

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and means which could be given to the pension system. It is not difficult to suggest a possible solution but it must be the solution that will be accepted by the public and will not give a cause for serious problems both in the social sphere and in the economy. We can see the absence of a social doctrine in the Czech Republic, which would characterize objectives and determine the approach to the solution of social problems in the Czech Republic in wider connections and a long-term perspective.

Basic Pension Insurance Benefits

From the new system, benefits are provided and based on the insurance duration, and archived income. These are old-age pensions, disability pensions, and pensions of survivors. Opportunities for early retirement are extended, and widower's pension introduced. It is provided under the same conditions as widow's pension. An increase of pensions due to incapacity is preserved as a benefit independent of income.

Old-Age Pension. A gradual increase of the retirement age was introduced; two months for men, and four months for women per (even incomplete) year of the law, effective to 2007, when the retirement age will represent 62 years for men, and 57-61 years for women (according to number of raised children). Probably the largest changes were made in the way of pension calculation (The rules for designation of earnings decisive for pension calculation changed):

1. The earning cited for pension calculation was originally (in 1996) the average earning during the ten years span before retirement. For each year of the effect of the Pension Insurance Act, this decisive period is extended by one year so that (within 20 years) this period will reach 30 calendar years.
2. All earnings within the given period will be incorporated into calculation. The highest earnings for a certain period will no longer be singled out. These earnings however, will be reassessed so that their levels are maintained in relation to the average wage at the period in which they were reached. This will result in so-called 'indexation' of earnings, i.e. multiplying by coefficients that express development of an average wage, beginning at the pension-granting year when earning levels were reached.
3. The method of determining calculation base from indexed earnings while excluding certain active periods remains unchanged compared to original calculations of average monthly earnings. Only the reduction amount is changed; the personal assessment base (earlier non-reduced average monthly earnings) is fully incorporated into the amount of CZK 6,600 (Czech Koruna). From CZK 6,600 to CZK 15,300, 30 percent are incorporated (not the original one third), and anything over CZK 15,300 10 percent is incorporated without further limitations. These fixed limitations by law will be adjusted regularly so

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that the relation between paid out and newly granted pensions, and between pensions and earnings is kept.

A two-tier construction of pension was introduced. Every pension will consist of the following two tiers:

1. Basic amount (flat-rate), which is equal for all pensions. It is provided through a fixed amount. The government is authorized under the law to increase this amount according to strict rules. The basic amount is granted only once in concurrence with two or more pensions, and it is not incorporated into the area from which a survivor's pension is calculated (since 1998 1,310 CZK).
2. Percentage amount (earnings-related) which is calculated from the calculation base, and the number of years of insurance, differ according to the type of pension: (1) for old-age pension and full disability pension, 1.5 percent from the calculation base is given each year of insurance; (2) for partial disability pension, 0.75 percent of the calculation base; (3) for survivors pensions, the basis is the percentage amount of the pension received by the deceased person or to what he was entitled at the time of his death, tariffs represent 50 percent for a widow's or a widower's pension, 40 percent for an orphan's pension (with respect to, orphan's pensions from both sides), from the amount of the deceased person's pension.

Also for full or partial disability pensions, the so-called additionally calculated period, i.e. the period from origin of disability to reaching retirement, is taken as period of insurance. During the 1990s, the amount of average old-age pensions in the national economy varied between 43.5 and 55.3 percent of average gross wages. The ratio between pensions and wages is the object of ongoing discussion regarding future reform. As a result of redistribution, the system shows considerable elements of income solidarity. This means that the pension to wage ratio gradually decreases as income increases. According to the existing legal regulations, for newly granted pensions this ratio represents 78 percent in the case of below-average wages and only 26 percent in the case of wages three times above average. This is caused by a substantial reduction of earnings, which is decisive for calculating pensions. The development of real pension values has been quite uneven since 1989, especially in comparison with the development of real wages. A certain decrease in real pension amounts has occurred after 1989. From 1993 onwards, the real value of wages has risen more rapidly.

Disability Pension. The term "full disability" has an entirely new definition. From the original four possible definitions, only two have survived; a decrease of ability for systematic economic activity at least by 66 percent, and the ability for economic activity only under completely extraordinary conditions according to health

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incapacity (the latter of the mentioned conditions is used less frequently). An insured person is partially disabled if his capacity for consistent economic activity was decreased due to an unfavorable health status at least by 33 percent, or if such status significantly deteriorated his general standard of living. For disability pensions is the formula for calculating it is the same as the formula for calculating old-age pensions. The pension account showed a deficit since 1997 (cf Table 4.2). This negative balance is still growing despite changes that were introduced in the system on a short-term basis in 1997, above all the tightening of valorization criteria.

Table 4.2
Pension System Revenues and Expenditures

	1993	1994	1995	1996	1997	1998	1999
Contribution rate (%)	27.2	27.2	27.2	26.0	26.0	26.0	26.0
Revenues (billion CZK)	83.0	101.6	120.9	134.7	147.2	156.3	161.8
Pension expenditures (billion CZK)	76.6	88.2	109.8	127.6	151.1	166.1	177.8
Administrative expenditures (billion CZK)	1.5	2.0	2.3	2.7	2.6	2.7	3.4
Deficit (billion CZK)	+4.9	+11.4	+8.8	+4.4	-6.5	-12.5	-19.4

Source: Ministry of Labor and Social Affairs.

So far, however, the main reason for the growing pension insurance deficit has not been the worsening demographic structure. It is primarily the economic situation in the Czech Republic that now plays an important role, and which has led to a decrease in the system's revenues. The current economic crisis has caused an increase in unemployment (in September 1999 the unemployment rate was 9 percent), a slower increase in wages and thus in the overall volume of contributions, as well as an increase in the number of non-payers of contributions, many of the companies struggling for survival in the economic crisis. This involves, then, a decrease in the number of contributing individuals of productive age, as a consequence of growing unemployment. The large extent of replacement periods, during which contributions are not paid, or advantages for independently economically active individuals are also significant. System expenditures have likewise risen thanks to more frequent use of favorable early retirement structures (above all as a result of the unfavorable situation on the labor market). The demographic forecast clearly shows the need for a rapid reform. There is no doubt about the fact that the pension system is highly sensitive to demographic and economic developments. This arises from the fact the basic pension insurance system is based on ongoing financing, in which pension payments for current pensioners are more or less covered by current contributions from economically active individuals. One of the decisive factors in this regard is the ratio between the number of pensioners and the number of persons making contributions to the system. The forecast for demographic development up to the year 2050, issued by

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the Czech Statistical Office, indicates that the Czech Republic will have to plan on significant reforms of its pension system. Retirement age (number of pensioners to a number of contributors) is in the year 2000 0.48 and the estimates for year 2050 is 0.93).

Basic Sickness Insurance Benefits

Sickness benefits are due to an employee who, in accordance with special legal provision, is recognized as being temporarily unable to perform his current employment due to his state of health. These benefits are provided for calendar days and are paid from the first to the last calendar day of the period of inability to work, or until recognition of full or partial disability, but only up to a maximum of one year from the beginning of the period of inability to work and can be prolonged by another year. Sickness benefits are computed from the employee's daily premium assessment base, but only on up to a maximum of CZK 550 per day. The amount of sickness benefit per calendar day amounts to 69 percent of the daily premium assessment base. However, for the first three days of the period of inability to work the sickness benefits amounts to 50 percent of the daily premium assessment base, which is computed by dividing the amount of the premium assessment base for the decisive period by the number of calendar days in the decisive period. The ratio of daily sickness benefit to daily wage has decreased from 66 percent in 1990 to nearly 45 percent in 2000.

The sickness insurance provides a short-term benefit for care of a family member to an employee (male or female) who cannot work because he is caring for a sick child under 10 years of age, or for a child under 10 years of age if a child-care facility or school has been closed by decision of the appropriate authority, or because he or she has to care for a family member whose state of health requires the care of another person. Benefit is due only if the child or the sick family member lives in the same household as the employee. It is provided only for the first nine calendar days of such care (16 days in the case of a single employee), provided that the need for the care persists during these days. Short-term benefit for care of a family member is calculated in the same manner as sickness benefit. The amount payable per calendar day is 69 percent of the daily premium assessment base (maximum CZK 550 per day).

Besides the Act on Provision of Maternity Leave and Benefits During Maternity stipulates details of the income support available during pregnancy and maternity and maternity benefit. Income support during pregnancy and maternity is paid to a female employee who performs a job which, under the law, a pregnant woman may not perform, or which could endanger her pregnancy according to the opinion of a doctor. It makes up the difference between her usual wage and the wage she receives after transfer to another job. This birth grant is provided for calendar days to a woman on maternity leave, in the amount of 69 percent of the daily premium

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assessment base (but only on up to a maximum of CZK). The benefit period in this case is 28 weeks (of which six to eight weeks prior to the expected date of birth).

The Role of Supplementary Pension Insurance

In March 1994, the new system of voluntary State contributory pension insurance came into existence. It became a supplementary income with basic obligatory insurance. The system could be called the third pillar of the pension scheme in line with common world practice. It has the following parameters:

1. It is voluntary, based on the personal decision of a potential participant.
2. It is based on civic principle, on the relation between a pension fund and a natural individual.
3. It provides the taking into account of competitive offers of other pension funds.
4. It is financed by the funds.
5. It is subsidized by the State with a State financial contribution which is derived from the level of premium and since the year 2000 has been even supported in the form of tax relief.

The guarantee of the possibility of getting supplementary revenues besides an obligatory pension scheme is necessary both as a result of accepted changes in the system (removal of preferences of specific groups of citizens) and the support of an adequate relation between old-age pensions and wages of higher income categories. Within the framework of supplementary pension insurance the wage limit for old-age pension can be compensated (e.g., at the age limit 62 years for men, they can retire in their 60s under the conditions defined in pension scheme) in such a way that the fund will be paying out; the pension during two years before the right to the pension from basic pension schemes arises. Supplementary pension insurance can offer a solution to incapacity at work (if people cannot do their job any more for health reasons, they can make so-called half pay which will be paid out during the switch over a new job). Economic reasons play an important role besides social reasons as well. Insurance funds are important on the capital market in industrialized countries, their property represents a significant share of the private sector's capital. Supplementary pension insurance provides even target allocation of capital because government influences even diversification of property administrated by pension funds. Supplementary pension insurance allows to cut down the burden of public expenditures for a long-term, because it transfers responsibility for the future to a citizen. The minority of citizens is dependent only on basic obligatory insurance.

So far supplementary pension insurance has not played its role in the Czech Republic, because there was short-term saving. Most contracts ended with paying out a single amount, only 2 percent of participants asked for old-age pension (about

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2,6 million people will participate in the supplementary pension insurance). A liberal law of supplementary pension insurance allowed the multiplication of the amount of pension funds to enter the market despite their absorption ability. Original amount of 45 pension funds has been reduced to approximately 25, when eight largest funds include more than 80 percent insured. Although no crashes of large pension funds have occurred, there are certain antecedents of problems of some institutions. If the citizen's confidence is again disappointed, they would not like to save in the supplementary systems and they will more focus on basic obligatory insurance. Amendment of the law, which went into effect on the January 1, 2000, tries to solve some failures of used supplementary pension insurance. The amendment especially brought higher State contributions, increase of the minimum length of savings, and tax relief for employers and employees. The amendment also tries to make the economy of pension funds more transparent. It provides better monitoring of their activities to the government. Other significant changes in supplementary pension insurance are expected in connection with establishing employees' supplementary insurance, which should start to work on the January 1, 2003. But the development of supplementary pension insurance in the following years depends on external conditions (economic growth, inflation, unemployment etc.) and above all on the accepted conception of financing basic system of pension insurance.

Labor Market and Employment Policy

Development of Employment. Historical development and further expansion of industry meant that for a long time the Czech Republic enjoyed high over-employment. The domestic workforce couldn't fill all the jobs that were created, sometimes not even in the first shift. A different state of affairs came about after 1989. Major structural changes proved to be necessary in the new social system. These were not just changes of ownership, but also rather major changes in the structure of entire sectors of the economy. The ownership changes and extensive restructuring of the economy could not pass off without a decline in gross domestic product and the impact that had on employment. In a relatively short period of time the Czech Republic was therefore introduced to unemployment. The average number of people in employment in all spheres of the national economy thus came to 47.3 percent of the population of the State in 1999. The socio-economic transformation after the fall of the totalitarian regime also affected women's employment. Before 1990 Czechoslovakia had one of the highest rates of women's employment in the world. In the period under scrutiny it fell slightly (from 46.2 percent to 43.3 percent).

Unemployment in the Czech Republic in the nineties did not move in one direction only. In the first years of the decade the number of people registered as applicants for job fell (the rate of unemployment was just 3 percent). Yet 1996 was

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marked by a sharp rise in the number of jobseekers. This rise accelerated. The rate of unemployment in December 2000 was 8.7 percent. Unemployment affects some parts of the population more than others. Most at risk in the Czech Republic are the handicapped, young people, people with minimum qualifications and women (especially with young children). The rate of unemployment displays considerable regional differences (Prague 3.4 percent, Most 21.5 percent, Karviná 18 percent, and Mladá Boleslav 3.2 percent).

Benefits for Jobseekers. When a person is made redundant or is unable to find suitable work within a time corresponding to or appropriate to his or her employment, he or she must report this to the local public labor office where he or she is registered. Registration is the first precondition for receiving unemployment benefit. The provision of material aid to people seeking work in the Czech Republic is governed by the employment act, which sets out the term of provision, the duration of provision and the amount. The act also imposes a number of duties on registered job-seekers. If these duties are not performed, benefits may be withheld. Most fundamental aspects have seen major changes in the course of the nineties. The first condition of the right to benefits, which applies unchanged throughout the entire period under scrutiny, is that the person seeking work had to be employed for at least 12 months in the last three years. The job-seeker is denied further benefits if he turns down suitable work (unless for good reasons of health or qualification) or if he has quit a job of his own accord and without good reason during the last 6 months.

Whereas in 1990 the term of support was set at 12 months, the present legislation dictates that benefits can be received for 6 months at most. The amount was also cut. In 1990 it equaled 60 percent of the previous net wage (at most CZK 2,400); now it is 50 percent of the net wage in the first three months, in the next three months 40 percent of the net wage (or 2.5 times the subsistence minimum, whichever is less). Because paying out benefits only treats the consequences of loss of employment and does not eliminate or prevent it, this is described as a passive employment policy.

Development of an Active Employment Policy. The sharp rise in unemployment in recent years greatly increases the importance of active employment policy. From the very start of transformation, after the fall of the totalitarian regime, the responsible functionaries understood that the risk of unemployment during the transition to a market economy requires more than just a social safety net. The system of public labor offices was built up with this in mind. These offices do more than just registering people seeking employment and dealing with administrative work linked to claims for benefits, recording and mediating vacant jobs etc.: they also implement active employment policy as conceived in the following forms:

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1. creating public utility jobs,
2. organizing public utility works,
3. requalification (retraining),
4. creating jobs for graduates and individuals practicing,
5. creating jobs for the handicapped including sheltered workshops and sheltered employment.

Sufficient funds are required if this policy is to be successful. In 1998 the amount of funds spent on active employment policy was a good 63.6 percent higher than in the previous year and amount to 1 billion CZK. The government's employment policy must focus on archiving the following fundamental goals:

1. introducing new economic policy measures to support the creation of new jobs and to alter the existing structure of employment;
2. increasing the motivation in the workforce to enter or return to employment by making work incomes far more attractive than social incomes;
3. bringing the preparation of the workforce into line with the requirements of the labor market;
4. bringing the scale and employment of foreign workers into line with the situation on the labor market;
5. increasing the scope and effectiveness of active economic policy measures;
6. ensuring that there are sufficient staff, organization and funds for the working of the employment services in line with the expected level of unemployment.

Educational Policy

The objective of educational policy in the 1990th was to remove negations and deformations of our educational system, to go back to its democratic traditions, bring it nearer to the educational system of developed countries and to the new requirements for education, requirements of the information era. In the educational system as a whole, principal changes must be done. The changes are concerned with the conception, extent and quality of education, its variety, social and individual utilization. Necessity of the changes is caused by the following two facts:

1. The first consists in the fact that our educational system was destroyed in previous so-called socialist development and is still influenced by the model of education in the 19th century (e.g., discipline is emphasized, subordination, minimalization of dialogues, participation etc.) and principles of modern educational policies are still insufficiently applied.
2. The second consists in the fact that nearly all educational systems, not only ours, but also the ones in all developed countries face difficult tasks. Educational systems should be in compliance with requirements of the society

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based on knowledge. It means that the principal social duty is to provide tools for individuals so that they become and stay educated persons all their life and they should have assumptions for the work and performance in other social roles.

Present reform is understood as a continual, long-term process, internal reform, which is orientated on the change of educational system (contents, methods, forms, educational goals style of work, motivation etc.) and which is determining, aimed at the tasks of articulation of the educational system. Changes in the 1990s complied with the main objective of educational policy: to provide the highest level of education for all pupils and students. Education is now understood as the shared responsibility of students, teachers and parents. The wrong idea that education is the concern of the State not private interest of a citizen is gradually disappearing. Therefore the State becomes only one of the others, even if a very important subject of educational policy. Excessive centralization in the educational system, nearly monopoly position of the State and unification of educational system were removed.

The right of citizens to individual choice of education has emerged. The educational system has become more open not only to the needs and interests of educated individuals and society, but also to the developed world. The relations between main partners in education (citizen, school, State) are based on respecting their rights. The extensiveness that was typical nearly of all schools was the trend in the first half of the 1990. The orientation was caused by political and democratic changes, attempts of schools to be free and independent; to support competition among schools etc. The supply of State schools was completed with private and Church schools. Nowadays more than 1/5 of students of secondary schools and 11 percent of students of grammar schools study at non-State schools. Since the year 2000 it has been possible to study even at private universities. However, the requirement of effectiveness of the educational system must be preferential. The following problems, especially their solution are among the key spheres where educational policy must be developed and attuned with internal and external conditions and requirements: (1) the role of government and other subjects in educational policy, (2) the provision of fair access to education and its quality, and (3) the financing and effectiveness of distribution and the use of sources on the development of education.

Development of Health Institution

The need for the transformation of health care was evident even before the end of the socialist era. It was visible, among other things, in the fundamentally different growth of the average life span of the Czech population versus that of other developed countries. While in 1960 the average life span in the Czech Republic occupied a leading position on an international scale, over the next thirty

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years it fell considerably. The need to improve the population's state of health and to adopt a complex approach to human welfare was promoted at scientific conferences, but not, however, in government programs. The general need for a new economic approach to health care was talked about in simplified or one-side terms, and thus the satisfaction of this need over the course of the transformation years was slow. It was necessary to increase overall resources for health care, but at the same time, it was also vital to return to an economic conception of the development of health care.

After 1990, health insurance was re-introduced alongside the hitherto exclusively State resources. Other types of resources were also legalized, such as private payments, sponsor gifts, company resources for purchasing services, the activities of charitable and other institutions, and so on. After several decades of simplified budget management, however, there was a lack of experience in regulating the market and standardizing the economy at the outset of the transformation process. This had unequivocally negative consequences.

Although health care institutions began to act independently, the forms of an extensive transformation of health care had not been precisely defined. Only during the process of transformation did the interests of institutions as well as individuals become diversified, and this significantly influenced both the effectiveness of the transformation and the activities of the health care system. At the beginning of the nineties, the legal code was tied to the former situation under socialism. Thus, at the present time, a system of health care (health insurance) exists alongside a system which is a part of a more broadly-conceived system of social security, and which provides cash benefits in the case of illness with no direct relation to the costs of treatment, prevention and rehabilitation. Since 1992, the decisive source of financing has been health insurance. The State pays health insurance premiums for certain groups of people without their own income (pensioners, school-age children, dependent children who have completed their mandatory education, women on maternity leave, and so on). The State puts other resources into the investment and non-investment activities of the institutional sphere. Collecting premiums and reimbursing health care facilities for their activities is overseen by the now quite stable system of health insurance companies. During the first three years there were 27 of them, after which the number subsequently fell to the current ten. Public expenditures on health care (health insurance and the State budget) represent around 5.2 to 6.7 percent of the GDP.

The overall nature of the transformation of health care can be seen by referring to the dimension of the economic transformations that occurred during the nineties, with regard to the preceding period as well. This can be demonstrated with the help of, for instance, the indicator for health care expenditures per capita. In the Czech Republic, figures for health care expenditures per capita consist of public health care expenditures (not support during illness, private payments, etc.). While during the eighties expenditures on health care rose slowly (by 180 percent up to 1989), in

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the nineties they increased 4.7 times (they therefore increased 8.5 times between 1980 and 1998). In per capita terms, this represents a growth from 1,470 CZK in 1980 to 2,600 CZK in 1989 and 12,500 CZK in 1998.

A dramatic increase in the level of health care had already occurred during the first years of transformation, but the year 1993 represented a turning point. Following the enormous growth of health care revenues and expenditures in the same rapid tempo. The tempo of the growth of revenues as well as of expenditures slowed, which caused dissatisfaction among health care workers. The population has experienced the improvement of facilities and the introduction of new technologies; foreign medicines have become available, and so on. The bed capacity in hospitals is gradually and slowly decreasing. In 1999 there were 6.6 beds per 1,000 inhabitants. The overall availability of physicians is an important factor. Of the total number of 228,000 workers in health care (converted, not actual figure), 39,000 are physicians (262 inhabitants per physician). It is positive that the situation in terms of the health state of the population began to improve rapidly after 1990. However, a great difference between the Czech Republic and other countries can be still perceived. This fact should have a mobilizing effect, and such comparisons should be used in defining goals for the further development of health care.

It goes without saying that progress is not caused only by changes in health care, but is also influenced by the overall climate in society, care for the environment, the level of social security, the level of culture, and so on. In forming subsequent phases of the transformation of health care, it is also important to proceed from an assessment of unfinished tasks of the transformation hitherto, from specific points that are sometimes forgotten about, and from the need for a more thorough integration of procedures.

Perspectives of Development of Social Policy

The Social Doctrine of the Czech Republic

The social doctrine represents a theoretically motivated set of basic values and principles from which the practical work of State authorities, cooperating institutions and also the public in realization of social policy will originate. It is based on the agreement of crucial political bodies and expresses the general principles of the new Czech State. The social doctrine should be drafted in such a way as to stimulate and facilitate the search for the best alternatives during the solution of concrete social problems. The social doctrine should not be a dogma. Its changes should be taken into account. The changes are both in direct relationship to the method of human recognition, social development and attaining experience of Czech political representation in the administration of public affairs. Wide and reliable discussion must precede such changes. The discussion on general tasks of

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social policy is beneficial. Demand for the social doctrine comes because of the following reasons:

The first need is stabilization. Czech society needs not only a social program, but also a social doctrine based on an updated conception of inalienable human rights, which is going to be the result of social consensus and help to solve everyday problems of social policy. In a short-term dimension the doctrine protects society from hasty excess of politicians, populists pressures of pre-election programs and opposition politicians. In a medium term perspective the doctrine as the agreement of involved parties stabilizes the social environment and facilitates transformation and updating of social tools in compliance with the change of social conditions without destabilizing the society. So far our society has not taken care of its social inheritance. And this is the second reason why the Czech Republic needs a social program. There is incompleteness of the set of instruments because we have inherited the social system which accompanied another economy, another social doctrine. Transformation of our system of social tools has not been completed yet. Therefore it is not perfectly adapted to the new needs of the free market economy, new social circumstances and democratic civic society. It has a lot of inner tensions causing social pressure. The third reason is long-term. Demographic changes and globalization of social problems will bring already known problems. Therefore society will set out how these problems should be solved with the help of the doctrine to avoid an undesirable social crisis. The solution should be slow, gradual and thus less painful for one generation.

Setting of long-term objectives at the highest political level is convenient for public acceptance of the social doctrine and its long-term realization. The vision of the objective should be a matter of agreement between political parties. The agreement has to have a long-term character and be applicable regardless of the political party in power. It could only contain what is really common (or majority) conception of objectives of the development of society and ways how to reach them in activities of social policy. Otherwise, the consensus could not be reached. The adoption of a social doctrine even could significantly advance the search for an adequate way of financing pension insurance in the Czech Republic.

Social Aspects of the Czech Republic's Entrance into the European Union

The entrance of the Czech Republic into the European Union has a significant social dimension. It anticipates big changes in present legislation. A considerable boost of institutions is expected as well, both in the sphere of administration of social security and health protection. Realization of legislative and institutional requirements of the Union will involve high costs, which will influence both the State budget and employers and employees. The negotiations will be focused on detailed evaluation of our preparedness to guarantee conditions of basic EU freedom, i.e. free movement of goods and services, free movement of capital and

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people. The Czech Republic ability to accept and actively collaborate with the EU basic policy, especially trade, ecological, regional, agricultural, transport and other policies, legally binding in the EU legislation. The Czech Republic and other candidate countries cannot rely on the change of adopted policies and legal rules, it can and it should negotiate main conditions and time horizons for their acceptance and effectiveness. The complexity of the negotiation process has increased.

The European dimension is opened for the Czech Republic at least in two directions in the sphere of social security. The first one is the mutual dialogue and common searching for optimum, politically consensual, socially balanced, economically tenable social protection of citizens from life and social risks. Such a dialogue has been running in the EU for a longer time and probably will become the substantial component of reflections on the following tendency of member countries and the Union as a whole at the beginning of the 21st century. Its pursuit is a unique opportunity for the Czech Republic to be inspired to realize such reforms of social and tax systems to bring nearer to the social and economic optimum. The second dimension is directly connected with a homogeneous economic area and the free movement of the labor force, which is usually called co-ordination of national systems of social security. The principal of elimination of discrimination and legal protection of the EU citizens on its territory is connected with a lot of legislative, administrative and technical requirements, but it is undisputedly one of the basic mechanisms of economic, social and humane work of the integration.

The integration of the Czech Republic into the EU has a sense of social relation. In accordance with it there is the EU commission's opinion, which sees Czech social policy explicitly in the context of European social policy with its all features like a high level of social security, social solidarity and co-operation with social partners. The expertise confirmed that the model of social redistribution practically coincides with the practice common in all EU member countries. But politically the most important problem is the problem of free movement of people. According to the European Commission there is no obstacle for the Czech Republic to prevent from the implementation of relevant part of *acquis communautaire*. It is said very diplomatically, because today both sides know well that in the part will not be – at least from the EU view – any effort to real application of acquits at least for several years after the Czech Republic entrance into the EU. We can expect that EU member countries will ask for delaying the real realization of one of the basic freedoms of common market, i.e. freedom of free movement of people till stronger equalization of incomes. The EU is afraid of massive and uncontrollable movement of labor force from new member countries on the European labor market where there are 18 million unemployed anyway. The Czech side will certainly weigh up its attitude towards such requirement if it is appealed during negotiations. Such step is extorted by political pressure of the public more than rational requirement issuing from the experience in other previous accessions. These ones showed that the

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difference in living standard—if the differences are not enormous—couldn't be a sufficient motive for mass migration.

In conclusion, it is possible to say that all the EU Commission's requirements in the social sphere could be realized over several years with consequences which will not mean radical changes to the present system of law, to the labor market and even in relations between employers and employees. But our capability of competitiveness in the EU will play the main role in social sphere, either positive or negative.

Conclusions

Along with economic reform at the beginning of the 1990s, began a fundamental restructuring of the entire social security system. The objective of the transformation process was to establish a social system that meets the needs of a market economy: (1) encouraging individuals, as well as social groups to take responsibility for themselves, and their social independence, particularly regarding the State; and (2) complying with international conventions, and meeting the requirements of coordination of social insurance systems.

Social policy within the period of transformation process played two basic roles in the Czech Republic, the instrumental and the conceptual. The instrumental role was to establish vehicles for compensation for social hardships of the economic transformation, and to render them politically feasible through their implementation. The task of the conceptual role was to present this social reform, a new concept, as a form of social protection for the population. The role of the State changed from the past, and became better defined. On one hand, conditions are established and developed for people to work within resolving their own situations and, with some personal effort, additional social concerns, situations, and events. On the other hand, the state may intervene, only when a citizen cannot manage a situation through his or her own efforts or the efforts of his family. A significant aspect of this social reform is reduction of people's dependence on the State. This was excessive during the former regime. The economic transformation in the Czech Republic was and continues to be implemented without large social pain and shock; this in spite of the fact that the policies affected wide and varying groups of people. In light of this, the implementation of this social policy is quite significant.

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Appendices

Appendix 4.1

**Development of Social Protection Expenditures in Structure
1990 to 1999 (in million CZK)**

	1990	1992	1994	1996	1998	1999
Social security system expenditures	82,253	115,840	149,582	195,004	236,460	254,213
Old-age benefits	45,527	63,699	85,730	125,561	161,805	173,014
Sickness and maternity benefits	8,999	10,162	16,173	20,410	18,534	19,287
Unemployment and employment policy expenditures	0	3,145	2,572	2,664	5,097	7,311
State social support system	13,025	14,748	18,073	28,319	29,637	31,328
Social care benefits and social services system	5,728	6,698	11,529	11,900	13,800	16,300
Administration expenditures	393	2,008	4,628	5,250	6,487	6,937
Health care system expenditures	30,052	45,651	86,418	110,662	129,800	145,367
Social protection system expenditures in total	112,305	161,491	236,000	305,668	366,260	399,570
GDP in current rates	626,200	842,600	1182,800	1572,300	1798,300	1836,300
Percent of GDP for social system protection	17.9	19.2	19.9	19.4	20.4	21.8

Source: Statistical Yearbook of the Czech Republic (2000).

Appendix 4.2

**Development of Real Values of Old-Age Pensions and Wages and
Relation Between Average Old-Age Pension and Average Wage**

	Average pension (in CZK)	Average gross wage (in CZK)	Real value (1989=100)			Relation between pension and gross wage	Relation between pension and net wage
			Pension	Gross wage	Net wage		
1989	1,598	3,170	100.0	100.0	100.0	50.4	63.8
1990	1,731	3,356	98.4	96.6	96.8	51.6	65.2
1991	2,176	3,932	81.6	72.2	71.9	55.3	70.4
1992	2,413	4,644	79.8	76.8	74.6	52.0	67.7
1993	2,734	5,817	75.6	79.6	78.8	47.0	60.1
1994	3,059	6,896	76.3	85.8	84.2	44.4	57.2
1995	3,578	8,172	80.9	93.1	91.1	43.8	56.6
1996	4,213	9,676	87.0	101.3	99.7	43.5	56.0
1997	4,840	10,696	91.0	101.3	101.6	45.3	58.3

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1998	5,367	11,688	88.9	102.0	100.3	45.9	59.1
1999	5,724	12,687	92.9	108.1	106.3	45.1	58.0

Source: Ministry of Labor and Social Affairs.

Appendix 4.3

Pensions Paid by Type of Pension 1990 to 1999 (persons, in thousand)

	Old-age	Full disability	Partial disability	Widow	Widower	Orphan	Other	Total
1990	1,737	353	130	635	-	66	31	2,952
1991	1,777	367	127	635	-	63	28	2,997
1992	1,804	382	123	633	4	60	26	3,033
1993	1,815	398	120	631	5	60	24	3,052
1994	1,811	410	117	627	5	60	21	3,051
1995	1,811	420	117	624	5	62	18	3,057
1996	1,806	408	124	625	31	58	-	3,052
1997	1,813	398	138	629	51	59	-	3,088
1998	1,859	392	145	627	68	57	-	3,147
1999	1,892	385	150	623	75	59	-	3,184

Source: Ministry of Labor and Social Affairs.

Appendix 4.4

Structure of Pensions Paid by Type of Pension 1990 to 1999 (in percent)

	Old-age	Full disability	Partial disability	Widow	Widower	Orphan	Other	Total
1990	58.8	12.0	4.4	21.5	-	2.2	1.1	100.0
1991	59.3	12.2	4.2	21.2	-	2.1	0.9	100.0
1992	59.2	12.6	4.1	20.9	0.1	2.0	0.9	100.0
1993	59.3	13.0	3.9	20.7	0.2	2.0	0.8	100.0
1994	59.3	13.4	3.8	20.5	0.2	2.7	0.7	100.0
1995	59.2	13.7	3.8	20.4	0.2	2.0	0.6	100.0
1996	59.2	13.4	4.1	20.5	1.0	1.9	-	100.0
1997	58.7	12.9	4.5	20.4	1.6	1.9	-	100.0
1998	59.1	12.4	4.6	19.9	2.2	1.8	-	100.0
1999	59.3	12.2	4.6	19.6	2.4	1.9	-	100.0

Source: Ministry of Labor and Social Affairs.

Appendix 4.5

Pension Expenditures by Type of Pension 1990 to 1999 (in million CZK)

	Old-age	Full disability	Partial disability	Widow	Widower	Orphan	Other	Total
1990	31,483	6,556	1,581	5,161	-	507	244	45,531
1991	38,803	8,222	1,764	6,528	-	563	172	56,052
1992	44,188	9,525	1,821	7,373	40	578	169	63,699

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1993	50,864	11,505	1,942	8,467	48	634	178	73,638
1994	57,759	13,507	2,122	9,274	62	724	182	83,630
1995	72,035	17,037	2,966	10,119	106	1,150	279	103,691
1996	85,063	19,887	3,967	11,681	330	1,432	5	122,365
1997	104,198	22,363	5,188	13,127	608	1,794	2	147,281
1998	144,606	24,579	6,162	13,747	831	1,882	-	161,805
1999	123,666	25,557	6,669	14,268	967	1,887	-	173,014

Source: Ministry of Labor and Social Affairs.

Appendix 4.6

Structure of Pension Expenditures by Type of Pension 1990 to 1999 (in percent)

	Old-age	Full disability	Partial disability	Widow	Widower	Orphan	Other	Total
1990	69.1	14.4	3.5	11.3	-	1.1	0.5	100.0
1991	69.2	14.7	3.1	11.6	-	1.0	0.3	100.0
1992	69.4	15.0	2.9	11.6	0.1	0.9	0.3	100.0
1993	69.1	15.6	2.6	11.5	0.1	0.9	0.2	100.0
1994	69.1	16.2	2.5	11.1	0.1	0.9	0.2	100.0
1995	69.5	16.4	2.9	9.8	0.1	1.1	0.3	100.0
1996	69.5	16.3	3.2	9.5	0.3	1.2	0.0	100.0
1997	70.8	15.2	3.5	8.9	0.4	1.2	0.0	100.0
1998	70.8	15.2	3.8	8.5	0.5	1.2	0.0	100.0
1999	71.5	14.8	3.8	8.2	0.6	1.1	0.0	100.0

Source: Ministry of Labor and Social Affairs.

Appendix 4.7

Expenditures on State Social Support Benefits (in million CZK)

	1995	1996	1997	1998	1999
Child allowance	12,770	12,194	12,495	11,493	12,474
Social allowance	6,029	6,244	6,224	6,273	6,251
Housing benefits	-	677	813	1,367	2,084
Transport benefits	-	839	938	947	994
Parental benefits	5,824	7,357	7,612	7,780	7,718
Charitable benefits	39	34	25	23	19
Foster care benefits	111	144	154	233	315
Child birth benefits	428	484	525	563	566
Funeral benefits	329	348	331	519	543
Total expenditures	25,531	28,319	29,237	29,637	31,328

Source: Ministry of Labor and Social Affairs.

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Appendix 4.8
Amounts of the Official Subsistence Minimum per Month in the Period
from 1991 to 2000 (in CZK)

(A) Amount to Cover Nutrition and Other Basic Personal Needs of a
Citizen (by a person's age)

	1991 (29/10)	1994 (1/2)	1996 (1/1)	1997 (1/7)	1998 (1/4)	2000 (1/4)
Child up to 6 years old	900	1,120	1,320	1,480	1,560	1,600
6-10 years of age	1,000	1,240	1,460	1,640	1,730	1,780
10-15 years of age	1,200	1,500	1,730	1,940	2,050	2,110
15-26 years of age	1,300	1,620	1,900	2,130	2,250	2,310
Adult	1,200	1,500	1,800	2,020	2,130	2,190

(B) Amount to Cover Essential Household Expenditures
(by size of household)

	1991 (29/10)	1994 (1/2)	1996 (1/1)	1997 (1/7)	1998 (1/4)	2000 (1/4)
Individual	500	660	860	1,020	1,300	1,580
2 persons	650	860	1,130	1,330	1,700	2,060
3-4 persons	800	1,060	1,400	1,650	2,110	2,560
5 persons and more	950	1,260	1,580	1,860	2,370	2,870

Source: Ministry of Labor and Social Affairs.

