REVIEW ESSAY

Business and the Welfare State in France and Germany

NATHALIE JANSON

In *The Politics of Social Risk: Business and Welfare State Development* (New York: Cambridge University Press, 2003), Isabella Mares seeks to demonstrate that the business community is not necessarily against the development of the welfare state. On the contrary, business interests were major actors in the design of social policies throughout the twentieth century. This idea contradicts the large welfare-state literature built on the assumption of class conflict. The naive view centering on class struggle inherited from the Marxists, however, is no longer appropriate, if it ever was. Too much recent evidence runs against it.

Mares tries to establish her thesis by testing a set of theoretical assumptions about business preferences toward social policies, relying on historical evidence for France and Germany. She chose those two countries for analysis because despite the comparable sizes of their welfare states, the design of their social policies differs. She traces those differences to the differing composition of their business communities.

Why would firms promote social policy? According to the author, firms and employees may have a common interest that arises from the risks employees face in the

Nathalie Janson is an associate professor of economics and finance at the Rouen School of Management in France.

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labor market—contingencies of disability, unemployment, or sickness—that discourage them from investing further in skills. Firms share an interest in the employees' investment in skills because such investment increases labor productivity for the firms at the same time that it increases earnings for their employees. By promoting social policy, firms compensate their employees for their investment even if the employees leave the firm, which entails their sacrifice of the earnings increment associated with continuity of employment in a given firm.

Mares characterizes the main determinants of business preferences in a social-policy space along two dimensions: risk redistribution and control. Because firms aim at maximizing investment in skills, they are especially sensitive to their risk exposure in the labor market and to their ability to control the compensation of their employees in relation to their investment. Mares derives an objective function that models a firm's utility function over the social-policy space:

$$U(R,C) = \lambda R \text{ (relative incidence of risk) } R + \lambda C \text{ (size of the firm, skill level) } C$$

With regard to risk redistribution, the higher the firm's exposure, the more it favors the socialization of risk in order to lower the costs of protecting employees. With regard to control, the larger the firm, the more it intends to control the administration of social policy. Moreover, if a company relies on a highly skilled labor force, it wants to guarantee that financial compensation will increase with the workers' qualifications rather than being locked into a flat-rate scheme.

Based on an analysis of indifference curves and the sign of the sensitivities toward risk redistribution (λR) and control (λC), Mares locates four maxima in the social-policy space, explaining the type of social policy that different kinds of firms support:

1. If $(\lambda R) < 0$ and $(\lambda C) > 0$, firms support private types of social policy. These firms are usually large and employ a highly skilled labor force.
2. If $(\lambda R) > 0$ and $(\lambda C) > 0$, firms support contributory insurance. These firms are highly exposed to risk.
3. If $(\lambda R) > 0$ and $(\lambda C) < 0$, firms support universalistic social policy. They might be small firms aiming at minimizing the cost of social policy.
4. If $(\lambda R) < 0$ and $(\lambda C) < 0$, firms do not support any kind of social policy. They might be small firms that employ unskilled labor or firms not exposed to risk.

The firms' location in the social-policy space varies according to their size, the skill of their labor force, and their risk exposure. Therefore, they do not support the same social-policy design. As a result, the dominant view expressed by the business community ultimately depends on its composition in terms of the different kinds of firms.

The implementation of social policies is the result of negotiations between the business community, the labor associations, and the policy reformers. After having characterized the social preferences of labor associations, Mares shows that in some circumstances the business community and the labor associations can share the same interest, a condition for the social-policy project to succeed. She makes an interesting distinction between strategic alliances and prestrategic alliances. In *prestrategic* alliances, the business community and the labor associations support the same social policy that happens to be their first choice; *strategic* alliances are formed when the two sides agree only on their second-best social policy. The latter case is more likely to occur.

Mares dedicates four chapters to testing the theoretical assumptions. She relies on historical evidence about three important areas of French and German social policies: accident insurance, unemployment, and early retirement. Notice the circularity of her reasoning: when characterizing the determinants of firms' social preferences, she chooses two variables—risk redistribution and control—based on historical evidence; but then she tests the theoretical assumptions by using the same historical evidence. Unfortunately, this methodological circularity prevents her from truly demonstrating anything.

The account Mares gives of the progress in the negotiations that led to the major social-policy reforms in the two countries during the twentieth century is detailed and well documented but at the same time tedious to read. Each chapter follows a similar pattern: first, the author recalls the predictions about the social-policy design that members of the business community should support, based on their preferences; then she goes through all the different steps of the negotiation process; and, finally, she compares the predictions with the positions of the business community during the negotiation process and reaches a conclusion with regard to the validity of the theoretical assumptions. Unfortunately, her repetition of the test for three different areas of social policy in two countries makes the demonstration tiresome. She reiterates the theoretical hypotheses six times, making the reader want to bypass the early pages of each chapter. Although the historical work itself is a great contribution, its presentation might well have been organized in a more efficient way.

