

The UK and the European social model: what can the UK learn from European welfare states?

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The rapid expansion of the welfare state in the 1940s placed the UK amongst the most advanced societies in terms of social policies, with a comprehensive social safety net, state pensions and free healthcare. But it diverged from its European neighbours after the economic troubles of the 1970s ushered in a more hostile environment for social spending. The Thatcher governments launched an assault on the welfare state, and particularly on those aspects of the welfare state that could be most easily replaced by private sector provision. The state pension was uncoupled from rising earnings, and supplementary pension provision halted. Unemployment benefits reverted to a flat rate instead of being related to past contributions. Entitlements to income support were restricted and subject to increasingly onerous conditions and monitoring. Inequality and poverty grew, in no small part due to the high levels of unemployment of the Thatcher years and the dismantling of collective bargaining, but also because of the paring back of the welfare state from a tentatively universalistic system into a means-tested social safety net.

Although most European welfare states also underwent reforms and cutbacks in the challenging period after the end of the post-war boom, they emerged into the twenty-first century largely intact, and in some ways more comprehensive than before. This resilience is in some ways surprising. The countries of continental Western Europe and Scandinavia faced much the same challenges as the UK: they were mature industrial economies where growth was slowing, the population aging, and the government struggling to meet its social commitments. But instead of attempting to replace the welfare state with market alternatives, they largely chose instead to reform rather than replace existing provision, allowing social spending to rise and letting taxes and borrowing take the strain.

The reasons for the UK's divergence have lessons for the ways in which the left approaches the politics of welfare today. In this piece I argue that our debate over the welfare state is too insular, and that cultural or linguistic barriers have blinded us to good examples of how to govern the economy and society from just a few hundred miles away. The UK is not the only country struggling with the difficult issues of how to ensure social cohesion while growing the economy, and there is a lot to learn from the highly successful countries in continental and Northern Europe, which, in a variety of ways, have managed to outperform the UK in terms of both productivity and equality. Rather than simply pushing back against Conservative ideology, or indeed against some of the demands of the radical left, Labour should be broadening its perspective to build a political programme which draws from the best of European welfare capitalism. This has lessons both on how the welfare state works in a dynamic economy, but also on how to appeal to a broad electoral constituency and to build the alliances to achieve political change.

Class politics and the 'median voter'

Early scholarship on the welfare state often drew on a soft Marxian view of political development, in which the socio-economic interests of the working class, especially in the manufacturing sector, inevitably collided with the interests of the employer class. Workers wanted higher living standards, employers wanted to squeeze wages to maximise profits, and class conflict naturally ensued. The welfare state was an outcome of this battle, with workers mobilising their numbers at the ballot box and in the workplace to push for a social wage and collective provision of key social services. Where workers were well organised, generous welfare states resulted as left parties won power and employers acquiesced in higher taxes and more public spending; where they struggled to build strong unions and left parties, the welfare state remained underdeveloped.

This 'power resources theory' seemed to do a good job of explaining why strong social-democratic parties and unions in Scandinavia had been able to hold political power for long periods, extending the welfare state across wide areas of social life, with generous benefits in case of illness, unemployment or retirement. However, it did less well at explaining the almost as impressive growth of social policies in countries that had less dominant left parties, such as Austria, France, Germany, the Netherlands or Italy. In fact, in some of these cases Christian Democratic or conservative parties seemed to have played just as important a role in building the welfare state, often in coalition with the left, and often through negotiation with workers' representatives and employers. So, rather than class struggle as such, the welfare state in much of Europe seemed to result from a class compromise acceptable to both sides, which was not based solely on social-democratic thinking.

What also underpinned this class compromise were the very different patterns of political conflict and cooperation that resulted from proportional representation in many European nations' electoral systems. In countries like the Netherlands, Austria or Germany, it was impossible for the left to win power alone, and even in Scandinavia social-democratic parties frequently had to share power. As a result, welfare-state development could not be solely focused on the goal of combating inequality and poverty; it also had to offer something to middle-income groups. Alongside redistribution from the rich to the poor, the welfare state also became a provider of insurance against a variety of social risks faced by all income groups, and was increasingly involved in the delivery of social services for the whole population. One of the key functions of the welfare state was assisting citizens in managing the uneven relationship between resources and needs across the lifecycle, smoothing income through taxes and benefits. This social insurance component of the welfare state, which remained underdeveloped in the British case, was and remains perhaps the core mission of most European welfare states.

