Rethinking the Welfare State:

Social Protection, Economic Integration, and Transport

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Abstract

This study reconsiders the effects of European integration on the welfare state. The analysis is centered on how the welfare state has historically performed its function and how European integration has changed this. Of concern is the maintenance of the social welfare status quo and the internal changes in the welfare state caused by the process of European integration. In a break with tradition, the focus of the research is on the social protection element of the welfare state rather than the 'formal' welfare state as it is commonly understood. For the purpose of assessing the effects of European integration on the social protection element of the welfare state, a case study of the transport sector—road and rail—is employed here. The analysis pays close attention to the process by which economic integration affects social protection and the overall welfare state implications of this. Through a combination of process-tracing and an evaluation of domestic responses, the research attempts to identify the driving force of integration.

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Chapter 1: Introduction

1.1 Direction of the Research

There is an ongoing debate about globalization and its effect on the welfare state. This debate is echoed in the process of European integration and the implications that this has on the European welfare states. The effects of economic globalization are not identical to European economic integration, but to the extent that we are concerned with a process of economic openness and interdependence, European integration is arguably the functional equivalent of globalization.[1] An additional distinction between the processes is the degree of institutionalization. Economic globalization has indeed been institutionalized in the form of bilateral, multilateral, and regional trade agreements, and international organizations such as the World Trade Organization (WTO). European integration has been institutionalized in the form of a supranational governmental organization to which its member states have delegated certain authorities and powers primarily in the realm of economic policy.[2] Given this consideration, the focus of this research is on the more highly institutionalized process of European integration when assessing the welfare state implications of economic integration.[3]

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[1] Maurizio Ferrera, "The European Welfare State: Golden Achievements, Silver Prospects," *West European Politics* 31, no. 1 (January-March 2008): 86.
[2] European Steel and Coal Community (ESCC), European Economic Community (EEC), European Union (EU).
[3] Evelyne Huber and John D. Stephens, *Development and Crisis of the Welfare State* (Chicago: University of Chicago Press, 2001), 7.

commonly understood. For the purpose of assessing the effects of European integration on the social protection element of the welfare state, a case study of the transport sector—road and rail—is employed here. The choice of a sectoral study with a focus on specific actors, national constellations, and the nature of reforms is appropriate for analyzing the welfare state given that, "to some extent, the welfare state is nothing but a collection of sectoral policy programmes and, logically, the national and the sectoral level must be connected."[4] The selection of transport, and road and rail in particular, is justified on the grounds that road and rail transport are "two important parts of a sector that in both its infrastructure and its service dimension is genuinely transboundary and, as such, is at the heart of the common market project."[5]

The analysis pays close attention to the process by which economic integration affects social protection and the welfare state implications of this both within and beyond the social protection regime. Through a combination of process-tracing and an evaluation of domestic responses, the research attempts to identify the driving force of integration, actors or otherwise. The countries of study are Germany, and to a lesser extent France. The emphasis on German transport is to some extent a biased case selection because it is where European integration in road and rail transport appears to have had the most significant effect. However, the justification of this selection is to illustrate the welfare state effects of transport integration as clearly as possible while at the same time illustrating varying national responses.

[4] Christoffer Green-Pedersen and Markus Haverland, "The New Politics and Scholarship of the Welfare State," *Journal of European Social Policy* 12, no. 1 (2002): 48.

[5] Dirk Lehmkuhl, "Harmonization and Convergence? National Responses to the Common European Transport Policy," *German Policy Studies* 2, (2002): 2.

1.2 Literature Review

The literature concerning the effects of European integration on the welfare state is both vast and multifaceted. There is a general consensus that European integration has implications for the welfare state. The consensus seems to stop here. One strand of the literature speaks to the resiliency of the welfare state in the face of globalization, or economic integration, hence path dependence[6] and continuity rather than change.[7] To some extent, the path dependence approach draws upon the varieties of capitalism literature[8] but is more so grounded in historical institutionalism.[9] Pierson and others have emphasized the 'new politics of the welfare state' and the asymmetrical politics of expansion and retrenchment, namely the politics of 'blame avoidance': "moments of budgetary crisis may open opportunities for reform. Advocates of retrenchment will try to exploit such moments to present reforms as an effort to save the welfare state rather than destroy it. Framing the issue in this manner may allow governments to avoid widespread blame for program cutbacks."[10] One focus within this literature has been on a convergence of solutions, reforms, and the overall structure of national welfare systems—the lack thereof has served to its benefit.[11] Leibfried and Pierson argue that European integration has limited both the sovereignty and autonomy of member states.[12] Scharpf has presented the challenges of economic integration

[6] James Mahoney, "Path Dependence in Historical Sociology," *Theory and Society* 29, (2000): 507-548. Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment* (Cambridge: Cambridge University Press, 1994).

[7] Francis G. Castles, *The Future of the Welfare State: Crisis Myths and Crisis Realities* (Oxford: Oxford University Press, 2004). Gøsta Esping-Andersen, *Welfare States in Transition: National Adaptations in Global Economies* (London: Sage, 1996). Evelyn Huber and John D. Stephens, *Development and Crisis of the Welfare State: Parties and Policies in Global Markets* (Chicago: University of Chicago Press, 2001). Stephan Leibfried, *The Future of the Welfare State* (Cambridge: Cambridge University Press, 2001). Fritz W. Scharpf and Vivien A. Schmidt, *Welfare and Work in the Open Economy, 2 Volumes* (Oxford: Oxford University Press, 2000). Peter Taylor-Goodby, *Welfare States under Pressure* (London: Sage, 2001).