Pension Reform in Poland

KLUZA STANISLAW AND KRZYSZTOF OSTASZEWSKI

The decade of the 1990s has been a fascinating one, both politically and economically, in Central Eastern Europe and beyond. The process of transformation away from Communism began with the election in Poland in June 1989, in which Communists were soundly defeated. Soon we witnessed the disintegration of East Germany, the *Velvet Revolution* in Czechoslovakia, and the rebellion in Romania, eventually bringing the collapse of the Soviet Union. While the events in the formerly Communist countries of the early 1990s were quite unique to those countries, in time they all faced a problem common to many countries worldwide, the pension crisis (WB, 1994). The way this problem presented itself in Central Eastern Europe—especially Poland—was, however, substantially different than in the most developed industrialized nations, and, in our opinion, can shed a new light on the same issues in the rest of the world. The World Bank presentation suggests viewing the pension problem as purely a demographic phenomenon. This is not the case in Poland: its “old-age crisis”—that is, a significant imbalance between the size of the elderly generations, and the generation of current working age, is about 20 years in the future. But these authors find the demographic explanation greatly lacking in economic insight. The former Communist economies faced the pension crisis very quickly, without the demographic underpinning suggested by the World Bank. What they had instead was nearly universal state pricing of pension

annuities—that is, a practical state monopoly of retirement provision. The old-age crisis is indeed a crisis of state pricing of retirement annuities, and as the case always is with state pricing, it has produced a shortage. This time it is a worldwide shortage of retirement annuities.

Poland was the leader in both the political reform, and the economic reform, in Central Eastern Europe. It has had an organized political opposition movement to Communism since circa 1976. That movement culminated in the explosion of the *Solidarity* trade union in 1980, followed by its crushing by the *Martial Law* imposed on December 13, 1981. But the brutality of the suppression of the free union movement did not stop the gradual “Polish way out of Communism.” Even with hundreds of thousands of political prisoners, and with state special security forces ZOMO killing some of the protesters, peaceful opposition continued throughout the 1980s. By the mid 1980s, the Communist government, struggling with declining standard of living and increasing difficulty of making foreign currency debt payments, began toying with economic reforms. One of the Communist Ministers of the Economy even promised that during his term, within a year, fresh bread and rolls would be available throughout Poland. He did have the good sense to resign a year later when the promise was not fulfilled. By the end of the 1980s, the Communists decided to start negotiations with the *Solidarity* leaders about at least limited power sharing agreement. These so-called Round Table Negotiations, in which the Communist party bosses met with people they previously considered jailbirds, culminated in an agreement calling for a limited free election in June 1989. In that curious election, a portion of the parliament was assigned to the Communists, while the remainder was elected freely. The Communists fielded candidates in both parts, but lost dramatically and were only elected in the part assigned to them by the agreement. *Solidarity* then offered to the Communists a deal whereas the government would be formed by *Solidarity*, but the presidency of the country would remain with the Communists, and be assigned to General Jaruzelski, the perpetrator of the 1981 *Martial Law* terror and massive arrests. Free presidential election was subsequently held in 1990 and won by Lech Walesa, *Solidarity* leader (in an amazing twist of fate, the subsequent 1995 election was won by a former Communist youth leader, Aleksander Kwasniewski, who became a force for reform within the Communist party and made it into a power in Polish politics, the social democrats).

The new government, created by the 1989 election, started a rapid reform program—that is, the *Balcerowicz Plan* (named after the Minister of Finance of the said government). Its main points were: freeing the consumer goods prices, privatization of some state-owned enterprises, easing of tariffs, and allowing interest rates to float freely, as well as allowing (a big change after Communism) unemployment. The plan, however, did not extend any of its market approach to the pension system. In fact, the new government has expanded early retirement and disability provisions, previously granted by the Communist government in a limited

fashion. We should add that the pre-1990 Communist governments have attempted to reform pensions, but those reforms were mainly in the form of raising the payroll tax. One substantial change was the separation of the retirement social insurance budget from the general revenue budget, achieved in 1986 with the creation of the *Retirement Fund* administered by ZUS (Social Insurance Enterprise).

A comprehensive review of the pension system history in Poland, and its issues for reform, is given in a recent Polish book by Stanisława Golinowska (2000), a leading scholar in this area in Poland. Notably, in 1989, pensions constituted only 8 percent of GDP, and the payroll tax was set at 38 percent. By 1992, pension expense reached 15 percent of GDP, and the payroll tax rose to 45 percent. Pensions were indexed to wages, and the rapid pace of reform, with great structural changes in the economy and resulting unemployment, combined with high replacement rate of wages by pensions, over 70 percent, created strong early retirement incentives, only made easier by the *Balcerowicz team*, which believed that this was a way out of the unemployment problem (falsely, in our opinion, as retiring workers do not necessarily leave jobs to the younger workers—since in retirement they often reduce their consumption, resulting contraction in aggregate demand may eliminate the jobs they had just left behind, making everyone worse off).

By the mid 1990s, Poland and many other Central Eastern European countries were facing serious problems in the financing of their pension systems. The problem was indeed especially pronounced in Poland. In the years 1994 to 1998, pension expenditures averaged roughly 14.5 percent of GDP. These substantial, and only paid by the public sector (in view of the virtual state pension monopoly created by Communism) expenses were financed by issuing public debt, the cost of which is estimated by Gomulka and Styczen (1999) to be at least 2.5 percent of GDP. By 1995, pension funding became one of the most important issues in the Polish economy. While the overall economy began a rather powerful recovery in 1992, the pension system was in a continuous deterioration. The problem was exaggerated by the political changes of 1993, when the former Communists (renamed social-democrats) came back to power in the election, and generally followed a “hands-off” policy towards any changes in approaches to the economy. However, beginning in 1995, even the “hands-off” social democrats were forced to begin a process of preparation for a comprehensive pension reform. Following the 1997 election, *Solidarity* coalition came back to power, with the program of four major reforms: administrative, pension, health care, and education. This accelerated the process, and in 1999, new pension system was put in place.

Global and Polish Pension Crisis

The World Bank (1994) document has brought to the forefront of the economic debate the global issue of funding of pensions. As many countries have experienced a birth boom following World War II, and a reduction in the size of adult population

due to war, it appears that the retirement of the post-World War II generation may be difficult to accommodate for many economies worldwide. Over time, birth rates in the developed world have declined, in many cases below the natural replacement rate of roughly 2.1, and looking into the future many countries project a sharp decline in the dependency ratio, i.e., the ratio of the size of the working population to the size of the retired and disabled population. The combination of these factors has produced a global crisis, which is often perceived as a demographic phenomenon. We would like our readers to entertain a different hypothesis, which we believe to be of significance, especially in the case of Poland. Polish social insurance system was created in 1920, following regaining of national independence in 1918. It is administered by Zakład Ubezpieczeń Społecznych (Social Insurance Enterprise), ZUS, the social insurance agency of the state. The system is modeled on the German social insurance scheme going back to the original Bismarck design. Until the new reform changed things, under the old system, ZUS collected payroll taxes for retirement and disability social insurance, as well as for unemployment benefits, and distributed those as prescribed by the law to retirees, disability beneficiaries and the unemployed. Until 1987, retirement benefits were not indexed in any way, and effective 1987, indexation to wages was introduced (changed in 1995 to inflation indexation). The system had all basic characteristics of social insurance: (1) it was meant to be self-financing (pay-as-you-go); (2) benefits were statutory, defined by law, and had no link to individual contributions on behalf of the employee, and (3) the system was administered by the state.

It should be noted that in its older, Communist-era, period, the system had cash-flow surpluses, which were utilized by the state budget without any specific accounting provision for this use of funds (amounting to a grant of funds from social insurance to general revenue budget). As the transformation outlined in the *Balcerowicz Plan* started, unemployment rose, and early retirement as well as easier disability provision was implemented, cash flow surplus quickly became a cash flow deficit, which was financed by general revenue budget. While the subsidy from the general revenue budget to social insurance can be perceived as a burden for the overall economy, one can actually make a case that such subsidy represents merely a return of previous excess social insurance contributions (Ostaszewski and Urbaniak, 1995). Given that there was no accounting for the assets transferred from social insurance to the state, and no market prices for those assets, this hypothesis is, of course, impossible to verify. For most of the 1990s, the formula for initial pension benefit was as shown in Box 5.1 (Gomulka and Styczen, 1999).

Box 5.1: Formula for Initial Pension Benefit

$$\pi_i = 0.24 w_* + 0.013 n_i w_i + 0.007 m_i w_i + \pi_i^*$$

Note: w_* = the national average wage; w_i = the average wage over the last several years (from 2 to 10, depending on individual circumstances); n_i = number of contributory years of work; m_i = number of contributory years of non-work (higher education, unpaid leave for mothers, 3 years per child up to 6 years, and period of receiving a state disability pension); and π_i^* = any special pension right (such rights were granted to certain employment groups: miners, soldiers, police, with some privileges also given to teachers, railroad workers, steel workers, sailors and some other groups).

What we would like to point out here is the contrast of such a pension scheme versus a private sector alternative. In the absence of a state pension, an individual purchases capital assets and the size of his or her final pension is determined by the contribution rate, rates of return available on capital assets, and the rate of purchase of annuities at the time of retirement. The crucial element of the private retirement system is that the rate of return, or the current purchase price of the future annuity, is determined by the market forces (and, unless one settles for an extremely expensive, fully guaranteed choice, subject to considerable uncertainty). What a state, even pay-as-you-go, system amounts to is state pricing of annuities, or capital assets in general, with a large portion of the risk of those annuities absorbed in the diversification allowed for by the universal nature of the system. Such a state system strives to achieve two goals, generally viewed as crucial for public policy, i.e. universal pension coverage, and alleviation of poverty among the elderly.

What is missing here is the key point that all systems of state pricing, including state pricing of cars, shoes, books, and indeed capital assets, as well, lead to inefficiencies: either shortages or excess supplies of goods and services not priced by the market. The current global debate about the pension crisis seems to largely ignore the fact that the crisis manifests itself in state pension systems, not in private retirement systems. State pension systems have produced a *shortage of annuities*, by reallocating resources away from production of annuities (i.e., economic investment and population expansion) to consumption (admittedly, in order to alleviate poverty, but one has to ponder if poverty is, in the long run, alleviated by consumption or by production?). Private pension systems generally do not lead to such shortages, but they are also unlikely to achieve universal coverage without some form of government mandate. Notably, the Chilean pension reform of 1981 has replaced previous state system by a universal system of privately priced pensions, and so did subsequent similar reforms in other countries. However, universal coverage under those systems is still achieved through state mandate.

State systems of pricing are also prone to non-market political methods of allocation of resources. Various political entities can lobby state agents to have resources allocated to them at preferential prices, or without paying for them at all. This crucial feature of state systems of pricing manifested itself dramatically in Poland during the late part of the 1980s and early 1990s. While under Communism totalitarian powers of the government allowed it to control allocation of resources to

retirees at will, as the powers of the central government were relaxed, and democratic and free-market reforms introduced, lobbying on behalf of the unemployed and underemployed became more effective. To alleviate the social cost of transformation, early retirement was allowed (and often encouraged) and the criteria for granting disability pensions were relaxed. As the government became less repressive and the private sector grew, it also became possible to evade payroll taxes. The combination of higher costs of pensions (more retirees and pensions for the disabled), higher unemployment, and lower taxable payroll (due to unemployment and evasion), had dramatic consequences. By 1995, the tax rate for pensions and disability stood at 45 percent. In addition to that, payroll tax of 3.18 percent was collected to unemployment and related benefits. This payroll tax was paid entirely by the employer, and it was paid as a percentage of the net pay before income tax (roughly equivalent to 31 percent of gross pay). This, of course, caused the labor costs to be very high, discouraging employment, additionally contributing to the problems of the pension system. On top of that, a significant informal economy has developed, where this high payroll tax was not paid at all, causing workers to lose their social protection, and pulling many legal entities, unable to compete with cheaper informal businesses, into the underground black market part of the economy. This informal economy, while providing often valuable goods and services, usually did not pay payroll tax, and other taxes as well.

One missing element in this analysis is the painful inheritance of non-market pricing of consumer goods in the Communist period: hyperinflation. During the extended period of price controls, which ended in 1990, extensive shortages of most goods, and surpluses of some, developed. When market was finally allowed to clear, prices of goods adjusted rapidly, causing the hyperinflation experience of the early 1990s. In fact, price increases had been happening in Poland since early 1970s, and were continuously a part of political problems. Most of anti-Communist protests in 1970, 1976, and 1980, were sparked by government's decisions to raise prices of some essential consumer goods, such as sugar or meat. Given a history of imperfect and inconsistent indexing of pensions, we can see how hyperinflation had contributed to the pension crisis.

The pension and disability system was also a major tool of poverty alleviation policies, and in absence of other pension resources, ZUS was the effective pension monopoly in Poland. On top of that, while many workers retired early, took disability benefits, or became unemployed, the remaining ones participated in a rapidly recovering economy, with real wages showing significant gains. As the benefits were indexed to wages, retirees indirectly benefited from the strength of the new economy, but did not pay for the costs of the same economy expressed in high rate of unemployment, underemployment, and work force withdrawal. State payroll tax receipts did not grow nearly as fast as the wage index. Because of the combination of these factors, and the generosity of early retirement provisions, the replacement ratio (ratio of the pension to the last wage) for the state pensions grew

to 68 percent, shockingly high by the world standards. For comparison, such ratio is roughly 60 percent in Belgium, 50 percent in Germany, and 25 percent in the United States.

This situation dramatically illustrated the key failing of any state pricing: resources end up being dramatically misallocated. This does not just happen for gasoline price controls in the United States, or toilet paper price controls in the Soviet Union. Price controls must produce some shortages and some gluts, for consumer goods, for machinery, and for capital assets. As a result of state pricing of retirement annuities, large segments of population were encouraged to participate in the political game of early retirement and disability, and discouraged from participating in the labor force. Directly and indirectly, these segments of population have lobbied for greater domination of state-priced annuities in the retirement/disability annuities market, and this lobbying was extremely successful. But long-term success of lobbying does depend on the underlying production, and the state's ability to tax it. Even as the production has recovered in Poland, the state's capacity to tax it has diminished. Even the state owned enterprises began delaying their payroll tax payments to ZUS. Not only the informal sector was cheating on their taxes, everyone learned the game.

Our key insight in this discussion of the Polish pension problem is a perspective, which we believe to be suspiciously absent from the global pension crisis debate. Could it be that the global pension crisis is not a demographic phenomenon after all? Indeed, the unusual demographic developments in the world, especially among the industrialized nations that participated in World War II, can be naturally expected to be priced into capital assets. If there are fewer people, human capital must become more expensive, and capital assets must become relatively cheaper. The markets will include all available information in the prices. But one cannot expect them to work so easily in the state pay-as-you-go systems. Markets adjust prices of future consumption (that is, capital assets) in a continuous manner based on the information becoming available. Payroll tax, pension formula, and indexing provisions of state pension systems require an act of the legislature to be changed. It is not always immediately obvious what the long-term consequences of demographic shifts are, but the market process allows many participants to express their opinions about them, again and again, during every day of trading of stocks and bonds. The volatility of private capital markets may not be always pleasant to market participants, but it allows quick and decisive action, where political process could take years. State pricing of capital assets is, of course, especially dangerous in a totalitarian state where not only market bets opposite to the state expert predictions cannot be placed legally, but even free expression of disagreement with those predictions is stifled. We should not be surprised that the global pension crisis looms largest in the former and current Communist states. Ironically, it looms larger in former Communist states than the current ones, because all of Communist economies are in a crisis, so pensions are no exception, while in formerly

Communist economies, pensions usually remain vestiges of the old system, while the rest of the economy reforms its way out of totalitarianism.

Reform Process

In 1994, the Government of the Republic of Poland published a strategic document entitled *Strategy for Poland*, which identified key problems with the existing pension system as:

1. low effective retirement ages,
2. excessively lax disability criteria,
3. high replacement ratios,
4. large redistributive component in the pension formula, and
5. excessive privileges for some categories of workers.

It was also noted that, because of the effective monopoly of ZUS, the pension system lacked diversification, which could be achieved with addition of private voluntary arrangements and private compulsory arrangements. It is quite common (WB, 1994; Gomulka and Styczen, 1999) to speak about an effective pension system as a three-legged stool, such three legs being:

1. the state compulsory system,
2. the private compulsory system, and
3. the private voluntary system.

The Government of Poland has started the path from one-legged stool to this three-legged stool with its 1994 publication. 1995 was the year of “increased pressure” for the pension reform. By then, the general revenue budget subsidy to ZUS became the largest single entry in the entire Government budget. Given Poland’s long-term ambition of joining the European Community, it became clear that without a comprehensive pension reform Poland was extremely unlikely to meet the EU criteria concerning the size of the budget deficit. The World Bank (1994) publication, a widely cited study, was extremely timely for the Polish situation.

On June 8, 1995 a free-market think tank based in Warsaw, Adam Smith Research Center, the oldest such entity in Poland, founded in 1989, hosted a widely publicized conference “Pension Reform: A Prerequisite for Economic Growth” in which the architect of the Chilean pension reform, Jose Pinera, was the keynote speaker. Pinera argued for a total privatization based on the Chilean model. On June 22, 1995 Ostaszewski wrote an article in *Rzeczpospolita*, presenting a similar idea in print. The next year, 1996, was pivotal. A conference sponsored by World Bank was held in Warsaw, with keynote presentations by Luca Barbone and Michal Rutkowski. Subsequently, the new Office of the Government Plenipotentiary For

Social Security Reform was created, with its head given the rank of a government minister. Its first leader became Andrzej Baczkowski, a tireless, hard-working proponent of reform, who laid the groundwork for the future developments, and was greatly praised by all sides of the political debate in Poland. After his untimely death, he was replaced by Jerzy Hausner who held this position for a relatively short time in 1997. Following the 1997 election, the responsibility was assumed by Ewa Lewicka, who became a powerful force for reform. In late 1997, a blueprint for reform was prepared, and submitted to the parliament for review. The Office of the Government Plenipotentiary For Social Security Reform also created brochures entitled *Security Through Diversity* (Polish Government, 1997), which provided a simplified, popular and widely distributed presentation of the proposed new system. Despite many calls for a full privatization Chilean-style, the Office of the Government Plenipotentiary For Social Security Reform decided to create a hybrid of the Chilean system with the Swedish system of “virtual accounts.” The key proponent of this approach was Marek Gora, one of the main architects of the reform.

The motivations of the proposed reforms were both macroeconomic and microeconomic. One microeconomic concern was to create better link between contributions and benefits, providing better labor incentives (including incentives to leave the informal sector and enter the legal economy). The second issue was to lower the employer payroll tax contribution, in order to lower labor cost, and improve incentives for creation of new employment. Two key macroeconomic concerns were: lowering the aggregate level of public expenditures on pensions, and creating incentives for growth of a private savings pool, and a resulting capital deepening.

Key Points of the Reform

A comprehensive reform package was prepared and presented to the Polish parliament in 1998. The system became effective January 1, 1999. The most important step in the initiation of the new pensions occurred April 1, 1999 the first day Polish workers were allowed to put their savings into new individual accounts. The new pension system consists of three “legs,” or tiers, as we will call them now. *Tier 1* is the compulsory state system, *Tier 2* is the compulsory private system, and *Tier 3* is the voluntary private system. What is very important to note is that while in the old system pension benefits were determined by government fiat, in the new system, all three tiers will pay pensions (required to be in a form of a lifetime annuity for the first two tiers) determined by the market forces, or at least by market-related objective macroeconomic data. This introduces badly needed market discipline, and should be very beneficial to the long-term solvency of the overall system.

The Polish reform is not a complete privatization. State pension system, *Tier 1*, remains the dominant part. But the reform did create universal access for all Polish workers to professionally managed individual investment accounts, which will allow them to enjoy the benefits of capital markets. The key provisions of the new system are as follows:

1. Persons born before January 1, 1949 remain in the old state system, and receive benefits as prescribed by appropriate legislation. Those born between January 1, 1949 and January 1, 1969 are allowed to choose between the old and the new systems. Younger workers must join the new system.
2. The old payroll tax for pensions was 45 percent, and the employer paid it. Half of it now becomes a part of wage base (the other half is paid the same as before), but contributions to *Tier 1* and *Tier 2* are tax-deductible for income tax purposes, thus the tax situation of workers and employers remains the same as before. In the new system, 35 percent goes to ZUS, and is divided between a pension contribution, and a disability premium. 9 percent is redirected for workers to contribute to new accounts that they can set up with a private investment fund of their choice. Those accounts closely follow the Chilean model. There is one crucial difference. The 9 percent going to the private accounts does not go there directly, but is first paid to ZUS which then forwards it to an appropriate pension investment company, based on individual worker's records.
3. Payroll tax contribution to *Tier 1* is used to continue a scaled-down state system. That system now also has individual "virtual" accounts (modeled on the Swedish reformed system). Deposits are held in workers' names, and interest is accrued to them based on the rate of growth of taxable payroll (not a market rate, unfortunately, but this peculiar way of crediting interest may create a hedge for the government against giving away benefits not supported by the economy). The state system allows the retirement benefits to be paid out only in the form of a pension at the statutory retirement age (early retirement age is defined as 62, and there is substantial credit for delaying retirement). The amount of the pension is based on the life expectancy of the cohort of the worker (creating an amazing incentive for workers to encourage their contemporaries to lead unhealthy lives, since if people in their generation die younger, they receive a larger state pension—some say that as a result, mathematically inclined yet heartless, teenagers may encourage their peers to smoke, while abstaining from smoking themselves).
4. Companies managing private accounts must receive the approval of a special newly created regulatory agency, the *Office of the Superintendency of Pension Plans*, headed by an early proponent of the reform, also a tough and demanding regulator—Dr. Cezary Mech. Companies must meet minimum capital requirements,

and their activities are subject to regulation and supervision. In particular, if they deliver returns significantly below the overall industry average, they may have to make contributions to their customers' accounts from their own capital. Additionally, there is a state guaranty fund to cover any losses due to any bankruptcy of a pension plan provider/manager (which is unlikely, but always possible). Companies managing pension money also face restrictions on their portfolios, limiting their foreign and derivatives exposures. These restrictions are somewhat heavy-handed, and one could only hope that over time they will be gradually lifted. But it is also quite clear that they are a product of the political process that led to the reform. Such process required compromises and calming fears about revolutionary changes. At this point, 21 private companies have received licenses to be pension plan providers for Polish workers. Most of them are alliances of Western and Polish financial institutions. Among the western financial institutions which entered this new market are: Aetna, American International Group, Allianz, Commercial Union (which runs fantastically successful insurance company in Poland), Amvescap (whose pension company, Arka-Invesco, is a joint venture with the Catholic Church), Citibank, Nationale Nederlanden, Banco Espirito Santo, Bank Paribas, Nationwide, Winterthur, Zurich, Hamburg-Mannheimer Versicherung, Pioneer. Interestingly, the largest Polish cable television company, Polsat, also runs a pension fund.

5. While the workers could start putting their savings into the new system on April 1, 1999, it was at the beginning of 1999 when advertising campaigns for the new pension plans started. One could see ads everywhere: on billboards throughout Poland, on television, and hear them on the radio. Commercials for pension funds have been quite ingenious, referring to the need for financial security, but also to familiar characters from popular movies or books. The most popular commercial shows a little boy named Bogdan, playing soccer with his teddy bear, giving the bear instructions on proper performance of its duties as a goalie. The message is: Bogdan says "Bankowy." Bankowy is the name of the pension fund provided by a consortium of leading Polish banks. While one can hardly find any connection between a teddy bear, a boy playing soccer, and pensions, this was indeed the most popular commercial. Alas, the company advertised was not a top choice of participants, in fact it did not even make the top three.

6. *Tier 3* is voluntary, and it may be in a form of a pension plan provided by employer, in which case, while contributions are not tax-deductible, benefits will be tax-free. Interestingly enough, since the fall of Communism, Poland has not had taxes on dividends and capital gains, thus this tax privilege seems spurious. However, the tax laws are being revised for EU entry, and taxes on investments are being implemented, therefore the relative attractiveness of *Tier 3* will be increasing. Also, while *Tier 3* contribution is treated as a wage expense to the employer, and

income to employee, it is not subject to the payroll tax for *Tier 1* and *Tier 2* mandatory pension contribution payroll tax, and those are quite substantial taxes indeed.

As of mid-2000, investment portfolios of pension funds consisted mostly of bonds (roughly 56 percent), shares listed at the Warsaw Stock Exchange (roughly 30 percent), with the rest mostly in cash equivalents and bank deposits. Pension funds face very severe restrictions on foreign content of their portfolios (no more than 5 percent) and on the use of derivative securities (no more than 5 percent). Both investment returns and internal results of pension plans in 1999 and 2000 have been discouraging. As a result of the 1998 Russian economic crisis, and subsequent restrictions on the cross-border trade with Russia and other non-EU nations east of Poland, Polish economy slowed its previously breathtaking (7 percent real) rate of growth, to about 5 percent real or less. Slower growth was also apparent in 2000. Performance of Polish capital markets in 2000 was mediocre at best, and pension funds have had negative returns up to date. On top of that, large advertising and marketing expenditures have hurt financial results of the pension companies. Yet these negative results have not been the main news in the early months of existence of the Poland's new pension system. As we had mentioned earlier, Polish reform called for the *Tier 2* contributions to be paid to ZUS and then forwarded to the private pension companies. It also called for *Tier 1* to be transformed into individual accounts. Yet ZUS has never created an individualized accounting system for contributions, and has not kept track of individual workers' contributions. In the traditional system in Poland, the worker nearing retirement had to secure an employment record from his or her current and former employers (and possibly universities, etc.), and such record was the basis for the pension benefit granted by ZUS. After all, the law did not base the pension on the contribution record, but on the employment record, and other special factors affecting the pension formula, given before. Yet in the new system, individual contributions are the key to determining the benefit level, and, even more importantly, account balance. What was not clear to the creators of the new reform was how unprepared ZUS was for such a major accounting change. Additionally, ZUS used to be able to count on general budget subsidy whenever it faced cash flows. But in 1999, the Government of Poland, and its Ministry of Finance, became very concerned with meeting EU entry fiscal requirements, and were hoping that the pension reform would release them from at least a part of the subsidy need.

The early stages of the reform brought about the exact opposite. State enterprises, especially the state railroad monopoly, dramatically delayed their pension contributions, ZUS was losing track of individual contribution amounts, and private pension companies, as well as their customers, were demanding their contribution money in pension accounts. The president of ZUS, Stanislaw Alot, facing those conflicting demands, and lacking appropriate subsidy from the budget,

decided to borrow money from ZUS line of credit with commercial banks. This caused mini-panic among retirees, and was promoted as a scandal by the media. While the credit cost was quite high, as credit is expensive in Poland, financial stability of ZUS was not endangered. But Stanislaw Alot quickly became the least popular politician in Poland, and was promptly replaced by Leslaw Gajek, professor of mathematics and an actuary from the Technical University of Lodz, a leading expert of the technical, modeling side of the reform (who was involved in, for example, resolving the issue of funding for special pension privileges for coal miners). Professor Gajek has succeeded in calming the storm, but the issue of improving the accounting and information processing systems at ZUS remains a serious one to this day, and contributions to *Tier 2* private accounts are still delayed. These problems are, ironically, much more an expression of the weaknesses of the old system than the new one, as they are the remnants of Communism which must be overcome, but they are an important reminder of the need to anticipate difficulties in the transition from a state pay-as-you-go system to a system of individual accounts, especially private ones.

Another issue that affected the public perception of the pension reform was the simultaneous implementation of three other major reform packages: health care, education, and national administration (Kolarska-Bobinska, 2000, provides a comprehensive review of this complex endeavor). While the reforms were badly needed, and instrumental in preparing Poland for its entry into the European Union, as well as for functioning in the global economy, the speed of their implementation, and the massive nature of having so many changes to manage by the government at the same time, have caused the public perception of the total reform process to be quite negative. The health care reform was particularly troubled: many citizens' health or even life were endangered in the transition period. Poles viewed in horror news of victims of medical emergency whose health insurance coverage could not be verified, and thus their ambulance service or emergency care were denied. While these problems were eventually resolved, initial shock caused the Solidarity coalition government to sink in the opinion polls. The governing group will most likely be replaced by the social democrats in the 2001 election. The reforms were badly needed, but their implementation needed more political, and indeed humanitarian, skill.

One more issue has become significant as the reform matured. By the end of 2000 there were clear winners and losers among the newly created pension funds. At the end of November 2000, the largest funds were:

1. Commercial Union, holding PLN 23 billion (roughly US\$ 5 billion) for their customers,
2. Nationale Nederlanden, PLN 18 billion (US\$ 4 billion), and
3. PZU (former state insurance monopoly), PLN 13 billion (US\$ 3 billion).

At the other end of the scale, there were pension companies with rather small share of the market:

1. Rodzina, PLN 8 million (less than US\$ 2 million),
2. Kredyt Bank, PLN 23 million (US\$ 5 million), and
3. Polsat, PLN 30 million (US\$ 7 million).

As we see, the most successful company (and in addition to its pension success, Commercial Union enjoys equally dramatic success in the Polish life insurance and annuity market) has over thousand times larger asset base than the two smallest companies. Given huge marketing expenses of a nationwide pursuit of customers in a country of nearly 40 million, small companies are at a great disadvantage against the giants. On the other hand, this situation offers an interesting opportunity for the giants: expanding a customer base by acquiring a competitor may actually be cheaper than trying to peel them away in direct competition. This in turn has alarmed the chief regulator of the funds: Dr. Cezary Mech (2000). In an opinion piece in an influential Polish daily *Gazeta Wyborcza* he has come out strongly against the idea of inevitability of mergers among pension funds. Cezary Mech was also among the key authors of a major position paper put out by the *Office of the Superintendency of Pension Plans* called "Security Through Competition" (Polish Government, 2000). While Mech acknowledged temporary problems with transfers of funds from ZUS, in his opinion, and in the opinion stated in the position paper, Polish consumers face the greatest threat from lack of competition among pension funds.

Notably, at the end of 2000, *Office of the Superintendency of Pension Plans* received an application for approval of a takeover of Epoka pension plan by Pekao-Alliance SA fund. Given limited history of functioning of pension markets, and capital markets in general, regulators are very worried about a real possibility of a collusive oligopoly among pension funds. Mech has suggested some approaches in regulation to counter that threat: limiting the market share of a given fund to 15 percent of the market, and reducing or eliminating asset management fees collected by funds based on assets managed in favor of loads on initial deposits. The regulators are also very concerned about increasing incidence of using pension funds assets to acquire corporate control. Mech appears to be very critical of hostile takeovers by pension funds, insisting that instead such funds should be long-term investors, preferably with value investing style.

These points raised by the regulators are strongly challenged by former two chief architects of the entire reform: Dr. Marek Gora and Dr. Michal Rutkowski. They argue that mergers of pension plans represent merely a natural expression of winners acquiring losers in the competitive pension funds market. They also believe that asset management fees assessed on total assets under management are in fact the most competitive way of collecting fees, and this should be the chief way for

compensating pension fund management companies—this is clearly in direct conflict with the regulators. Interestingly enough, many American pension companies (e.g., Fidelity) are quite willing to waive initial sales charges, hoping to make greater long-term gains on asset-management fees.

It should be noted that the *Office of the Superintendency of Pension Plans* has wide supervisory role in the Polish system, and, given that it is a new body within the Polish government, its specific role is still subject to interpretation and possible legislative correction. In less than two year of this regulatory body's existence, twelve of the pension fund companies have brought appeals of its decisions to the court supervising it: the Supreme Administrative Court (*Naczelny Sad Administracyjny*). The court's decisions in such matters are final. Most of the cases are about administrative penalties assessed by regulators (13 funds were given such penalties, and their total amount approaches one million dollars). Other issues are not that unusual in the insurance industry: for example, the regulators objected to ten-year amortization schedule of certain advertising expenses by Skarbiec-Emerytura, a mid-sized company. The court actually sided with the pension fund, even though the regulators believed the cost should be expenses immediately (which, interestingly, is exactly the way such costs are expensed by insurance companies in the United States). Most advertising costs of Polish pension funds are, however, expensed immediately, as the regulators require.

Long-Term Perspectives

In 1995, not only was the ZUS subsidy overwhelming the general revenue budget (amounting to about 21 percent of it), but the long-term stability of ZUS looked very bleak. While long-term actuarial analysis was not required by law in Poland, it was essential for the political decision makers to familiarize themselves with long-term models for the purpose of structuring the reform. Insightful post-reform studies of long-term actuarial outlook of the pension system in Poland have been put forth by Gomulka and Styczen (1999). Their simulation results indicate that in the absence of the reform, already bad old system would have deteriorated significantly due to population aging. Ironically, Poland had developed a serious pension crisis *without* demographic problems. Nevertheless, the country does face the same long-term demographics as most of the developed world, eventually. Gomulka's and Styczen's simulations also indicate that as a result of the reform, state finances will improve considerably in the second quarter of the twenty first century. The new pension system has many natural stabilizers built in, and is in many ways market-based, thus providing a cushion from destabilizing influence of political lobbying.

The question of the long-term success of the new pension system is a deeper one. It is quite difficult for it to be addressed in simulations. We must keep in mind that major changes in policy have often unintended consequences, and socio-economic

processes have multilevel nonlinear dependencies, nearly impossible to predict. A very large portion of the pension system in Poland still remains under the state control, and while at this point it is not subject to lobbying, it may well be so in the future. Also, it is quite difficult to assess possible anti-selection in the *Tier 1*. The pension level in *Tier 1* is based on an actuarial estimate of life expectancy. But the remaining population receiving lifetime pensions may well be a select one, living beyond the estimate based on the overall cohort longevity. In the long run, the system may have to be adjusted, or even, at some distant point, reformed again. This new system, however, represents an unquestionable departure from state pricing of capital assets, and thus should help avoid unrestricted lobbying for benefits at the expense of the productive capacity of the economy.

Conclusions

Polish pension reform has been achieved as a result of a national debate, in the climate of openness, with a degree of tension, but with eventual consensus. This is a dramatic change for the formerly Communist totalitarian nation. Poland has succeeded in implementing major reforms in the 1990s with a fully functioning democratic political system in place. The new pension system also succeeds in addressing the key problems of the outdated system it replaced: it encourages work and savings, stabilizes public finances, and lowers the replacement ratio provided by the state pension without endangering poverty alleviation programs.

Its problems of implementation did not result from bad design of the new system, but rather from unexpected vestiges of old Communist bureaucracy. Nevertheless, those problems provide an important reminder of how difficult it is to anticipate consequences of major policy changes, and how often good policy is not enough in the political arena: it must be also implemented carefully and with political skill. Robert Peel had given Britain freedom from Corn Laws and Bobbies in the streets of London. In the long-run Britons appear grateful to him. In the short run, he was politically dead.

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6

The Hungarian Welfare Model: Social Policy at the Crossroads

ZOLTAN KARPARTI AND ZSUZSA SZEMAN

The Hungarian society has been in crisis since the early 1980s. Some of the crises are inherited from the socialist period or from the period prior to socialism (regional inequalities, hierarchic-redistributive administration etc.), but some of them, mainly political, economic and social ones, have been born during the transition since 1990.

The last government of the socialist regime was conscious of the inherited crisis without having time to launch the program of transformation. The first democratic government after 1990 thought that inherited crisis can be solved by simply sweeping away the socialist system. Due to the mistaken perception of the nature of inherited crisis, the Antall Government (1990-1994) further deepened the existing social and economic cleavages. The new socialist Horn-government (1994-1998) accepted and made conscious the difficulties of transition and endeavored to undertake unpopular measures (Bokros-package, austerity measures named after Lajos Bokros Minister of Finance of that time) to improve economy but giving rise to new social tensions by weakening social safety web. The present center-right Christian-nationalistic Orban Government (1998-) introduced a new policy of "balance," which aims at strengthening the economic middle class but is losing sight of the increasing poverty.

The main results of the systemic change and transition can be summed up as follows: the establishment of a competitive multi-party system and parliamentary democracy; new democratic institutions were born: the institution of state-presidency, the Constitutional Court, the National Audit Office, the institution of Ombudsman which no doubt represent the depository of further democratic development, centrally planned economy was replaced by market economy; since the systemic change (1990) there has been a relative political stability (there was no mid-term political crisis leading to resignation of any government); Hungary joined NATO and has good chances to become member of the European Union. Since 1997 macro-economic indicators have show general improvement, unemployment rate has somewhat decreased, there has been growth in industrial production and foreign investment.