The author's methodology is also certainly a major flaw. She seems to endorse a classic Popperian approach in testing new theoretical assumptions, but she does not rely on a classical statistical approach to make the tests, resorting instead to the presentation of highly detailed historical evidence. Many questions might be raised: What is the scientific ground for having chosen France and Germany? Is an examination of the histories of these two countries sufficient to refute any general hypothesis? Why examine the three chosen policy areas in particular, and why only these three?

Mares claims that her model departs from the tradition of the welfare-state scholars, who inherited from the Marxists an approach based on class struggle. She rightly maintains that the latter approach is unsatisfying because it is too narrow and as a result cannot account for all the differences observed in social-policy designs among developed countries over time. For a contemporary reader, it may be surprising to find out that the country that adopted the most universalistic social policy was England, with the Beveridge Plan after World War II, and not France, where the tradition of class struggle was deeply rooted (going back as far as the French Revolution). Nowadays, however, England is considered relatively friendly toward free-market ideas. Even though trade-union membership decreased all over Europe in the past twenty years, social policy designs did not change in the same way across the continent. For example, England adopted radical pro-market changes, whereas France opted for an even more universalistic social-policy design over the same years. The standard welfare-state approach based on class conflict also does not explain why social-policy arrangements existed before the advent of the welfare state. In the nineteenth century, companies began to offer social benefits such as housing, coverage of medical expenses, and work breaks as a means of retaining their employees and reinforcing the employees' loyalty to the company. (The English department store Marks & Spencer was a pioneer in designing social policies to increase the employees' loyalty.) Private social policies developed by firms or industrial associations go against the assumption of class struggle.

As Mares points out, firms, like employees, face a problem of uncertainty in the labor market that may prevent investments in skills. Firms need, to a certain extent, a skilled labor force, but employees may be reluctant to invest in the acquisition of skills because they are not sure they will be sufficiently rewarded for their investment, especially when the risk of unemployment is high. Nonetheless, the author neglects two important factors: investing in skills may itself reduce the risk of unemployment; and firms themselves may offer training programs directly. In the latter case, companies have a strong incentive to prevent their trained employees from leaving. As a result, companies have an incentive to offer—in addition to the wage or salary—various "fringe" benefits that enforce employees' loyalty.

Serious questions may be raised about just what Mares's book contributes to knowledge. To be sure, the welfare-state literature in history and political science often relies on the strong assumption of class conflict. In light of that attribute, her demonstration of the business community's important role in the design of social policy amounts to a substantial contribution. Nonetheless, *contribution* is a relative concept. In the present case, one might observe that the field of social sciences is vast, and what may be innovative in welfare-state research is not necessarily innovative in economics. Indeed, the idea that the business community promoted the development of the welfare state calls to mind common themes of public-choice theory. Based on a cost-benefit analysis, that theory shows the conditions under which it is rational for firms to support the welfare state's development. One might maintain that this demonstration is no different from Isabella Mares argument, which relies on a cost-benefit analysis and shows that social-policy design outcomes depend on the business community's composition. Mares, however, seems unaware that she is reinventing the same wheel that public-choice theory has been rolling for decades.

Moreover, Mares seems entangled in a crucial conceptual confusion. A demonstration that the business community has an incentive to develop and implement social policies and did promote them in the past does not necessarily imply that it has promoted welfare-state development as such. Mares confuses the necessity of social policy with the justified existence of the welfare state. The fact that companies have a strong incentive to develop social policy in order to attract and retain a skilled labor force does not imply that the welfare state should exist in the first place. To be fair, Mares does not claim that the promotion of social policy necessarily implies the development of the welfare state—she simply does not discuss the matter. She does state, "In many economies with well-developed systems of social protection, support for the welfare state is much broader, reaching deep in the business community. The finding of this book that business is not irrevocably opposed to the development of institutions of social insurance brings, I submit, good news for many welfare states" (p. 265). Yet, when accounting for the historical evidence from France and Germany, she mentions more than once the concern expressed by the business community as a whole about the costs associated with the development of the welfare state and in particular about the cost of the bureaucracy. These recurrent statements show, if anything, that the business community would not necessarily have supported any welfare-state development in the first place. Once the welfare state was in place, the fact that the business community tried to minimize its cost by extracting some benefit from it was part of its profit-maximizing function—making the best, as it were, of what business people might well have regarded as a bad situation.