[8] Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Cambridge: Polity Press, 1990).

[9] Paul Pierson, *Politics in Time: History, Institutions, and Political Analysis* (Princeton: Princeton University Press, 2004).

[10] Paul Pierson, "The New Politics of the Welfare State," *World Politics* 48, no. 2 (1996): 177.

[11] Maurizio Ferrera and Martin Rhodes "Building a Sustainable Welfare State," in *Recasting European Welfare States, West European Politics* 23, no. 2 (2000): 257–282.

[12] Stephan Leibfried and Paul Pierson, *European Social Policy – Between Fragmentation and Integration* (Washington DC: Brookings Institution, 1995).

in terms of the competence asymmetries between what is gained at the supranational level and lost at the national level as well as the "joint decision trap."[13] Moreover, Scharpf has also focused on the challenges of regulatory harmonization and the imbalance between positive and negative integration.[14] There is also a growing volume which has centered on the role of the European Court of Justice (ECJ) and the implications of judicial activism.[15] Additionally, some scholars have focused on the changes in the welfare state equilibriums at the national level,[16] "from equity to efficiency, from solidarity to market."[17] Others focus on the domestic adjustments associated with the economic, fiscal, and monetary discipline enforced by supranational authorities and the corresponding welfare state recalibration.[18] The literature also speaks to the effects of monetary union and the Maastricht criteria as limiting the traditional social policy toolbox.[19] Falkner has focused on the constraints of integration in terms of liberalization and competition law and the 'social dumping' associated with competitive devaluation of competition law.[20] The complexity of the EU as a system of

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[13] Fritz W. Scharpf, "The Joint-Decision Trap: Lessons from German Federalism and European Integration," *Public Administration* 66, (1988): 239-278. Fritz W. Scharpf, "The Joint-Decision Trap Revisited," *Journal of Common Market Studies* 44, (2006): 845–864.

[14] Fritz W. Scharpf, *Governing in Europe: Effective and Democratic?* (Oxford: Oxford University Press, 1999).

[15] Dragana Damjanovic and Bruno De Witte, "Welfare Integration through EU Law: The Overall Picture in the Light of the Lisbon Treaty," EUI Working Paper LAW No. 2008/34 (Florence: European University Institute, 2008). Fritz W. Scharpf, "The Asymmetry of European Integration, or Why the EU Cannot Be a 'Social Market Economy'," *Socio-Economic Review* 8, (2010): 211-250. Stephan Leibfried, "Social Policy Left to the Judge and the Market?," in *Policy-Making in the European Union, Fifth Edition,* eds. Helen Wallace, William Wallace, and Mark A. Pollack (Oxford: Oxford University Press, 2005), 243-278.

[16] Janine Goetschy, "The European Employment Strategy: Genesis and Development," *European Journal of Industrial Relations* 5, no. 2 (1999): 117-137.

[17] Sophie Jacquot, *National Welfare State Reforms and the Question of Europeanization: From Impact to Usages*, Working Papers on the Reconciliation of Work and Welfare in Europe (Edinburgh: RECWOWE Publication, Dissemination and Dialogue Centre, 2008): 15.

[18] Maurizio Ferrera and Anton Hemerijck, "Recalibrating Europe's Welfare Regimes," in *Governing Work and Welfare in a New Economy: European and American Experiments,* eds. Jonathan Zeitlin and David Trubek (Oxford: Oxford University Press, 2003), 88–128. Jonathan Zeitlin and David Trubek, *Governing Work and Welfare in a New Economy: European and American Experiments* (Oxford: Oxford University Press, 2003).

[19] Andrew Martin and George Ross, *Euros and Europeans: Monetary Integration and the European Model of Society* (Cambridge: Cambridge University Press, 2004).

[20] Gerda Falkner, "Social Policy," in *Europeanization: New Research Agendas,* eds. Paolo Graziano and Maarten Vink (Basingstoke: Palgrave Macmillian, 2006).

"multilevel governance"[21] and its conceptualization as a "regulatory state"[22] have been applied to explain not only the political process, but also the policies and regulations and their effects. In contrast to both the bottom-up and top-down approaches to understanding economic integration, Knill and Lehmkuhl have identified a third mechanism, that of "framing integration" whereby the beliefs and expectations of the actors are altered.[23] Additionally, some scholars have explored the interactive process of European integration, rather than being bottom-up or top-down.[24] While the literature has documented certain harmful impacts of globalization on welfare state sustainability,[25] certain ambiguities regarding the operationalization and measurement of globalization and economic integration challenge its interpretation.[26]

Three specific considerations help to clarify the direction and placement of the research at hand in the voluminous literature on Europeanization, economic integration, and the welfare state. Regarding the process of integration, Scharpf has commented that,

> The basic difficulty with…explanations [that are] interest-based or ideological is that they focus exclusively on the agency of purposeful actors while ignoring the (institutional) structure within which actors must define their strategic choices.[27] They try to explain Treaty revisions and legislative action by reference to the interests, preferences, world views and strategies of actors in national governments, the Commission and the European Parliament while ignoring or downplaying the effect of formal and informal decision rules and the impact which judicial decisions have on the available options of political actors. Instead, structure and agency should be considered as complementary rather than mutually exclusive, explanatory approaches.[28] In the highly structured European policy processes, decision rules, and

[21] Beate Kohler-Koch and Rainer Eising, *The Transformation of Governance in the European Union* (London: Routledge, 1999). Liesbet Hooghe and Gary Marks, *Multilevel Governance and European Integration* (Lanham, MD: Rowman and Littlefield Publishers, 2001).