At the same time: all governments tried to rebuild or restore the former system of clientele or create a new one by using privatization of state property as political means; social tensions, regional and social inequalities have been deepened, regional inequalities increased, labor force became defenseless and job security has tremendously been weakened, no efficient tools and institutions have been established to represent and promote workers' interest; old value-systems have been disintegrated but no new ones established; corruption has grown in all spheres of society.

Hungary became the scene of social and economic processes in a state of extremely rapid change. In this context the nonprofit organizations in Hungary created the third sector of this "most recent period". The opportunity that arose made it both possible and necessary to examine the problems and questions for which the various Western theories seem to have provided reassuring answers. Research and analyses have shown that while the Hungarian nonprofit sector adopted standards generally found throughout the world, its development also followed a separate path. It has characteristics that do not always fit into the various western theories of economics, sociology and welfare policy. The reason for this is that with the *systemic change* the social gap in the countries of Central Eastern Europe *has widened* and the fault lines, which also appear in social welfare care have become more marked. As a result, there was and still is a growing need for civil organizations operating in the social welfare field.

In this paper we endeavor to give a brief account of the main features of the changing Hungarian welfare model. In the first part of the paper we will focus on general issues like employment policy, family provisions, pension reform, public health service and sickness benefits, and education.¹

The second part of our paper is an attempt to give a short *historical description* of developing of the civil sector and based on the findings of a recent empirical survey of the factors explaining the *proliferation* of these organizations and their increasing activities in order to substitute public services. Until the systemic change of 1990 the "socialist welfare state" that existed in a unique form in the countries of

Central Eastern Europe did not allow scope for either the civil organizations or the market in the area of services.

The Main Features of Social Policy

Due to worsening economic conditions cuts in social welfare budget have been significant since 1990. Though in 1997 an improvement started in economy the reduction of public services continued. Throughout the whole decade the proportion of welfare expenditures in percentage of the GDP decreased more than 10 percent (in 1990 it was 38,2 percent, in 1999 it dropped to 27 percent). In the main sectors of welfare there have been drops both as regards the percentage of GDP as well as real value (see Table 6.1). State expenditures are still the highest (with decreasing real value, however) in education, while state subsidy in housing and local welfare policy has significantly dropped.

The deterioration of public services has speeded up since 1995 especially in the program of FIDESZ-MPP elected to power in 1998. There is a threat of growing poverty due to three processes: squeezing public social services, the continuing devaluation of real wages, salaries and pensions (cf Table 6.2); and the constant increase of energy prices which puts heavy burdens on family households. On the top of these Hungary has still a very rigorous and in many respect unjust taxation system in which even the lowest wage is taxed by 20 percent. At the same time there are no actions to prevent this process of impoverishment.

Table 6.1
Welfare Expenditures Changes of Real Values of in percent of GDP, Welfare Expenditures, 1991-1999 (1991 = 100)

	1991	1999	1991	1999
Education	5.6	4.4	100	87
Health	5.5	4.3	100	85
Social insurance, social and welfare services	20.7	14.9	100	79
Housing, settlements, and regions	4.0	1.1	100	31
Spare time, culture	1.7	1.2	100	77
Environment protection	0.7	1.0	100	159

Source: Ministry of Finance (2000).

Table 6.2
GDP, Wages and Pensions in Real Terms

	GDP index	Real income per capita	Real wage per wage earner	Real value of provisions per pensioner
1989*	100	100	100	100
1990	97	98	96	97

1991	85	97	90	90
1993	82	89	86	83
1995	86	86	80	76
1996	87	86	76	69
1998	96	-	83	73

Note: *1989=100.

Source: Yearbook of CSO (1998).

The Report from the EU Commission on Hungary cautiously summarizes the progressive and regressive elements of the national social policy: "Progress was made in terms of legal transpositions in all areas." However, implementation of legislation is frequently scheduled to take place later on and in some cases not until the time of accession. This will make it difficult to monitor implementation and enforcement. Health indicators are poor compared to the EU. Attention will need to be paid to the enforcement and implementation of, in particular, health and safety and labor law directives. Further work is required to align Hungarian legislation with the directive on equality of treatment. Social dialogue is not accorded the requisite importance and this situation needs to be addressed. The new structures need to be used in a way that permits effective social dialogue. There is a need to actively promote sound developments in social dialogue within the country. The lack of effective consultations at national level is harmful to social dialogue, not only at European level, but also at the decentralized levels (sectors, regions, enterprises). Hungary needs to take steps to strengthen autonomous social dialogue at these levels.

Hungary has made progress in transforming the labor market and is adapting its employment system so as to be able to implement the European Employment Strategy. Nevertheless, Hungary still faces major challenges, in particular the need to review the tax and benefit systems in order to increase incentives for people to participate in the labor market, the need to enhance the low employment rate, in particular for women and older workers and the need to reduce the size of the informal sector. Hungary recognizes the need for sustainable, universal social protection and subscribes to principles agreed by the Member States. The stated overall aim is to improve the level and efficiency of social protection. Health care reforms, long discussed, have yet to show progress.²

Employment Policy

The basis of the socialist employment policy was the principle of full employment. On the one hand firms likely to face bankruptcy could survive by continuous state assistance. On the other hand the "right to work" was one of the decisive elements of the socialist social policy. The collapse of the regime and the socialist industry caused an incredible shock in the economy. Between 1990 and 1997, 1,497 million persons left the labor market (Statistical Yearbook, 1997). The

rapid decrease was mostly due to lay-offs and early retirement. The most visible changes in the labor market had occurred till the end of 1993. In the first years of the new economic-political system the number of employed pensioners dropped from 432,000 to 117,000 and the number of registered unemployed grew from 24,000 to 663,000 by the end of 1993. In this year the number of unemployed persons reached the peak, since then it has gradually decreased (in 1997 478,000). From 1998 a slow improvement started (in 1999 this figure is about 400,000). National unemployment rate dropped below 10 percent in 2000. This latter could be explained by the economic growth since 1996.

But the situation is more than paradoxical. In the meantime the level of employment and the ratio of economically active population has further decreased. The activity rate of total population was 36 percent in 1998 (in 1990 this figure was 46 percent). The ratio of inactive population aged 25-54 is 24.1 percent, the highest among post-socialist transition countries expected to become members of EU in the first or second run Yearbooks and surveys of CSO, Central Statistical Office of Hungary). As to unemployment policy the conditions of provisions have seriously tightened since 1998. In 1999 an amendment of the law (Employment Act 1991) reduced the unemployment insurance benefit period from 12 to 9 months. The income-replacement allowance (originally without time limit, in 1995 it was reduced to two years) is altogether abolished from May 1, 2000. The unemployed may continue to receive the assistance from the local authority (introduced in 1997) but this assistance is bound to the accomplishment of at least 30 days public work per year. The result of these measures is that more and more unemployed fall out of registration and the number of long-term unemployed is increasing. The other consequence is that people are increasingly absorbed by the black economy, which by now makes up 30-40 percent of the national economy by estimation.

As far as regional differences are concerned, we witness great inequalities between West and East Hungary: The reasons for increasing unemployment in the Eastern regions of Hungary are: the collapse of socialist heavy industry in the northern counties; by losing their jobs in the industrial centers former village-commuters were forced back to their rural residence (village unemployment grew to 49 percent of the total unemployment by 1997); privatization of agricultural cooperatives and industrial auxiliaries; the concentrated presence of unskilled and semi-skilled gypsy population in this area (Northern Hungary, Great Plain, Southern Transdanubia).

Gypsy unemployment is the most serious problem in present day Hungary. In 1997, 10 percent of the gypsy population (approx. 600,000 by estimation) lived in Budapest, 30 percent in other towns and 60 percent in villages. 40 percent lived in those two northern counties (Szabolcs-Szatmár-Bereg and Borsod-Abaúj-Zemplén) where economic difficulties of the transition were the heaviest. Keeping in mind that in 1978 still 75 percent of the gypsy population lived in villages, the decrease shows that an "urbanization" of gypsies can be observed: more and more gypsies

are moving to Budapest and the big cities (first of all Miskolc), creating new ethnic “ghettos.”

Historically seen, unemployment rate among gypsies has recently grown at an incredibly high pace. At the mid 1980s still 80 percent of gypsy men and about 50 percent of gypsy women were employed because of the extensive industrial and employment policy of the socialist regime. By 1994, 70 percent of gypsy men became unemployed, 54 percent received unemployment benefit and another 42 percent income supplement (cf Gere), which means that the gypsy population fell out rather early and rapidly of the labor market, their entitlement for social benefit soon depleted and by now the great majority (an estimated 75 percent) lives on community aides, family benefit and from occasional-seasonal work. Their worsening social conditions are aggravated by their low education and lack of skill, thus by their little chance to rejoin the labor market (21 percent of them are absolutely uneducated with no completed class—the national ratio is 2 percent; completed secondary or higher grade has only 1 percent as opposed to the 27 percent national average). Besides social provisions the only possibility is the increasing involvement in the grey and black economy. The integration of the gypsy population is also hindered by the rejective, sometimes hostile behavior of the society.

Family Provisions

One of the few achievements of the socialist regime was that the system of child-care benefit had been gradually introduced in the Hungarian society. Maternity leave (GYES, sometimes called child-care aid) was introduced in 1967, child-care allowance (GYED) was introduced in 1985 and remained in force until 1995. According to the former law, GYES allowed, without no exempt, the working woman to stay home on unpaid leave, if she had previously been employed for at least 12 months within a one and half year period, until the child reached 2.5 year of age (later 3 years). Child-care allowance (GYED) was paid if the mother had previously been employed at least 270 days. At the end of this period, she received a fixed benefit amounted to 75 percent of her previous income.

The three consecutive governments since the systemic change have greatly enlarged the family policy though their assessments have been different. The ideology in the family policy of the *first government* was characterized by conservatism, which aimed at encouraging childbirth and reinterpreting the role of family and mother. In 1992 the single payment at childbirth was transformed into a pregnancy allowance (a monthly payment throughout pregnancy equal to the family allowance). In 1993 a sort of mother’s wage was introduced for mothers raising three or more children. It was means-tested up to 1998, and it was related to former employment up to 1996. Nevertheless, the real value of family allowance fell by 30-

35 percent between 1990 and 1994. Paradoxically enough, child-care institutions lost their former status as a statutory provision.

The program of the *second government* was more social-liberal but it soon took a different course because of economic constraints. The result was a reform of public finances, which meant the narrowing of free-of-charge provisions and the partial privatization of services. The real value of family provisions (family allowance, child-care benefit, child support, pregnancy assistance) was further reduced, eligibility conditions were tightened (though income threshold remained relatively high) and a tuition fee in higher education was introduced. All in all these measures were both socially and politically disadvantageous. This government, however, enacted the Law on Child Protection, which was a significant step toward the legislation of European Union. Unfortunately this law was not harmonizing with other regulations on other family assistance (especially housing), thus it could not prevent the increasing indebtedness of the family (eventually the loss of home).

As we mentioned before, the *third government* (still in power) gives priority to middle class families. In its family policy a positive change is that family allowances and child-care benefit became again universal. The system of family provisions has become, however, more fragmented. Three different allowances are in effect: universal family allowance, means-tested child-protection allowance and a universal tax allowance. This latter one proved to be harmful for those families who do not have regular job, consequently do not pay taxes. Thus the poorest families are excluded from this benefit.

Though some social rights have been institutionalized in the last decade, the whole system of family provisions remained disintegrated and the real value of family provisions has dropped to less than half of the figure in 1990. Child poverty has become an acute problem and the social situation of unemployed families with children has significantly worsened.

Pension Policy

From the beginning of the last century Hungary has been a seriously aging society. In 1900 only about 9 percent of the population was at age of 60 and older. In 1990 approximately 25 percent (2,520,000) of the population was retired. In 1998 this figure increased to 3,157,000 (31 percent of the slightly more than 10 million population) (Yearbooks of Central Statistical Office).

The growing proportion of elderly people makes continuous reform of the pension system inevitable and urgent. The new Pension Act (1997 autumn) anticipates some major changes in the old pension system, not primarily in its structure but new elements were brought about in the direction of further marketization. It implemented major change in elevating retirement age to 62 years for both sexes to be reached in 2009.

The elements (known as pillars) of the new system are as follows: (1) the universal basic pension aimed at offering some old-age security to everyone; (2) a compulsory, pay-as-you-go, traditional social security pension, proportional to the wages and to the length of the contributing period, and (3) an insurance based on voluntary savings, freely chosen by the citizens. The range of choice of insurance company became tremendously wide: by 1998 the number of registered voluntary pension pay-offices amounted to 155, that of branch- and firm-organized pay-offices to 80, and there are already 46 big private insurance companies with more than 5,000 steady members. There is a fourth element (sometimes called “zero” pillar), which is a provision for those who cannot fulfill the eligibility criteria. This benefit is a result of the transformation of the earlier regular social assistance into a means-tested old-age provision. The number of these pensioners will likely grow due to the longer contributory period (minimum 20 years) to be introduced.

The changing situation of pensioners can be described as follows:

1. The rapid increase in the number of pensioners is partly due to the mass-scale unemployment. Retirement and especially early retirement is an escape from getting unemployed. At the same time possibilities of part-time jobs for pensioners have tragically narrowed down. (The number of people cumulating pensions and earnings dropped from 440,000 in 1989 to 110,000 in 1998).
2. The greater the number of pensioners the less the real value of average pensions. Since even the total expenditures on pensions have been squeezed, the real value of pension decreased at a greater pace than the real value of the wages. The relative situation improved somewhat in 1998 when the full indexation to wages was still applied but this is most probably not a long-term tendency.
3. Due to the ongoing changes in the labor market, younger people are forced to retire. These households are experiencing a more rapid worsening in financial conditions. Most of them have very small chance to rejoin labor market. Their situation is aggravated by the very much debatable taxation system, which combines earnings and pensions.
4. The structure of prices affects unfavorably the elderly (as well as the poor, families with children and the sick). It endangers the satisfaction of basic needs (medication, energy, food) of elderly or pensioners more than the decrease of incomes. The reduction of consumer price subsidies (from 7 percent of the GDP in 1987 to 0,6 percent in 1997) hits pensioners, unemployed and families with many children.

Health-Care System

As it is well known, Hungary has ever been ranked high in alcohol consumption and suicide. Since 1990 homelessness has rapidly been growing. Because of the growth of social problems, alcoholism, homelessness and poverty there has been deterioration in the health status of the Hungarian population in the last decades. The number of persons died due to alcoholic liver cirrhosis grew (while in 1980 this figure was 1,556 by 1995 they numbered 7,304). Life expectancy at birth has decreased, especially in the case of men. In 1970 life expectancy was still 66.3 years. In 1980, it was only 65.5 years; in 1997 it was 64.8 years. Considering mortality rate by age, the most endangered age-cohort is that of men between 40-49 years of age. It grew from 5.23 in 1970 to 9.7 in 1996. An explanation might be to this fact that this is the generation the most exposed to overwork (self-exploitation) and stress in order to cope financial burdens in the household. These men in their most active years have to take care both of their children and their parents, therefore the most afraid of becoming unemployed.

Hungarian society, as we mentioned before, is rapidly aging. In 1960 the aging index (the ratio of population below 14 of age and over 60 of age) was 54.3, in 1997 this index was 109.9. Between 1980 and 2000 Hungarian population had a loss of more than 6 percent (from 10,710 thousand to 10,043 thousand). The high morbidity and mortality rate (primarily due to cancer and vascular diseases) contributed to the decrease of population. Though infant mortality has lessened, child birth rate has dropped significantly.

The reform of health care began at the end of the 1980s. The National Health Protection Program was launched in 1987 with starting drug experiments in 26 hospitals. In 1989 private medical practice independent of the state system was allowed. From 1990 a switch was made from central budget financing to financing through the compulsory social insurance system. In this year ownership of the health care institutions was transferred to local authorities. The Ministry of Social and Health Affairs became the Ministry of Welfare. In 1991 the State Public Health and Medical Officer Service was set up and Public Hygiene and Epidemiological Stations were established.

The biggest change occurred in 1992 when Social Insurance Fund was split into Pension Fund and Health Fund. The system of family doctor care was set up, making possible the free choice of a physician. The marketization of certain elements of health care was also gaining ground (first of all dental treatment). Since then a range of ambulance services and surgeries for which a fee was charged has been extended and state subsidies have been gradually withdrawn from the price of medicines (which meant the constant rise of price). Employed persons having social insurance card and social insurance identification code are still for free medical care and medicine for subsidized price. The major change was that the cover of costs of health care have been shifted to the companies who are obliged to pay both sick-leave and social insurance contribution. To avoid this duty companies tend to employ workers from the black-market, which they do not report to the Social

Insurance Board even taking the risk to get punished. Another problem is still the overall low wages of employees in the public health care system.

The reform has opened the way for a higher standard in market-based care for the more prosperous, but the provision of basic services for the disadvantaged strata (unemployed, elderly, homeless, handicapped) is at risk.

The privatization in health care brings closer the individual's demand and its immediate costs, but at the same time it means that the right to services beyond the basic package depends on income. Also the costs of administration became extremely high. In addition, the systems of registrations and information are not unified. Programs are uncoordinated among public and civil sector and the central role of the Ministry of Finance in decision-making is still very strong. Consequently, the interest-representation (professional interests) in health care policy is weak. Indebtedness in hospitals is growing, and technical equipment is mostly outdated. Under these circumstances doctors and nurses continue healing beyond their capacity in order to avoid organizational breakdown.

Since 1995 (stabilization program) sickness benefits and the eligibility to them gradually shrunk. Strict measures were taken regarding paid sick-leave, the number of recipients has drastically decreased since in the new system sickness benefit has been shifted to the employers to a large extent. By 1998 the real value of sickness benefit dropped to 35 percent of that of 1990 and the proportion of those on sickness benefit within the employed fell by half (Statistical Yearbooks, CSO). One of the reasons is that employees, once they have a job, are afraid of taking sickness leave even if they are seriously ill. At the same time the discrimination against people with greater health risk and/or disability leads to social exclusion of certain social groups.

Earlier corporate social policy has completely disappeared. The emphasis has shifted to pure manpower policy and the demand for young trained manpower has tremendously grown. Firms are focusing on training their managers who are also given access to costly monthly check-ups and treatment in the private health care market. Other employees are preferred to be contracted as independent entrepreneurs (if they operate own firm), so they finance social insurance for themselves. Rank and file usually receive universal health care if the firms are prepared to pay the flat rates charged by doctors grouped in occupational associations (by now in firms like "deposit partnership") operating in the health care market. Nevertheless, firms tend to hire labor from the black market, thus escape contribution to the health insurance fund. Local trade unions are very weak (if they operate at all) and appear only if the firm already went bankrupt.

In Hungary there are hundreds of thousand of small entrepreneurs who, in an effort to evade social insurance contributions and tax, employ family members or hire someone from the black labor-market (recently refugees from the neighboring countries).

Education

The educational level of the population has greatly improved through time. From 1949 till 1996 the proportion of those with no schooling had dropped from 4.8 percent to 0.7 percent. The ratio of the population with completed primary school increased to 85.2 percent, with completed secondary school to 34.7 percent and with high-level education to 12.1 percent (Statistical Yearbook, 1997).

With the systemic change compulsory enrollment in schools according to residence ended, the location of school is a matter of free choice. Church and foundation schools also appeared on both primary and secondary levels. Former state owned and operated schools were claimed and given back during the re-privatization on legal basis. These buildings were the properties of the different religious denominations, mostly catholic ones before World War II. Now these schools are operated again under church rule, but the staff remained mostly the same. Only about 1 to 2 percent of children go to primary and secondary schools run by religious denominations.

On high education, college and university level, the systemic change has brought about a shift away from the state. By 1993, 35 percent of all universities and colleges were non-state, the number of students had risen from 76,600 (1990) to 103,700. The increase was much less from 1994 to 1996, only 1,300. Later this process speeded up and by 2000 the number of students in higher education has more than doubled since 1990. The church owned and operated high educational institutions altogether amounts to 31.1 percent in 1997-1998, while the same ratio for other educational institutions under church rule are still rather insignificant (kindergartens: 1.3 percent, primary schools: 4.3 percent, secondary schools: 6.7 percent. Among church operated universities and colleges there are some famous ones, for example Pázmány Péter Catholic University with a strong law school, Wesley János College and the Theological College of Veszprém giving priority to social workers' training. Also very significant is the Lauder Javne Jewish secondary and post-secondary school, etc.

As a consequence of the marketization of specialized education, social differences have increasingly become conspicuous. Better-off and rich families can afford the high fees, while poor families are not able or only with great sacrifice to finance their children's proper vocational education. Even in primary schools children were reported to faint because of hunger, milk and bread roll distributed in the schools on a charitable basis mean the main meal for many children. Though education would create the most efficient way for the gypsy population to catch up with the majority, their education in general is not yet solved. There are still dropouts in great number among them and forceful assimilation does not seem to be the most effective way. Roma children in great number are placed in schools of special pedagogy, which creates huge handicaps later in their educational progress. Besides these special schools in 1998 there were still 150 schools having segregated

classes for gypsies. It is still a matter of debate which solution, integration or segregation, is the more efficient. No doubt, the integration is the only possible way in the long run. There are in increasing number vocational schools for them mostly operated by foundations, but their number is still very few and are working in a very poor social, financial and increasingly biased environment.

The proportion of national budget allocated to education has continuously decreased but at a lower pace than in other welfare sectors. The salary of teachers, though there has been some improvements recently, is still behind the average. In 1998 the real value of the net wages in education was 20 percent lower than five years before. As far as students are concerned: in 1995 the Hungarian Parliament voted for compulsory tuition fees (about 14 percent of the minimum wage) for all universities, but fees for individual institutions vary. In specialized colleges and universities, teaching practical and most desirable subjects in economy the fee is extremely high, only well-to-do people can afford it. Taking into consideration the high rate of unemployment and the social conditions of manual workers, there are many young people who cannot continue education on higher level. Not only the high amount of the basic and supplementary tuition fees and the increasing social inequalities threaten the fulfillment of the main goal of education that is to lessen social inequalities for the future. Recently a new supportive financial system has been introduced which allows for students the accessibility to some limited loan from the bank.

As a closing assessment of the first part of our paper we can state that the transformation of the welfare model shown above and the withdrawal of the state caused a further deterioration in the situation not only of already disadvantaged strata and groups—the unemployed, the elderly, the homeless, large families, children at risk, the Roma minority, etc. Though there is a developing new entrepreneurial class, a previously unobserved process, the relative erosion of the traditional middle class (in welfare sectors, education and culture) also began, bringing the danger of prolonged social decline.

This middle and low-middle class, however, plays a significant role in the resurrection of civil life. Nonprofit organizations are becoming important actors, providing a missing link in social welfare services, for example in care for the elderly, or playing a supplementary role and helping to ease social problems. Local authorities and civil organizations are trying to ease social tensions and to an increasing extent are working together on concrete tasks (still without legally guaranteed guidelines). In this supplementary role, a state-civil mix, in some cases a state-civil and market sector mix has already been established in practice and we can speak of a special form of two-fold or three-fold services complementing each other.

Welfare Provision by the Hungarian Civil Sector

In Hungary the roots of the nonprofit organizations, both within the church and among the urban middle class, reach back to the Middle Ages. Then in the first half of the 19th century and especially in the last decades of the 19th century there was a flourishing. With their activity they had a considerable influence on the course of *official social policy* and created the foundations of cooperation between the two sectors, which served as a model and spread in the 1930s. The growing fascist tendencies and the outbreak of war greatly restricted freedom of association and led to the termination. Change of political direction in 1949 and the rapid introduction of state socialism brought the dissolution of foundations. From 1946 a series of regulations restricted the free operation of associations. "Social organizations" qualified as politically innocuous were allowed to remain.

Partly as a result of traditions and partly due to the new legislative changes, despite the debates and conflicts, the Hungarian civil sector showed explosive growth in the nineties. In 1997 there were over 50,000 registered associations and foundations. In the first half of the decade the regulations were constantly tightened, while the proportion of state sources in funding was around 20 to 22 percent, below the level found in Western Europe. Foreign sources did not play a decisive role either in the development of the Hungarian civil sector. The renaissance of a few civil activities, among others in the fields of culture or environmental protection, began in the eighties. The amendment of the Civil Code in 1987 opened the way for the creation of foundations. One of the most significant acts immediately preceding the systemic change was introduced in 1989, restoring full freedom of association. At the same time a factor of decisive importance for the development of the civil sector was that a modern tax system was also introduced in 1988, creating the possibility of extending direct support to foundations. In reality, direct support for associations was not ensured until 1996 when taxpayers could specify the civil organization to which 1 percent of their income tax would be paid, and with the Nonprofit Act of 1997.

The real significance of foreign aid lies not only in cash donations, but in the model-building and innovative activity of the organizations supported, and in support in kind given to the Hungarian civil sector. Major foreign supporting organizations and programs (such as Phare, United Way, Soros Foundation, British Council, British Know How Fund, etc.) played an outstanding role in strengthening the Hungarian nonprofit sector. The innovative efforts of the Phare regional source centers, the DemNet and other supporting organizations have also revived the earlier models (e.g., from the interwar years) based on co-operation between the civil and local government sectors in the solution of social conflicts.

In this article we call attention to some of the main results based on a Hungarian representative survey³ carried out in 1999 among nonprofit organizations representing 9.8 percent of organizations in social nonprofit activity. In the time of the survey out of 5,000 registered organizations 3,300 devoted their activities to social services. 320 organizations were included in our sample.

The “Beneficiaries” of the Services

The organizations provided the most support for people at the two extremes of the social age tree: children and youth, and the elderly. In view of the disadvantaged situation of these strata and the risks to which they are exposed this is not surprising. Groups supported by the organizations: (1) 51 percent of the civil organization supported children, youth; (2) 44 percent elderly; (3) 31 percent handicapped; (4) 30 percent health impaired; (5) 28 percent families with problems; (6) 25 percent needy, poor, unemployed; (7) 18 percent national, ethnic minorities; (8) 10 percent alcoholics; and (9) 19 percent others with maladjustment problems.

Around one third of the organizations in our survey named the handicapped as a target group. This proportion is probably even higher if we take into account the overlap between the classifications of children/youth and the handicapped.⁴ 30 percent of the organizations dealt with “ordinary” health-impaired, and 28 percent with families struggling with problems.

A quarter of the organizations regarded the poor or persons close to the poverty trap, the unemployed as their target group. 18 percent of the foundations, associations, charity organizations and churches offered their services to ethnic minorities and nationalities.

Only one tenth of the organizations supported alcoholics even though this is an increasingly serious social problem in Hungary today. Almost certainly more of them dealt with this problem because it does not always appear in the guise of alcoholism. There are many alcoholics among the poor, the unemployed, family members with problems and the health impaired. This means that the nonprofit organizations help alcoholics in various ways even when they are directing their attention to the family, an elderly person or some other “beneficiary.”

The classification of addicts, the homeless, neurotics, children with learning disorders and attempted suicides in the “other” category mentioned by 19 percent of organizations is an indication that the services of foundations, associations, charity organizations and churches cover wide strata and groups of society.

Activities of the Social Nonprofit Organizations

The nonprofit organizations interviewed were asked to select the activities they perform from 29 services listed on the questionnaire. On the basis of the replies the organizations fall into three main groups according to the activity they actually perform:

1. The first category comprises the services provided by quite a high proportion, 21 to 39 percent of the organizations. These were: aid in cash; legal and lifestyle advice/administration; aid in kind, e.g. clothing, food, heating fuel; information flow, provision of information; clubs and targeted activities for

- pensioners; holidays; community support; training, further training, support of specialists.
2. The second category comprised 11 to 19 percent of the organizations. The activities were: support with (or lending) technical aids; residential homes (incl. nursing and medical care); visits; exploring needs; psychological/mental help; provision of medicines; service related to prevention (medical screenings etc.); rehabilitation and therapeutic service (exercises, physiotherapy etc.); home help/care; free meals (take-home service); medical care; transport; household related service (cleaning, repair).
 3. The third group consisted of activities with fewer than 10 percent of mentions. Among others: day-care (club for elderly or handicapped incl. meal); hospice; home nursing for the sick; weekend care/help; temporary accommodation; day-warming room.

In reality the tasks undertaken by the organizations covered an even wider spectrum. This can be seen in the fact that 36 percent of organizations mentioned in the "other" category social/welfare services for alcoholics, the unemployed, addicts, attempted suicides and others.

Organizations do not only provide a variety of aid kind of help. They also attempt to create connections between the different links to improve the quality of life of the recipients of support: they provide a physically handicapped person with a technical aid and transport him or her in a special vehicle to the place where they or others have organized a holiday. In this way the civil organizations have begin to introduce services which were previously unknown in Hungary but were widespread in the Western societies such as the personal safety alarm system which was first introduced by the Hungarian Maltese Charity Service in Budapest as an innovative model in 1994 and now it is widespread in Hungary. It is especially important that the service was elaborated and adapted by the organization in different ways, taking into account different circumstances, such as village, town, farm, health and financial conditions of the clients.

In the case of one third of the organizations the activity of the nonprofit sector extended to the *whole settlement*, in close to one *fifth it covered a county/region* and in close to a *quarter it covered the whole country*. A relatively high 16 percent provided services for former enterprise employees or professional and occupational groups. The flexibility with which civil organizations extend beyond the limits of the local community, whether their activity covers "only" the villages in the immediate vicinity of the town or wider areas, a county or region or even extending over the national border must be regarded as one of the most important results.

The Structure of Income

Here is given only a short summary of the sources mentioned. Most of the organizations mentioned money brought forward from the previous year. 39 percent mentioned income from the 1 percent of income tax over which taxpayers have the right of disposal. This was followed by interest and yields from invested funds. Lagging somewhat behind these three main sources was a central group of receipts in which one quarter to one fifth of the organizations mentioned support from the public in the current year, non-normative support from local authorities, the estimated value of voluntary work, support from foundations, churches or associations, donations in kind. An examination of the sources of receipts by volume and percentage distribution shows normative support from the central budget to be especially prominent. This accounted for close to half of all receipts.

Paradoxically, this substantial sum was distributed among only 29 organizations, 9 percent of the sample. The second largest source of receipts, representing 14 percent of the total (much less than the biggest source) was income derived from fees for services, but this too involved almost the same number, 28 organizations. These two figures indicate that only a minority of non-profit organizations carrying out social/welfare activities provide services within institutional frames: (1) for which they receive a capitation, the sector-neutral, normative state support to which state, nonprofit and market actors are all entitled if they carry out certain tasks prescribed in the law or other regulations, (2) and/or they also collect fees.

Organizations operating in country towns have a strong presence in all categories of sources of receipts. The "receipts gap" between organizations operating in villages and those in towns is seven-fold for investment, non-normative support from the central budget, and support from banks and insurance companies, sixteen-fold for the estimated value of donations in kind.

The Budapest–village gap found in normative local authority support was 274-fold, while for Budapest–towns it was only close to three-fold. These figures again confirm that the institutionalization of nonprofit organizations operating in the social welfare field and their regular activity also recognized by the state is the strongest in Budapest.

The Size and Structure of the Organizations

The nonprofit organizations studied had a large number of volunteers: an average of 68 persons per organization and a total of 21,760 persons. (It must be kept in mind that most of the big organizations were included in the sample.) The great majority (80 percent) of civil organizations had voluntary help. The presence of volunteers is highest by national comparison too in the field of social activities. A survey conducted by the Central Statistical Office in 1995 found 109,163 volunteers in the social activity group.⁵ At the same time, it seems probable on the basis of our survey that there has been a further increase in the number of

volunteers in the sector. Our 320 organizations reported having over 20,000 volunteers. If we compare this to other statistical data we can form a picture of the processes occurring in the recent past and currently, the shifts between sectors in the different areas of social activities: earlier volunteers had moved from the state sector and the nonprofit organization close to the state towards the new social actor in the nonprofit sphere.⁶

The high degree of flexibility shown by the small and large nonprofit organizations (those close to the state and those of the true type) is due in considerable part to the volunteers. This increases their viability and makes it easier for them to become accepted by the state, the local authority and the general public. In our survey the majority of the organizations (77 percent) had *no paid employees* at all, entrepreneurs were present in 17 percent of organizations.

If we look at the frequency of supporters of nonprofit organizations we can find the following order: (1) private individuals 70 percent; (2) local authority 37 percent; (3) market actors 37 percent; (4) foundations, associations 23 percent; (5) State administration institutions 20 percent; (6) other institution 18 percent; (7) Churches 15 percent; (8) foreign organizations 13 percent; and (9) trade unions 3 percent.

Looking at the extent to which support returns to the supporting groups, in the course of this redistribution the greatest part, 71 percent naturally flows back to the "sector of private persons."

Taking into account also the nature of the support received and given, it can also be seen that a kind of quasi-barter, a relationship based on the principle of exchange is beginning to take shape between the local authority and the civil organizations. Local authorities support nonprofit organizations with cash while the latter in exchange assist local authorities and the state institutions providing welfare services mainly with donations in kind.

Some Aspects of the Local Role of Civil Organizations

A recent survey conducted in four small towns⁷ located in different regions and in different economic situations confirmed that the local authorities and the civil organizations perform different tasks that substitute each other to only a small extent.

In smaller settlements civil organizations try to build partnerships not only with local authorities but also with other civil/non-profit and market actors. Civil organizations acquire social capital that enables them to counterbalance the lack of sources faced by civil organizations operating in small towns since state does usually not reach smaller settlements. The ministries and national authorities played no part at all in the lives of civil organizations operating in the social field in any of the towns studied.

In Table 6.3 we attempt to recapitulate the experiences we gained in this research from a comparison of the social welfare tasks undertaken by the nonprofit

organizations and the local authorities. Recognizing that this comparison may be a simplification, we nevertheless consider it interesting to show the “traits” of the two actors.

Table 6.3
Comparison of the Social Welfare Tasks Undertaken by the Nonprofit Organizations and the Local Authorities

(Social) Nonprofit organizations	Local authorities
Preventive	Reacting to problems
Innovative	User
Complex	Breaks down into “parts”
Oversteps locality	Local
Client-, user-oriented	Service provider-oriented
Dynamic	Static
Has many links	Has few links
Flexible	Less flexible
Relies on voluntary work	Operated with paid employees
Identified needs	Minimizes/maintains level of needs
Guided by strong personalities	Guided by organization

Summing Up

It can be said that our investigation on civil organizations in Hungary revealed a welfare model based on multiple sectors, a model in which the different actors are in continuous interaction with each other, constantly changing, entering into contracts and cooperation with the other actors. The interaction was the most intensive in small towns where economic and social problems weighed most heavily on the town. At the same time it was also found that very poor economic situation can prevent the emergence and strengthening of a three-sector model; in such settlements a strong two-sided relationship arises. It also became obvious that in settlements where civil organizations have many links and cultivate good formal or informal relations, these relations can be put to effective use not only in the life of individuals living in the town but for the whole small town community. These informal contacts play a very important role in the survival of the organizations, in their operation over the long term and when the need arises can also counterbalance their lack of capital. At the same time, they definitely cannot act as a substitute for a role played by macro-level state policy, which has only a limited presence in the life of Hungarian nonprofit organizations and did not appear at all in the case of small town civil organizations in the field of social welfare.

Budapest and the great country towns (primarily county-seats) are granted with extremely high central subsidy in comparison with other settlements. Disproportional allocations, traditional in the modern history of Hungary, hits the great bulk of small communities that fall outside the central state authorities’

attention and, at the same time, have no capacity to organize effective local social maintenance. As shown in the study above, the present public welfare system in Hungary, in many respects, is unable to counterbalance the effects of the new market economy, which is mostly dominated by international capital and foreign corporations (their activity is the main impetus to the growing GDP), poverty has become widely dispersed and new regional enclaves (ghettos) have been established.

NOTES

- 1 We are using statistical data from the yearbooks and other publications of the Central Statistical Office (CSO) as well as of Ministries and other government institutions.
- 2 Commission on Hungary's Progress Towards Accession (2000: 34).
- 3 The questionnaire mainly consisted of structured questions with containing with a few open-ended questions.
- 4 Fábíán, G. (1997: 67–76).
- 5 Társadalmastatistikai Közlemények (1997: 86).
- 6 For example, between 1990 and 1996 unpaid volunteers in the field of home care disappeared and the number of those paid a token fee fell by half; cf Információs Évkönyv (1997: 72).
- 7 Széman and Harsányi (2000b).