This welfare model has its critics, from both right and left. From the right, the accusation is that taxes and spending are unproductively high, and that the deadweight costs of bigger government are incurred for nothing more than 'churning' income from the citizen as taxpayer to the same citizen as welfare recipient. However, the inability of the UK to outgrow these economies despite a smaller welfare state suggests that the costs of this kind of circular government spending should not be overstated. From the left, the criticism would be that the welfare state should be primarily focused on eliminating poverty and securing greater equality, a goal undermined by the high levels of social spending on mid and higher earners.

However, the better performance of most European countries in terms of poverty reduction, whilst also maintaining generous provision for middle-income groups, suggests this criticism is also based on flawed reasoning. In fact, the most advanced European welfare states are still a useful model for British reformers to follow. The rest of this essay will explain why.

Beyond morality tales: the politics of welfare

There is not much that can be achieved in terms of greater social equity without progressive forces gaining influence over the policy process. Unfortunately, in the UK the first-past-the-post electoral system has made that very difficult, with Labour in government for only thirty years since the Second World War, and just thirteen since 1979. This outcome is in some ways quite puzzling, since survey data consistently shows that most British voters are broadly favourable to the notion that the government should play a role in providing economic security and reducing the gap between rich and the poor, yet since the 1970s elections have returned either Conservative governments, or Labour governments offering only conditional support for the welfare state (the Blair/Brown years). There are many reasons for Labour's inability to translate public support for greater equality and redistribution into parliamentary majorities, such as the fragmentation of the anti-Tory vote and the territorial divides within the UK, or the powerful role of the right-wing media. But the electoral system has a deeper role in shaping voting patterns in ways which undermine the welfare state.

Torben Iversen and David Soskice have developed an interesting theory as to why first-past-the-post is so damaging for the redistribution cause.¹ In the British system, votes tend to converge around two main parties because of the reluctance of voters to waste their votes on minor parties with little chance of winning parliamentary seats. As a result, elections usually produce a majority for one or the other of the main parties. This means that voters face a stark choice between Labour and the Conservatives (a choice increasing numbers of voters over recent decades have rejected, without managing to fundamentally alter the way governments get elected). Survey data shows that most voters are supportive of some redistribution, and standard theories of political economy show that they are right to be so: the median voter stands to benefit from higher taxes and spending, since taxes are disproportionately levied on higher earners. Yet the only way of achieving this is to support Labour, and in a Westminster-style system, once Labour is in government, voters have little opportunity to shape what it does. A two-party system represents a structural barrier to this support for redistribution turning into policy. It does so because it sharpens the dilemma facing middle-income voters who might otherwise be willing to support a centre-left coalition of the kind that still wins elections in other European countries with proportional systems.

In an unequal society, the majority of voters stand to gain from a bigger welfare state, but who will gain the most? If Labour is led by the left, it could be expected to focus most of its redistributive effort on the poorest groups, leaving voters closest to median earnings benefiting much less. These voters are vulnerable to Conservative attack lines suggesting that they would be on the hook for higher taxes to support the poor, or perhaps that Labour's ambitious redistributive spending would weaken the economy and government finances. If they are sufficiently worried, they could back

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the Conservatives instead, even though by doing so they forego the opportunity to benefit from a fairer distribution of income achieved through progressive taxation and universalistic welfare benefits. The historical record suggests this has often been the case. Elections that Labour could have won, such as those in 1992 or 2015, were lost through successful Conservative messaging that Labour's tax plans would have hurt middle-income voters and damaged the economy. Even in 2017, the high-water mark of support for a more pro-redistribution Labour since the 1960s, Corbyn was still defeated by the strong growth of the Conservative vote around the regressive Brexit project.