[22] Giandomenico Majone, *Regulating Europe* (London: Routledge, 1996).

[23] Christoph Knill and Dirk Lehmkuhl, "How Europe Matters: Different Mechanisms of Europeanisation," *European Integration Online Papers* 3, no. 7 (1999).

[24] Claudio M. Radaelli, "The Europeanization of Public Policy," in *The Politics of Europeanization,* eds. Kevin Featherstone and Claudio M. Radaelli (Oxford: Oxford University Press, 2003), 27-56.

[25] Geoffery Garrett and Deborah Mitchell, "Globalization, Government Spending and Taxation in the OECD," *European Journal of Political Research* 39, no. 2 (2001): 145-177.

[26]David Brady, Jason Beckfield, and Martin Seelib-Kaiser, "Economic Globalization and the Welfare State in Affluent Democracies, 1975-2001," *American Sociological Review* 70, (2005): 921-948.

[27] Anthony Giddens, *The Constitution of Society* (Cambridge: Polity Press, 1984).

[28] Fritz W. Scharpf, *Games Real Actors Play. Actor-Centered Institutionalism in Policy Research* (Boulder, CO: Westview, 1997).

> more generally institutions, are bound to create strong asymmetries, favouring some actors and some policy goals, and impeding or obstructing others.[29]

Concerning the institutionalist literature on the welfare state Starke makes the following claim:

> A particular way of understanding the bearing of existing welfare state structures on the current politics of change is through mechanisms of path dependence. Institutional welfare state arrangements already in place today are often depicted as highly path-dependent, in that distinct policy legacies largely determine both the extent of change and the types of change that may be possible…the specification of the causal mechanisms underpinning the 'reproduction' of the path are crucial for these types of arguments…Much may thus depend on the specific structural design of welfare state programmes and their degree of 'maturity'…Yet, even here, disagreement remains, for example, about the importance of universalism for the resilience of welfare states or the causes—and the causal mechanisms—of path dependence.[30]

In somewhat of a break with institutionalism, the project here is more in line with a neo-functionalist take on globalization captured by Tanzi in the following:

> A process of deep economic integration among countries will require a change in the role of the state in pursuing social protection. The end process would be a world where industrial countries will have to do less public spending, will reduce the use of tax expenditures for achieving particular social objectives, and will also have to reduce the role of specific socially-directed regulations.[31]

The reach seems to speak to each of these three points, but neither completely nor consistently. Section 1.3 speaks to this.

[29] Scharpf 2010, 213.

[30] Peter Starke, "The Politics of Welfare State Retrenchment: A Literature Review," *Social Policy & Administration* 40, no. 1 (2006):110-111.

[31] Vito Tanzi, "Globalization and the Future of Social Protection," *Scottish Journal of Political Economy* 49, no. 1 (2002): 127.

1.3 Contribution of the Research

The research at hand illustrates the following points. First, the welfare state is not as resilient as it the historical institutionalists, namely Pierson, have thought it to be. While the formal welfare state remains highly intact—social protection as it was once realized—is no longer. Second, what historical institutionalism has interpreted as resiliency is no other than the state's commitment to sustain the welfare state status quo. This however is not incompatible with the insistency that reform and retrenchment do not create political vulnerabilities and are the politics of "blame avoidance."[32] Whether the state responds to the adaptive pressures of integration for the purpose of blame avoidance, compliance, efficiency, lack of a better option, or out of sheer benevolence, the domestic response is in line with designing limits to stake and hence sustaining the status quo via other means. Third, in line with the literature on varieties of capitalism, the domestic response varies based on the national constellation of market containment and regulation—the regime of social protection that is. However, here there is indeed an element of path dependency, as the national constellations of the social protection regime are more diverse than the typologies applied to the national structures of welfare capitalism. In other words, path dependency is more appropriately applied to the national responses to the retreat of social protection rather than the overall resilience and reform of the welfare state status quo; hence, differential domestic responses to changing internal dynamics of the welfare state regarding social protection. Fourth, the research is supportive of Pierson's claim that the welfare state ought to brace itself for an age of permanent austerity. Additionally, it does not contend that the changing socioeconomic and political dynamics external to the welfare are to blame for this. What it does contend however, is that in failing to recognize the importance of social protection as a

[32] cf. Paul Pierson, "Coping with Permanent Austerity: Welfare State Restructuring in Affluent Democracies," in *The New Politics of the Welfare State,* ed. Paul Pierson (Oxford: Oxford University Press, 2001), 410–56.

central element of the welfare state, and subsequently failing to recognize the changes that have taken place in the manner which social policy goals are achieved in light of these changes, historical institutionalism has failed to place a fair share of the blame for the dawning of the age of austerity on the vulnerability of the welfare state in the face of economic integration, and the resiliency of the state's commitment to sustain the status quo, for whatever purpose this might be attributed. Fifth, breaking with the literature once again, the research illustrates, in the case of those economic sectors that are within the national constellation of market correction and market containment—which again, serves the purpose of social protection—that the process of integration is not necessarily top-down nor bottom-up. Rather, it can be initiated in either manner, but once this initiation has occurred, although dependent upon *in what sector* this is initiated and *conditional on the national constellation* for social protection, once the liberalization process has been set in motion it can hardly be contained; whereas the spread of markets occurs in a manner best characterized by the concept of the 'domino effect.' Despite the institutional constraints of integration, actor preference, or the direction in which liberalization is thought to be triggered, once the markets are unleashed they spread with the force and speed of globalization. As this pertains to the various national constellations of the social protection regime, it highlights welfare state vulnerability rather than resiliency, and the domestic response is blame escapement rather than blame avoidance. In other words, the politics of expansion[33] isn't all that different from the politics of retrenchment, inasmuch that escaping the potential blame of social dislocation is of the same sort as blame avoidance for retrenchment.