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7

The Welfare State System in India

CHRISTIAN ASPALTER

For most people in the Western world, India represents still a mystical country full of fairy tales to be told. This article tries to preempt the impending great demand for new studies on society, culture, politics, and, of course, the economy of India in the years to come. India certainly is a complex matter, with all the different religions, languages, scripts, ethnic variety, and scattered political landscape of India, with which the British left the people of India after their retreat, trusting the fate and the future of India to Pandit Jawaharlal Nehru and the Congress Party (founded in 1885) that had led and fought for India's independence more than seven decades later, in 1947.

In India, it is meaningful to separate the notion of the traditional "welfare state" from the Western socio-cultural overcoating and to cloth it in a garb that reflects the reality of India in the last two centuries. The author here puts forward the following (trouble-free) definition of a welfare state or welfare state system: it is the sum of all governmental regulations and provisions that aim the enhancement of people's living conditions; here the author includes: laws, regulation, and planning in the fields of employment, taxation, social insurance and social assistance, health care, education, housing, and population policy (cf Aspalter, 2001, 2002b: 11).

The Political History of the Welfare State System During Colonial Rule:

A Macro-Perspective

During the time of increasingly absolute British rule in India, from the early 19th century until the year of India's independence—1947—the welfare-political arena of India has seen the formation of a great deal of social movements, which—unlike 19th-century Europe—grew out of distinct, and sharply divided social classes (the “castes”, the *Jāti*) and, later on, religious communities of that time who bitterly opposed the existing distressing state of social affairs. Among those movements were: the *Brahmo Samaj* movement (1816), the *Arya Samaj* movement (1875), the *Theosophical Society* (1893), the *Ramakrishna Mission* (1897), and the *Anjuman-Himayt-i-Islam* (1898).

Along with those new social movements, also copious numbers of social reformers emerged on the political scene of British India. Among the most outstanding social reformers were: Raja Ram Mohan Roy (1772-1833), Sir Syed Ahmed Khan (1817-1898), Ishwar Chandra Vidya Sagar (1820-1891), Swami Dayanand Saraswati (1824-1883), Dadabhai Naoroji (1825-1917), Ramakrishna Gopal Bhandarkar (1837-1925), Bankim Chandra Chattopadhyaya (1838-1894), Sasipada Banerji (1840-1925), Mahadev Gobind Ranade (1842-1901), Kundukuri Veereshalingam Pantulu (1848-1919), Gopal Ganesh Agarkar (1856-1895), Dhondo Keshav Karve (1858-1962), Madan Mohan Malaviya (1861-1946), Pandita Ramabai (1862-1924), Swam Vivekananda (1863-1911), Lala Lajpat Rai (1865-1928), Gophan Krishna Gokhale (1866-1911), Bhagini Nivedita (1867-1911), Kamakshi Natarajan (1868-1948), Mohandas Karamchand Gandhi (1869-1948), and Bhimrao Ramaji Ambedkar (1893-1956) (cf Sharma, 1998; Kshirsagar, 1994; Mehra, 2002).

The political climate of the 19th and early 20th century in India left enough room for the creation of first social/socio-religious welfare movements and the political agitation of individual social reformers, some of whom accomplished the initiation of a new social movement, such as Swami Dayanand Saraswati who attempted to bring about social and religious change by reviving the Vedic religion and the Indian cultural tradition, in which, as he pointed out, there cannot be found any support whatsoever for repugnant customs, such as “caste” discrimination, the restrictions on widow's remarriage, and child marriage (Sharma, 1998: 3). Krishna Gokhale, for example, was the founding father of *Servants of Indian Society* movement, who promoted voluntary services by workers for the various welfare activities.

Together with the rather benevolent attitude of the British these social activists' efforts resulted in a number of very important pieces of social and labor legislation, which aimed at the alteration of harmful social practices and social inequalities,¹ as well as first provisions in social security (this, however, for a very limited clientele). These laws included: the *Regulation No. 17* of 1829, the *Indian Slavery Act* of 1843, the *Caste Disabilities Removal Act* of 1850, the *Fatal Accidents Act* of 1853, the

Hindu Widow Remarriage Act of 1856, the *Female Infanticide Prevention Act* of 1870, the *Brahmo Marriage Act* of 1872, the *Factories Act* of 1881, the *Workmen's Compensation Act* of 1923, the *Provident Fund Act*² of 1925; the *Trade Unions Act* of 1926, the *Hindu Inheritance (Removal of Disabilities) Act* of 1928, the *Trade Disputes Act* of 1929, the *Child Marriage Restraint Act* of 1929, the *Hindu Women's Right to Property Act* of 1937; the *Mines Maternity Benefit Act* of 1941, and the *Coal Mines Labor Welfare Fund* of 1944 (cf Goel and Jain, 1988; Punekar and George, 1974: 339; Sastri, 1960: 292-93; Madan, 1973: 312).

One of the most important welfare regulations of the government was the re-arrangement of marriage practices by law, which horrendously suppress women. The Brahmo Marriage Act of 1872 is the first, and still very modest, attempt of the government of British India to eradicate suppression of women by means of marriage customs; that is to say, the new law provided for monogamy, a minimum marriage age of 14 for girls (and 18 for boys), and the registration of marriages. But, intermarriages between different "castes" were still taboo due to ancient custom. However, one of the smallest states of India today, Mysore, led the way with regard to permitting intermarriages of two Hindus of a different "caste" in 1908. One decade later, in 1918, Mr. Vithalbhai Patel attempted to legalize "inter-caste" marriages by introducing a new bill in the Imperial Council; which, however, was not passed (cf Goel and Jain, 1988; Natarajan, 1959).

With the arrival of Mahatma Gandhi in India (who was coming from South Africa) in 1920, the subsequent political mass movement for the liberation of India from British rule and the liberation of women and the "depressed castes"—that is, including the scheduled classes, other backward classes, and member of India's numerous tribal communities—was getting at the forefront of national politics. But, at a closer look we see that the idea of liberating the depressed people of India did not originate from Mahatma Gandhi. In fact, Dr. Anne Besant, for example, the president of the Congress Party, put forward a strong statement and addressed the social question of the time as early as in the year 1917, that is, three years before the arrival of Mahatma Gandhi in India. In this statement, Besant stressed the necessity of "removing all disabilities imposed by custom on the Depressed Classes" in the name of social justice and righteousness. Furthermore, she described these disabilities as being of "a most vexatious and oppressive character, subjecting these classes to considerable hardship and inconvenience". This declaration, however, followed a similar resolution at a Mumbai ("Bombay") meeting held under the auspices of the Depressed Classes Mission Society that was founded in 1906 (Natarajan, 1959: 135, 144).

When Mahatma Gandhi lifted the ban on participation of women in large gatherings of the Congress party, he helped forward a nationwide liberation women's movement calling for a removal of customary suppression of women in Indian society. Furthermore, Mahatma Gandhi declared himself keenly interested in the removal of untouchability of all depressed classes. The main difference between

Mahatma Gandhi and Bhimrao Ramaji Ambedkar, the chief architect of the Indian Constitution, has been that Gandhi put independence first, and wanted to achieve the abolishment of class distinctions by means of independence and new nationhood, and Ambedkar—who was born into an untouchable cast himself—instead insisted on dissolving completely the age-old social segregation of the untouchables prior to national unity and statehood (Nikam, 1998; Mehra, 2002).

The caste system in India was introduced by “Indo-Aryan” immigrants from Persia and Central Asia (thus, composed of a variety of ethnic groups, cf O’Neil, 1985) who sought to protect their status and the ruling elite in a society where most members were of multicultural, and multiethnic, origin. The “Indo-Aryans” were the landed high society of that times, and their descendants settles in far-away places like Assam. The four most famous social classes, the “castes,” were: the *Brāhmanas* (the ruling class/priests) and the *Ksatriyas* both of which, in essence, constituted the upper classes, both they represent twice-born (*dvija*) classes and, thus, were entitled to the performance of sacrifices. The next major classes, or “castes,” were the *Vaiśyas*, who engaged in the professions such as the trading commodities, domesticating of animals, and farming. The lowest strata of society were the *Śūdras*. The first three classes were not allowed to travel in the company of *Śūdras*, common meetings and meals were also strictly prohibited. The professions ascribed to the *Śūdras* included handicrafts, culinary arts, and services. Since more and more *Śūdras* began to work in agriculture, the *Vaiśyas* were downgraded to become *Śūdras* as well. There had been dozens of other important “castes” in ancient India, all of which undergone many changes, many became distinct, regrouped, renamed, or simply merged with others. Intermarriages between members of different “castes” had been meticulously forbidden (cf O’Neil, 1985; Bajpai, 1992).

In the 1920s of Mahatma Gandhi, this strict multi-layered apartheid system, which is known as the “caste system,” still plagued society, and obstructed social progress and development. In the words of Dr. Besant, Mahatma Gandhi was a first-class social reformer, but he was not a politician. After Mahatma Gandhi had dominated the Congress, he turned the Congress into a “Social Reform League” and stopped the political work of the Congress party. In the years of social reforms under the leadership of Mahatma Gandhi, a great deal of progress could be achieved, but he was not a revolutionary social reformer from the very beginning. In May 1924, he called for the opening of all public temples to the depressed classes, but he also, at the same time, broke away from the reformers by opposing the lift of prohibition of “interdining” and intermarriages. He also declared his disapproval of the existing education for all classes. Mahatma Gandhi’s ambiguous policy stand in the question of social equality in between all “castes” and his principal acceptance of the “caste system,” however, also won over a sizeable part of more conservative, orthodox reformers (Natarajan, 1959: 137-51).

In the year 1923, the Indian social security system has made the first important step in direction of a significant welfare state system, with the passing of the *Workmen's Compensation Act*, which was the first social security legislation of modern India; and still is of vital significance for today's workforce. According to the provisions of this Act, compensation is paid for accidents that lead to death, or total or partial disablement for more than three days, if the accident has occurred in the course of employment; also included in this scheme is compensation for occupational diseases. The Workmen's Compensation Act applied only to workers with a monthly income of less than RPS 1,000.³ All workers in factories and mines, as well as plantation workers, other than clerks, however, are covered by this Act. The Provident Fund Act of 1925 provided social security provision for state employees and railway workers only (Chowdhry, 1985a: 287; Rath, 1976: 219).

The rather undisputed rule of the British in India, did not lead to the establishment of a bulk of new social policies other than those aiming at the removal of *diswelfare*, such as long-standing malpractices in the realm of marriage, inheritance, women's social and political participation. And this, again, was only made possible due to the political rivalries mainly between different religious communities on the one hand (cf Aspalter 2002d), and the upcoming of general social discontent that resulted in the raising of new generations of social reformers on the other, which set off as early as the first decades of the 19th century. As a consequence, new social movements emerged that aimed especially at social amelioration by means of abolishing or changing a number of appalling customs.

These social movements forced the colonial government to act and break with their long-term practice of acquiescing silently to the wants and demands of the ruling "castes," in return for their support of the colonial regime. The British played both sides, by deferring social reform that was feared by the Hindu establishment—making them increasingly dependent on the support of the British in sustaining the ancient apartheid system, the "caste system," and by actively supporting the Muslims in their attempt to raise to power for a second time (formerly ruling most of India, especially between 1200 and 1700), at least in the federal states where they constituted a majority of the population. Muslims were very concerned about their limited chances of self-control and self-governance in a Hindu-majoritarian country. This made the Muslims a great strategic coalition partner of the British in limiting the power of the *Harijans* (literally: the "children of God"); a name for Hindus that has been put up later on by Mahatma Gandhi, to protect their specific interests against the raise of Muslim power and the rigorous rule of the British (cf Stern, 2001).

The third force in 19th and early 20th century Indian politics, the depressed classes, which were composed of the Untouchables, the OBCs (members of *other backward classes*), and the hill tribes, brought upon slow and significant change in Hindu society, slowly benefiting the masses. The women's movement joined in the movement of the poor by about the late 1920s. A significant event here was the

removing of barriers at temples that tried to prevent the access of the depressed classes by 200 women in Dacca in 1929 (today's capital of Bangladesh) with the help of members of the Young Men's Association (cf Natarajan, 1959: 151).

Though it was too early to think about social security plans and other meaningful social policy measures, during and before the time of Mahatma Gandhi, the government did launch a series of social policy legislation that concentrated on the reduction of social *diswelfare* more than the creation of new forms of welfare programs and regulations.

The Political History of the Welfare State System After Independence: A Macro-Perspective

In the newly independent India, the leadership of the Congress party, above all, sought to protect the rights of the *Harijans* and to help resurrect a strong and pure Hindu nation. As a result of which, for example, the Hindi language has been "cleansed," and Arabic and Persian words omitted, which led to a new linguistic division between Muslims and Hindus, who, from then on, spoke Urdu (the national language of today's Pakistan) and "purified" Hindi. The earlier attempts of Mahatma Gandhi to promote Hindustani (which was widely used in Northern India before 1947) as the new, and only, national language of Independent India, obviously had failed.

But the Muslim League, established in 1906, which did not join the Indian National Congress, opposed the erection of an Indian nation that included the predominantly Islamic parts of the Indian Subcontinent. In 1937, the Muslim League demanded a separate federal state within an Indian nation; but since 1941, they proclaimed the partition of India and the creation of a sovereign Islamic state, apart from the rest of India. The Partition of India followed in 1947, comprising two predominantly Muslim regions: the former province of Bengal (today's Bangladesh) in the East and the northwestern provinces of British India (including Western Punjab and Western Kashmir).

In the period following the partition, the Indian government began to pass a series of new laws with regard to labor and social welfare, even before the implementation of the new constitution in 1950. The new laws were: the *Industrial Disputes Act* and the *Coal Mines Labor Welfare Fund Act* of 1947; the *Factory's Act*, the *Dock Workers (Regulation of Employment) Act* of 1948, which both addressed the issue of work hours, conditions of work, leisure time, and health and safety; and the *Minimum Wages Act*,⁴ the *Coal Mines Provident Fund, Family Pension and Bonus Scheme Act*, and the *Employees State Insurance Act* of 1948; and the *Industrial Disputes Banking and Insurance Company Act* of 1949; the *Employee's Provident Fund Ordinance* and the *Plantations Labor Act* of 1951, the *Employees Provident Fund Act* of 1952, and the *Maternity Benefit Act* of 1961 (Rath, 1978; Goel and Jain, 1988; Barura, 1995; Madan, 1973: 312).

The second significant step forward concerning the construct of a more comprehensive social security system in India, the *Employees State Insurance Act*, provided for: (1) medical care treatment; (2) cash allowances during sickness; (3) maternity benefits; (4) employment injury; and (5) benefits pensions for dependents of workers due to employment injury to the insured persons in factories and specialized workshops employing 20 persons or more, as well as other laborers and clerical staff with a monthly wage up to RPS 1,000. By the year 1980, the Employees State Insurance covered 6 million workers and their families, adding up to 27,787,800 persons—in actual fact, a very limited coverage of India's total working population (cf Goel and Jain, 1988: 18-24; Banjeri, 1985: 296).

The Constitution of India of 1950 did not sustainably increase the frequency or the content of welfare legislation of the new republic, when compared to earlier social policies. Article 38 (1) stipulates the advancement of a social order, in which social, economic, and political justice shall form the basis of all institutions of the national life. In Article 38 (2), the Constitution lays down that the state shall, in particular, strive to minimize the inequalities in status, facilities, and opportunities, not only amongst individuals but also amongst groups of people who reside in different areas, or engage in different vocations.

Furthermore, Article 39 (e) requires that the state shall direct its policies towards securing the health and strength of male and female workers, and that children of tender age are not abused, and that all citizens are *not forced by economic necessity* (this passage may connote a kind of justification of e.g. child labor!) to enter vocations unsuited to their age or strength.

On top of that, Article 41 of the Constitution specifies that the state shall, *within the limits of its economic capacity and development* (this passage is, indeed, very indefinite, and leaves room for a wide range of interpretations), make effective provisions for securing the right to work, the right to education, and the right to public assistance in cases of unemployment, old age, sickness, and disablement.

Finally, Article 45 insists on the introduction of free, compulsory, and universal education until the completion of the age of 14, within a period of 10 years from the commencement of the Constitution; as well as the promotion of educational and economic interests of weaker sections of society and, in particular, of the Scheduled "Castes," and the Scheduled Tribes and shall protect them from social injustice and all forms of exploitation (cf CRI, 2000).

The history of social legislation and administrative regulations of the Republic of India mirrors quite a bit the provisions given in the Constitution, but many important parts, such as the provision and coverage of social security, had been kept very vague. In fact, after 1950, the Indian government undertook numerous efforts in the field of social security. The first new more important social law of the 1950s was the *Plantation Labor Act* of 1951, which set forth provisions for medical care and sickness benefits for plantation workers.

The next great piece of law in the field of social security was the *Employees State Provident Fund Act*⁵ of 1952, which provided old-age, invalidity, and death benefits. Today, Central Government employees are entitled to benefit from the General Provident Fund scheme, and employees of public sector undertakings and other autonomous organizations, like the Steel Authority of India, the Indian Airlines Corporation, Air India, the Port Trust, news agencies, railways, mining companies, etc., can profit from membership in the Contributory Provident Fund scheme. With regard to the Contributory Provident Fund, it needs to note that employee's have to contribute at least 8.5 percent,⁶ while the government/employer also contributes the equal amount. To discourage withdrawals from the Contributory Provident Fund, the government has set up a new Incentive Bonus Scheme in 1975 (Chowdhry, 1985a: 290-91, 1985b).

Over the years the government established, in addition, sickness insurance, a pension plan, maternity benefits, special disability benefits, hospital leave, a productivity-linked bonus scheme, various reductions of housing, electricity, and water rates, a deposit-linked insurance scheme (which functions similar to a life insurance), and death-cum-retirement gratuity for Central Government employees. Employees of public sector undertakings and other autonomous organizations may profit from Employees State Insurance, Employees Family Pension Scheme, housing benefits, special social assistance schemes for disabled persons, widows, dependent children, etc. Important social legislations of the Central Government, besides State Government Legislation, were the amendment of the 1929 Maternity Benefit Act in 1961; Employees' Family Pension Scheme of 1971; Employees Provident Fund and Miscellaneous Provisions Act of 1972; the Payment of Gratuity Act in 1972; Mica Mines Labor Welfare Fund Act 1972; the Beedi Workers Welfare Fund Act of 1976; Iron Ore, Mine, Manganese Ore Mines and Chrome Ore Mines Labor Welfare Fund Act of 1976; Deposit-Linked Insurance Scheme of 1979; Chine Workers Welfare Fund Act 1981, and the implementation of the Employee's Pension Scheme in 1995 (cf Wadhawan, 1989; Barura, 1995; Kurz, 2001).

As stated by Article 42 of the Indian Constitution, the state shall make effective provisions for securing the right to work; education; and public assistance in case of unemployment, old age, sickness, disablement, and in other cases of undeserved want. Whereas employees and workers in the public and semipublic sector are able to rely on a rather comprehensive system of social security, members of the private sector—be it in cities/towns, or the countryside—are left out from any such provisions. There are comparatively meager attempts, for example, with regard to employment security in some federal states. In Maharashtra the Employment Guarantee Scheme offers work to mainly laborers (adult persons) in the vicinity of their place of residence at daily wages that are slightly lower than the minimum wages. Other work programs include the Food for Work Program, which offers surplus food grains from buffer stocks, besides some smaller cash payments, to

unemployed rural workforce for work in the construction of various amenities and infrastructure.

In India, there is a connection between higher levels of unemployment and economic development, the greater the degree of economic development the higher is the rate of unemployment, due to the absence of traditional forms of pre-capitalist relations, and decreasing shares of self-employment in the rural countryside. However, in these backward areas, high degrees of underemployment and extremely low wages pose an even greater problem for the Indian workforce (Chowdhry, 1985a: 154-55; Nagaraj, 1999: 79).

Pertaining to old-age income security, it needs to say that there is no social insurance system for old-age pensions. The only schemes that exist are old-age assistance schemes (which, however, are misleadingly referred to as pension schemes, by Central and State Governments). A number of State Governments have introduced old-age assistance schemes for destitute persons, based on an income-test. The minimum age requirements as well as benefit levels, in the mid-1980s for example, varied considerably between 65 and 70 years, and RPS 20 (Andhra Pradesh) to RPS 75 (Jammu & Kashmir) a month respectively. The first federal state to implement such a scheme was Uttar Pradesh in 1957; it was followed by Kerala in 1960; Andhra Pradesh in 1961; Tamil Nadu in 1962; Karnataka, Rajasthan, West Bengal, and Chandigarh in 1964; Punjab in 1968; Haryana, Himachal Pradesh in 1969; Bihar in 1970; Orissa, Dehli, Lakshadweep, and Mizoram in 1975; Jammu & Kashmir in 1976; Gujarat, Goa, Damman & Diu, and Tripura in 1978; Nagaland in 1979; Maharashtra and Meghalaya in 1980; and, finally, Madhya Pradesh in 1981. The rate of the so-called "pensions" is a lot lower than the minimum wages; and certainly to meager to secure a basic living for the needy (Goel and Jain, 1988: 301-02; Chowdhry, 1985a: 95-97).

Worthwhile to note is also the highly diverse structure of state authorities (at State Government level) that are in charge of old-age assistance schemes (cf Jagannadham, 1967; Goel and Jain, 1988: 149-92). In Andhra Pradesh, Chandigarh, Dehli, Haryana, Madhya Pradesh, Mizoram, Punjab, and Rajasthan there is a *Department of Social Welfare* that is responsible for running these old-age assistance schemes. In Himachal Pradesh, it is the *Directorate of Social Welfare*; in Nagaland the *Directorate of Social Security and Welfare*; in Gujarat the *Department of Social Welfare and Tribal Development (Directorate of Social Defense)*; in Lakshadweep the *Department of Social Welfare and Culture*; in Uttar Pradesh the *Department of Labor Welfare*; in Bihar the *Department of Labor and Employment*; in Tripura the *Department of Education (Directorate of Social Welfare and Social Education)*; in West Bengal the *Relief and Social Welfare Department (Welfare Branch)*; in Goa and Damman & Diu the *Institute of Public Assistance*, in Maharashtra the *Housing and Special Assistance Department*; in Orissa the *Community Development and Rural Construction Department*; in Jammu

& Kashmir and Karnataka the *Finance Department*; and in Kerala and Tamil Nadu the *Revenue Department*.⁷

It becomes clear that the Department of Social Welfare of the Central Government only provides initiative and leadership to the respective government authorities in charge of social welfare, and serves mainly as a clearinghouse of information and forum for exchange of ideas and very general policy guidelines. Furthermore, it administers certain central and centrally sponsored schemes, and it deals with matters related to interstate welfare problems (cf Rath, 1978: 227; Dubey: 146-61).

In the field of health care, we see also great differences in the administration, as well as the number and scope of health care policies implemented. When looking at the level of spending of different State governments, it becomes clear that those states with highest levels of poverty and population explosion—namely Bihar, Uttar Pradesh, and Madhya Pradesh—are spending a great deal on health care programs than in the rest of India. The respective levels of per capita spending are RPS 9.61, 11.73, and 17.05, against a national average of RPS 19.91 per capita health care spending. Other—however positively—outstanding examples are Punjab, Maharashtra, and Kerala; with a per capita spending of RPS 25.69, 25.34, and 25.20 in the year 1979/1980. The overall focus on health care provision of the Indian welfare state system was decreasing over time, from 3.3 percent of government outlays between 1951 and 1956 (during the First Five-Year Plan) to 1.9 percent between 1980 and 1985 (during the Sixth Five-Year Plan) (cf Banjeri, 1985: 40-41).

The disparities of social welfare provision between different federal states of India, as displayed below (cf Table 7.1), are not to be explained by differences in economic development. Kerala is, in no doubt, the leader among all states on the Indian Subcontinent with regard to achievements in social development. The federal state of Kerala, for example, achieved a total fertility rate of 1.8 (against the worst result, that is, Uttar Pradesh with a total fertility rate of 4.8) in 2000; with a relatively low percentage of the population living below the poverty line, that is, 25.4 percent (compared to 55 percent in Bihar and 48.6 percent in Orissa) in 1993-1994; with the highest percentage of literate female population, that is 86.2 percent (compared to 20.4 percent in Rajasthan, 22.9 in Bihar, and 25.3 in Uttar Pradesh) by the end of the 1990s; and the lowest proportion of child workers in the population (cf GOI, 2000a, b, c; Ramachandran, 2000). The experience of Kerala has shown that—though being a relative poor and economically disadvantaged federal state in comparison (with e.g. a high rate of unemployment)—it is possible to protect its people against extreme destitution and hardships (cf Ghai, 2000).

Table 7.1
A Comparison of Kerala with Other States: Total Fertility Rate (2000),
Population Below Poverty Line in Percent (1993-1994), and Female Literacy
in Percent (2000)

Selected States	Total Fertility Rate	Population Below Poverty Line	Female Literacy
Kerala	1.8	25.4	86.2
Tamil Nadu	2	35	51.3
Andhra Pradesh	2.5	22.2	32.7
Karnataka	2.5	33.2	44.3
West Bengal	2.6	35.7	46.6
Punjab	2.7	11.8	50.4
Maharashtra	2.7	36.9	52.3
Gujarat	3	24.2	48.6
Orissa	3	48.6	34.7
Assam	3.2	40.9	43.0
Madhya Pradesh	4	42.5	28.9
Rajasthan	4.2	27.4	20.4
Bihar	4.4	55	22.9
Uttar Pradesh	4.8	40.9	25.3

Sources: Government of India (2000a, b, c).

Broad-scale social security and assistance schemes for the Indian population at large are a dream for still quite some time—even now at the beginning of the 21st century—the relevant provisions of the Constitution, can be understood, thus, as a general direction for policy makers, to establish a more comprehensive welfare state system. However, more than half a decade has passed since the implementation of the 1950 constitution, and India was proud to have, by and large, a “socialist-oriented” ideology. The extensive national of a great number of industries (including e.g. the life insurance industry) are the direct consequence of the overall socialist-oriented leadership of India.

While Mahatma Gandhi was changing Indian social history with his social reform movements between 1920 and 1948, PM Pandit Jawaharlal Nehru and his daughter, PM Indira Gandhi (and to some extent also her son, PM Rajiv Gandhi) put forward, especially policies of nationalization of a wide range of industries. The massive efforts of the Indian leadership, above all the Congress Party, of the late 1940s and early 1950s to accomplish the erection of an Indian welfare state system—though residual in nature, and greatly limited to the clientele of government employees and workers in semi-governmental industries—were successful, and, then, continuously extended in the decades thereafter, especially in

the field of population/family planning, but also with regard to health care, employment, nutrition, and social assistance.

The Political Explanations for Development and Non-Development of the Indian Welfare State System

The development of the Indian welfare state system, as Drèze and Sen (1999: 375-76) point out rightly, is not only dependent on government action, but also on that of the general public, which in return can be “particularly important in promoting the positive functions of the government,” such as the provision of public services in social security, health care, child immunization, primary education, and rural infrastructure. Drèze and Sen, furthermore, note that the vigilance and involvement of the public—which, of course, includes social reformers, social movements and the media—can be “quite crucial not only in ensuring an adequate expansion of these essential services but also in monitoring their functioning” (1999: 376).

The modern Indian nation—besides the continuing ramifications of former British rule—has to be thankful, on the one hand, for all the good things that exist in India today to the Gandhi/Nehru dynasty and, thus, the Congress Party (which was highly dependent on the Gandhi/Nehru family until the 1990s and beyond, cf Brass, 1994: 73), and, on the other hand, may blame them for all the bad things, or the things that do not work, or work unsatisfactorily at the same time (Priyadarshi, 2000). This may appear to be a harsh critique, seen from the eye of any person that is not particularly familiar with the history and the successes and failures of present-day India. But—when seen from a greater historical perspective, and especially with the far-reaching understanding of a political scientist (as in the case of Priyadarshi, cf also Balan, 2002; and SarDesai and Mohan, 1992)—this sharp comment contains a lot of truthful bits and pieces.

An earlier study of the author (2002a) on success and failure of population policies in India from 1947 to the present, also pointed at the fateful historical and political circumstances of India at the time of Independence, where the historical compromise of Nehru to pacify and integrate the remaining Muslims in the newly-established Indian nation (after the split of British India into the Indian Union and Pakistan, i.e. including Bangladesh that was formerly known as Eastern Pakistan) led to a misfortunate constellation of state authorities and respective their powers, which had been laid down in the constitution of the new Indian republic in 1950 (cf Kamal and Meyer, 1977: 83-86; Stern, 2001).

While Nehru fought for a heavily centralized administration of new India, the Muslim League—which worried about the security and self-rule under majoritarian Hindu rule—pushed for a much more decentralized form of government. The result of which is that politics in India, in general, are centrally planned, but—especially with regard to economic and social policy making—and rely on the assistance of

governments of each federal state (who of course are often governed by different and opposing political factions and parties). Thus, it was Nehru's vision of a centrally planned and governed state and the subsequent compromise between this vision and sociopolitical reality of the multifaceted Indian society, with its numerous social, religious, lingual, and ethnic cleavages (cf Majeed, 2002; Basu, 2000: 76-87; Chandra, 1999; Chhibber, 1999; Vanaik, 1997; Singh, 1996: 41-51).

Nehru's vision of a strong, central state is not an unusual one for societies with developing economies. South Korea, Taiwan, and Singapore, for example, all have experienced decades of single-party, authoritarian rule; one of which, Singapore, has, in fact, become one of the world's leading economies, and it seems Singaporean, for the time being are rather satisfied with what they have got. In India, history thought of a very distinct path of socio-political development:

The politics of India, of course, seen from a more narrow perspective, is highly related to the birth of the Indian nation, for and in which Mahatma Gandhi⁸ and Pandit Jawaharlal Nehru played a central role. Both Pandit Jawaharlal Nehru and Mahatma Gandhi fought against imperial rule, starting in 1919 and 1920 respectively. The manifold sufferings and endless efforts of these two leaders of the independence movement in point of fact led to the establishment of the Indian Union in 1947, and the Republic of India in 1950. The roots of Indian nationalism—and, hence, that of the Indian independence movement—reach back into the second half of the 19th century, after the British East India Company exerted full control over India for the first time in 1850.⁹

The political outcome of the constitutional compromise of the year 1950 has, indeed, had long-standing and far-reaching consequences in the field of social and economic policy making as important political institutions have been weakened and power conflicts multiplied (cf Kohli, 1991: 383; Das, 1991; Kamal and Meyer, 1977). While Indian planners—who were located in various departments and agencies of the central government in New Dehli—recognized the stringent need for tackling problems such as unemployment, malnutrition, social justice, universal health services, housing, and environmental protection, state governments and their subordinated departments and agencies were not directly under the control of those planning agencies. In a great deal of cases of policy implementations, local governments opposed the policies of the central government, and their policy planning agencies, due to general political power struggle between different parties and faction that ruled India on national and federal state level (cf Banjeri, 1985; Sharma, 2002). In India, undeniably, there exists a fundamental exclusion of some states and regions—due to vast regional, i.e. economic, disparities—from the body politic, from the framework of the state and, by a long way, also from civil society (Kothari, 1997: 48).

India is a country that is composed of dozens of different political entities that are loosely connected via the Constitution of the Republic of India (cf Grover, 1997; Narang, 1996). The ill-assorted and rather intricate relationship between the Central

Government and State Governments; the President and State Governors, and the State Governors and the State Parliaments (which are directly elected by the people), imposes great restraints for policy-making capacities of the central government (cf CRI, 2002).

Centrally devised policies, as a consequence, were least likely to be implemented in a rather swiftly, and in universal form. Varying policy successes across the federal states of the Subcontinent provide clear evidence for the impact of different political set-ups and policy compromises and interpretations on state government level, especially with regard to policy implementation. Only when financial offers or restraints were at the Prime Minister's disposal could the central government be reasonably sure of cooperation from the side of state governments (cf Kamal and Meyer, 1977: 86).

The political landscape of India is as multifaceted as that of all of Europe together, with strongholds of communists in the East (West Bengal) and the South (Kerala); with Muslim strongholds in Assam (25 percent of population), Kerala (24 percent), West Bengal (20 percent), Uttar Pradesh (17 percent), Jammu & Kashmir (16 percent), and Bihar (16 percent) (against a national average of 12 percent) (cf GOI, 2000b); and with strong lingual and ethnic cleavage between the Indians in the North, largely speaking languages that belong to the Indo-European/Indo-Germanic language family, and the Indians in the South who speak Dravidian languages.¹⁰ Moreover, there is no unitary national language in India. English is only spoken by some 2 percent of the population; Hindi is spoken by only about 40 percent of the population. All together, there are 24 national languages and scripts in today's India (Gandotra, 1998; GOI, 2000b; Das Gupta, 1970).

Cast division, in addition, continues to plague the country and, thus, hinder social, political, and economic progress, despite the fact that first signs of attempted social and political inclusion of a growing number of backward classes by the ruling elites are becoming increasingly ostensible (due to the changing social composition of political representation) in the most populated, most impoverished North of the country (Kumar, 1999), where the cast system still exercises the highest degree of control over social life. As a result, the political discourse—and, thus, also the cultural and societal exchange—remains to be highly fragmented across the Indian subcontinent.

Conclusions

The cleavage-based political framework of post-Independence India has, hence, produced a unique political setting in which social policy making was made a great deal more lengthy and thorny, than in most countries of the developed Western world. Functional theories that explain the relative absence of welfare state institutions in “Third World” countries with their comparative socio-economic backwardness cannot explain the striking differences of welfare state development

in e.g. Mainland China and India, from the late 1940s onwards. The author here found that conflict theories in mainstream welfare state theory that are based on numerous political and socio-political parameters are, indeed, capable of explaining the striking gap between policy efforts and policy outcomes in the case of India, as well as in any other countries, wherever they may occur (cf Aspalter, 2002c).

Theda Skocpol and Ann Shola Orloff, in the case of the United States, has come to an equivalent conclusion, blaming the state's weak institutional structures for the relative delay in the built up and the unfinished outline in welfare state development (cf Skocpol 1987a,b; 1988; Orloff, 1988). Further comparison of political and institutional impacts on social policy making, both in so-called developed and developing countries, may indeed broaden the road to a better understanding social politics as such, and hence provide the possibility of putting forward new political remedies—in social policy in particular and politics as a whole—that not only address the symptoms, but also, and especially, the causes of delay and imperfections in the realm of social policy formulation and administration.

In a nutshell, Indian social policy dilemmas have arisen from social, political and economic legacies of the past, which—though most being of a more persistent nature—have to be addressed by a strong, centralized state who is, then, capable and willing to gradually transform the current state of structural dualism.¹¹ The requirements of a functioning welfare state system and the formulation of economic and social policies and programs, intrinsically, involve coordination, planning (Prakash and Raj, 1972: 168), and *policy execution* on nothing less but a national scale; this, in collaboration with competent local authorities assisted by local communities, and not, as is the case, by a mixture of centralized planning, fragmented organization at state level, and a system of poorly equipped local authorities for administering social welfare (Jagannadham, 1974: 90).

NOTES

- 1 In other words, the “abolition of social disabilities inherited from the past,” which today is still one of the most important goals of Indian social policy (cf Gokhale, 1974).
- 2 Which was greatly restricted in scope covering only government employees and railway workers (cf Rath, 1978: 219).
- 3 As of 1985 (cf Chowdhry, 1985a: 287).
- 4 Which empowered the appropriate government to fix minimum rates of wages payable to employees in industries specified in the respective schedule.
- 5 Amended in 1960 and 1962.
- 6 As of 1985 (cf Chowdhry, 1985a: 291).
- 7 As of 1985 (cf Chowdhry, 1985a: 291).
- 8 Literally meaning “Great Soul” Gandhi, which is a honorary name; his birth name was, however, Mohandas Karamchand Gandhi (1869-1948).
- 9 The British Empire took over the rule of India in the year 1857.