In the absence of electoral reform, pro-welfare forces are stuck with the suboptimal scenario of pro-redistribution Labour campaigns running into the rocks of negative campaigning, or more pragmatic Labour leaders winning power with reassuring messages for more centrist voters but having little ambition to address the country's deep inequalities. The recent furore around Keir Starmer's refusal to commit to abolishing the cruel two-child limit in income-related benefits introduced by the Cameron government illustrates these points with unpleasant clarity. The policy, which prevents families from claiming benefits for any children born after their second (with some exceptions), has had a brutal effect on some of the poorest children in society, yet is widely supported by the public: over 60 per cent of respondents surveyed by YouGov in July 2023 wanted to keep the cap, including 47 per cent of Labour voters (with only 35 per cent of Labour voters in favour of scrapping the policy).ⁱⁱ One pessimistic conclusion would be that most British voters simply do not care about the poor, but a less depressing interpretation is that voters who have struggled to meet the costs of bringing up their children with little direct financial help from the state are loathe to pay through their taxes for others to have large families. Conservative discourse on this and related issues, such as the principle that a family on benefits should not receive more than the overall average household family income, tap into a reluctance amongst many middle-income voters to finance social support that they are unlikely to have access to themselves. This suggests that a recalibration of the welfare state to appeal to a wider range of citizens could have electoral benefits, building a coalition for welfare expansion rather than retrenchment.

Redistribution and risk-sharing: how to build a pro-welfare coalition

One of the reasons why so many British voters appear so hostile to redistribution is the increasing association of the concept of 'welfare' with means-tested benefits that are available only to lower-income groups. The UK is usually classified in comparative social policy studies as a 'liberal' welfare state, meaning that its main focus is to provide a safety net for the poor, rather than to offer financial security to a broader range of citizens. This safety net is related to need, rather than previous earnings, meaning that for a household accustomed to anything above a low income, the benefits on offer only compensate a small part of the income lost in the case of unemployment, sickness or disability. The UK 'replacement rate' for loss of income through unemployment is the third lowest among OECD countries, behind the United States and Turkey. Income support for a single person covers around 50 per cent of a 'typical' market income (which the OECD defines as 67 per cent of the average wage) – which is the lowest in the whole OECD; and it is 64 per cent for a family with two children.ⁱⁱⁱ Even a small amount of savings disqualifies potential recipients from this already limited help.

Even for retirement, where coverage is much more comprehensive, the UK state pension is relatively limited, especially for higher earners. The net pension replacement rate ranges from 79 per cent for those earning half average earnings, to only 48 per cent for those on twice average earnings – the equivalent figures for the Netherlands are 94 per cent and 87 per cent! For British retirees, the income security guaranteed by the state, despite the generous ‘triple lock’ indexing brought in by the Cameron government, remains a significant income loss for the majority of workers, and the decline of occupational pensions, which topped up retirement incomes for most workers of the boomer generation, has meant that more and more people will lack an adequate income in old age. In the liberal welfare state, the government’s role is to provide a floor below which incomes should not fall, but not to sustain incomes above that floor, beyond incentivising individualised private investment arrangements which may or may not provide the expected returns, and tend to increase inequality between households.

In much of the rest of Europe the welfare state does much more than insure against destitution. Pensions in particular are an area where public provision goes way beyond a safety net, in some countries (such as Italy) almost entirely crowding out private provision by offering pensions with very high replacement rates funded out of high levels of compulsory contributions over the working life. This is expensive: in France and Italy public pensions spending is around 15 per cent of GDP, almost three times what the state pension costs the Exchequer in the UK.^{iv} What is more, in most European countries much of this state pension spending goes on the middle class, since pensions reflect lifetime earnings, with lower provision for the lower-income groups.

This may appear to be wasteful churning, but one clear consequence is that an overwhelming majority of citizens in European countries with extensive public pensions have a major stake in the welfare state. The recent riots in France over the raising of the retirement age (from a rather youthful 62) show the deep commitment of many citizens to protecting social provision for the whole population. Invitations to middle-income voters to pay lower taxes and take more personal control over their finances appear to largely fall on deaf ears. In much the same way as NHS reform remains the third rail of British politics, cuts to public pensions resonate way beyond the left. Even though the biggest beneficiaries remain high earners, there is extensive redistribution in most public pensions systems, with significant risk-sharing that pulls up the most vulnerable groups. By bringing the middle classes into the welfare state and limiting means-testing, it acquires the kind of political fortifications that the UK’s more modest arrangements have mostly not enjoyed. The social insurance logic of public pensions extends into other areas too, improving unemployment compensation and other welfare benefits.