The research asserts that the challenges to the welfare state are to be found within the internal structure of the welfare state itself, and the new liabilities which this has placed on the state in order to simply maintain the welfare state status quo. Likewise, the research

[33] This is not to imply fiscal expansion, although this might be the case. Expansion rather refers to an increase in the state's liabilities and obligations via the formal welfare state in the absence of social protection.

illustrates that the state has not reneged on its commitment to the welfare state and the provision of social welfare on the whole. Additionally, the changing internal dynamics and the state responses to them—in the name of welfare state preservation—have not shifted the burden of proof to the formal welfare state alone; it has also shifted the burden of proof to the state and its ability to sustain the provision of social welfare amidst these changes. The burden of proof for the legitimacy of the welfare state is on both the state and the formal welfare state because the state response to the changes of the internal structure of the welfare state implies increased financial liabilities and obligations not limited to the formal welfare state. Nevertheless, these external obligations and liabilities are central to the provision of social welfare in accord with the welfare state status quo and have been shifted from the markets to the state through the process by which social protection has been retrenched, namely liberalization and privatization—economic integration.

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Chapter 2:
European Integration and the Welfare State

More than ever, national economies have become interwoven, interdependent, and integrated to such an extent that they are becoming less of something uniquely national and more a part of a larger economic regime. In the European Union this is even more pronounced, as the national economies are becoming even more Europeanized than they are globalized.[34] The global financial crisis that stemmed from the US housing market bust in 2007 illustrates this all too well. The financial fallout and subsequent fiscal incapacities which have evolved into sovereign debt crises—most prevalent in, but not limited to the EU—attest to the domestic implications posed by globalization, and more specifically economic integration.

2.1 The Symptoms of the Welfare State?

It appears as though a consensus has emerged that the welfare state status quo is not sustainable. Moreover, the deleterious fiscal condition of many EU member states and the subsequent gloomy economic forecast which this has created for those 'unaffected' member states lends at least an ounce of credibility to this viewpoint. A growing number of academics and politicians alike have come to foresee the immediate post-crisis response not as temporary adjustments to propel a rebound, but as the dawning of an age of permanent austerity. So why then is economic efficiency incompatible with the welfare state? Judging from contemporary history, one would have to assume that it's not. When Hobsbawm applied the term "Golden Age" to the postwar Keynesian era it wasn't simply a reference to the grandeur of the social welfare regimes or the efficiency and subsequent growth of the

[34] Neil Fligstein and Frederic Merand, "Globalization or Europeanization? Evidence on the European Economy Since 1980," *Acta Sociologica* 45, (2002): 7-22.

national economies. It was about the coexistence of these phenomena, hence the golden age of *welfare capitalism*.[35] So what then happened to the welfare state?

To begin, consider the more recent developments surrounding the European welfare states. National governments are facing significant financial constraints. To a certain extent, this is the result of budget deficits which have accumulated into substantial public debts constraining the state's room to maneuver. Welfare state expenditures have certainly contributed to this, as the provision of services and redistributive transfers imply a cost to the state. It is also argued that economic integration has contributed to this as well through a variety of means from capital mobility to increased foreign competition, to name a few. Nevertheless, the fiscal challenge of the state is twofold: eliminating budget deficits and reducing the public debts. In EU member states this challenge must be considered with reference to the economic interdependencies associated with the Single Market as well as the lack of monetary autonomy implied by the European Monetary Union (EMU). The fiscal constraints of economic integration have become all the more pronounced in the aftermath of the 2007 financial crisis. Additionally, the resulting European sovereign debt crises, through the conditionality that coincides with the EU and International Monetary Fund (IMF) backed European Financial Stabilization Mechanism (EFSM) upon receipt of a government bailout, the restructuring imposed by the European Financial Stability Facility (EFSF) upon the request of emergency loans, and the rigid criteria of the reformed Stability and Growth Pact (SGP) applicable to all Eurozone members, have transformed 'fiscal constraint' into something which more closely resembles the loss of fiscal autonomy. In this sense, European integration, "the functional equivalent of globalization," has an even greater effect than globalization itself regarding the fiscal constraints implied by economic interdependence.[36] In short, European integration implies certain fiscal constraints and vulnerabilities associated

[35] E. J. Hobsbawm, *Age of Extremes: The Short Twentieth Century, 1914–1991* (London: Michael Joseph, 1994).
[36] Ferrera 2008, 86.

with the Single Market (SM) and the EMU, not all of which are directly related to the welfare state.

Whether or not EU member states are engaged in a regulatory race to the bottom or experiencing an outflow of capital and a declining tax base as some scholars have predicted; at any rate, European integration has constrained the domestic policy mechanisms for dealing with fiscal challenges. At the same time, European integration has resulted in levels of economic growth which are arguably otherwise unattainable. There is however at least one option still on the table: to cut social spending. This is the position in which the EU member states now find themselves: balancing their social responsibilities at the national level with the fiscal responsibility demanded and imposed supranationally. Given that in the OECD, on average the state itself accounts for over 40% of Gross National Product, of which the provision of social welfare in general makes up more than half, a bankrupt state does not bode well for any and all members of economic union, and the currency instability which this causes for those members of the Eurozone is perhaps even more concerning.[37] The most recent welfare state trends are characterized by austerity: cutting social spending, trimming social services, increasing the retirement age, decreasing pension benefits, raising education contribution requirements, and some states are even 'rethinking' their public healthcare system. Not to be confused, the welfare state is alive and strong, and in many cases it is larger than ever,[38] but the state itself can't seem to foot the bill—it is fiscally overburdened and to varying degrees constrained with few options on the table.