- 10 The Dravidian people originally came from Northwestern India who moved to Southern India after the arrival of the “Indo-Germans/Indo-Aryer” that come from the river *Oxus* (“Amu-Darja”) in today’s Uzbekistan. Another stream of immigrants from the same area migrated to parts of Northern and Central Europe. The term “Aryer” has been misused and, in fact, abused by the horrifying Nazi Regime in Germany in the first half of the 20th century, which constructed a terrible “race theory” that led to the systematic killings of at least 5 to 6 million people of Jewish origin, as well as so many gypsies, and those people who resisted the Nazi Regime. Each “race theory” is, by its very nature, completely arbitrary, and completely senseless. As a matter of fact, there are no races—just different mixes and blends of one *humankind*! Originally, the term “Aryer” in Ancient India meant a “class of people that were devoted to religious services,” in a way a term referring to the “upper class” of Ancient India. The actual origins of members of this “upper class” are manifold, coming from Iran, Central Asia, or elsewhere (cf e.g. Nagarajan, 1994).
- 11 Structural dualism in India is not only existent in overall economic, political and social realm, but it is also visible in the policy outcome of the welfare state system, the health care system, e.g., is heavily biased towards the privileged-class, the urban population (cf Banerji, 1996: 311).

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8

The Welfare State in Mainland China: From Enterprise-Based to Insurance-Based Social Security

NELSON W.S. CHOW AND CHRISTIAN ASPALTER

East Asian welfare state systems did not beget a European-style class compromise, which is founded on social democratic and Christian political movements, to moderate capitalism by means of a regime of extensive welfare provision covering unemployment, pension, sickness, maternity, and further benefits for those seriously disadvantaged by the market (cf Ghai, 1999: 157-58). In China—though it was attempted, from the very beginning, to establish a fully-fledged socialist system, which does not rely on the rule of market, and which features socialist welfare provision for all of the population—the government in China did not develop a comprehensive welfare state system either.

In fact, China is moving still closer to its neighbors in terms of welfare state provisions, as the Communist Party (CPC), at this point, is abandoning much of the form and substance of “genuine socialism.” The Chinese government, as things stand now, clearly prefers contribution-based, fund-managed social insurance

systems for health, unemployment, and pension insurance, and it opposes “pay-as-you-go” systems that are financed through taxation. It even candidly opposes the idea of using large amounts of the national budget to provide basic social security benefits. On top, social security schemes that are designed for the better-off sections of the working population have been given priority over social assistance schemes for the poor and vulnerable, such as the elderly, orphans and people with disabilities, since the latter are not perceived as “politically and economically” productive (cf White *et al.*, 1998: 216-17).

This article takes into account the impact of modernization and reform policies on the overall development of the Chinese social systems. The economic and political reforms ever since the late 1970s, together with the fast graying of society, have a significant impact on how the political elite, and the society as a whole, addresses issues of social welfare, especially that of caring and providing for an increasingly frail population (cf Olson, 1994).

The Chinese welfare state system is the product of the Communist Party (CPC)—which like other Communist parties in the world—is supposed to create an equal society. From the late 1940s to the mid-1960s, the Chinese welfare state emphasized universal welfare schemes and a comparative high level of welfare benefits with respect to social insurance (“*social security*”) and social assistance (“*welfare*”). However, the sheer size of China and its different developmental status across the country—especially the differences between the developed East and the latter developing West—and the disruptions of political stability during the years of the *Great Proletarian Cultural Revolution* lead to the development of an own kind of welfare state system in China, i.e. a welfare state, which mainly addresses the needs of city dwellers, while leaving the majority of the population, the farming population, out of the reach of the welfare state. The notion of a welfare state system, as well as the necessity for social security and social assistance provisions, are not understood yet by the people living in the Chinese countryside. The rural population is still used to plant its own rice and vegetables, and to raise their own livestock. Even though their money at hand makes up only a tiny part of an average income of a city dweller, they make a rather decent living *for traditional standards of the Chinese countryside*. This, though, will change over the next couple of decades, as the tide of economic development moves on from the Chinese coastal areas to the hinterland. The participation in social insurance schemes and, to a lesser extent, also the provision of social assistance benefits will be, in next to no time, unquestionable part of the average middle-class family’s idea of a decent living standard (cf Aspalter, 2000b).

Over the last two decades, the Chinese welfare state has developed into a more universal social security system, with the limitation that e.g. pensions systems were brought from the firm level to the provincial level only. Even so, a unified pension insurance system on provincial level in China—a country with nearly 1.3 billion inhabitants—easily matches the size of its counterparts on national level in the

developed welfare states of the Western world. We may note that although the Chinese welfare state system, i.e. including social insurance, social assistance *and other forms of welfare*, only caters to one fourth to one third of the overall Chinese population at most. The core welfare services and benefits of the Chinese welfare state system, however, only cater to half of the people living in the bigger cities, at least 150 million people (cf Chang, 1999: 159). Thus, it constitutes one of the mightiest welfare state systems on earth (i.e., when including regulations and provision, housing, health and education, community development, etc.), not in terms of money spent¹; however, *in terms of people covered by social insurance*, China constitutes the world's largest welfare state system. By the end of 2001, there were 106.3 million workers and employers (including some 1.08 million farmers) as well as 33.46 million pensioners who were covered with pension insurance. In addition, 103.55 million workers and employees were protected by unemployment insurance; 76.29 million people had basic health care insurance, and 43.45 million were covered by the industrial injury insurance scheme. In comparison, in the year 2001, there were (only) 11.7 million urban residents nationwide drawing the minimum living allowance, the country's prime social assistance scheme (NBS, 2002; Wang, 2002; CD 2002a,b; cf also CD, 2001).²

On the other hand, China—in its attempt to increase competitive forces in its socialist market economy—gradually shifts away from the former “*institutional-redistributive*” welfare state system, in which a large share of the population profited from state welfare provision via employment in state companies. In the past two decades, the Chinese government has gradually switched to policies implementing a “*performance-achievement*” model of welfare state system. The Chinese populace—as the growing Chinese market provides a great deal of new employment opportunities—is more and more depending on market forces. Consequently, with regard to the labor market, we may note that the Chinese welfare state system is becoming increasingly “*commodified*”—that is, the market forces replace the safety of employment and social security provided by the state. The following sections of this article, first, reappraise the historical development of the Chinese welfare state system and its political context (which is vital for the understanding of the Chinese welfare state system as it is today) with special focus on labor insurance that included a large number of social security benefits—such as various in kind and cash benefits (medical treatment and income maintenance support, etc.) for occupational and non-occupational injury, sickness and disability; occupational and non-occupational death; retirement pensions; full-paid maternity leave, and free schooling, medical care, and kindergarten, etc. (cf Wong, 1987: 68-70). Subsequently, the social security reform and development in the second half of the 1980s and the 1990s are discussed in greater detail, with a special focus on state planning in field of social security. This article closes with an assessment of the current welfare system in China and the directions it needs to take in the years to come.

The Development of the Welfare State System in the Political Context

The First Ten Years: The Successful Implementation of Labor Insurance

The birth of the Chinese welfare state system dates back to the year 1948. In that year, the Communist Party of China established the first labor insurance program—still in the heydays of the civil war with the Nationalists in Manchuria (Northeastern China), which, at that point in time, was under the control of the Communist forces. The *Manchurian Labor Insurance Program* promulgated by the Communist Party of China (CPC) on December 27, 1948. After the hasty withdrawal of the China Nationalist Party (the Kuomintang) to Taiwan in late 1949, the Communist government announced the introduction of the *Labor Insurance Regulations (LIR)* in October 1950, which had been promulgated nationally in February the next year (cf Dixon, 1981; Aspalter, 2002: 90).

The long practice of the Communist Party in participating in policymaking (i.e., since 1921)—in combination with the pro-welfare Communist ideology (cf CPRC, 2000)—enabled it to establish without delay an all-embracing social security system. The Communists won the support of the farmers by propagating land reform and the support of laborers by focusing on industrial development and social welfare provisions. The Communists tried to realize the Marxist theories and to create a stupendous socialist welfare state. For this purpose, land had been confiscated and industries nationalized. Common farmers and workers were at the center of the Communist Party's attention. But, pertaining to social security provision, farmers had been left out since their coverage with social security programs was only desirable but not "politically necessary," i.e. vital for the support and the future of the Communist regime. It is for this reason that state intervention focused, first and foremost, on the improvement of welfare of city dwellers, which helped to sustain the legitimacy of the state and the power of enterprises over the workforce (Wong and Mok, 1995: 16). The powerful increase in legitimacy, thus, lessened very much the likelihood of social uprisings—especially among the highly mobile urban population, and in large-scale factories. It also strengthened the support of the long-term ruling Communist Party. Another reason was the government's intention to sustain and increase productivity rate of the workforce in key industries for national development.

The labor insurance program provided benefits for, e.g., the sick, the disabled, pensioners, as well as expecting and nursing mothers. The labor insurance scheme covered those employees who worked in state-operated, joint state-private, cooperatives, private factories, and mines; and in public service enterprises with more than 100 workers and staff—this, for example, in the transport, postal and telecommunication sectors. The 1953 revision of the Labor Insurance Regulations (LIR) extended significantly the coverage of labor insurance, then including also

factories, mines, and transport enterprises, communication services, and public construction enterprises (Selden and You, 1997: 1658; Chow, 2000: 22).

The 1953 revision of labor insurance concluded the first stage of the development of social security in Communist China. It stipulated that the expenditures on the benefits should be borne in full by the management or owners of enterprises. The financing of the welfare system, thus, was entirely left to the companies themselves—whether they were publicly owned, co-operative owned, or privately owned. Though, only a portion of labor insurance benefits to be directly disbursed by the enterprise management since it had to pay three percent of the payroll into the Labor Insurance Fund that was under the charge of the *All China Federation of Labor Unions* (“Chuan Guo Chung Gong Hui”) with its widespread network of local branches. The majority of the fund, 70 percent, was determined for the provision of old-age pensions, disability allowances and subsidies to dependants, sanatoriums, rest homes, and homes for the aged and the disabled. A special feature of the *Labor Insurance Fund* was that 30 percent of the fund was given to companies that got into serious financial difficulties; thus constituting a preventive social policy aimed at securing employment. The 1953 Labor Insurance Regulations (LIR) promised a pension of 50 to 70 percent of the wage at retirement to male workers and employees who worked for more than 25 years at the age of 60, and to female workers and employees who worked for more than 20 years at the age of 50. Old-age pensions, as a result, were as high as in the most advanced welfare state systems of the developed Western world (cf Chow, 2000: 22-25, Dixon, 1981; Aspalter, 2000a, 2001a, c).

The first years after the Chinese civil war of the late 1940s saw the implementation of a socialist social security system modeled along the one previously established in the Soviet Union. The Communist parties of the Soviet Union and China have seen their social system as a testimony of the supremacy of socialism. In the first two years of operation, the *Labor Insurance Scheme* covered well under 10 percent of the working population. The amendments of the *Labor Insurance Regulations* in the years 1956 and 1957 extended the coverage of labor insurance anew. In the year 1958, the membership of the program broadened to 45 million, compared to 24 million only two years before (Wong and Mok, 1995; Dixon, 1981).

The Era of Political Turbulence: Years of Stagnation and Continuation in Chinese Social Policy

Since the late 1950s, the development of social insurance in China had experienced a slight setback in terms of coverage. There were no new developments in the field of social and labor insurance. The political turmoil of the Great Leap Forward in the late 1950s and the Cultural Revolution in the second half of the 1960s interfered with the institutionalization of the social insurance system (cf

Aspalter, 2000a; Riskin, 2000). The fate of the Chinese social insurance system after 1948 has been tightly bound to the political stability of the leadership within the Communist Party of China—in other words, the ups and downs of Mao Zedong in his political career.

These ups and downs, yet again, were caused by the *Great Leap Forward* and the *Cultural Revolution*. The failure of the former constituted the reason for the purge of Mao, who was replaced as head of the state, but kept his position as party chairman. The latter was Mao's ticket back to the very top position within the Communist Party, as a new power bloc inside the CPC emerged in 1961. This new dominant group assembled around a group of moderate politicians under the leadership of Liu Shaoqi, Deng Xiaoping, and others. This party faction stood in opposition to Party Chairman Mao Zedong, Minister of Defense Lin Biao, and their supporters. These two groups were in dispute over the methods with which their common goals were to be achieved. Between 1961 and 1965, the group around Liu and Deng managed to strengthen party organization and party discipline, set up realistic economic planning instruments, and decentralize decision making (Meisner, 1999; Hsu, 1999; Shinn and Worden, 2000).

Due to this lack in political stability, and caused by the many changes of power elites, Chinese social and economic development nearly came to a standstill. To boot, the power struggle in between the Communist Party in the first half of the 1960s led to the outbreak of the Cultural Revolution, during which also local and provincial authorities, as well as party and labor union organizations, were fiercely attacked by revolutionary forces. For that reason, the government, the party, and the labor union organizations had been significantly weakened, especially at intermediary administrative levels.

During the Cultural Revolution, the labor unions were badly assaulted by the Red Guards, who mainly carried out Mao's attack on the party and the state. Labor unions had been abolished and, as a result, no institution existed that was in charge of the management and provision of retirement benefits. Accordingly, the administration of the pension system had been given into the hands of enterprises on an *ad hoc* basis in 1969 (Lee, 1993). It follows that, the understanding of the development of the Chinese welfare state system—and the labor insurance system in particular—is tied to the understanding of state institutions, but also its structures (cf Chen, 1996). Only in the early 1980s, the state began to relocate the management of pension system and other social security systems to higher administrative levels.

From the late 1950s to the late 1970s, the overall development of social security schemes had been stagnant. However, there was considerable growth in other social welfare sectors, such as housing, medical care subsidies and collective welfare of enterprise units that included e.g. sanatoriums, rest homes, orphanages, as well as homes for the old and disabled. Traditional rural social assistance, on the contrary to urban social insurance, not only continued to play a vital role in the villages, but

was even made mandatory after the implementation of the commune system in 1958. Responsibility for providing welfare to the very needy—mainly orphans and lonely elderly—was restored at village level (cf Chow, 1995b). The system of cooperative social security provisions developed into one of the most important columns of the Chinese welfare system, and continued to be vital until the late 1970s.

The Communist social security system for urban workers—that experienced its high time from the early 1950s to the late 1970s—became to be known as the *Iron Rice Bowl* (“Tie Fan Wan”) system; i.e. a Chinese version of the “cradle-to-the-grave” welfare system in Sweden; however, designed for a limited part of the work force only. The *Iron Rice Bowl* system guaranteed the provision of employment according to employment status. That meant that the state had to finance life-sustaining goods, services and the resources needed for 115 million industrial workers and employees regardless of their work records (Aspalter, 2001b, c; Yeung, 1986).

By the late 1970s, the Chinese welfare state system accommodated about four fifths of the urban population, due to the high share of people employed in the state-owned sector and their family members in overall urban population. The percentage of the population living in the cities at that time was only 19 percent. Thus, the Chinese welfare state was only existent in the cities, and not in the countryside. In 1978, out of 95 million workers who were entitled for pensions, 74.5 million were former state sector workers and 20.5 million collective workers (Selden and You, 1997: 1658-60).

The Chinese welfare state system, from the very beginning, was designed for the urban workforce, who was employed by the government, state-run companies, and collective enterprises—that is, a clear majority of the workforce. It is for the reason of the government’s need, in the past, to ensure social peace in the cities that the Chinese welfare state system was particularly designed for city dwellers. Nonetheless, the argument that people living in the countryside, most of who had been farmers, were not in such a great need for social insurance benefits, because they are living in an archaic society, is also valid. The dualism between the urban and the rural China in terms of social welfare development is highly linked to the different stages of economic development of the respective areas. Since China was, at that point, still a Third World country, it would have been impossible to set up a social insurance system financed by the national budget that would have integrated the vast majority of the populace living—which is in non-developed parts of China—into the welfare state system.

The government had to tackle other, more burning predicaments first—for example, upholding minimal standards of living in the cities, where people cannot rely on vegetables the plant themselves and livestock they raise themselves and where people cannot depend on the financial assistance and care of a great number of family members, relatives, and neighbors as much as people in the countryside. As a result, the Chinese government upgraded social care service institutions and

extended welfare provision in other sectors, such as public housing. Another pressing concern of the government was the China's demographic development, since it wanted to put an end to the miserable living conditions of its people and, in concert, to enhance economic and social development. For these reasons, the government propagated the new "one-child-per-couple" policy early on in the 1970s, which meant to cut back on population growth. These policies included scores of incentives and disincentives in order to ensure the success of the new population policy. In the large cities, the new birth control measures were much more effective than in the countryside (Mackerras *et al.*, 1994; Chow, 1999).

The modernization of China, as it is well known, reached a turning point in 1978, with the gradual introduction of market principles and market economy the Chinese welfare state system. At that time, the Chinese welfare state comprised a wide range of programs aimed at enhancing the social security of the people, such as retirement pensions, birth control allowances, sick leave and benefits, health-care insurance, collective amenities, cultural facilities, housing benefits, subsidies, social relief, and disaster relief (Lee, 1993: 35).

The Coming of Deng Xiaoping and the Introduction of Reform Policies

From the late 1970s onwards, the political control of the CPC, and consequently the state, was in the hands of the reformers, such as Deng Xiaoping, Jiang Zemin, and Zhu Rongji, who sought to open the country and to prop up economic growth and to further the development of the social system; and not class struggle. In 1976, after the death of Mao Zedong and the long-term Prime Minister Zhou Enlai, Hua Guofeng became chairman of the CPC and Prime Minister. After Mao's death, the Gang of Four tried to seize power. However, this attempt failed. Hua Guofeng became the new strongman of the CPC. At the 1977 National Party Congress, the balance of power again started to favor the group of reformers gathered around Deng Xiaoping. Hu Yaobang later replaced Hua Guofeng as party chairman.

At the dawn of the 1980s, Deng Xiaoping became the second most powerful leader of the Communist Party in history of the People's Republic of China. His rise to power marked the watershed in postwar Chinese history. Whereas before everything pointed at a downward direction, i.e. in economic, political and social terms, the Deng Xiaoping era brought economic prosperity for most of the country, renewed political stability and, for us most importantly, a new era in social politics. In December 1978, at the Third Plenum of the Eleventh National Party Congress Central Committee, the "Four Modernizations" policies of Zhou Enlai had replaced the policy of promoting class struggle. Three years earlier, Zhou Enlai outlined the "*Four Modernizations*" program for the four sectors of national and economic development, namely agriculture, industry, national defense, and science and technology. Only after the introduction of these new policies, the government could again pay more attention to the provision of social insurance as factional infighting

within the Communist Party leadership came to an end (Harding, 1990; Hsu, 1999; Meisner, 1999, Shinn and Worden, 2000).

The year 1978 also marks a watershed in social politics. Before, the state ran a sort of “cradle-to-the-grave” welfare system for most of the city dwellers that was tied up to the workplace providing pension and sick leave benefits, health-care benefits, public housing, various social assistance programs and a great number of community and cultural amenities. Under the new economic policy initiated by Deng Xiaoping in 1978, the government has emphasized the new principle of distribution of benefits in the realm of social security according to work and performance, and enterprises had been made responsible for their own profits and losses. Following 1978, the year of great reforms under the national goal of modernization and the “Reform and Open” policy, the government began to increase social welfare outlays for retirement pensions, health services and housing. Between 1978 and 1984, the government geared up for the major changes of the social security system to come by launching a succession of studies, discussions, and dialogues. Major restructuring only took place in 1985 and thereafter.

Beginning in the early 1980s, China began to remodel its pension system by centralizing the managerial power of retirement schemes from enterprise level to local government level. Fujian was reportedly the first province to bring in the system of “*unified management*” (“Tong Chou”). The purpose of this restructuring is the greater pooling of risks in order to secure a long-term balance between contributions and retirement benefits. Subsequent to 1984, the realization of this new retirement pension system has been expeditious.

The ensuing ten years, the state began to unify the pension system and experimental schemes for unifying maternity insurance schemes (which formerly also operated on company level); and conducted smaller improvements in other social security domains. By the late 1980s, approximately 80 percent of all townships and counties across China have implemented pooled pension funds. In several municipalities and provinces, some forms of retirement pensions have been introduced on municipality/province level—for example, Beijing, Shanghai, Tientsin, Hebei, Guangdong, Jiangxi, Fujian, Henan, Anhui, Shandong, Shaanxi, and Jilin (Lee, 1993; Hu, 1997).

The economic reforms that transferred financial responsibility from the central authorities to enterprise level set in motion a massive lay off in the state sector. Millions of workers and employees lost their jobs. Unemployment in China, can be largely seen as “the product of a race between the increasing demand for labour from fast economic growth, on the one hand, and the burgeoning supply of labour coming onto the market from the redundant workforces in agriculture and state enterprises, on the other” (Riskin, 2000).

As a consequence of fast economic restructuring and massive layoffs in the state sector, the government also was compelled to create a new unemployment insurance system in July 1986 for national enterprises. However, it has only applied

to “some workers and staff members of state-owned enterprises” (Gao, 1999). The introduction of an unemployment insurance fund required all publicly owned enterprises to contribute to it a sum equivalent to one percent of the total wage bill. The purpose of the unemployment insurance fund was to support workers who had been laid off by their enterprises and were awaiting employment (Chow, 1988). The recognition of the existence of unemployment was itself something novel in China as it would imply a failure on the part of the state not to provide enough work, a phenomenon totally unacceptable by traditional socialists.

So far, the Chinese unemployment insurance system does not suit the requirements imposed by the changeover to a socialist market economy. The entire labor system needs to be reformed, which calls for the gradual extension of unemployment insurance to all employees of enterprises owned by the state and those in other enterprises (cf Gao, 1999). The factual rates of unemployment in China are about twice as high as indicated in official statistics, since only a fraction of the unemployed are registered with the local labor bureaus. Migrant workers are left out completely from this registration. For instance, in Shanghai, the estimated real unemployment rate amounted to 7 to 8 percent in 1993 (Riskin, 2000).

In the 1980s, the formerly established system of co-operative health care that had accomplished a great deal in bringing medical care to the countryside in the 1960s and 1970s had been almost completely dismantled, which had significant long-term negative effects of health conditions of the Chinese rural population. Under that system, people in need for social assistance could rely on the collective, and a collective in financial difficulties could rely on the state. Despite the fact that 90 percent of the farming populace was incorporated into a medical care system by 1978, twelve years later—in the year 1990—only 4 percent of people in the countryside were covered by co-operative social care. The collective is no longer a significant provider of social security and there is little or no state support for the aged and the infirm. State medical support, relief aid for backward areas, and help for “*five-guarantees households*” (providing food, clothing, shelter and burial expenses) only covered seven million people in 1989—that is to say, less than 1 percent of the rural population (Riskin, 2000; Chang, 1999).

Throughout the 1980s and 1990s, to boot, over 100 million farmers have left their home villages and poured into the cities, especially those situated in the east (Hu, 1997; Chow, 1995a). These new development exacerbated social conditions—especially with regard to health and housing—in China’s coastal sections, as well as larger inland cities. For that reason, the Chinese government has been working very keen on the extension of social insurance.

Following 1979, major reforms transformed the mismanaged, and highly abused, health-care services. The state embarked on the introduction of a new responsibility system to ensure the correct use of financial and medical resources. The amount of state subsidy to hospitals, then, was determined by evaluating the actual situation of hospitals and their need and, of course, the availability of funds. The remainder,

thereafter, could be used for technical equipment and employee's welfare, which mostly constituted a second salary in addition to the meager, basic salary. Responsibility for profits and losses was restored to health-care institutions. Furthermore, the state abolished the state monopoly in health-care provision, allowing the establishment of private practices. The government also began to promote development of medical cooperatives, which helped to reduce the waste of health service resources caused by surplus and shortage of either technical equipment, hospital person and beds, by facilitating out-patient services and regular on-duty services of doctors in hospitals attached to mines, factories and enterprises and other hospitals. These reforms freed hospitals from regional and subordinate restrictions that produced so much squandering of medical resources (Sun, 1993: 57-59).

In the period between 1978 and 1994, the annual expenditures on social security benefits rose from RMB 7.8 billion to RMB 195.6 billion. These expenditures included collective welfare subsidies, medical care expenses, funeral expenses, pensions for the families of the deceased, living allowances to people who are in difficulty, family planning subsidies, heating subsidies in winter, and expenses associated with recreational, cultural and propaganda activities. The prodigious social reforms ever since 1978 have transformed the in earlier times enterprise-based social security system into an insurance-based social security system. Ahead of the 1980s, the Chinese state bore all the financial burden of the social security system. From then on, the state, the work units, and the employees share the expenses for social security. The new social security system—into the bargain—joins together personal accounts and a greater social pooling of risks. Old-age insurance and unemployment insurance have become the bedrock of the new Chinese welfare state system. Be that as it may, the present-day dualism between the countryside and the cities, hitherto, goes on to disadvantage farmers—especially on the subject of pensions and medical care—in comparison to city dwellers (Liu, 1988; CIRD and CASS, 1998; Chi and Zhu, 1998).

Social Security Reform: From Enterprise-Based to Insurance-Based Social Security

At the 4th Session of the 9th National People's Congress (NPC) of the People's Republic of China (PRC) held in March 2001, the Chinese Premier, Zhu Rongji, in announcing the 10th Five-Year Plan for National Social and Economic Development, 2001 to 2005, reiterated once again the importance of perfecting the social security system (The State Council, 2001). That the Chinese social security system needed improvements was perceived in the context that the reform of state-owned enterprises would never be successful unless workers adversely affected by the reforms were guaranteed of sufficient support. As a socialist country with the government playing the major role in the running of the economy, the social

security system in China represents, to a large extent, the only form of welfare that is available to the majority of workers working in the urban areas (White, 1998).

The reiteration of the importance of perfecting the social security system was a follow up of a decision made in the 1st Session of the 9th NPC held in March, 1998, that it was a national policy “to encourage mergers, standardize bankruptcy, redirect laid-off workers and improve efficiency by reducing redundant staff.” In encouraging publicly owned enterprises to be competitive and allowing them to dismiss redundant workers, promises were made in the same session that “efforts will be made to quicken the reform of the social security system, including the workers’ basic old-age insurance, medical insurance and unemployment insurance.”

The need to change the social security system was argued on both practical and ideological grounds. On the practical side, the reform of the social security system was perceived to be necessary as it had imposed a heavy financial burden on national enterprises, making some of them economically unviable and consequently impeding the pace of economic reform (WB, 1985). On the ideological side, the reform of the social security system was regarded as a rejuvenation of China’s commitment to socialism as the changes would further improve the welfare of the workers (Davis, 1989).

A proposal was, hence, included in the 7th Five-Year Plan for National Social and Economic Development, 1986 to 1990, to construct “a socialist social security system with Chinese characteristics” (The State Council, 1986). In this plan, the meaning of a socialist social security system was defined as the introduction of social insurance, with funds “raised through various channels,” and “to foster the fine tradition of mutual assistance among relatives, friends and neighbors.” Consequently, a measure was introduced during the 7th Five-Year Plan period to set up a contributory old-age protection fund, requiring all new recruits of state-owned enterprises under the contract worker system to contribute to it a sum equivalent to not more than three percent of their basic wages. It should be pointed out at this juncture that as the provision of social security had been perceived, ever since the establishment of socialist China, as a state responsibility, contributions from workers were not required. The present requirement that workers should also contribute, though at only three percent of their wages, towards their old-age protection definitely represented a radical departure from the Lenin’s principles on social insurance, one of which was that the finance of social security should only come from the state (Chan and Chow, 1993).

Social Security Developments in the 1990s

The 8th Five-Year Plan for National Social and Economic Development, 1991 to 1995, largely confirmed what had been stated in the 7th Five-Year Plan on social security development (The State Council, 1991a). The 8th Five-Year Plan stressed that, while the “eating from the same iron pot” syndrome must not be allowed to

continue, attention should be given to narrow the gap between the rich and the poor, which had arisen as a result of the economic reforms. In particular, the social security system was identified as the one measure, which could have played an important role in rectifying the uneven distribution of incomes. The old-age and the unemployment insurance systems set up in 1986 were firmly approved in the 8th Five-Year Plan and it was suggested that insurance funds involving the contribution of workers should be established more widely and extensively. It was also proposed in the 8th Five-Year Plan that a national organization should ultimately be set up to co-ordinate the various social insurance schemes.

On June 26, 1991, the State Council issued a decision on what should be done in reforming the old-age insurance system for enterprise workers (The State Council, 1991b). Although the decision covered mainly the area of old-age protection, it also indicated the way in which the Chinese social security system should develop in future. It is thus important to record below the principles laid down in the decision:

1. In order to replace the existing enterprise-based system, the decision proposed that the new old-age protection system should comprise three different funds: the basic insurance fund, the enterprise supplementary insurance fund and the workers' individual savings. In other words, the responsibility to provide for old age would be shared between the state, the enterprise and individual workers.
2. While collective retirement funds were to be set up, the State Council stressed that consideration must be given to the variations between regions and provinces, and differences between schemes should be allowed as long as they were in compliance with the national policy.
3. Enterprises were required in the decision to make their tax-free contributions on the basis of their total wage bill and workers would not be required to contribute, as a start, more than three percent of their wages.
4. Contributions of the enterprises and the workers were proposed to be paid to a special account in the bank opened by a social insurance agency, to be set up under the supervision of the *Ministry of Labor*, with the responsibility to manage the funds.
5. The *Ministry of Labor* with its bureaus at the district levels would be responsible for the overall operation of the urban enterprises' old-age insurance funds.
6. The reform of the old-age insurance arrangements of government departments and affiliated units and those in the villages would be left to the *Ministry of Personnel* and the *Ministry of Civil Affairs* respectively.

The 1991 decision of the State Council set out thus the direction for the future development of old-age pensions in China, as well as affirmed once again the changes, which had been introduced since the mid-1980s. The old practice of

requiring individual enterprises to pay for the old-age pensions of their retired workers has hence been replaced by collective old-age insurance funds. This definitely represents a better arrangement as it ensures not only the availability of funds for the payment of old-age pensions but also brings into effect a certain degree of pooling among the enterprises. The importance of pooling, first at the city and the county level and ultimately at the provincial level, has further been stressed in two documents issued by the State Council, respectively in 1995 and 1997, on old-age insurance funds.

The measure to require newly recruited contract workers to contribute towards their old-age protection was later extended to all permanent workers and consequently inculcated in the enterprise workers the concept of contribution. But the most significant change contained in the decision of the State Council in 1991 is that, old-age pensions provided in accordance with the *Labor Insurance Regulations*, should only be regarded as a first level of support; they should be supplemented by additional benefits provided by individual enterprises as well as what the workers themselves are able to save up. Although the new arrangement might be perceived as a shedding of the responsibility of the state, it clearly complies with the principles laid down in the 7th and the 8th Five-Year Plans for National Social and Economic Development in that the task of providing for one's social security needs should be shared between the state, the enterprises and individual workers (Chow, 2000).

While the *Ministry of Labor* was busy with the social security coverage of the urban workers, the *Ministry of Civil Affairs* had been experimenting, since the mid-1980s, with old-age insurance protection for farmers working in the villages. As a result of the 1991 decision on old-age pensions, the *Ministry of Civil Affairs* was formally charged with the responsibility to introduce old-age insurance protection schemes in the villages. Though progresses were reported on the establishment of old-age insurance protection schemes, which were in fact no more than compulsory savings schemes, farmers covered had never been extensive (WB, 1997). The *Ministry of Civil Affairs* appeared also to have failed to manage the old-age insurance funds in a successful manner. Hence, when the new *Ministry of Labor and Social Security* was established in 1998, the old-age insurance funds among the farmers were transferred to the new ministry. However, up to early 2001, proposals were yet to be put up by the new *Ministry of Labor and Social Security* to meet the retirement protection needs of the farmers; social security remains in China a concern of the workers living in the urban areas.

Based on the decision in 1991, the State Council further issued a "Circular on Deepening the Reform of the Pension Insurance System" in 1995. The circular stipulated that from then on, old-age insurance arrangements would no longer be limited to workers of state-owned enterprises; coverage would be extended to all urban employees, including the self-employed and those employed by private enterprises. The principle that individual workers, enterprises and the state would

each make a contribution towards the financing of the old-age pensions would remain unchanged. As to the actual arrangement, the circular stressed that enterprise old-age insurance funds and individual worker's old-age savings accounts should be further developed to supplement the basic old-age pension presently provided for retired workers of state-owned enterprises. It was hoped that with the establishment of the enterprise old-age insurance funds and the individual worker's old-age savings accounts, the level of benefits provided under the basic old-age pension could be reduced from the present 83 percent replacement rate of previous wages to around 60 percent.

In the circular issued in 1995, the State Council proposed two options for the financing of the basic old-age pension: the first one was based on the defined contributions approach and the other on the defined benefits approach. Without going into the details of the two options, it suffices to point out here that contributions would come from both the enterprises and the workers; the enterprises would contribute about 25 percent of the local average wage and workers' contributions would gradually be raised from the present three percent to eight percent. In return, the workers, upon retirement, would be receiving about 35 percent of their previous wages. The above arrangements were subsequently endorsed in the 9th Five-Year Plan for National Social and Economic Development, 1996 to 2000, issued in 1996 which further stated that in the villages, the support of the aged would remain a primary responsibility of the family system, though old-age insurance funds should be developed to provide further protection (The State Council, 1996). It is obvious from the 9th Five-Year Plan for National Social and Economic Development that efforts would be made in future to establish in China a social security system which would no longer consist of, as in the past, benefits entirely provided by the state; but would instead depend on contributions made by individual workers, enterprises and the state.

In the field of health care, the Chinese government conducted a series of great reforms beginning with 1994. Two years later, the 9th Five-Year Plan for National Social and Economic Development set out to incorporate 50 million new members into the medical insurance system. Again, the government focused on the provision of the stronger sections of the population in social security provision. Today, the Chinese health-care system is only marginally established on the countryside, since 80 percent of all hospitals and doctors are concentrated in urban areas. Major reforms are conducted to alleviate the burden on the state, to better make use of medical resources, by introducing a mechanism of competition between medical institutions and a market-operating mechanism for medicine production and circulation, and to extend the medical care system's coverage of the population. In 1998, the government began to replace the former free health-care system for state-owned enterprises with a basic health-care insurance where employers contribute, currently, 6 percent, and employees 2 percent of wages (Hu, 1997: 47-54; Zhu, 2000; SC, 2002; cf also CD, 2003).

As the Chinese health-care sector is still to the overwhelming extent government controlled, the on-going opening of the medical market, after China's entry into the World Trade Organization, creates more room for development of private hospitals. Today, there are about 60,000 state-run hospitals, 1,477 private hospitals, and some 200 Sino-foreign funded hospitals in the country (CD, 2002a; Xing, 2003).

The 10th Five-Year Plan for National Social and Economic Development further called for a perfection of the social security system, ensuring that contributions made by individuals would not be used for other purposes, while the contributions of enterprises would only be used to fund the basic old-age pensions.

It was also contained in the 10th Five-Year Plan for National Social and Economic Development another proposal to lay down a minimum living standard for every Chinese citizen. Though the idea of a minimum living standard was first originated to protect the laid-off workers, while enterprises were urged to become more competitive, it also represented a major social policy change in that the role of the government would now be reduced to providing the minimum. While it would be too early to conclude that the social security system to be established in China would be moving closer to the "performance-achievement" model found in most industrially advanced countries, much of the "institutional-redistributive" principles held dear in the days when the system was first set up would probably disappear or simply be regarded as no longer applicable.

Whither Goes the Chinese Social Security System?

The Chinese social security system, taken as the only form of social policy in China, was first set up in the early 1950s and covered mainly workers employed in state-owned enterprises. Today, notwithstanding the adoption of the market economy, state-owned enterprises still played the most dominant role in the operation of the economy and employed the largest number of employees. Any change in the nature of the state-owned enterprises, both as production units and as welfare institutions, would thus affect, to a large extent, the welfare of the majority of the urban workers and their families.

The reforms that China has been carrying out in its social security system since the mid-1980s, together with the restructuring of the urban economy, have generally been perceived to be necessary and producing, in most instances, positive results. The most significant change that has occurred in the Chinese social security system is that it is no longer operated on the basis of individual enterprises and contains, at least, some elements of the "pooling of risks." Urban workers in China are now ensured of certain payments when they retire, become unemployed or injured, and that these payments are no longer related, as in the past, to the financial vicissitudes of their employing enterprises.

So far as reforms in old-age pensions are concerned, a new system consisting of social pooling and individual accounts is now in existence, as a valid alternative to

meeting the income security needs of the urban retirees. Problems remain, however, for workers who have already retired or are approaching retirement age, as they simply would not have enough to support themselves in old age. The financing of pensions for this transitional cohort of workers failing to build up their own individual accounts is one of the problems that China must resolve in restructuring its social security system.