No free lunch? Making welfare productive

A major roadblock to achieving a comprehensive welfare state that integrates the middle classes into a generous social protection scheme is the high levels of tax revenues and government spending required to sustain it. The success of the Thatcher project was in part to leverage middle-income groups’ reluctance to fund redistributive policies with higher tax rates, convincing them instead to take a higher

disposable income and make their own financial arrangements to fund retirement and confront economic uncertainty. A housing boom, stoked by financial deregulation and a limited fiscal burden on property ownership, allowed a generation of voters to make capital gains that could help protect them from the risks of income shocks and aging. For a while this helped boost economic growth, but the wheels came off the model after the 2008 financial crisis, dragging down a Labour government with it.

The austerity of the 2010s initially reduced the share of GDP spent by the UK government to well below the levels of other Western European countries. But reducing government spending did nothing to improve economic performance: the UK has stagnated, while the most successful economies after the crisis were countries such as Germany, the Netherlands and Sweden, confirming that a bigger state and more generous social provision is far from inconsistent with a strong economy. This is no surprise to students of the European political economy. The economic historian Peter Lindert has argued that the welfare state is a 'free lunch'^v – that higher taxes and social spending do not in fact depress economic activity, if anything the opposite, because democratic governments have an electoral incentive to avoid imposing deadweight costs on the economy. The state can improve economic performance by using public provision of key services such as education and healthcare, and by facilitating labour market transitions through 'social investment' policies such as subsidised childcare and skills retraining, which help productivity as well as improving households' living standards. In other words, the famous trade-off between efficiency and equality identified by the American economist Arthur Okun in the 1970s can be averted with intelligent policy.

During the Covid-19 pandemic, UK public spending reached almost half of GDP (48 per cent) in 2021, a similar level to that in the Netherlands and Germany. Although tax revenues lagged well behind, at only around a third of GDP, the British state is now deeply embedded in the economy, and social spending is not too far behind the levels of comparable Western Europe countries. The furlough measures applied to sustain the economy during lockdown, while eye-wateringly expensive, showed that the British state has a perhaps surprising capacity to intervene quickly and decisively in the economy. The tax rises brought in by the Sunak government in response to the Truss-induced credibility crisis of autumn 2022 stand to raise government revenues as a share of GDP to 35 per cent, far higher than for most of the last century. Although this is in part a function of the UK's stagnating economy, it establishes a foothold for government to expand its share of spending. Tentative moves in the direction of social investment, such as increased spending on childcare, and wide support for greater help for children in lower-income households, as reflected in support for footballer Marcus Rashford's free school meals campaign, point towards an opening in shifting UK welfare policy away from a reluctant provision of minimal living standards, towards a more active social policy that can help improve labour market participation as well as securing solidarity.

There is no escaping the challenges facing the UK welfare state, nor the political roadblocks hindering progress: the electoral system, the overbearing role of financial services and the housing market in the economy, the abysmal state of the country's infrastructure and the poor health of much of the population. However, a succession of crises have entrenched government's role in the economy and opened up a political opportunity to use government as a tool for improving both social cohesion and

economic performance, along the lines well established in similar advanced economies in Western Europe. The constraints on achieving this are more political than material: our longstanding refusal to learn policy lessons from successful nearby countries (often looking instead to far less appropriate examples such as the United States); the clunky majoritarianism of our political system; and the drag on economic performance of outdated ideas about small-state capitalism. The welfare state can be a free lunch fiscally, and can benefit a solid majority of the electorate. What is lacking is the political awareness that voters can be persuaded that the welfare state can be a vehicle for social and economic progress.

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Notes

ⁱ Torben Iversen and David Soskice, 'Electoral institutions and the politics of coalitions: Why some democracies redistribute more than others', *American Political Science Review*, Vol 100 No 2, 2006, pp165-181.

ⁱⁱ See <https://yougov.co.uk/topics/politics/survey-results/daily/2023/07/11/fa421/1>.

ⁱⁱⁱ See <https://stats.oecd.org/Index.aspx?DataSetCode=NRR>.

^{iv} See <https://data.oecd.org/socialexp/pension-spending.htm>.

^v Peter H. Lindert, 'Why the welfare state looks like a free lunch', *National Bureau of Economic Research*, Working Paper 9869, 2003: <https://www.nber.org/papers/w9869>.