Indeed, the goal of economic union and the responsibility of the EC was economic integration for the purpose of efficiency and growth; a goal which has been largely achieved for the community as a whole throughout the past two decades—but this is only half of the

[37] Michael Zürn and Stephan Leibfried, "A New Perspective on the State: Reconfiguring the National Constellation," *European Review* 13, no. 1 (2005): 24.

[38] Regarding overall spending levels.

picture.[39] The founding treaties were based on the principle of "mutual non-interference" whereby the national welfare states were to remain outside the realm of the supranational in their social regulation capabilities which were not to be constrained on any grounds by the process of, or for the purpose of, economic integration.[40] Ferrera explains the arrangement as follows:

> The limited competences assigned by the Rome Treaty to the supranational level in the social policy sphere reflected the explicit objective of a division of labour between national and EC rulers that was seen as virtuous for both the market and the welfare state; it also rested on an implicit favour, a positive orientation vis-á-vis social protection, high labour standards and full employment objectives, whose national scope and closure pre-conditions were taken for granted and thus assumed as inherently non-problematic for a project essentially aimed at creating a customs union. European integration and the welfare state were to remain only 'loosely coupled'.[41]

However, the constellation under which this was achieved is in dire straits as it has been destabilized by the process of economic integration and by the deteriorating fiscal conditions of the state. In order to maintain the viability of economic and monetary union, member states must improve their fiscal situations. The current arrangement is unsustainable given the present conditions of public finance throughout much of the community. Something happened along the way which heightened the state's incapacity to resolve both the looming and realized fiscal crises while sustaining spending levels—a substantial portion of which are attributed to the welfare state—and what happened can most convincingly be attributed to economic integration.

[39] Alan Milward, *The European Rescue of the Nation State, Second Edition* (London: Routledge, 2000).

[40] Maurizio Ferrera and Stefano Sacchi, "A More Social EU? In What Areas? In What Forms?," *European Governance* 1, no. 1 (November 2007): 16.

[41] Ferrera 2008, 88.

2.2 Plus ça Change, Plus c'est la Même Chose?

As Hayek predicted, "the power of the states which comprise the federation will be yet more limited, much of the interference with economic life to which we have become accustomed will be altogether impracticable under a federal organization.[42] Market-distorting redistributive welfare schemes have failed in the sense that they are on the verge of collapsing the European economic order. Thus, the current situation necessitates an additional shift from embedded neoliberalism to a more pure neoliberal economic regime.[43] In other words it is inevitable that national governments must dismantle or at least cut back the welfare state to the point of equilibrium, as they lack alternative means to balance the maintenance of the welfare state status quo with their deteriorating fiscal status quo… Or so the story goes.[44]

The subordination of social policy considerations to the economic objectives of deregulation, privatization, competition, efficiency, and the overall supremacy of "market-preserving federalism" arrived no earlier in continental Europe than did Reaganomics and Thatcherism in the Anglo-Saxon liberal market economies of the US and the UK.[45] Additionally, if the more recent political rhetoric of 'Social Europe' within the EU is taken beyond face value, then there is reason to believe that a reassessment and perhaps even an ideological shift are in the making. Nevertheless, the points remain: the European welfare states are facing fiscal challenges; a single sovereign debt crisis within the EU affects not one, but all states, especially those members of the EMU due to the high degree of economic integration and the incomplete or inadequate design of monetary union respectively;

[42] Friedrich A. Hayek, "The Economic Conditions of Interstate Federalism," in *Individualism and Economic Order,* ed. Fredrich A. Hayek (Chicago: University of Chicago Press, 1939), 264-265.

[43] John Gerard Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 36, no. 2 (Spring 1982): 379-415.

[44] Jean-Baptiste Alphonse Karr, *Les Guêpes* (January 1849). Translated from French as "the more things change, the more they stay the same."

[45] Barry Weingast, "The Economic Role of Political Institutions: Market-preserving Federalism and Economic Development," *Journal of Law, Economics, and Organization* 11, (1995) 1–31.

European integration has largely restricted the capacity of EU member states to correct their fiscal imbalances without directly adjusting the balance of payments; economic union based on the logic of competition further limits the policy options, as higher taxation and regulation for the purpose of increasing public revenue are likely to be counterproductive; governments respond with austerity not least because their options are limited, but also because such a response is favored supranationally; this ideological bias has become all the more important in light of EU intervention in the form of member state bailouts—for the purpose of shock containment—in the name of monetary stability. But this is only part of the story, and it is the part that we ought to be concerned with least. Certainly the welfare state is burdensome for the fiscal state, but this is not indicative of the problem; it merely describes the current situation. Quite the contrary to the conventional diagnosis, the fiscal burden associated with the modern day welfare state is not the cause of the welfare state itself. Rather, it is the effect of the much greater force of European integration which has undermined the delicate balance of the welfare state properly understood.

2.3 The Welfare State Properly Understood

In his thought provoking analysis of the modern day welfare state, Schwartz highlights the shortcomings of the institutional logic represented above.[46] Specifically, his assertion is that the application of the welfare state as the dependent variable misconstrues causation.[47] The question is not about the resiliency of the welfare state and the pressures caused by the effects of economic integration, but rather it is about what has changed within the welfare state itself through the process of economic integration. Following this line of

[46] Herman M. Schwartz, "Round up the Usual Suspects!: Globalization, Domestic Politics, and Welfare State Change," in *The New Politics of the Welfare State,* ed. Paul Pierson (Oxford: Oxford University Press, 2001), 17-44.