Government officials responsible for the reform of the Chinese social security system have generally viewed the financing of pension obligations for the transitional workers as a technical problem, to be left to the actions of local governments. However, as existing pension funds have already incurred considerable financial liabilities to both old and new workers, there is little likelihood that the funds would be sufficient to fulfill their promises. The situation is further complicated by the fact that savings in individual accounts of the new workers in most localities are only notional, and that the extension of old-age pensions to employees of private enterprises has also met with great resistance.

The transition from a pay-as-you-go system to a fully or partially funded system is a challenge for all nations undertaking such a change. The challenge is even greater for China, as funding has always come from the government and workers have only recently been required to make their contributions. Furthermore, other than supporting a rapidly increasing number of retirees, the new social security system has also to provide for the surplus and laid-off employees, as well as serving as a safety-net for all who fall into poverty. The burdens that the new Chinese social security system has to bear are so great that there is a fear that the entire system might collapse, with the government shouldering, once again, all the responsibilities. The fear is not unfounded as in reforming the social security system the Chinese government has often placed greater emphasis on its short-term stability and continuity, rather than its long-term feasibility and viability.

China has learnt the hard lesson that the Labor Insurance Regulations, copied from the Soviet Union and enacted in 1951, were totally unsuitable for China. In reforming its social security system, China accepted thus that the formulation of a new set of social policies, which could serve the purpose of protecting the people from the hardship resulting from the economic reforms, was long overdue.

Whither will the Chinese social security system go? This is certainly difficult to tell at the moment as China has only openly adopted the socialist market economy for less than a decade. Looking ahead into the future, it appears that as long as China remains a socialist country, any form of social welfare, including the social security benefits, would still carry a sense of state benevolence. So far, rectification has been made in defining more clearly the social security responsibilities of the enterprises, in creating a greater scope of risk pooling, in making the workers more conscious of their roles in social security protection, and in enlarging the system by including the assistance provided by families, friends and neighbors. However, the reforms have yet to bring the desired change in the perception of the people, to help

them see social security as a form of income protection. The social security in China is still one of protecting the strong and neglecting the weak, as only permanent workers in the cities are covered. This certainly cannot be appropriately called “a socialist social security system with Chinese characteristics” (cf Chow and Xu, 2001). The hopeful sign is that reforms are still in the pipeline and the Chinese social security system is moving towards the direction of meeting the income security needs of the Chinese people.

NOTES

- 1 For example, a comparison of USD spent (Western welfare states, like Germany for instance, are leading in this category); however, a *proper* comparison in terms of PPPs (purchase power parities) is unfortunately not at hand. A comparison of PPPs is not to be based on the relative costs of services, and universally sold items, such as hamburgers (as usually applied in economics), either. In Hong Kong, while being one of the most expensive cities in the world, hamburgers are among the very cheapest in the world. To be clear, any simple comparison of prices, using only a single, or a couple of, items, is bound to producing inexact results.
- 2 The US has less than 50 million insured covered with social security, Russia around 35 million. Here, I (Christian Aspalter) would like not to compare the Chinese social insurance system with social security systems applied in the US and Russia in more depth; though detailed information have been provided by Prof. Krzysztof Ostaszewski and Prof. Boris Alexeev respectively, to both of whom I am very grateful for their kind support.

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9

The Welfare State System in Malaysia

JOHN DOLING AND ROZIAH OMAR

Malaysia's system of social welfare has resonance with systems in those other countries in South and East Asia that have also experienced high rates of economic growth over the postwar period. In common with Hong Kong, Singapore, South Korea and Taiwan, it has developed a low-tax, low public expenditure economy in which the greater part of that expenditure is aimed directly at economic growth. The minor position afforded to social spending is supported on national priorities promoting economic growth allied to expectations that the family, in particular, plays a key role in protecting the individual against misfortune. In addition, where extensive systems for assuring welfare of the population have been put into place, the state's role has been mainly as regulator with much of the funding and benefits related directly to contributions made from personal income. The Malaysian welfare state system, then, ensures that individual welfare is tied closely to family and group support and to labor market position, giving it many of the hallmarks of what has been labeled the Confucian welfare state (see Jones, 1993).

Yet, there is another side of the Malaysian system that sets it apart from most other welfare systems in Asia. The particularities of its history, especially the legacy of the British colonial period, have been important in framing a number of the

foundation stones of the present welfare state system. Pivotal, however, has been the multi-ethnic nature of Malaysian society. It is not, as the other high economic growth countries of the region, Chinese- and Confucian-dominated; it has a mix of ethnic groups—mainly Malay, but with large Chinese and Indian minorities. Islam has a dominant presence promoting family and community to ensure the welfare of its *ummah* (members). Moreover, the tensions, as well as the opportunities inherent in the ethnic mix, have had profound consequences in the post-Independence period for the shaping of the Malaysian approach both to economic development and welfare provision. Most importantly, decisions about economic growth and social spending have been guided by principles aimed at achieving national unity through equity between ethnic groups.

The first section of the chapter examines developments in the pre-Independence period as a backcloth to understanding the general developments in the Malaysian approach to welfare. The approach itself is examined in section two which outlines the developments leading to the construction of the twin towers of Malaysian welfare policy arising from the interplay between the pursuit of economic growth and the social and political goals aimed at achieving national unity. In the third section, the main dimensions of each of the broad areas of welfare—pensions, social security, social services, education, housing, and health—are outlined, while in the final section, a number of challenges facing the present system are discussed.

The Pre-Independence Period

Political Developments

From the 15th century, various parts of the area of modern-day Malaysia, particularly Melaka, were ruled by a succession of external powers—from China, Portugal, the Netherlands—and from the late 18th century Britain and, briefly, during World War II, Japan. It was during the British colonial period that the greatest economic and social changes took place. During the nineteenth century the British established a communications infrastructure to enable the development of the country's rubber and tin resources, while also putting a legal and administrative structure in place. Britain deliberately developed a diverse ethnic balance that was to have expression in the division of labor. A British-educated Malay elite was to work in the administration with other Malays continuing their farming and fishing. Immigrants from China were brought in to work as traders and tin miners and from India to work on the rubber plantations. Indeed, such was the scale of the immigration that by the early decades of the 20th century the indigenous Malays were outnumbered.

Following the Japanese surrender in 1945, Malaya, which consisted of Peninsular Malaya, Singapore, and North Borneo, came once again under British colonial rule. But the social and political circumstances were now very different. The Chinese Malayan Communist Party (CMP) resented what was seen as the

collaboration of some native Malays with the Japanese, while the United Malays National Organization (UMNO) fought to preserve Malay privileges. At first, the British acceded to UMNO establishing in 1948 the Federation of Malaya, which accorded native Malays special privileges, which were denied the Chinese and Indian communities. The CMP, however, fought a guerrilla struggle against the continuation of Colonial rule, and in 1950 a state of emergency was declared. Five years later Britain agreed that Malaya would be granted independence.

Religion and Asian Values

Islam arrived in Malaya in the 15th century and is part of the diversity and division within modern Malaysia that loosely maps onto the ethnic divisions. In 1995, of the total population of 19.38 millions, 61 percent were *Bumiputra* (literally sons of the soil, referring to the indigenous Malays), 27 percent Chinese and eight percent Indian (Ministry of National Unity and Social Development, 1996). Whereas the *Bumiputra* are Muslim, the Indians are largely Hindu and the Chinese largely Buddhist; the Chinese and the Indians both have Christian minorities. There was a period of Islamic fundamentalism in Peninsular Malaysia in the 1970s and Islam is a dominant force in the country, inseparable from *Bumiputra* interests and politics.

The dominant religious and philosophical dimensions have direct importance for the nature of social welfare. Elsewhere in the developed parts of Asia, Confucianism—in its many variants—has a major significance (see Jones, 1993). In general, it holds that women as inferiors should take care of their superiors (men) and junior member of the household so that “they are obliged to take on the welfare duties for family members and relatives.” Children, for their part, are to be indebted to their parents for the support and nurture they have given and are required to show filial piety. Under Confucianism, then, the family takes a large responsibility for welfare of its members and, so, solves “the social problem internally” (Lin, 1999: 55). Moreover, the belief in hard work and individual effort may be accompanied by a stigma attached to recipients of state welfare. Insofar as this is followed by the Chinese in Malaysia, it mitigates against much Western-style welfare provision through the state.

For the *Bumiputra* majority Islam shapes their beliefs and actions and whereas it differs in fundamental ways from Confucianism (or indeed from so-called neo-Confucianism), they do have some things in common. Thus, the Malay principle of *Balas Jasa* holds that children are honor-bound to repay their parents for what they have done on their behalf and women’s responsibility is seen as that of caring for family members. Beyond the family, society is essentially co-operative. *Gotong Royong* is a form of mutual help that requires the Malay to “help his neighbours when needed, whether it is for building a house or celebrating a wedding, and this help creates an obligation to reciprocate when need arises” (Fisk *et al.*, 1982: 109).

Although with urbanization *Gotong Royong* has lost some importance, as an ideal it continues to shape thinking about welfare responsibilities and provision.

Overall, then, the majority of the population of Malaysia subscribes to belief systems that locate the primary responsibility for the well being of the individual within the family and the group rather than the state. Consequently, the establishment by the British colonial government and later the Malaysian government of formal social welfare provisions, was superimposed upon existing welfare arrangements. Thus traditionally in Malay society there has been a custom of providing gifts to couples on their wedding enabling them to set up home, and of giving alms on death. The *Zakat Fitrah* contributions, along with other funds operated by the village mosque, provide help to the poor and needy. The immigrant groups from China and India also brought their own customs as well as developing new forms. The Chinese laborers, for example, had mostly been members of triad societies prior to arriving in Malaya and these continued to support them as a form of social security.

Another, and central dimension of the structure within which the social welfare system has been established, is the subordinate role of women. Both Muslim and non-Muslim women are subject to legal systems that differ significantly to those to which men are subject, and in ways that discriminate against them. Embedded in the differences is a set of beliefs that “assumes women’s role is motherhood and their reproductive tasks of bearing and rearing children takes precedence over any other activity” (Rashidah, 1995: 9). For their part, men are assumed to be the primary income earners, and although female activity rates have increased in recent years, the burden of caring continues to be disproportionately placed on women’s shoulders.

The British Social Welfare Legacy

According to a report produced by the International Labor Office (ILO, 1964) the main welfare-oriented activities of the Colonial Government, during the 100 years of British rule, were aimed at ensuring a steady flow of labor into Malaya’s principal export industries—tin and rubber. In fact, there were a number of initiatives directed at the well being of both the migrant workforces, as well as indigenous people, though these were far from being either comprehensive or well funded. Thus, a social welfare program established in 1912 with the intention of supporting both groups was closed, due to financial constraints, during the 1930s (Faizah *et al.*, 2000).

The origins of a more permanent and systematic welfare structure—even if still less than comprehensive—can be traced to 1945. The *Department of Social Welfare* was set up with “the objective of providing a vehicle primarily to assist the displaced and distressed victims of the war.” Before long, however, it came to provide “a permanent base for various social welfare services, catering for those in

need services for children and the disabled” (Abdullah, 1992: 372). In 1947, it incorporated the Probation Service that had been created to tackle the growing problems of juvenile delinquency and political agitation. In the same year, it also took responsibility for programs aimed at the welfare of the aged and aborigines, as well as providing protection for women and girls against being recruited into prostitution, while in the following year welfare for the blind became a responsibility (Abdullah, 1992).

Notwithstanding such expansion of programs, the provision of welfare services was not a universal effort, covering the population at large, but rather was very selective and mainly restricted to groups generally categorized as “those in need of special help, if they were to lead normal, happy lives” (Jones, 1958: iii). Indeed, from the very beginning, social welfare programs were viewed as burdens on public expenditure that detracted from the resources available for economic growth. As it was to be stated in the draft development plan, the overriding issue was considered to be “how to equate expenditure on development in the six years 1950 to 1955 with the limited amount of revenue which may be available for the purpose” (Malaya, 1950: 2). In consequence, the position that was taken was “that apart from whatever may be provided by the *Colonial Development and Welfare Fund* very little capital will be available for expansion of the social services” (Malaya, 1950: 3)

The setting up of the *Department of Social Welfare*, however, preceded by a matter of just a few years a piece of legislation that was to be of major significance in establishing welfare provision, not just for specific groups in need, but for the mainstream of Malaysian society. Under legislation enacted in 1951, the *Employees’ Provident Fund* was established. This was aimed at lower-paid workers outside government service with the intention of providing them with financial security after retirement, or in the event of disability occurring during working life. In its principles, the *Employees’ Provident Fund* was akin to Singapore’s *Central Provident Fund*: a system of forced saving imposed on workers, augmented by contributions from their employers, that can be viewed as a redistribution of income across the individual’s life cycle. As a type of personal or individualized welfare fund it also came to be extended, beyond its original focus mainly on lower income workers and on income after the period of formal employment, to provide finance for wider segments of the population and for other needs of individuals and their families—for example, housing and health care. It thus reinforced, at the heart of the Malaysian welfare state system, the principle that it is the individual and the family as much, if not more than, the state that has the major responsibility for well being through the certainties and uncertainties of life.

The Independence Period

The Constitution established at Independence in August 1957 reflected the “Bargain of 1957” reached between the main political parties. In return for rights of

citizenship being accorded to all inhabitants of Malaya, the indigenous Malays retained privileges in areas such as business licenses, land ownership, and governmental positions. In fact, there was considerable inequality of income and wealth in favor of the Chinese and to a lesser extent the Indian communities. The Chinese were by now mainly located in the cities and larger urban areas and controlled much of the industry and trade. The native Malays were concentrated in rural areas and had per-capita incomes considerably lower than those of the other main ethnic groups.

From a purely economic point of view, the decade following Independence was a clear success. At the time of Independence, Malaysia's rich natural resources were central to its economic development. The government continued with the practice established in the Colonial period of drawing up national five-year plans to guide the long-term project of economic growth. By the end of the 1960s, GDP in Peninsular Malaysia had increased by 86 percent, a rate of growth considered one of the better ones in Southeast Asia and among developing countries generally.

Initially, the strategy had promoted the development of import substitution industries prompting the large-scale migration of people from rural to urban areas to work in the new labor-intensive factories and workshops. The unplanned urbanization, frequently squatter settlements on the fringes of the larger towns, formed pockets of poverty that bred dissatisfaction. The balance provided by the "Bargain of 1957" was finally broken in the run up to the 1969 election. There were many dimensions to this but particularly significant was that the Malay hopes that their economic status would converge on that of the non-Malays did not materialize. There was no doubt that in absolute terms there had been improvements, but "for every step the Malay took, the non-Malays seemed to take two and were forging ahead" (Faaland *et al.*, 1990: 13). The 1969 race riot brought the bitter feelings to a head forcing recognition that unless the structural problem embedded in Malaysia's multi-ethnic society was effectively addressed, it would endanger the overall economic achievement of Malaysia. As the Introduction to *Fifth Malaysia Plan* (Malaysia, 1986: 4) was some years later to put it: The May 1969 Incident revealed that emphasis on economic growth could not adequately deal with the socioeconomic imbalances that characterized Malaysian society.

The practical reaction took shape in the form of the *New Economic Policy*, the first phase of which was marked by the *Second Malaysia Plan*. Its opening sentence was clear and to the point: "national unity is the overriding objective of the country" (Malaysia 1971: 1). It went on to specify the two essential objectives of eradicating poverty and restructuring society that would together redress the economic imbalances. The way in which these two objectives and the solutions—to be pursued over the plan period (1971 to 1976)—were described, gave a clear indication of the practicalities of the new bargain. According to the plan, poverty was "associated with those who are unemployed, underemployed, and those engaged in activities where productivity is so low that living standards are well

below the national average.” Solutions were seen in terms of increasing productivity in low-productivity occupations, to facilitating the movement of labor from low to high productivity jobs, as well as providing a “range of free or subsidized social services.” As for the restructuring of society, this was deemed necessary in order “to correct economic imbalance, so as to reduce and eventually eliminate the identification of race with economic function” (Malaysia, 1971: 5). This was to mean modernizing rural life, improving education and training, and encouraging a balanced growth of urban activities.

Although freestanding social services were not left out of the equation, then, their role was to be a minor one, supporting the improving of access, particularly by the Malays, to better labor market opportunities. Central was the aim to bring “the poor into the mainstream of economic life” and to bring Malaysians, “regardless of ethnic origin, to participate in commercial and industrial ventures” (Malaysia, 1986: 5-6). This was not to be direct redistribution through taxation and in the form of transfer payments or even benefits in kind, but rather the increasing of “*Bumiputra* involvement in modern commercial and industrial activities by introducing employment and ownership quotas” (Ismael *et al.*, 1993: ix). Important, too, was to be education and training which would be implemented in a way that would allow the *Bumiputra* to compete effectively for jobs through the range of economic sectors and incomes. State provision of housing, for its part, would facilitate the geographical redistribution of the population, in particular the movement of *Bumiputra* to the towns. As much as anything then this was an equality of opportunity in the sense that everyone, regardless of their ethnicity, could get to the starting line of the race in which the prizes were shares in the country’s growing economic cake. It was also intended that there would be greater equality of outcome across the ethnic groups. Underlying the distributional objectives, and indeed reinforcing its focus on the labor market was the belief that they had to go hand-in-hand with economic growth. One way that Malay wealth could be proportionately increased without potential divisiveness was to ensure that the overall “national economic cake” continued to expand.

Thus, the basis of the Malaysian system was a principle that both growth and equity (at least in particular forms) were necessary; without any one of the twin towers, the other would fall over.

Table 9.1
Public Expenditure: Percentage Allocations in Five-Year Plans

Expenditure areas	1966-1970 (a)	1971-1975 (b)	1976-1980 (c)	1981-1985 (d)	1986-1990 (e)
Economic	63.3	67.2	59.3	57.9	58.8
Security	15.7	15.2	20.3	23.9	11.7
Administration	3.3	2.9	2.8	2.1	7.0
Social	17.7	14.7	17.6	16.2	22.5
Education	7.8	7.4	6.9	7.6	13.9

Health	3.5	2.9	1.7	1.5	1.8
Housing	4.6	2.4	5.5	3.7	4.9
Other	1.8	2.0	3.5	3.4	1.8
Total	100	100	100	100	100

Source: (a)(b) Malaysia (1971); (c)(d) Malaysia (1981); (e) Malaysia (1986).

Note: (a)(c) are estimates, (b)(d)(e) are allocations.

This principle took financial expression in the budget allocations laid down in the five-year plans (see Table 9.1). During the New Economic Policy period, 1971 to 1990, the largest share of federal expenditure came under the “economic” heading, with social expenditure taking a minor proportion. Within the social expenditure, only education, health and housing took amounts that could be considered at all significant. Being subsumed within the “other” category; it is clear that areas of state provision, such as social services and transfer payments accounted for very small quantities of public expenditure. It should not be overlooked, however, that these figures hide both the non-financial distributions, such as those effected by the granting or withholding of licenses and the imposition of quotas, and the welfare expenditures met from employee and employer contributions. These factors influence both the total amount of welfare provision as well as its distribution.

With the exception of a serious recession in 1985/1986, economic growth continued unabated throughout the two decades of the *New Economic Policy*. Between 1960 and 1990, GDP increased by an average annual rate of 6.8 percent (Ismael *et al.*, 1993). At the end of the *New Economic Policy* period, Dr. Mahathir, Prime Minister since 1981, introduced the *National Development Plan*. Carrying on many of the objectives and principles of the *New Economic Policy*, this was an ambitious 30-year project to take Malaysia by the year 2020 into a fully developed and modernized country. Vision 2020 recognized the need to develop many aspects of Malaysian culture, society, and economy—but there was no marked change in either the general approach to welfare provision or the proportion of public spending allocated. Moreover, the strong pro-business stance encouraged further direct foreign investment, which in turn fuelled economic growth. This continued until 1997 when Malaysia experienced the impact of the Asian financial crisis whereupon GDP fell and unemployment grew. By the end of 1999, however, GDP had more or less recovered its former rate of growth and unemployment had fallen, though the exchange rate against the US dollar remained low.

The Main Areas of Welfare Provision

In one sense at least welfare provision in Malaysia bears comparison with welfare provision in other countries: with economic growth, industrialization, and urbanization has come more developed services, covering larger proportions of the

population. Yet, there continues to be a distinctive Asian—and particularly Malaysian—character with an emphasis on welfare through income and the actions of household and group members. These features are apparent in the individual service areas discussed in this section.

Pensions

Policies addressing the financial needs of older people are characteristic of the Malaysian approach to social welfare. There are provisions, indeed several programs, but they fail to incorporate large segments of the population; moreover, even for those included there is a major responsibility on the individual, along with their family, to generate the necessary resources themselves. The provisions are not comprehensive; they rely on a minimum of state funding and constitute redistribution, not across income groups, but across individuals and generations.

Traditionally in Malay communities, people kept working for as long as they were physically and mentally able to do so. There was not, in other words, a formal retirement age. According to figures provided by Fauzi Yaacob Mohammed (2000) even in 1990, 44.4 percent of the 60-to-64-year age group, and 30 percent of those 65 years and older were in paid employment. In general, considerably more men than women in these age groups will be in work, and more so in agricultural and informal sectors. This self-support through paid employment is based on a strong work ethic. When individuals are no longer able to work, it is generally expected that younger members of the extended family—sons, daughters and even grandchildren—will support them. This system related to the practice of extended families living together in the family home, women doing the caring and the cooking, and men working outside the home. In recent decades there has been some weakening of this ideology as well as the increasing practice of older people not living with their adult children (Tey, 1995). Nevertheless, it remains common for children, as soon as they themselves are earning, to provide financial support for their parents.

Alongside these traditional arrangements there have been introduced a number of formal provisions governing retirement and financial support. Although the precise date of its introduction is not generally known (see Wahid, 1970) the first of the formal retirement schemes, set up in the period of British Malaya, was the *Civil Service Pension Scheme*. Its present position, grounded both in the Constitution and later legislation, is that of a noncontributory scheme that provides support to employees in public service when they retire or their dependants in the event of their death in service. Although there are exceptions that can be invoked by either the employer or the employee, in general public servants compulsorily retire on reaching 55 years of age. On doing so they can expect to receive a pension not greater than one half of their final salary.

Whereas the *Civil Service Scheme* is noncontributory, the *Employees' Provident Fund* relies on contributions from both employee and employer. Established in 1951, its principal objective was to provide financial support on retirement, or of disability or death in work, of workers outside the government sector. When first set up, it excluded those working for small companies and those with higher incomes; those included were required to pay 5 percent of their income into the fund, with their employer contributing an equal amount. In the intervening half century, the scheme has been widened to incorporate other groups of workers. For example, in 1964 some higher-income workers were included, while in 1967 it was extended to workers in Sabah and Sarawak, and in 1977 to the self-employed. The amount of the contribution has also been steadily increased; since 1997 employees have contributed 11 percent of their income, employers 12 percent. Upon reaching the age of 55 years the worker could then withdraw whatever had accumulated in their personal fund so providing them with an income through their old age. A withdrawal could also be made in the event of the worker becoming unable to work due to physical or mental incapacity or leaving the country with no expectation of returning.

The adequacy of the *Employees' Provident Fund* is partly an issue of its coverage. Notwithstanding some widening it appears that only about half the workforce belong to this or the *Civil Service Scheme* (Vijaya, 1997). The main groups presently excluded are the self-employed, such as traders and farmers. Indeed in a total workforce of around 7 million, as at the end of 1996 fewer than 12,000 self-employed people were members of *Employees' Provident Fund*. For those outside the scheme, income in old age will be mainly dependent on either personal savings or on the family. Even for those inside the scheme, the financial benefits are sometimes quite small. The problem arises as a consequence partly of the widening of the conditions other than retirement (as we will discuss later, to include some housing, health care, and education expenditures) under which people have been allowed to withdraw money and partly of the extended periods of education delaying the entry of many into the labor market. In fact, many of those in *Employees' Provident Fund* are unskilled and semiskilled workers with most receiving pensions on retirement of around RM 300 to 400 (US\$ 75 to 90) per month, an amount well below the official poverty line (Vijaya, 1997). These characteristics thus do much to contribute to a situation in Malaysia where old age is increasingly equated with low income, a problem that may well become exacerbated as, on the one hand, the extended family system and the ideology of filial piety weaken and, on the other hand, people live longer.

Social Security

From the end of the 1960s the Malaysian welfare system moved more firmly beyond its focus on financing retirement to incorporate social security and social

services provisions. The Employees Social Security Act of 1969 introduced the requirement that all industries employing at least five people contribute to a social security fund with coverage for all employees earning under RM 2,000 per month. This included most lower income and many middle income groups, with workers continuing to be covered even if their incomes rose above the RM 2,000 limit, a “once in, always in” principle. Though it excluded some groups, such as domestic servants, the legislation covered a large proportion of the working population (Paguman, 1991). In order to implement the provisions the legislation set up the *Employees Social Security Organization* (SOCSO). Through this, workers are provided with financial support in the event of a range of eventualities, such as industrial accident, occupational diseases and invalidity and including such specific provisions as sickness and maternity benefits, employment injury benefits, temporary and permanent disablement benefits, constant attendance allowances, and funeral benefits (Row, 1984). With some, the amount of the benefit is related to the income of the worker, rather than being a flat or constant amount independent of income. Thus, temporary disablement benefit is payable at a rate of 70 percent of income and invalidity pension is paid at a rate between 25 and 65 percent of the insured’s average income.

Social Services

Formal social services provisions were established under British Colonial rule and in 1946 had been brought under the wing of the *Department of Social Welfare*. In subsequent years, both before and after Independence, it has undergone many changes, organizationally and functionally. The organizational changes have involved moving to and fro between the *Ministry of Health* and the *Ministry of Labor*; in 1990 it became one of the departments in the *Ministry of National Unity and Social Development*. The functional changes mainly consisted of additions to its range of activities. Thus, in 1960 it took on responsibility for the welfare of those physically disabled, in 1967 those chronically ill and in 1984 childcare. By the early 1990s there was an extensive list of areas of responsibility and a positive vision of its role, as outlined by its former director-general:

To uplift the living standard of the poor, the depressed and those who fall within its ambit. This is through various programs that would enable those concerned to develop positive attitudes and acquire necessary skills for their eventual participation in development efforts (Abdullah, 1992: 377).

The social workers, employed by the department and whose job it is to implement this vision, have available the facility to provide financial support, though “it should be noted that in every case, under whatever category, the element counseling is highly predominant.” Indeed, the general intention is that counseling is necessary in order to give to people “who have lost their sense of self-worth due

to prolonged deprivation and other physical, emotional, and spiritual conditions,” positive attitudes that would “enable them to develop their capacity for greater resilience for active involvement in socioeconomic life” (Abdullah, 1992). One interpretation of this focus is provided by the same author, who points out that the budget available to the department is low, constituting in 1990 less than a quarter of 1 percent of the federal budget. At such a level it might be considered that there may be little practical alternative to encouraging people to search all possible sources of financial aid such as family and friends before dipping into the department’s limited pot, and even then in many cases encouraging them to seek solutions through the labor market and self-help. The target groups for social welfare as identified by the *Department of Social Welfare* in 1990 are: children at risk, normal families with problems, elderly in need, the sick and terminally ill, vagrants, victims of natural disasters, people with disabilities, juvenile and young adult delinquents, and voluntary organizations (Abdullah, 1992).

Education

Prior to Independence, the majority of those schools offering education most appropriate to the development of a modern economy were to be found in the cities and larger urban areas. It was the children of the urban Chinese in particular, rather than the rural Malays or the Indians on the estates, who were best placed to take advantage. Education became a major concern of the early Malaysia plans, taking a sizeable proportion of the budget. The principal emphasis lay on the development of primary and secondary education seeking to increase levels of provision and enrolment. In both it met with considerable success, with secondary enrolment increasing over the period 1956 to 1968 by a factor of 5 for Chinese and 4.5 for Malays. But, in other respects progress was less spectacular. Adult literacy, for example, increased slowly and to levels below those in most comparable countries in the region, a failing that has been attributed to the inefficiencies inherent in teaching in a multi-ethnic environment (Ismael *et al.*, 1993).

Under the New Economic Plan, education was afforded a special role, being “regarded as a vehicle to modernize society and attain social goals, and as a way to achieve equal opportunities for all and promote national unity” (Faaland *et al.*, 1990: 58). Central to the strategy that developed was to impose *Bahasa Melayu*, rather than English or any of the other languages used by the peoples of Malaysia, as the official medium of instruction. This could be seen as both a symbol of unity—a single education system for all—as well as facilitating *Bumiputra* competitiveness in the labor market.

From the 1970s onwards, the increasing output of the secondary school sector created, as Snodgrass (1980: 248) put it, “social demand for places at higher levels,” to which the government responded by expanding the tertiary sector. Prior to 1970 there had been only one local university, but by 1973 there were five. There was

also a large increase in the number of government scholarships. With the priority of correcting ethnic imbalance these “were granted on need, as opposed to merit, with informal quotas set to enhance *Bumiputra* participation” (Ismael *et al.*, 1993: 25). As with earlier developments in education, the increase in access gave rise to issues concerning the language of instruction. Until the 1970s the University of Malaya, for example, taught primarily in English, providing advantage to applicants who had been educated in English medium secondary schools, those being a high percentage of urban Chinese. This was resolved by a decision to impose *Bahasa Melayu*, effectively creating “a unified system of education based on the Malay medium” (Snodgrass, 1980: 250).

At the present time, the Ministry of Education offers free schooling between the ages of 6 and 16, consisting of six years primary, three years lower secondary, and two years upper secondary. The Ministry also makes provision at the tertiary level through 10 polytechnics (mainly offering engineering and other technical programs), 31 teacher-training colleges, 10 universities, one college, and one institute. Access to all is based on academic merit. Alongside government provision there is at all levels—from pre-school to university—a buoyant private sector.

Housing

Prior to Independence, formal housing policy was limited. The British administration provided housing, the “institutional quarters,” for British workers in public service. There was also some resettlement of Chinese in the *new villages* as part of attempts to weaken the base of the communist party. After 1957, the concept of low-cost public housing was introduced. According to Tan (1983) this was based upon the government’s desire “to provide adequate housing for its citizens” allied to a belief in the ideology of a home owning democracy. Further, quoting from the *Third Malaysia Plan*, he notes that the government’s commitment was that such housing should be enjoyed irrespective of income. The objective had taken on a new relevance with the *New Economic Policy* and its twin strategies of restructuring society and eradicating poverty. Part of the agenda involved encouraging migration from rural to urban areas, to create a new Malay commercial presence in the cities that hitherto had been dominated by the Chinese. Thus, in 1957 of the 1.7 million urban residents 21.0 percent were Malay and 62.6 percent Chinese, while by 1990 the total had grown almost fourfold to 6.5 million, but with Malays now constituting 45.6 percent and Chinese 43.7 percent (Malaysia, 1996).

One of the results of the large and rapid increase in the size of the urban population was that, as Tan (1983: 65) noted, “the demand for housing in the urban areas far outstrips supply.” In these circumstances slums were commonplace: it is reported that 37 percent of the residents of Kuala Lumpur in 1971 were living in slums and squatter areas (Linn, 1983; R.A. Mohammed, 2000). In the succeeding three decades the shortages have persisted. One response of the Malaysian

government contained in all of the five-year plans has been a budgetary allocation for the provision of low-cost housing. However the allocations are small leading one observer to conclude that

the state gives low emphasis towards the need of housing (in the social sector) compared to other sectors such as economy and security. The state feels that housing is a luxury consumer item and the budget is limited for spending it on housing as it is an unproductive sector (Nurizan, 1989: 64).

The housing provided through the state has been intended for home ownership. Low-cost housing, achieved in part by low standards of size, facilities, and finish, has been deemed necessary in order to be consistent with the low incomes of many groups in the population. For most of the population, particularly in the urban areas, housing has been provided by the private sector. Here, size and quality standards have reflected the different segments—largely defined by income—of those people exercising demand for housing. Broadly, then, the nature of the housing in terms of the value and quality enjoyed by people reflects the ability of them and their families to pay, which reflects, in turn, labor market position.

The government has facilitated the growth in home ownership in a number of ways. Thus in 1976, the National Bank introduced guidelines requiring commercial banks and finance companies to channel at least 10 percent and 25 percent, respectively, of increased lending to housing loans to individuals, whilst also setting interest rate limits. Cagamas (*Perbandnan Cagaran Malaysia*, or National Mortgage Corporation) was established in 1986. The National Bank owning 20 percent with private financial institutions the remainder, it provides security for those lending in the housing market, thereby supporting the market. In 1994, there was a significant development in the rules governing *Employees' Provident Fund*. Every member's account was separated into three parts. 60 percent was to be retained in *Account I* to meet pension needs, with 30 percent in *Account II* that could be withdrawn to meet housing costs, and 10 percent in *Account III* to meet health-care costs. What started out as a compulsory savings scheme to fund old age was thus widened to incorporate other dimensions of welfare.

Health Care

The origins of the present health-care services date back to at least 1923 with the setting up of the maternal and child welfare services. In later years, this developed into a major force for the spreading of modern methods of health care. With Independence, a department of health was established, later receiving full status as the *Ministry of Health* and funding allocations, from general taxation, through the national five year development plans (see Table 9.1). As a proportion of GDP, these allocations have been markedly less than those common in both Western,

industrialized countries, as well as some of the less developed countries of the Asian region, such as India and Nepal (see Peabody, 1999).

The Ministry of Health has a wide range of responsibilities in the fields of both preventive and curative health care to which end it has created a network of hospitals, health centers, and clinics. The *Rural Health Service* set up to meet the health needs of rural areas operates through health centers, maternal and child welfare clinics, and mobile health teams to reach the most isolated communities. As early as 1980, the *Rural Health Service* had succeeded in offering access to a health facility within 5 km of their home to over 90 percent of the rural population and has played a central role in improving health and life expectancy (Omar, 2000). In the urban areas, health care is provided through a system of general and district hospitals and clinics. In addition to public provision, there is a growing private sector, particularly in the very largest urban areas, that caters mainly to high-income groups.

Table 9.2 provides some indicators of improvements in accessibility to health care—through the numbers of doctors and dentists—and in healthiness. In fact, the improvements hide some significant divisions and developments that have contributed to the establishment of priorities for the health system. Firstly, there are great geographical differences as between the more favorable indicators for the Western and more urbanized states of Penang, Jahor and Selangor and the less favorable Eastern and more rural states, particularly Terengganu and Kelantan. Secondly, since the 1980s it has become more apparent that so-called life style diseases have become more prevalent, particularly in urban areas. Dietary changes, increased smoking, reduced exercise, and higher levels of stress have all contributed to greater risks of heart attacks, strokes, diabetes, and cancer. In recognition of this development the *Seventh Malaysia Plan*, covering the period 1996 to 2000, shifted expenditure away from its earlier emphasis on curative health care in the form of the construction of hospital and patient care facilities toward promotional and preventative programs.

Table 9.2
Selected Indicators of Health Status

Indicator	1980	1997
Life expectancy/men	66.7	69.6
Life expectancy/women	71.6	74.5
Crude death rate (per 1,000)	30.9	25.8
Infant mortality rate (per 1,000)	24.0	8.8
Doctors per 10,000	2.8	6.6
Dentists per 10,000	0.5	0.9

Source: Ministry of Health Reports.

A major issue facing the health system, first formally mooted in 1983, has been privatization (see Omar, 2000). In 1991, the government published its *Privatization Master Plan*, which proposed some privatization of the system in order to meet a number of objectives. The government clearly saw this as a way of reducing its direct funding as part of a more general wish to curb public expenditure and tax levels, with the ultimate goal of achieving greater economic growth. The government also argued that privatization would bring about greater efficiency resulting in cost reductions. There have been moves in this direction—for example, alongside the state provided hospitals the number of private hospitals increased from 135 containing 3,666 beds in 1985 to 219 with 8,936 beds in 1997. But, in general, there has been less privatization than the government first intended, as a result of opposition from a number of quarters. Both the *Citizens Health Initiative* and the *Malaysian Medical Association* have lobbied strongly, arguing the case that private health care will often be more expensive and particularly disadvantage lower-income groups. The government responded in the *Private Healthcare Facilities and Services Act* 1998 with provisions strengthening the emphasis on equity objectives.

Challenges to the Welfare System

In common with a number of other Asian countries, Malaysia has developed a welfare system that places emphasis on economic growth; public spending has been mainly directed toward economic investments; state provision of welfare services and transfer payments are limited; and individual well being is premised on individual contributions from income, and family and group support. In conjunction with this, there is an emphasis on achieving some convergence in the economic activity and rewards as between Malays and non-Malays. Both parts of these arrangements form a mutually supportive whole. Following the 1969 riots it was apparent that the pursuit of growth would not be sustainable without greater ethnic balance, but balance would be achievable only if growth was sustained. The coherence, and indeed long-term success, of the Malaysian approach is currently being forced to confront a number of challenges.