[47] Schwartz, 33-34.

reasoning, the next step is to consider the evolution of continental European welfare capitalism over the past several decades. For this purpose, the internal changes can be traced through the process of integration.

The political logic behind the golden age of the Keynesian welfare state is the socioeconomic balance struck under economic regime of embedded liberalism. Ruggie explains this as follows:

> The essence of embedded liberalism, it will be recalled, is to devise a form of multilateralism that is compatible with the requirements of domestic stability. Presumably, then, governments so committed would seek to encourage an international division of labor which, while multilateral in form and reflecting some notion of comparative advantage (and therefore gains from trade), also promised to minimize socially disruptive domestic adjustment costs as well as any national economic and political vulnerabilities that might accrue from international functional differentiation. They will measure collective welfare by the extent to which these objectives are achieved.[48]

Embedded liberalism coupled international trade and multilateralism with the domestic capacity of market-correction and a shared respect and understanding for the legitimacy of social objectives, albeit an asymmetric one.[49] In the Polanyian framework, embedded liberalism can be perceived as the "economic collaboration of governments and the liberty to organize national life at will."[50] Thus, embedded liberalism embodies the Polanyian "principle of social protection," whereby "using protective legislation, restrictive associations, and other instruments of intervention,"[51] the function of the welfare state is not only the provision of assistance-based redistributive transfers, but more importantly it is the means by which the markets are constrained from being "determinative of the life of the body social."[52] As Polanyi comments, "Indeed, human society would have been annihilated but for the protective countermoves which blunted the action of this self-destructive mechanism."[53]

[48] Ruggie, 399.
[49] Ruggie, 398.
[50] Karl Polanyi, *The Great Transformation* (Boston: Beacon Press, 1944), 254.
[51] Polanyi, 132.
[52] Polanyi, 111.
[53] Polanyi, 38.

To fully represent the depth of the concept of social protection as it is operationalized in this research requires two additional qualifications. First, social protection cannot simply be understood in its more traditional context as the balancing mechanism resolving the exploitative power asymmetry of the capital-labor dichotomy. Social protection is about sheltering society—"not human beings and natural resources only but also the organization of capitalistic production itself"—from the potentially devastating effects of market failures.[54] Second, social protection is not about redistribution per se. As Polanyi emphasizes, "man's economy, as a rule, is submerged in his social relationships. He does not act so as to safeguard his individual interest in the possession of material goods; he acts so as to safeguard his social standing, his social claims, his social assets."[55] Certainly it is as a bit abstract to think of social standing, claims, and assets as detached from the economic considerations of modern capitalist society; however, this is not the point of emphasis. The purpose of social protection is not subsistence but rather it is about the maintenance of a right to the application of productive assets to the markets, and most importantly, to the income stream that this produces. In this sense, social protection not only secures social existence, but by granting and maintaining these rights it serves as a mechanism for the provision of social welfare.

It is possible to distinguish between two distinct *mechanisms* of the provision social welfare that comprise the welfare state: social protection on the one hand, and the formal welfare state on the other. Of course, both are similar in the fact that they require state intervention in the markets, but the *degree* of these interventions and the *form* of the welfare which they provide are by no means alike. Schwartz differentiates between the two as such:

> The formal or overt welfare state—[is the] systems of tax funded transfers and state provided or funded social services ameliorating life and economic risks for workers…the welfare state was never simply an instrumental tool for advancing

[54] Polanyi, 132.
[55] Polanyi, 46.

> labour's interests…'welfare'—understood much more broadly as 'social protection'—was about sheltering all income streams, not simply wages, from market pressures…'social protection encompasses a much broader conceptualization of 'welfare' as a shelter for workers and owners from the market.[56]

To clarify, social protection and the formal welfare state are each mechanisms for the provision of social welfare, and thus the two primary components of the welfare state properly understood.[57] Historically, they have functioned in a complementary and mutually reinforcing manner, whereby sustaining the national welfare regimes.

2.4 Understanding Social Protection as Property Rights

As an element of the welfare state, social protection can be understood as the process by which income streams are disconnected from market outcomes. Outside of the formal structure of the Keynesian welfare state, redistribution was generally achieved through instruments such as trade protection, minimum wages, centralized collective bargaining, product market regulation, zoning, delegated control over markets to producer groups, and perhaps most importantly through regulation of the service sector.[58] Social protection is the outcome of market regulation, market containment, and the provision of socially desirable and politically salient public interest services—and the process by which it is achieved is for the purpose of attaining social policy goals beyond social protection itself. Borrowing the terminology from Schwartz, effective state control over the national economy "creates property rights to income streams."[59] These property rights are specific to the social policy goals and the provision of social welfare by the state on behalf of its constituency. They can be further understood as pertaining to the income streams created through the domestic markets of the national economy, and applicable to the state constituency. It is along these lines that social protection applied to capital and labor alike. Understood as the process by

[56] Schwartz, 17-18.
[57] 'The welfare state proper'.
[58] Schwartz, 31.
[59] Schwartz, 31.

which the state shelters income streams from market outcomes, social protection is not a citizenship right nor is it a political or legal right. Property rights emerge when there is a demand for them, and the when the state responds to this favorably by establishing rights to protect resources.[60] Additionally, it is understood that property rights are only demanded and therefore only granted under conditions of scarcity of the resources to which they apply.[61] The significance of defining social protection as provided through property rights to income streams has to do with the nature of theses income streams as well as the state's ability to secure them. Since the income streams are produced through the domestic markets of the national economy, in order to secure them the state must be able to contain and regulate the markets. For social protection to occur by means a property right requires that the *state* maintain control over the *national* economy. At the point that the economy is no longer exclusively national, meaning that the state does not have effective control over the markets, it is no longer possible for the state to maintain these domestic property rights. Prior to economic integration, the welfare state had provided social protection through effective control over the national economy. Property rights were granted by the state to its constituency and pertained to income streams from the domestic markets of the national economy. These income streams were protected through a carefully organized and delicate combination of regulation in the private sector, state monopolies in the public interest services, and by strategically managing competitive pressures through effective state control over the *national* economy. Social protection was therefore uniquely embedded in the national economy, the domestic markets, and the income streams of the state's constituency.

As long as the state maintained effective control over the national economy, it could intervene in the domestic markets for the provision of social welfare and for the purpose of

[60] Hernando De Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000).

[61] William H. Riker and Itai Sened, "A Political Theory of the Origin of Property Rights: Airport Slots," *American Journal of Political Science* 35, no. 4 (November 1991): 951-969.

attaining social policy goals. Hence, the state created constituent property rights to income streams provided by the domestic markets through effective control over the national economy. These property rights were the primary element of the provision of social protection in both the public and private sectors under the welfare regimes of the golden age. In explaining the operation of this system of social protection, Schwartz notes,

> Property rights guaranteed stability for wages, employment, and, for regulated private owners, steady revenue and profit streams. State regulation dampened or eliminated competition by segmenting markets for services such as telecommunications; road, rail, and air transport; power and water generation and distribution; and retail distribution.[62]

Moreover, on average theses four sectors comprise roughly one-third of OECD economies and together are a primary element of the cost of production in the manufacturing sector. In other words, social protection in the public interest utilities sheltered a substantial portion of the income streams provided through the domestic markets.[63]

2.5 The Interaction Effects

The realization of social protection occurs on multiple levels within the context of social welfare. First and foremost is the direct manner in which the state shelters an industry or firm from the markets in order to limit the impacts of market fluctuations and the uncertainties that coincide. By creating stability, confidence, and predictability, the state protects the income stream of the industry, firm, individual business owners, and the self-employed, thereby extending these property rights to workers by means of stable and secure employment. *Private sector social protection* applies to both capital and labor in the private sector of the economy. Second, through state ownership of firms in the public utilities and network services, the state created social protection by providing a large amount of stable

[62] Schwartz, 31-32.
[63] Schwartz, 32.

employment. *Public-service social protection* serves the provision of both social protection and public services. Above all, the welfare state functioned by be means of effective state control over the national economy. Accordingly, the state was able to utilize the market to achieve a wide array of social policy goals.

State monopolies in public interest services were justified on additional grounds captured in the German term '*Daseinsvorsorge*'[64] meaning the "provision of basics for existential needs."[65] Leibfried and Stark explain the concept as such:

> This was a political or social consensus about the desirability of universally accessible and affordable services provided at uniform quality across the whole country—in the countryside in particular—as something resembling a citizenship right, that is, as something market provision alone could not and would not have guaranteed.[66]

Beyond social protection, state monopolies in the public interest services serve the purpose of social welfare through the provision of socially desirable goods and services along the principles of security, affordability, accessibility, and continuity.[67] Furthermore, given the nature of the network services and public utilities, their provision deemed them politically salient thus increasing the legitimacy of state monopolies and market containment.[68] State monopolies in public interest services enabled public-service social protection. Through their provision by state monopolies, these socially desirable and politically salient services could be subsidized where necessary to achieve social policy goals. Public ownership enabled redistributive transfers associated with the formal welfare state to be provided at the firm level. Although nearly identical to *Daseinsvorsorge* on the grounds of public service provision, the '*raison d'être'* of public monopolies implied doing so not only to ensure the

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[64] Ernst Forsthoff, *Die Verwaltung als Leistungsträger* (Stuttgart: Kohlhammer, 1938).

[65] Arthur J. Jacobson and Bernhard Schlink, *Weimar: A Jurisprudence of Crisis* (Berkeley: University of California Press, 2000), 326-327.

[66] Stephan Leibfried and Peter Starke, "Transforming the 'Cordon Sanitaire': the Liberalization of Public Services and the Restructuring of European Welfare States," *Socio-Economic Review* 6, (2008): 177.

[67] Adrienne Héritier, "Public-Interest Services Revisited," *Journal of European Public Policy* 9, no. 6 (December 2002): 996.

[68] Adrienne Héritier and Susan K. Schmidt, "After Liberalization: Public Interest Services and Employment in the Utilities," in *Welfare and Work in the Open Economy Volume II: Diverse Responses to Common Challenges in Twelve Countries,* eds. Fritz W. Scharpf and Vivien A. Schmidt (Oxford: Oxford University Press 2000), 557.

provision of these services, but to do so in a redistributive manner. This implied using 'profit' as a financing mechanism for the provision of social welfare through a practice of cross-subsidization between services and between types of users.[69] For instance, the state owned gas firms could directly subsidize heating fuel for families, the elderly, and the poor during the winter months; something that would otherwise require redistributive cash transfers from the formal welfare state. Certainly the state is picking up the tab either way, but public ownership allows for cross subsidization—or in other words, the financing of subsidization in one case with the profit accumulated in another.[70] Cross-subsidization via social protection achieves redistribution between income groups, between urban and rural areas, and between different types of services;[71] it is both inter-firm and intra-firm—or as Castles has phrased it, "social protection by other means."[72] As a result, the formal welfare was largely sheltered from the markets which subsequently increased its sustainability.