With the important exception of the continued efforts to re-distribute the country's wealth in a way that responds to the inferior position of the *Bumiputra*, the considerable increases in the standard of living of Malaysian citizens—evidenced in housing, health care, diet, and so on—can be largely attributed to economic growth and full employment. This was hit severely by the impact on Malaysia in 1997 of the Asian financial crisis. While rejecting and indeed criticizing IMF support, the government nevertheless imposed many strictures equivalent to those imposed by the IMF elsewhere—e.g., Korea and Thailand. The consequences for the Malaysian people also bears similarity to the general pattern in

the countries in the region most affected: unemployment (though in the case of Malaysia somewhat dissipated by the return of many immigrant workers to their countries of origin), combined with a move into informal sector jobs, higher food prices and increasing interest rates. As Bezanson and Griffith-Jones (1999) argue, in these circumstances there is generated a realization of the need for more effective social protection nets. This is pertinent to the Malaysian case since the core of formal welfare support, the *Employees' Provident Fund*, is a direct dependency on contributions from income and from employers. Should Malaysia's future be one in which the full and continuous employment of the two decades before 1997 becomes rarer, its existing insurance and savings arrangements will in turn become less effective.

Alongside the macroeconomic changes are changes in the nature of the family and the role of women. The *National Policy for Women* formulated in 1989 was intended to stimulate greater female participation in the labor market. The *Seventh Malaysia Plan* (Malaysia, 1996) indicated that labor force participation for women increased from 47 percent in 1990 to 49 percent in 1996. It also announced strategies to increase this further including providing more training and educational opportunities, more flexible working hours and career breaks. Despite the inclusion also of advice and counseling services, there seems likely to be a clear and increasing tension between women's labor participation and caring roles that in the longer run may need to be resolved through the provision of non-family based care. Rashidah (1995: 12) has summarized the problem:

Some observers would say that women have been used as labor in the country's economic development, but not provided, with social supports in terms of child-care facilities and progressive family laws. There has therefore been an exploitative aspect of the various development policies, and women's lives have in fact become more difficult as they try to juggle their various roles.

Malaysia is also experiencing the trend common elsewhere encapsulated by the phrase "fewer babies, longer lives." Malaysians are delaying marriage and having fewer children; whereas the average growth rate in the early 1990s for the Muslim Bumiputras was 2.6 percent, for Chinese it was 1.1 percent, and Indians 1.7 percent (Ministry of National Unity and Social Development, 1996). Along with this average household size is falling, as is the proportion of extended families. As more and more adult children form their own nuclear families the existing arrangements for caring for elderly parents are likely to become more problematic.

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Welfare Reform in Taiwan: The Asian Financial Turbulence and Its Political Implication

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For East Asian countries after many decades of a so-called “economic miracle,” this is an age of frequent crises and upheavals. As growth is slowing down, the state of the economy is no longer only an economic issue. In Indonesia, we saw the collapse of Suharto’s power and the spread of violence. “Mobs attack people and property for any reason—political, religious, ethnic or merely criminal,” so the *Economist*.¹ In Korea, a worker demonstrated his protest against the International Monetary Fund (IMF) as “I’M Fired.” The picture of that Korean worker had hit headlines of a great number of newspapers and magazines in Asia.

Under such a situation, the Asia-Pacific Economic Cooperation Forum (APEC) for the first time goes beyond its nature as an economic organization and highlights the importance of the social dimension in economic development. So it came up with the joint declaration in November 1998, which put forward that for the APEC economies most affected by the crisis, it is important to continue and accelerate

structural reforms within a framework of prudent, growth-oriented macroeconomic policies, to take measures to restore capital flows into the region, and to strengthen the social safety net.² But what kind of social safety net do the APEC members need? We find no answer in the joint declaration and this leaves a lot of room for further discussion.

Fortunately, Taiwan was relatively immune to the crisis, compared to its neighbors. This sharpest economic melting down indeed raised fears that Taiwan could be next. Local economists and policymakers warned the possibility of a “disaster” or “recession” to come. But, the *Far Eastern Economic Review* noted, “if that’s a crisis, it’s one that almost any other East Asian country would envy.”³

Taiwan was not completely save from the economic crisis in the region. In Taiwan, however, the crisis was to be found rather in the political sphere than in the economic sphere. This paper will trace back historical development of Taiwan’s response to the crisis. First of all, we will locate Taiwan in the international context to see how good its economic performance was in the last years. Second, we would look at social conditions and policy responses to the crisis. Third, with regard to the social dimension, the government did not pay enough attention to the problems of the people and, thus, the political pressure to initiate social reforms was aggregating. This in turn radically damaged the legitimacy of the government and the ruling party, the Kuomintang (KMT). Fourth, the spillover effects of the crisis were linked, more or less, to the KMT’s defeat in the presidential election in March 2000. Finally, we examine the challenges of the Democratic Progressive Party (DPP), who is now in power, with regard to the social dimension of the economic crisis.

Taiwan as an Economic Model?

As the crisis began with the collapse of the Thai Baht in July 1997, it spread very fast to equity and currency markets throughout Southeast and East Asian countries. It reached a peak in 1998 when Japan and Korea were also in trouble. Taiwan was also hit, while Hong Kong and China were mobilizing huge foreign reserves to support their currency values. It is necessary to examine Taiwan’s economic performance during the crisis, locating it into international context. We will use four indicators, namely GDP growth rates, exchange rates to the US Dollar, consumer price changes and unemployment rates, to compare Taiwan with some of its neighbors. These four indicators cover macroeconomic performance and purchase power, as well as, more indirectly, the levels of human well-being; which can give us a comprehensive overview of the economic and social impact of the crisis.

Table 10.1 shows GDP growth rates in Taiwan, Korea, Hong Kong and Singapore between 1996 and 1999. We see that GDP growth in Taiwan was modest before the crisis. In 1996, it is only better than that of Hong Kong. But this completely changed, particularly in 1998, as Taiwan became the top of the league,

while the economies of Korea and Hong Kong were shrinking significantly. Although it was still positive, GDP growth in Singapore was dropping over 80 percent in just one year, compared to Taiwan's 30 percent. In 1999, Taiwan has shown steady improvement, as well as Korea. But Hong Kong's economy was still in a slump, and there were no better signs in Singapore either. We could say that Taiwan was hit indeed, but its economy remained active during the crisis.

Table 10.1
GDP Growth Rates in Selected East Asian Economies, 1996 to 1999, in percent

	1996	1997	1998	1999*
Taiwan	5.7	6.8	4.8	4.9
Korea	7.1	5.5	-5.5	2.0
Hong Kong	4.5	5.3	-5.1	-0.5
Singapore	6.9	7.8	1.5	1.0

Note: * =Projected.

Source: Amended from ADB (1999).

However, macroeconomic management is by no means an easy task. To maintain economic activeness, currency value has to be adjusted carefully according to market conditions. But when it is floating too radical, great damage will occur. Table 10.2 displays changes of local currency exchange rates to the US Dollar. We find that Hong Kong has done its best to support its currency value, especially backed by China, while the devaluation of Korean Won was nearly 50 percent. Taiwan and Singapore were located in the middle field. Export-oriented industrialization is the basic model of development in East Asia, and the state plays a particularly important role in it.⁴ A low currency value could benefit local products in competing with the world markets, but the price it pays for is a decreasing purchase power. On the contrary, an over-valued currency could endanger exports to world markets, though imported goods would become relatively cheap. Both cases can result in high unemployment if balance cannot be restored between supply and demand for a country's currency in a short period of time.

Table 10.2
Changes of Exchange Rates to the US Dollar in Selected East Asian Economies, 1995 to 1998 (1995=100)

	1995	1996	1997	1998
Taiwan (NT\$)	100	96	92	79
Korea (Won)	100	96	81	55
Hong Kong (HK\$)	100	100	100	100
Singapore (S\$)	100	100	93	82

Source: Amended from ADB (1999).

Korea had a higher inflation in 1998 because of the radical devaluation of the Won (Table 10.3). Inflation in Hong Kong was around 6 percent before the crisis, but, interestingly, it has been improving as the crisis began, implying that the Hong Kong Dollar could be over-valued by political intervention from China. The economies of Taiwan and Singapore ranked in the middle field, consumer prices were floating within a reasonable range. As the inflation rate is low, public investment projects will not lead to an overheating of the economy.⁵ This should bring Taiwan out of the crisis as soon as possible, and secure employment opportunities. So we observe, from Table 10.4, that unemployment rate in Taiwan was increasing but it remained very stable during the crisis, compared to radical climbs in Korea, from 2.0 percent in 1996, to 6.6 percent in 1999, and in Hong Kong from 2.8 percent to 6.1 percent in the same period.

Table 10.3
Changes of Consumer Prices in Selected East Asian Economies, 1996 to 1999,
in percent

	1996	1997	1998	1999*
Taiwan	3.1	0.9	1.7	1.9
Korea	5.0	4.5	7.5	2.0
Hong Kong	6.3	5.9	2.8	-1.5
Singapore	1.4	2.0	-1.5	0.5

Note: * =Projected.

Source: Amended from ADB (1999).

Table 10.4
Unemployment Rates in Selected East Asian Economies, 1996 to 1999,
in percent

	1996	1997	1998	1999*
Taiwan	2.6	2.7	2.7	2.9
Korea	2.0	2.6	6.6	6.6
Hong Kong	2.8	2.2	5.7	6.1
Singapore	2.0	1.8	3.2	3.6

Note: * Monthly average between January and August, 1999.

Source: Amended from DGBAS (1999a).

In short, it is true that Taiwan is a case every other Asian country may envy. It was an outstanding economy, with a rather good GDP growth, a relatively stable currency a low inflation, and modest rates of unemployment. There seemed to be no crisis in Taiwan at all, but some commentators doubted it.⁶ The Taiwanese public, however, was convinced that there was a crisis. Before we explore this issue further,

we should look at social conditions during the crisis, and the governmental policy responses.

Social Consequences of the Asian Crisis in Taiwan

The world has witnessed a great development in the past decades, but it seemed not to have been able to avoid the adversities caused by unemployment and poverty. This is closely linked to the changes of economic production that is not aimed at consumption of direct producers, but commodities for profits. Workers have also become commodities themselves on the labor markets.

Industrialization and capitalist development instigated manifold changes of the Taiwan economy. The former can be observed from the increase of the labor force that is employed in industry and the service sectors, which has increased from 55 percent in 1966 to 90.5 percent in 1997—the labor force employed in the agricultural sector declined from 45.0 percent to 9.6 percent over the same period of time. Simultaneously, paid work has become the most important form of occupation, as the share of paid work in overall work is now over 70 percent, up from 45.3 percent in 1966.⁷ This is the major social aspect of capitalist development, namely the proletarianization of labor in Marxist terms. Such a development will generate a new contingency to lose work and income, and, therefore, poverty follows.⁸ Taiwan has been enjoying a long time of full employment, which is one aspect of its economic miracle. Now the miracle is under deconstruction, gradually but significantly.

As the Asian crisis stroke Taiwan, a great number of firms were ruined. Table 10.5 displays the number of firms that closed down, and the ones that opened. Although the number of new firms remained very stable, the number of firms that closed down reached a historic high in 1998. A gap of 1,062 firms signaled the coming of economic recession and harsh market situations. For workers, this was implying limited job opportunities and growing difficulties to find proper jobs. Two possible results follow: (1) the growing unemployment, and (2) a new conflict between employers and employees. Tables 10.6 and 10.7 together give us a brief but significant overview of the consequences.

Table 10.5
Number of Closed-Down and Newly Opened Firms in Taiwan, 1996 to 1999

	1996	1997	1998	1999
Closedown (A)	5,339	2,904	6,788	3,982
Newly Opened (B)	5,414	6,039	5,726	5,846
B-A	75	3,135	-1,062	1,864

Source: Data from DBGAS website.

By the end of 1996, the number of unemployed persons was 242,495, and increased to 282,742 in 1999. Comparing to other Asian economies, unemployment in Taiwan was increasing but without dramatic growth. Nevertheless, the most important change was the reasons to explain why people were out of work. In 1996, the major reason for unemployment was dissatisfaction with work conditions. After working for many years, people simply looked for better wages and better working conditions.

However, just four years later, in 1999, the reasons for being unemployed have changed a great deal. The risk of being laid off has become a major concern of the people.

Table 10.6
Reasons for Unemployment, 1996 to 1999

	1996	1997	1998	1999
No. of unemployed	242,495	256,240	256,917	282,742
Without work experience	23.2	22.4	22.9	21.3
Lay-off	28.2	27.7	27.8	32.1
Dissatisfied work conditions	32.5	32.8	32.0	30.4
Others	16.1	17.1	17.3	16.2

Sources: Data from DGBAS (1998, 2003).

Incidents of labor disputes doubled during the Asian crisis, from 2,659 cases in 1996 to 5,860 in 1999. If we look at the number of workers involved in disputes, it grew even more dramatically, from 21,654 in 1996 to the peak in 1998 with 103,568 workers involved, though down to 30,440 in the next year. This figure has been beyond 62,391 in 1989, at the time of political democratization of Taiwan, when all-important social movements fought for the introduction of full democracy. Also, from Table 10.7 we learn that contracts and wages were two major issues responsible for labor disputes.

Table 10.7
Labor Disputes, 1996 to 1999

	1996	1997	1998	1999
No. of Disputes	2,659	2,600	4,138	5,860
No. of Workers Involved	21,654	81,004	103,568	30,440
Contracts	1,271	1,172	1,954	2,976
Wages	891	737	1,321	1,953
Retirement	239	251	306	360
Occupational hazards	262	366	493	656

Sources: Data from DGBAS (1998, 2003).

At the beginning of 1999, unemployment seemed to become more critical, and there were no signs of a possibility of improvement in the near future. This great pressure forced the government to propose policies and measures maintaining and promoting job opportunities. The Council of Labor Affairs declared the year as “the Year of Employment Security,” by which to establish a more consistent employment security system. The proposed measures included:⁹

1. From January 1, 1999 the Labor Insurance would have unemployment benefit particularly for those who are laid off, which also integrates employment services and retraining to help workers to find a way back to labor market as soon as possible.
2. The Council of Labor Affairs will provide subsidies, up to one year, to employers who would hire middle- and senior-aged workers in order to curb unemployment.
3. To prevent the vicious closedown of firms, by which employers evade their responsibility to take care of their employees, transferring capital to other countries, the Council of Labor Affairs would set up a monitoring system to watch out for and regulate layoffs in great numbers.

In the political economy of Taiwan, there were other political interests that continued to additionally worsen the situation for laborers by pushing the government to increase the share of imported foreign laborers, who worked for wages that were far below the minimum wages of Taiwanese workers.

Originally the purpose of importing foreign laborers is to fill the gap between supply and demand of native laborers. But such a function has changed to a competition between the two sides, native laborers versus foreign laborers, for limited job opportunities. By the end of 1998, there were around 271,000 foreign laborers in Taiwan; most of them came from the Philippines and Thailand. Tricky enough, the number of unemployed persons in Taiwan was 282,742 by the end of 1999. In other words, the foreign laborers just and effectively replaced the native laborers. This situation is not a problem if economy continues to grow fast and more job opportunities are created. But the financial upheavals in Asia have also affected Taiwan. Economic growth rate was down and jobs were becoming scarce, and then the conflict was provoked to become radical.

To cope with the financial upheavals, capitalists were pursuing for a reduction of costs in which of course included labor costs. They preferred to hire foreign laborers instead of domestic laborers. For this reason, the Chinese National Federation of Industries, which is one of two important employers' organizations in Taiwan, exerted great pressure upon the Council of Labor Affairs to increase the number of foreign laborers allowed into Taiwan, that were adding up 38,000 laborers.¹⁰ Conversely, unions opposed the increase of foreign laborers and worried about their negative impact on the employment of domestic workforce.

Employers' organizations usually hold a greater power in policy process, they did have better opportunities to lobby for and push through their own interests. The consistency and effectiveness of governmental policies to conquer the adverse consequences of the Asian financial crisis, therefore, were seriously put in danger. The higher share of foreign laborers counteracted the expected impact of economic policies set by the government.

Governmental Policy and Its Implications

The reasons for Taiwan's successfully coping with the crisis have attracted a lot of attention from analysts and policymakers. Most of them focus on two distinctive characteristics of the Taiwan economy. The first reason is Taiwan's special political status in the international community and its ever huge foreign reserves. Taiwan suffers diplomatic isolation since the early 1970s because of the change of America's global strategy, and China's hostility.¹¹ In 1999, the number of countries to have official relationships with Taiwan, for example, was less than 30. Taiwan is not allowed to join international organizations such as the United Nations and the IMF. This makes it difficult, or even impossible, for Taiwan rely on foreign help in times of need. As a result, huge foreign currency reserves become necessary not only as bulwark against hostile China, but also for the stability of its own currency and financial markets. By the end of 1999, Taiwan's central bank has accumulated around US\$ 100 billion in reserves, which is among the largest reserves in the world. Two implications emerge: (1) the huge reserves contribute significantly to Taiwan's capacity to act against the crisis, particularly in stabilizing its financial markets with its own resources, and (2) the difficulties to receive foreign aid also kept Taiwan's external debt at a very low level. In 1997, for example, the debt-reserve ratio for Taiwan was 0.24, compared to 2.06 in Korea, and 1.70 in Indonesia.¹²

The second reason for Taiwan to successfully cope with the crisis is, though not so significant, Taiwan's core strength of cost-effective manufacturing that is to be explained by its huge share of small and medium-sized businesses, which employ 78 percent of the total labor force. In Korea, on the contrary, a few number of mammoth business conglomerations, called *Chaebols*, dominate the economy, and employ most of the labor market, which, in times of economic difficulties, can quickly lead to mass unemployment that cannot be absorbed by other companies. The industrial structure of Taiwan makes it able to adjust quickly to market changes. In particular, it is possible to let market forces sweep away uncompetitive businesses, without worrying about a large number of unemployment, since other companies, or new ones, will take over the laid-off workforce.¹³

To restore public confidence and market order as soon as possible, a lot of financial measures, accompanying with huge national resources, were launched by the government, including:¹⁴

1. Two-Taxes-in-One Program that gives investors and employers special preference to pay either business tax or income tax, depending on which is more favorable to them, costing NT\$ 30 billion every year.
2. Bailouts for selected companies that apply to the Finance Ministry for help, costs are confidential.
3. A NT\$ 283 billion stock-market-stabilization fund, which was financed by labor insurance and retirement funds, to boost share prices, and to ease the anxiety of the Taiwan's 5 million punters. This fund has been further enhanced and reorganized into the National Security Fund, being NT\$ 500 billion strong.
4. A floating tax rate on stock transactions and tax-free earnings from the stock market further stimulate share prices, costing about NT\$ 100 billion.
5. Banks encouraged to roll over loans to troubled corporate borrowers for six months, and the term for this is the decrease of business tax rate on banking from 5 percent to 2 percent, costing NT\$ 40 billion every year.
6. Low-cost mortgages offered to encourage the purchase of the 900,000 unsold houses on the market, costing NT\$ 150 billion.

The total costs of above measures amounted to, at least, around NT\$ 600 billion, depending on how much money has actually been spent. This was equivalent to 16 percent of the total government expenditure in 1998.¹⁵ It is probably true that such measures could have important impacts preventing Taiwan's economy from an even deeper recession and therefore helping Taiwan out of the slump, "given the inevitable delays and lags in these (public investment) projects, stimulating private consumption through tax cuts is also necessary. The government should also encourage private investment by broadening the scope of investment tax credit laws," as the Asian Development Bank commented.¹⁶ However, such measures also provoked two political debates concerning the fairness of taxation, on the one hand, and the class nature of the state, on the other. Both eventually caused serious damage with regard to the legitimacy of the government and the ruling party.

Regarding fairness of taxation, the debate emerged as to whose taxes should be cut. Obviously, the people who will benefit from the government preferential measures were mostly the people with enough surplus money to make investments in the stock market, namely the middle and upper classes. What the wage earners will benefit seemed only to be low-cost mortgages, but this program was also helping well-connected property developers who have oversupplied the island with 900,000 high-priced houses. Interestingly, the non-homeowners' "Shell-less Snail" movement, who fought for many years to press down house prices, did not appreciate such low-cost mortgages, and even criticized it fiercely. They argued, the government should not save those profit-addicted developers and must let them down, so that house prices in Taiwan will return to a normal and affordable level.¹⁷ But policymakers did not pay much attention to the matter.

Moreover, a further problem emerged as the government proceeded with its policies. Without other revenue sources such incredible tax cuts implied a huge fiscal deficit. Who will eventually shoulder the new tax burden? Table 10.8 gives us some possible answers. We find the importance of income taxes in the government revenue increasing significantly, from 22.28 percent in 1991 to 35.50 percent in 1999, while other taxation sources were mostly decreasing. Wage earners were indeed the main contributors to income tax revenue, implying the fact that they are the final payers to the bills induced by the governmental policies.

Table 10.8
Tax Structure in Taiwan, 1991 to 1999, in percent

	Customs Duty	Income Tax	Commodity Tax	Tax on Stock Transaction	Business Tax	Land Value Increment Tax
1991	9.61	22.28	11.08	6.83	15.24	16.02
1992	9.05	21.92	12.23	3.61	15.30	20.07
1993	9.45	23.43	12.94	2.6	17.03	16.65
1994	9.08	23.85	12.68	4.94	17.35	13.96
1995	9.55	27.71	13.18	2.66	17.92	10.69
1996	8.46	28.58	12.38	3.48	18.26	9.74
1997	8.16	27.17	10.91	8.86	17.16	10.37
1998	7.99	30.07	10.76	6.94	18.21	8.34
1999*	7.13	35.50	10.74	4.55	25.74	6.83

Note: * 1st quarter.

Source: Amended from DGBAS (1999b).

Then the class nature of the government and the then ruling party (the KMT) became an important issue. It was very hard to believe the political slogan of the KMT claiming to be a party for all people. Rather, it was indeed the party for the classes with wealth and higher incomes. The most significant example is the debate on cutting the tax rate for stock transaction. In February 1999, the former Premier Hsiao Wan-chang hosted a national conference on economic challenges when he was resisting great pressures from businessmen to cut the tax rate for stock transactions from 3 to 1.5 permill, or to abolish that tax completely. The businessmen group sought former President Lee Teng-hui and the KMT for help, which provoked a conflict between the Premier and the President. A compromise was soon achieved, particularly after the President heavily criticized the Premier's resistance. The tax rate was changed to float between 3 and 1.5 permill, signaling the victory of the businessmen group and the President.¹⁸ Some analysts commented on this, as follows: "the Taiwanese state is a capitalist state to the bone" and "where is Robin Hood?"

As pressures arising from fiscal deficit were aggregating, especially owing to the fact that the government would not like to raise taxes that were aimed at the rich

classes, the policymakers had to do their best on balancing the budget. Here, social welfare became a scapegoat. We will turn to this issue in the next section.

Welfare to Be Blamed

The government has been introducing quite a lot of welfare provisions throughout the whole of the 1990s, but this was not a smooth process without conflicts. The Constitution of 1949 had imposed wide range of welfare responsibilities upon the state. In Articles 152 to 157, the Constitution demands that the state should maintain full employment, guarantee working conditions, harmonize industrial relations, establish social security system, protect maternal welfare, and realize a national health system.¹⁹ Furthermore, the revision of the Constitution in 1997 declared for more specific welfare measures, such as the National Health Insurance (NHI), and protections for women, the handicapped, and the minorities.

Social security in Taiwan consists of social insurance and social assistance, in which the former has expanded its coverage significantly. The first legislation about social insurance is the Military Servicemen's Insurance Law enacted in 1953. Although the Labor Insurance Program and the Military Servicemen's Insurance program were enforced in the same year—1950—the former did not become a statute until 1958. By 1980, three major systems of social insurance had been established for military servicemen, civil servants, and laborers, to cover the risks of maternity, injury and sickness, medical care, disability, old age, and death.²⁰ But the benefit for medical care has been transferred to the NHI in 1995. In the three major systems, labor insurance is the largest one to cover 7.5 million workforce, equivalent to 34.5 percent of the total population.²¹ And national pension insurance (NPI) is under planning at this point.

For those who are poor, social assistance is the way to get cash benefits. The first act in this field is the Social Relief Law 1943, helping those in poverty because of age, youth, pregnancy, disability, or disaster. It was replaced by the Social Assistance Law 1980, with a more progressive development of adopting "income," rather than the causes of poverty, as the key criterion for eligibility. But the 1980 act contained no article to regulate the poverty formula, leaving great power in the hands of government officials to determine the level of the poverty line according to their wishes, rather than the needs of the poor. An incredibly low poverty line was set up, under which only 0.5 percent of the total population qualified for it.²² This became the first target for improvement, as the government proposed the Social Assistance Law 1997. The new act specifies the poverty line as 60 percent of per capita consumption expenditure in the previous year. Some scholars estimated that now around 5 percent of the total population should be eligible to social assistance.²³

Apart from social assistance, there are some kinds of allowances, specifically for

the aged with insufficient incomes. Since 1994, the Living Allowance for Middle-Low Income Elderly People and since 1995 the Welfare Allowance for Aged Farmers have been set up by the government and together, until 1997, benefited around 583,024 people. In addition, some local authorities governed by the DPP provided cash benefits to the aged, but these were not so regular sources.

In health care, the NHI is the first universal welfare system in Taiwan that covers all of the population. The National Health Insurance Act was finally passed in 1994, and put into practice in March the following year. The act defines the Department of Health (DOH) as the direct responsible department of the Central Government to the policymaking and supervision of the NHI, and the Bureau of National Health Insurance (BNHI), which is also an official agency under the DOH, as the insurer to run the system. The NHI is obviously a state-run and centralized social security system. By the end of 1997, the number of the insured in the NHI was 20.5 million, around 96.3 percent of the total population of that time.²⁴ This figure is far higher than before the NHI was enforced, when the population covered by at least one kind of social insurance programs added up to only 59.7 percent.²⁵

The Children Welfare Law 1973 is the first act in personal social services, in favor of a particular disadvantaged group of people. And then came the Aged Welfare Law and the Handicapped Welfare Law in 1980, and the Youth Welfare Law in 1989. Nearly all of these acts were revised in the 1990s to improve and enhance the service capacity, except for the Youth Welfare Law. Furthermore, in the 1990s four brand-new acts were enacted, especially concentrating on cases of abuse and violence, particularly that of children and women. These included the Regulation Against Child and Adolescence Prostitute in 1995, the Act Against Sexual Violation in 1997, and the Act Against Domestic Violence in 1998, plus the Act for Social Worker Qualification in 1997, by which the government established a professional social work system dealing with these problems, as well as guaranteeing higher quality of services. In short, we may say that personal social services in Taiwan have been gradually shifted from general welfare to more specific areas of need.

In addition, the Council of Labor Affairs launched a series of measures to establish a more consistent employment security system. Since January 1, 1999 unemployment benefits have been installed particularly for those who have been laid off, with the purpose to integrate employment services, to retrain the laid-off workforce, and to help workers to reenter the labor market.

The main reason behind this was the political competition from the side of the DPP, rather than the demands for social reforms.²⁶ APEC members have already formerly recognized the importance of social development as a concrete foundation to real economic miracle, but the necessity of social safety net seems not to receive much attention and positive response from Taiwanese politicians. Former Vice President Lien Chan clearly argued that Taiwan should not develop a European-style welfare state, in order to avoid low investment and heavy burdens upon

governmental finance. He proposed a welfare model in which private enterprises and voluntary services, apart from the state, should be two major providers of welfare services.²⁷

High-ranking politicians in Taiwan always blame state welfare for slowing down economic growth and eroding the financial health of the government. Hsueh Chi, for example, the former Deputy Minister for the Council of Economic Planning and Development (CEPD), said that a large scale of state welfare will cause inflexible labor markets and high governmental expenditure, and these in turn induce high unemployment and low economic growth.²⁸ Such a point is very typical for Taiwanese economic policy makers.

For this reason, plus the very violent earthquake at the morning of September 21, 1999 that also caused a vast amount of public money to be spent on disaster relief, the policymakers had to find some ways to save money. The coming pension insurance became the main target. Although the Premier and the President both promised to establish a national pension system in 2000, it was still regarded as expendable and therefore postponed. This decisionmaking further consolidated the KMT's reputation of being a capitalist party.

The Growing Demands for Social Reforms

The year 2000 was a highly politicized year for Taiwan because of the presidential election in March the same year. In January 2000, just three months earlier than polling day, a leading magazine published its new issue, entitled "Why Don't You Anger, Middle Classes?" in which it pointed out the existence of a great number of social problems, that needed to be dealt with by the government. Its findings were:²⁹

1. The income gap between the top 20 percent of households to the lowest 20 percent of households has been broadening significantly, from 4.2 times in 1980 to 5.5 times in 1998. This happened particularly in the 1990s.
2. The government did improve the welfare system in the past two decades, as we analyzed in the last section, but the effects were limited. Government transfers to the lowest 20 percent households only rose very marginally.
3. Since 1980, the market values of stocks in Taiwan increased by over 38 times, reaching NT\$ 8,377 billion in 1998. As it was almost tax-free it had a very preferential effect on the rich classes and, therefore, deteriorate the income gap between the rich and the poor.
4. Apart from the stock market, land is another important source to make profits. Between 1976 and 1996, land profits were estimated to add up to NT\$ 10,030 billion, of which only 10 percent were taxable. Also, this got worse in the 1990s.

5. Wage as percentage of personal income was 55.7 percent, but it contributed 72.3 percent of total income taxes. While the percentage of employers' incomes was 16 percent, it contributed only 5.3 percent of total income taxes. This gives evidence to the heavy burden imposed on the waged classes.
6. To raise profits for enterprises, especially through tax credits, fiscal deficit was increasing significantly in the 1990s. The public debts as percentage of GDP was growing from 4.8 percent in 1990 to 16.3 percent in 1998—that is, NT\$ 200 billion to NT\$ 1,400 billion respectively.

In early 2000, what concerned the people most were: (1) what are the new problems of our times, and (2) who should be responsible for them. A national survey, with 1,112 effective samples, has revealed a lot of interesting points:³⁰

1. 62.7 percent of the respondents thought that the income gap got worse compared to a decade earlier.
2. The reasons for this situation were “Black-Gold Politics,”³¹ such as stock market speculation and insider trading, unfair taxation, purchase of overpriced land and other property, and other kinds of illegal actions.
3. Over 60 percent of respondents worried about the possibility of things getting worse in the future.
4. Regarding the question who should be responsible, 68.5 percent of the respondents blamed the President and other KMT politicians.
5. The most desired welfare reforms that the government should put into action were in the field of physical safety and family livelihood.

Obviously, the people have been aware of injustice and therefore called for social reforms. A similar survey conducted by a national newspaper has shown comparable results. Based on a size of 1,051 samples, this survey compared the changes of people's feeling between 1998 and 1999, just the years in which the government launched numerous countermeasures to offset the negative effects of the Asian financial crisis. Many important changes happened in only one year's time.³² For example, though Taiwan's economic growth and employment were relatively better than that of its neighbors, the worry about the widening income gap was increasing a great deal. There were no significant changes in living quality, but the degree of dissatisfaction with governmental performance was increasing radically to over 50 percent. Policies on justice, social welfare, and taxation all received a more negative evaluation in this survey.

The Asian Financial Crisis and the copious rescue efforts of the government for the financial and production markets uncovered conflicting class relationships within only a short period of time. Therefore, the feeling of relative deprivation of the waged classes was growing progressively. What people now asked for were not only prosperous economic growth and employment opportunities, but also a just

social welfare system and fair taxation. As the myth of the KMT as an intermediary equally for all classes was broken, it could win some votes from the benefiting classes but it also lost some from the relatively-deprived classes.

On March 18, the public went to the polling stations to select their new president for the coming four years. The election result changed the distribution of political powers ever since World War II. Chen Shui-bian, the presidential candidate of the DPP, won the election with 39.3 percent of votes, while former Vice President Lien Chan, the presidential candidate of the KMT, lost the election with 23.1 percent of votes only. And the independent candidate, James Soong who was former secretary-general of the KMT, came in second with 36.8 percent of votes.³³ This result angered the traditional supporters of the KMT and therefore induced a three-day protest at the door of the party headquarters, forcing the outgoing president, Lee Teng-hui, to step down as party chairman. The KMT's collapse was so total that its future survival was in doubt, particularly under the threat of the coming People First Party—a new party organized by James Soong and his supporters that was expected to be the strongest opposition party. For the KMT, it was even very difficult to maintain its status as a well-functioning opposition party after it lost its grip on power. Before, the KMT has been in power for over 50 years and accumulated a huge assets worth over NT\$ 200 billion.

There are three implications from this result. First, as the ruling party that led Taiwan out of the Asian financial crisis the KMT should have had an incredible advantage to win the election. We could argue, the reason for the KMT's defeat was not an economic one. Rather, its nature as a capitalist party and its serious neglect with regard to social reforms should be taken into account. Economic growth, thus, is still important to obtain governmental legitimacy, but aggregating pressures for social reforms can offset such gains in legitimacy.

Second, some politicians from the KMT blamed James Soong for this defeat because he took away a large amount of KMT supporters. It could be one reason, but not the only one. The reformer James Soong has attracted quite a lot of supports from the middle classes. Although he was excluded from the KMT, he did not suffer electoral defeat, which is the likely case in Taiwan once members decide to run independently without the backing of their political party. Moreover, the share he had in the election was bigger than that of the KMT candidate, former Vice President Lien Chan, implying that the KMT and its policy orientation were rejected by a sizeable part of the waged classes.

And, finally, the DPP won and has been in power since May 20, but the share it has won was less than 40 percent, meaning that the new president can not rely on an absolute majority. This limits the scope and capacity of the new government to make policies. Nevertheless, Chen Shui-bian has tried to proceed with some social reforms, as well as to keep the economy growing and the stock market prospering. The new government, subsequently, has faced an elaborate challenge—that is, to

find a balance in catering to both the waged classes and the employer classes at the same time.

Challenges for the New Government

The DPP has long shown its concerns for social welfare. For example, in the parliamentary election of 1992 a debate on whether or not Taiwan should become a welfare state hit the road, in which social welfare occupied the top of the political agenda for the first time. In 1993, the DPP published its white paper on social welfare, proposing.³⁴

1. The establishment of a universal social insurance system covering benefits of pension, health, work injury, and unemployment.
2. Family allowances for children and youths.
3. Higher cash benefits for social assistance recipients.
4. More welfare services for disadvantaged groups.
5. A comprehensive medical care system and network.
6. A housing policy for everyone.
7. Collective bargaining of work conditions.
8. The establishment of a ministry particularly responsible for social welfare at central government level.
9. The inclusion of social welfare into national development plans.
10. New redistribution of resources across the nation.

In responding to this challenge, the KMT has tried to achieve a more consistent social policy, resulting in the publication of *The Guiding Principles of Social Welfare Policy* in 1994. There were nine principles for Taiwanese welfare development, as follows:

1. Emphasis should be put on the balance between economic and social development.
2. A proper social administration system should be established.
3. The family should be at the center of social welfare policy.
4. There should be teamwork between different governmental departments and stronger emphasis on the importance of professional social work.
5. Harmony and cooperation between employers and employees should be secured.
6. The social insurance system should be financially independent.
7. There should be a mixed economy of welfare.
8. Public housing should be aimed at low-income families.
9. Equal opportunity for access to medical care should be guaranteed.

This could be regarded as the most comprehensive social policy statement of the KMT since it has ruled Taiwan. However, in comparison with the DPP's white paper, we can see that the KMT pursues an economics-first policy, because it argues strongly for (1) the importance of economic growth in supporting social welfare; (2) the sharing of welfare responsibilities with the family and the private sector; (3) the harmonization of industrial relationships, and (4) the financial independence of social insurance in order not to increase the governmental burden. Economic concern was still the priority of the KMT, while the DPP seemed to prefer with a more social democratic welfare state.

In his presidential campaign, Chen Shui-bian has proposed the following welfare policies: (1) a NT\$ 3,000 welfare allowance per month for the elderly who do not receive any pension; (2) free medical care for the children below three years of age, and (3) low-cost mortgage with 3 percent interest rate only for first-time buyers of houses. These measures are much more universal in their nature but the question where the money comes from is also very critical one. It is not only a problem of governmental intentions, but also one of its capacities to materialize its reform proposals. It should be noted that capitalist globalization has significantly constrained the capacity of a national welfare state. It sharpens international competition and this, in turn, changes the balance of power between capital and labor.³⁵

In a global economy, the flow of capital is far more fast than that of the labor force; particularly working rights are still controlled and managed at national policy level, and not a superior—that is, international—level. The capital can easily move to profitable areas elsewhere while the labor force is left to lose their jobs. Workers are forced to compete with each other not only at domestic but also at international level.

In Taiwan, labor-intensive industries moved to low-labor-cost areas, predominantly Southeast Asia and China, in case they could not import low-waged foreign laborers. This generates high rates of unemployment and, yet again, prop up pressures on the welfare state. If the government pours more public resources into the welfare state, then the shortage of money for economic development will be critical and damage profitmaking of enterprises even deeper. If the government would not like to expand its welfare efforts, then it could lose its status as a ruling party in the forthcoming election.

Although the possibilities for supranational social policy, or international social development are advocated,³⁶ these developments are far behind the process of globalization. Interestingly, the new DPP government soon abandoned their ideals on social welfare due to a series of controversies over financial predicaments, the national pension program, and protests against the fourth nuclear power plant, which caused a major stock market slump, with the stock market at only half the value than it was before the general election. On September 16, 2000, just after 100 days of President Chen Shui-bian in office, he declared that economic development

will become the government's new priority and social welfare programs will be postponed. Before the DPP came to power, the KMT typically argued, "social welfare will have a negative impact on economy" and "how can you have social welfare without economic development?" whenever the DPP proposed new welfare policies. Surprisingly, those words have now come from President Chen himself.

It is clear that there are at least three assumptions behind President Chen's words. First, economic development and social welfare are mutually incompatible. If you want the former, you must sacrifice the latter, and vice versa. Second, under any circumstances, economic development has a higher priority than social welfare. Social welfare, therefore, can wait, but economic development cannot. Third, the DPP's past platform on social welfare was devised improperly, or at least turned out to be infeasible.

In the presidential campaign, President Chen stressed his modest origin—i.e., being brought up in a very poor family—to remind the public that he understands the needs of the common people. Nevertheless, he seemed not really to keep his promises on social reforms. During the 1970s, the *New Left* theorists argued over whether the state was an administrative body for capitalists, or whether it was shackled by capitalist structure. President Chen's abandonment of his erstwhile social welfare platform in favor of economic growth would seem to lend weight to this particular view.³⁷

Conclusions

In my analyzing welfare capitalism in Taiwan, I concluded that capitalist development and democratization are two major traits of Taiwanese society.³⁸ The former refers to the necessity of economic growth not only for consolidating Taiwan's status in the global political economy but also for providing resources for social welfare. The latter refers to the state's legitimacy that helps to stabilize existing political order and mode of production, in which social welfare is an important means to harmonize conflicting class interests. However, both requirements stand in a very complex, and sometimes contradictory, relationship to each other. Moreover the development induced by the state in the previous stage would eventually react on the next stage. We saw this very clear in the case of Taiwan during the time of the Asian financial crisis.

It is true that the KMT, as the then ruling party, led Taiwan peacefully through the Asian financial crisis, but it is also true that reasons for the defeat of the KMT in the presidential election were the policies it formalized to counteract the crisis. The KMT, thus, laid down the seeds for its own failure. The DPP is more likely to go ahead with some social reforms. But, whether or not the scope would effectively meet the people's expectation is unclear? Whether or not the capacity of the new government is sufficient to realize its promises is also unclear?

Now it is the beginning of a new political era in Taiwan. However, the challenges and difficulties Taiwan is facing are not so new. With its pro-social democratic characteristics, the development of Taiwan under the leadership of the DPP serves as an interesting case for testing theories—that is, theories that focus on structural constraints that are imposed by capitalism and its particular mode of production, in local as well as global perspectives.

ACKNOWLEDGMENT

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NOTES

- 1 *The Economist* (January 30, 1999).
- 2 *South China Morning Post* (November 19, 1998).
- 3 *The Far Eastern Economic Review* (February 11, 1999).
- 4 Detailed discussion please refers to World Bank (1993).
- 5 ADB (1999: 64).
- 6 *The Far Eastern Economic Review* (February 11, 1999).
- 7 DGBAS (1998: Table 19).
- 8 Gough (1979: 32-33).
- 9 *United Daily News* (February 23, 1999).
- 10 *United Daily News* (March 12, 1999).
- 11 Ku (1995: 361).
- 12 ADB (1999: 26).
- 13 *The Far Eastern Economic Review* (February 11, 1999).
- 14 *The Far Eastern Economic Review* (February 11, 1999); *China Times* (February 25, 1999; March 9, 1999; June 8, 1999).
- 15 DGBAS (1999b: 13).
- 16 Asian Development Bank (1999: 64).
- 17 *China Times* (31 December, 1998).
- 18 *China Times* (22 February, 1999).
- 19 Ku (1997: 32-33).
- 20 Ku (1995).
- 21 DGBAS (1998: Table 90).
- 22 Ku (1995).
- 23 Chen (1996).
- 24 DGBAS (1998: Table 92).
- 25 BNHI (1996: 8).
- 26 Detailed discussion please refers to Ku (1998a, b).
- 27 *United Daily News* (December 30, 1998).
- 28 Hsueh (1997).
- 29 *The Commonwealth* (January 1, 2000: 64-68).
- 30 *The Commonwealth* (January 1, 2000: 92-96).

- 31 A special Taiwanese term to describe an ever-close relationship between politicians, businessmen, and Mafia members.
- 32 *United Daily News* (December 30, 1999).
- 33 *United Daily News* (March 19, 2000).
- 34 DPP (1993).
- 35 Wilding (1997).
- 36 Midgley (1997).
- 37 *China Times* (20 September, 2000).
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11

The Welfare State in South Korea: Implications of the Economic Crisis

SOONMAN KWON

In contrast to its active involvement in economic development, the Korean government has played a minor role in social development. Since unemployment has never been a real issue before the economic crisis that resulted in the International Monetary Fund (IMF) rescue loan in late 1997, the government's budget allocated to unemployment-related policy was very limited. Unemployment insurance was only at the initial stage of development. Although the national health insurance scheme covers the entire population, it is based on low contribution and a benefit coverage that is too limited to provide adequate protection against the economic loss from illness. With minimal financial support by the government, the national health insurance system has faced serious financial instability. Before the economic crisis, the national pension scheme did not cover self-employed people who live in urban areas. It has also suffered a chronic fiscal instability caused by too generous benefits relative to the contribution. Welfare program has failed to provide protection for the poor due to its stringent eligibility criteria and limited benefits.

The economic crisis has had a chilling impact on social development in Korea and shocked the entire nation because the Korean economy had been enjoying rapid growth for a long time. One of the most striking effects has been a huge and sudden

rise in unemployment that Korea has not experienced for the past thirty years. With little institutional capabilities to deal with the huge unemployment, the economic crisis has hit vulnerable groups harder, increased the proportion of part-time and daily workers, and reversed the trend of steady improvement of income distribution. The economic crisis along with the trend of aging population, globalization, and competition calls for an expanded role of social policy. Consequently, the role of government should be redefined and the government budget in social policy should be expanded.

Implications of the Economic Crisis for the Welfare State in Korea

Effect of the Crisis on the Economy

As conditions for the emergency loan, IMF requested several measures that it regarded as necessary to rescue Korean economy. As a textbook prescription, IMF requested a high interest rate to stabilize the Korean currency, discourage consumption and firms' investment, and curb inflation pressure. Although the high interest rate increased savings, it also contributed to over-killing the economy due to the consumption freeze and the bankruptcy of heavily indebted firms. IMF also put substantial pressure on banks for better performance in order to reform the financial sector. The squeeze of loans by banks led to the bankruptcy of many small and medium-size firms, resulting in huge unemployment.

The foreign exchange rate almost doubled immediately after the crisis, from 800 to 1,700 Won per US dollar in January 1998, which has stabilized to around Won 1,200 since January 1999. The higher exchange rate has contributed to the increase in export and the trade surplus. Consequently, foreign currency reserves rose from US\$ 88.7 billion in December 1997 to US\$ 485.1 billion in December 1998 (BOK, 2000). The stock price index plunged after the crisis and then returned to normal in 1999. The government shut down more than twenty financial institutions and acquired non-performing loans from banks. The speedy recovery of the economy seems to be led by the rise in domestic consumption and investment that was empowered by rapid adjustments of macroeconomic policy such as fiscal expansion. The budget deficit increased from less than 1 percent of GDP (Gross Domestic Product) in February 1998 to 5 percent of GDP in November 1998 (KDI, 1999).

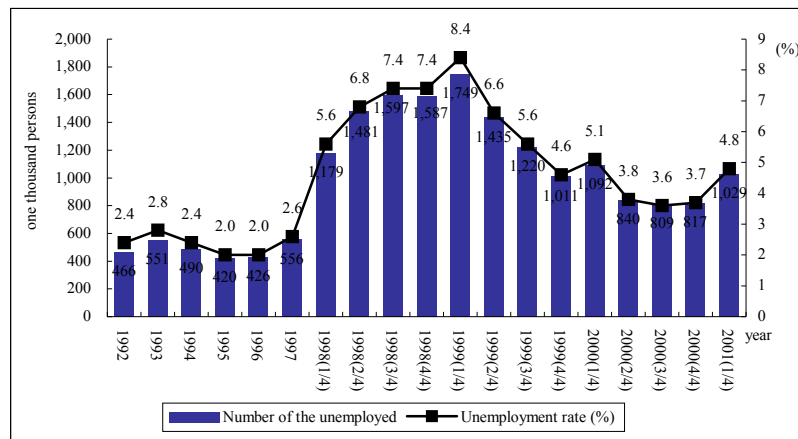
Effect of the Crisis on Social Developments

The economic crisis led to the bankruptcy of a huge number of firms, most of which were small and medium-size ones. Although the extent of layoffs in large corporations and public enterprises was not as big as expected, large-scale employers responded to the crisis by freezing new hires. Low layoff by large employers—Korean *Chaebol* firms—provides us with both good news and bad news. If *Chaebols* succeeded in corporate restructuring and downsizing, layoff was

unavoidable. Delayed restructuring will make major corporations, which have suffered from over-investment and excess capacity, vulnerable to future external shocks. The government has a dilemma in pushing *Chaebols* toward corporate restructuring, such as corporate divestiture, because it will result in more unemployment.

The social impact of the crisis was most prominent in unemployment. The unemployment rate jumped from 2 percent in 1996 to 8 percent in the first quarter of 1999 (Figure 11.1). In the first quarter of 2001, the unemployment rate declined to less than 5 percent. The number of unemployed was 426,000 in 1996, peaked to 1,749,000 in the first quarter of 1999, and decreased to 1,029,000 in the first quarter of 2001. The message from the reduction in the number of the unemployed may not necessarily be rosy. As the crisis lingers, if the unemployed give up searching for a job and withdraw from the labor market, the unemployment statistics improve.

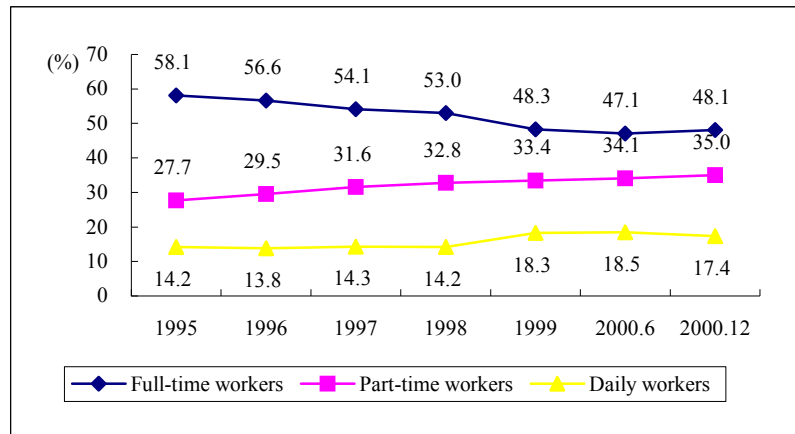
Figure 11.1
Trend in Unemployment



Source: National Statistical Office (2001).

Besides unemployment, the nature of employment is also of concern. The proportion of daily and part-time workers has increased from 14.2 percent and 27.7 percent, respectively, in 1995 to 17.4 percent and 35.0 percent, respectively, at the end of 2000 (Figure 11.2). Compensation for daily and part-time workers is lower than that for full-time workers in comparable tasks. They have low income and limited job security because they are not eligible for membership in a trade union nor enjoy various employee benefits.

Figure 11.2
Trend in the Type of Employment



Source: Ministry of Labor (2001).

Unemployment in Korea may have a greater social impact than what the number represents. Korean society was unaccustomed to high unemployment because of its rapid economic growth and the corporate culture of lifetime employment. Consequently, institutional capability, such as a social safety net to deal with unemployment, is rather poor. Furthermore, married women are not active in the labor market and households are usually dependent on the labor income of their (male) heads. Unemployment of the male head of the family means not only financial disaster for the family but also a social stigma and mental burden to the male head himself.

The crisis had a negative effect on household income not only because of the increase in unemployment but also because of reduced wages for workers. The distribution of income also deteriorated because the income reduction was not even across different groups of people. In terms of labor income, greater unemployment among vulnerable groups, such as women, less well educated workers and employees in small firms has had a negative impact on income distribution. The effect of non-labor income on income distribution was also negative because the windfall interest income due to the interest rate hike benefited the wealthy; but the price of their land and housing has risen to the pre-crisis level after experiencing only a short-term decline.

Table 11.1 shows the trend in income distribution. Before the economic crisis, income distribution was improving over the years in terms of Gini coefficient and the income of the poor relative to the wealthy. However, through the economic

crisis income distribution deteriorated back to the level of the eighties. The level of income of the 40th–70th income percentile was 54.5 percent of that in the 80th–100th income percentile in 1997, but it was down to 48.8 percent in 1999 (KIF, 1999). The relative income of the 10th–30th income percentile showed a worse change from 29.8 percent in 1997 to 24.9 percent in 1999. The drastic deterioration of income distribution in only two years is also evident in terms of the Gini coefficient, which changed from 0.28 in 1997 to 0.32 in 2000 (NSO, 2000; Yoo, 1998).

Table 11.1
Inequity of Labor Income in Selected Years

	Gini coefficient	Income of the 40 th –70 th percentile (index)*	Income of the 10 th –30 th percentile (index)*
1986	0.340		
1988	0.327		
1990	0.300	52.14	29.22
1991	0.302		
1992	0.287		
1993	0.289	53.56	29.84
1996	0.288		
1997	0.282	54.54	29.77
1998	0.316	49.96	25.65
1999	0.320	48.75**	24.88**
2000	0.317		

Source: Yoo (1998); Korea Institute of Finance (1999); National Statistical Office (2000).

Notes: * Income of the 80th–100th percentile is set to 100. ** First half of 1999

Social Policy Programs and Reform Issues

The economic crisis has aroused the people's attention to the role of the social security system in Korea. In contrast to economic policy, government role in social development has been largely neglected. The proportion of the social development budget in the total budget of government was quite low before the crisis (Table 11.2). The central government budget for social security, health and environment, and human resources development (other than education) accounted for only about 9 percent of the total budget in 1997, which increased to 13.1 percent in 2001.

Table 11.2
Central Government Budget in Social Development in 1997, in percent

	1991	1993	1995	1997	1998	1999	2000	2001
General Administration	11.2	11.9	10.4	10.7	10.0	9.7	9.1	9.6

Defense	25.4	24.6	22.1	21.3	19.3	17.3	17.0	17.1
Education	17.7	19.8	18.8	18.9	16.6	14.2	14.3	17.2
Social Development	10.2	9.2	8.1	9.2	9.8	11.4	11.9	13.1
Economic Development	16.4	20.7	21.4	25.5	30.3	29.2	26.1	25.6
Local Finance	11.0	11.7	10.6	10.6	9.3	8.3	9.3	10.9
Others	8.0	2.1	8.6	3.8	4.4	9.9	12.3	6.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Planning and Budget (2001).

The economic crisis has called for the reform of social policy in four critical areas: labor and unemployment insurance reform to deal with unemployment, national pension reform to provide income support, national health insurance reform to cut the vicious circle of poverty and ill health, and welfare reform for safety nets. Because Korea has had stable economic growth and employment, it lacked a support system for the unemployed, and public expenditure on labor market and unemployment was quite low. The social security system was designed as an insurance scheme financed by the contributions of the beneficiaries with the minimal government involvement in financing. The economic crisis has pushed the government to extend the population coverage of the unemployment insurance and the national pension schemes and to implement an expanded welfare program for the poor.

Labor Policy and Unemployment Insurance

Labor Market Programs and Unemployment Insurance in Korea. One of the most urgent tasks of social policy following the economic crisis was to deal with huge unemployment. A Tripartite Commission consisting of labor, management and government was formed in January 1998 for the purpose of reaching an agreement on major labor issues. The political inclusion of labor was a significant step toward industrial democracy in Korea. In the past, labor had a share only in the economic benefits of development, not in the political ones, such as high wage and stable employment (Park, 1998). One of the major outcomes of the Commission was the New Labor Standard Act in February 1998, which allows layoffs with some conditions and procedures for employment adjustments. Since then, however, the Tripartite Commission has not played a leading role in the major policy making for labor. Mutual trust between labor and management will be vital to the success of the Tripartite Commission.

Confronted with huge unemployment, the government immediately allocated much more of the budget to various labor market programs and extended

unemployment insurance. The government's policy toward unemployment has two different approaches: active and passive labor market programs (Kimenyi, 1995). The active labor market policy includes job placement, employment subsidy, and vocational training. In an effort to create jobs, the Korean government has launched social overhead capital (SOC) investments. It has also provided credit guarantees for small and medium-size firms and venture enterprises that have the potential for job creation. The passive labor market policy includes unemployment compensation and safety nets to tackle cyclical unemployment resulting from insufficient aggregate demand for goods and labor. Public works programs are a typical government policy to provide temporary income support without work disincentives. The effectiveness of the public works program has been frequently questioned, however, because of the low efficiency and productivity of the projects involved.

Unemployment insurance was first introduced in 1995 for firms with more than thirty regular employees. Following the economic crisis, it included firms with more than ten regular employees in January 1998 and was rapidly expanded to all workplaces in October 1998. The rapid expansion to cover more workers has made a less generous benefit package unavoidable. Currently, unemployment insurance pays 50 percent of workers' average earnings for the preceding twelve months with the minimum benefit set at 70 percent of the minimum wage. The duration of the benefit depends on the length of employment and on the worker's age when he/she lost the job (maximum seven months).

Reform Issues in the Labor Policy and Unemployment Insurance. The problem with labor-related government expenditure in Korea is that it spends too much on active labor market programs relative to passive ones, despite the fact that current unemployment is rather cyclical due to the plunge in aggregate demand (Park, 1998). In 1998, almost 70 percent of unemployment-related government expenditure was allocated to active labor market programs (Ministry of Labor, 1999). The government needs to shift the focus of its labor market policy from active to passive measures and from a policy directed towards the unemployed to a poverty alleviation program.

Despite unemployment insurance, the Korean labor market is still in need of a social safety net for persons who are unemployed but not covered by unemployment insurance. New entrants into the labor market are not covered because the eligibility for unemployment benefits requires an insured period of at least six months. Daily workers are not usually covered because of the lack of proper administrative mechanisms. Unemployment insurance should expand its coverage of benefits and beneficiaries to provide sufficient income security for the unemployed.

After experiencing the economic crisis, firms are likely to diversify employment patterns to enhance the flexibility of the labor market. Korea needs mechanisms to deal with such side effects of labor market flexibility as the increase in part-time and temporary workers mentioned earlier. The labor market in Korea is

characterized by duality; i.e., regular workers in large firms enjoy secure long-term employment, high pay and high unionization compared with workers in small firms and temporary workers in large firms (You and Lee, 1999). Competition, labor market flexibility and technical innovation will aggravate the problems of the dual labor market. Inequality in labor income will rise and so will the need for a social safety net.

National Pension Scheme

Public Pension in Korea. A public pension scheme was initiated in 1988 for firms with more than ten employees, and the self-employed in rural areas joined the National Pension Scheme in 1995. Then, in April 1999, the economic crisis expedited the implementation of the pension scheme to cover the urban self-employed as well. The national pension scheme in Korea is a funded (rather than pay-as-you-go) system where the principal and interest of the contribution are the major source of the benefits. The contribution rate is 9 percent of the employees' income. For the self-employed who have recently received coverage, the contribution rate was set in 1999 to only 3 percent of income to encourage participation; this will increase annually to 9 percent by 2005.

The replacement ratio, which is the ratio of the benefit amount to earnings before retirement, has recently been reduced from 70 percent to 60 percent, with forty years of contributions. The pension payment to beneficiaries consists of a flat payment (50) and an income-related payment (50 percent). The former is for the purpose of income redistribution and is based on the average income of all insured people. The income-related part is determined by the income of the individual. The proportion of the flat versus income-related part was 57 percent and 43 percent before the recent reform.

Reform Issues in the National Pension Scheme. The pension system has been suffering from serious fiscal instability for a long time. Fundamental defects in the design of the pension scheme, such as low contribution and too generous benefits, have caused a serious fiscal problem. For long-term sustainability of the pension scheme, several reform measures are urgently needed. A decrease in the replacement ratio was the first step in the reform. Also requested is a gradual increase in the age of eligibility for old-age pension payments from 60 to 65 and an increase in the contribution rate. It was recently decided that the pension scheme should be adjusted every five years based on an analysis of the fiscal status of the pension fund.

Inefficient management such as the government's direct borrowing at low interest rates for public sector projects has aggravated the fiscal problems of the pension fund. Efficiency and transparency in the management of the pension fund are particularly important at this early stage of the national pension scheme with a

huge fund accumulation. It has been proposed that the government borrow from the pension fund only through marketable government bonds and that the fund's performance be periodically disclosed to the public (NCPR, 1997). Furthermore, the Fund Management Committee and the Executive Committee of the National Pension Corporation should increase the proportion of representatives of the insured.

In the process of expanding coverage to the self-employed, the national pension scheme has encountered even tougher problems. For persons who have been affected by the economic crisis, income security in the future is not an option, and many of them have refused to pay contributions to the pension scheme. They were exempted from mandatory enrollment, and in return are not eligible for pension benefits. A third of urban population does not currently participate in the National Pension Scheme (Table 11.3). Many of the poor self-employed and daily and part-time workers were excluded from the pension scheme; consequently, it has failed to provide a social safety net for those who are most in need of income security.

Table 11.3
Participation in the National Pension Scheme (as of February, 2000),
in thousand persons

	Participant	Persons exempt from contribution		
		Total	Not applicable*	Unable to contribute**
Workplaces	5,308	-	-	-
Urban	8,624	4,638	1,170	3,468
Rural	2,081	682	171	511
Total	16,230	5,320	1,341	3,979

Notes: * Those who cannot pay the contribution including students and those who are in the military service. ** Those who defer paying the contribution for temporarily due to unemployment and business failures.

Source: Moon (2000).

The most serious problem that the national pension scheme is facing at present is the underreporting of income by the newly covered self-employed. The level of their reported income has proved to be only about 60 percent of the income of those who already were covered by the pension scheme. The strategic reporting of income has caused a substantial cross-subsidization and inequitable allocation of the economic burden of the social security system. Underreporting of income has also had a negative effect on current pension beneficiaries because half of the pension payment (flat part) is determined by the average income of all insured people.

Several temporary measures are being proposed to tackle the problem of income assessment. One option is to temporarily separate the pension fund into a fund for employees and a fund for the self-employed. Although this could mitigate the inequity between employees and the self-employed, it does not solve the inequity among self-employed people. An alternative measure would be to reduce the proportion of the flat payment of the pension because its amount relies on the reported income of all insured people and affects income distribution.

In the long run Korea needs a fundamental reform toward a two-tier system such as that proposed by the National Committee on Pension Reform (1997). The basic pension (flat payment) is a lump-sum pension payment based on the minimum cost of living. According to the proposal, its relative portion will be reduced. The income-related pension is a fully funded system and will allow the opting out for a private pension. Competition among private and public pensions will improve the efficiency of pension funds, too. To solve the problem of inequity in contributions and to enhance social solidarity of the social security system, a tax administration reform is a requirement to improve the assessment of the income of the self-employed.

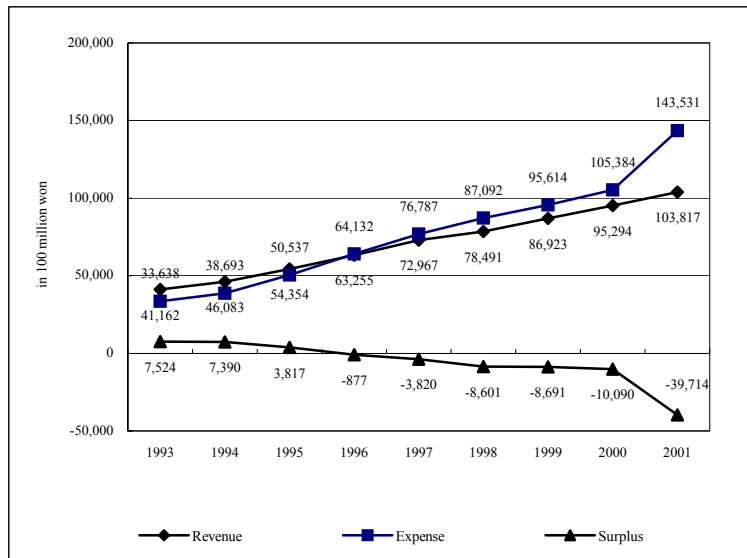
National Health Insurance

National Health Insurance Program in Korea. In terms of population coverage, health insurance achieved universal coverage much earlier than the pension scheme and unemployment insurance. Although social insurance for health care with universal coverage was instituted in Korea in 1989, it still does not provide adequate protection against income loss from illness (Kwon, 2003a). Low contributions of less than 4 percent of income, a limited benefit package, high co-payment by patients and inefficient service delivery are major shortcomings of the national health insurance system. For example, patients' out-of-pocket payment for insured medical care averages 15 percent and payment for uninsured services (meals, sonograms, magnetic resonance imaging etc.) averages 29 percent of the total medical expenses (NHIC, 1999). The financial burden on patients has become more severe during the economic crisis.

Financial instability of the health insurance program is of critical concern. Figure 11.3 shows that the health insurance fund has incurred a deficit since 1996, and the size of the deficit has been increasing. Financial stability of health insurance hinges on the behavior of both health-care providers and consumers. For example, from 1994 to 1998, the medical expenditure of the elderly (over 65 years of age) increased by 176 percent, whereas the proportion of elderly to the total population increased by only 16 percent (NHIC, 1999). Patient days per claim case and the expenditure per patient day also increased considerably. However, the role of providers is more critical than that of patients in the escalation of health-care

expenditure because of the weak consumer sovereignty and information asymmetry that are inherent in medical care.

Figure 11.3
Financial Status of National Health Insurance



Source: Ministry of Health and Welfare (2000).

Physicians have a financial interest in providing more medical care because they are reimbursed on a fee-for-service basis. Besides the frequent visits per claim case, the volume effect is greater in laboratory testing and medication that require less of the physician's time. Providers also have strong incentives to substitute uninsured medical services (for which physicians can set their own prices) for insured ones that are subject to strict fee regulation. The rapid diffusion of high-cost medical technology is associated with provider incentives to induce patients to use those uninsured services.

Since there is no system for separating the prescribing and dispensing drugs in Korea, both physicians and pharmacists can prescribe and dispense drugs. There is no check-and-balance mechanism to regulate doctors' and pharmacists' prescriptions and patients' drug utilization. Providers purchase drugs at much lower prices than the reimbursement they receive from the insurer, and pharmaceuticals are the most important source of profit for many providers. They have a vested

interest in prescribing and dispensing a greater amount of the drugs that yield the highest margins for them. As a result, expenditure on pharmaceuticals accounted for as much as 40 percent of the total health expenditure in 1996, thus becoming a major threat to the fiscal stability of the national health insurance system (NHIC, 1998).

Reform Issues in National Health Insurance. Health insurance has historically depended on increased cost-sharing for consumers to solve the problem of financial instability. However, patient cost-sharing, which is already too high in Korea, is inefficient because it restricts patient access to necessary as well as unnecessary medical care. It is also inequitable and regressive because the amount of patient cost-sharing is not related to income. Providing financial incentives for physicians to minimize health-care costs is a better alternative because physicians have the knowledge to effectively contain costs. Therefore, the reform of the payment system for medical providers is essential to encourage them to provide cost-effective care and to improve the financial health of the insurance fund.

Per-case payment system or global budgeting is respectable candidates for a new payment system to replace the fee-for-service system. After three years of pilot study, the DRG (Diagnosis Related Group)-based prospective payment system will be implemented for nine common surgical procedures in the near future (Kwon, 2003b). Under the prospective payment system, the financial incentive for physicians is in complete contrast to that under the fee-for-service system. Providers may have an incentive to harm the quality of care, although there is little evidence of its negative impact on patient outcomes in the United States (Coulam and Gaumer, 1991). Government and insurer should pay close attention to quality assurance once the new payment system is in place.

The health insurance reform should include an increase in contributions and the expansion of benefit coverage to provide adequate financial protection against illness. Limited benefit coverage also raises obstacles to the payment system reform because the more aggressive payment system of the national health insurance system will lead physicians to shift to uninsured services and thereby increase the patient's burden. The benefit package should also be redesigned to reduce the coverage for minor illnesses and provide more coverage for catastrophic illnesses. This is in line with the rationale of insurance and effective risk-spreading. A tough challenge is that increasing contributions and redesigning the benefit package are not politically popular measures because the change will impose a short-term (tangible) burden to a large number people and its expected benefit is substantial but intangible.

Health-care policy always has distributive implications and the separation of prescribing and dispensing drugs is no exception. Physicians and pharmacists have actively lobbied against the government policy toward the mandatory separation of the prescribing and dispensing of drugs. Civic groups representing the interest of

consumers have played a significant role in pushing physician and pharmacist associations to come to the bargaining table and agree on the new policy (Kwon, 2003c). Unfortunately, several lengthy physician strikes have forced the government to adopt brand-name prescriptions and to raise medical fees by 45 percent in a year, which has been the most important factor contributing to the recent insolvency of the national health insurance fund.

Welfare Programs

Welfare Programs for the Poor in Korea. Welfare programs have failed to provide necessary protection for the poor mainly because of the strict criteria of eligibility and the limited benefits. The eligibility is based on age—above 65 or below 18 years of age—or the inability to work. The eligibility also requires the satisfaction of income and property criteria separately. The strict eligibility is closely related to the trend of the decreasing number of beneficiaries of the welfare program. The benefits include cash, medical care and education but they are not sufficient for beneficiaries to maintain the minimum standard of living. For example, beneficiaries of the welfare program are still facing a barrier to the access to medical care because of higher out-of-pocket payment required at the point of service (Kwon, 2000).

Social workers in local governments play critical roles in the administration of the welfare program such as reviewing applicants, evaluating income/property and living conditions, providing support services, follow-up of beneficiaries, etc. Social workers are usually understaffed and are overloaded not only with welfare programs but also with other programs of the local government. Inefficient job design and work process, lack of career development and motivational problems associated with social workers have contributed to the ineffective management of the welfare program such as the existence of nontrivial number of unqualified (non-poor) beneficiaries.

A new welfare program, Basic Living Security, was legislated in 1999 and implemented in October 2000. Under the new program, those whose assessed income—incorporating both income and property into a single measure—is below the specified minimum cost of living are eligible to the welfare benefits regardless of age or the ability to work. Conditional on the beneficiary's active searching for jobs or participation in the vocational training program, the new program provides benefits to those who have the ability to work but earns less than the minimum cost of living. Benefits are adjusted to take into account the size of family and expanded to provide housing subsidy. In principle the new program aims to ensure that the total amount of earnings and program benefits should cover the basic cost of living for the beneficiary, and consequently the cash benefit is curtailed when the assessed income increases.

Reform Issues in the Welfare Program for the Poor. Since the welfare program depends on the means test for the selection of beneficiaries, inaccurate income assessment is a critical barrier to the success of the welfare program. Inaccurate income assessment results in a cross subsidy among the beneficiaries and those who failed to pass the means test on the margin. Introducing a single measure incorporating both earnings and property in the new program is an improvement, but assessing the property in a comparable measure of income is still a tough task. Income assessment is particularly important in Korea because of the benefit design: once the assessed income is below the threshold level a potential beneficiary is entitled to all types of program benefits, otherwise nothing. In the long run, it will be necessary to design the benefit package more flexibly and provide benefits selectively by considering the needs of individual beneficiaries. Program administration by social workers in regional offices will be critical to the effective implementation of the welfare program.

In contrast to the old welfare system where those who have the ability to work are not eligible, the new program allows them to get the benefits if the assessed income is below the minimum cost of living. Now work incentive is a critical issue because a beneficiary gets smaller benefits as he/she earns more income from labor. The deduction of some portion of earned income in the means test is necessary to prevent the moral hazard of beneficiaries. Currently, 10 percent of earned income is deducted in the means tests, but it is not enough to provide them with strong incentives to work. Furthermore it may be necessary to introduce a limit on the duration and amount of welfare benefits for those beneficiaries who can work. Without such arrangements for workfare, the new welfare program can result in moral hazard and welfare dependency.

Coordination among social policy programs is also of concern (Kim, 2000). In 2000, the minimum monthly cost of living for the means test of the welfare program was Won 930,000 (about US\$ 800) for families with four members, whereas the minimum monthly wage required in the labor market is only Won 420,000. The minimum wage below the minimum cost of living means that the labor policy fails to guarantee a minimum standard of living for workers and at the same time has a negative impact on the incentive to work. The maximum amount of benefits of the unemployment insurance is only Won 1,050,000 per month. Currently the level of pension benefit can be as low as Won 220,000 per month, meaning that the pension cannot cover the minimum cost of living defined by the Basic Living Security program. Labor policy—on minimum wage and unemployment insurance and welfare programs need to be coordinated. In the long run, the level of benefits from social insurance programs should be expanded to provide enough security and cover the minimum cost of living.

Conclusions

The economic crisis has the effect of putting a freeze on all sectors in Korea. It was a shock to Korean society that had been accustomed to rapid economic growth driven by government-led development. In the three years since the outbreak of the economic crisis, there are many signs indicating that the Korean economy has recovered from the crisis. In social development, however, there is more bad news than good. Although the current unemployment rate of around 5 percent is not high compared with other industrialized countries, it is still twice the pre-crisis level. A sudden increase in unemployment means a bigger economic and socio-psychological burden on the Korean society. Vulnerable groups were hit harder by the economic crisis, and the proportion of part-time and daily workers has continued to increase. The economic crisis has reversed the trend of a steady improvement of income distribution.

Government has long neglected its role in social development. Before the economic crisis broke out, government expenditure for social development was minimal. There are also many problems in the structure of social insurance and welfare programs such as the inefficient payment systems for health-care providers and too much emphasis on active labor market programs compared with social safety nets and poverty alleviation programs. Unemployment insurance and the pension system still fail today to cover everyone who needs the protection. Despite the universal coverage of the entire population, the national health insurance system cannot provide adequate income security because its benefit coverage is too limited. It is urgent that the government puts more resources into social developments, and expands and coordinates social policy programs to provide adequate security for living.

However, there are many barriers to strengthening the social security system. An equitable distribution of the economic burden of the social security system is of concern in expanding coverage of the population. The difficulty of evaluating the income of the self-employed has resulted in a cross-subsidy from employees to the self-employed, which has created resistance against raising the contribution for more benefits. Resistance by beneficiaries will aggravate the chronic problem of financial instability that both national health insurance and national pension are laboring under. In the long run, tax administration reform is essential to improve the assessment of income for an equitable and financially sustainable social security system.

More fundamental reform should be in the paradigm of the role of government and public policy. Economic development is to be driven by market competition, and government should play a role as referee, not coach, of the game by helping design fair and transparent rules of the game. However, government should play a much more active role in social policy arenas. Besides the economic crisis, the rapid aging of the population makes it necessary for the government to prepare for a decline in the labor force and a rise in expenditure on social security. Globalization, liberalization, and competition also call for strengthening social safety nets.

The Welfare State in Italy

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