The interaction between the formal welfare state and social protection occurs by two processes. On one hand private sector social protection serves to buffer economic actors operating in the private sector of the national economy against the harmful effects of market forces, whereby alleviating what is otherwise an increased liability of the formal welfare state. All the while the system is able to sustain the status quo in terms of quality, scope, and the level of services and transfers provided by the formal welfare state, as there exists a division of labor between these two mechanisms of social welfare provision. On the other hand, public-service social protection goes beyond that of the private sector by providing socially desirable and politically salient goods and services in accordance with the state's

[69] Mark Thatcher, "Reforming National Regulatory Institutions: the EU and Cross-National Variety in European Network Industries," in *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy*, eds. Bob Hancké, Martin Rhodes, and Mark Thatcher (Oxford: Oxford University Press, 2007), 153.

[70] Mark Armstrong, Simon Cowan, and John Vickers, *Regulatory Reform: Economic Analysis and British Experience* (Cambridge, MIT Press, 1994).

[71] Leibfried and Starke, 177.

[72] Francis G. Castles, "Social Protection by Other Means: Australia's Strategy of Coping With External Vulnerability," in *The Comparative History of Public Policy*, ed. Francis G. Castles (Cambridge: Polity Press, 1989), 16–55.

social welfare responsibility and commitment, without requiring direct redistributive transfers on the part of the formal welfare state. This is achieved by sheltering the formal welfare state from the markets and by the provision of goods and services in a manner that subsidizes with profit rather than redistributing with taxes—again, made possible by state monopolies in the public interest services.

2.6 The Change within the Welfare State

In short, the welfare state of the golden era was much more than the provision of social welfare through the formal welfare state as is often understood. It was multidimensional in that it consisted of two general mechanisms of welfare provision: social protection and the formal welfare state. The former functioned by establishing property rights to income streams for both labor and capital, thus preserving the welfare of both in a mutually reinforcing structure. The latter operated by providing direct redistributive transfers aimed at the goal of subsistence while maintaining the basic elements of social welfare such as healthcare, pensions, unemployment protection, family benefits, public education, and a variety of other social services under an equitable system of collective social risk-sharing and contributive redistribution. Examining the current structure of the welfare state in isolation overlooks the significant changes that have occurred in the provision of social protection—the massive decline in frequency and density that is—and the implications this has for the formal welfare state. Although as illustrated above these are not one in the same; nonetheless, social protection and the formal welfare state together make up the system of social welfare. Therefore, they must be understood as distinct yet complementary elements of a single regime which is the welfare state properly understood.

The greatest change within the welfare state between the golden age of welfare capitalism and the silver age of permanent austerity is the retreat of social protection. This has largely disappeared for both capital and labor alike. The purpose of the welfare state is to provide transfers to sustain individuals' livelihood and to ensure universal access to basic services deemed essential to this purpose through redistributive collective risk sharing when and where the markets fail to do so. Historically speaking, this has been the primary responsibility of the formal welfare state, and this responsibility has not undergone significant erosion to date. However, the formal welfare state developed this responsibility and performed its function alongside its historical counterpart, social protection. As the second dimension of the welfare regime, social protection contributed in a manner that was both complementary and supplementary to the responsibilities with which the formal welfare state is charged. In the absence of social protection, the responsibilities of the welfare state have become more troublesome as the commitment of the state is constrained by fiscal considerations, many of which are beyond its control. Both private-sector and public-service social protection mechanisms were carried out in such a way that corresponds with the responsibilities of the formal welfare state and the social policy goals of the state. The outcome of fettered markets was sheltered income streams which to a certain extent achieved a desirable social welfare outcome prior to the redistributive and risk sharing functions of the formal welfare state. Above all, the mechanism of public-service social protection was often able to pay for this, as the primary concern of state monopolies is the provision of socially desirable goods in accordance with the goals of public service, not the accumulation of profit. In the absence of social protection the market has no business with the preservation of these income streams, thus the formal welfare state is left to go it alone. The responsibility remains, yet a mechanism by which this was fulfilled has largely disappeared. But has the retreat of social protection meant the burden of the welfare state, the fiscal crisis of the state, or a combination of the two?

This analysis of the structure and functioning of the Keynesian welfare state illustrates two distinct provision mechanisms. In identifying these mechanisms it becomes clear what has changed within the welfare state between then and now. Additionally, this has allowed for a consideration of their interaction as separate and distinct yet complementary elements of a single welfare regime. Furthermore, recognizing this multidimensionality permits an assessment of the causal relationship between social protection and the formal welfare state whereby eliminating the problem of endogeneity. The following three chapters address the changes in social protection in the context of European integration in the transport sector.

Chapter 3:
Private Sector Social Protection & the Case of Road Haulage

3.1 The Common Transport Policy

As laid out in the Treaty of Rome (*Rome*), the European Economic Community (EC) was to develop a Common Transport Policy (CTP).[73] Aside from agriculture, transport was the only other industry which was devoted its own title within *Rome*. However, unlike the Common Agricultural Policy (CAP), the CTP was established rather late in the integration process. According to *Rome,* the founding principle behind the establishment of a CTP is as follows:

> Where the application of provisions concerning the principles of the regulatory system for transport would be liable to have a serious effect on the standard of living and on employment in certain areas and on the operation of transport facilities, they shall be laid down by the Council acting unanimously. In so doing, the Council shall take into account the need for adaptation to the economic development which will result from establishing the common market.[74]

The initial challenges of establishing the CTP stem from multiple sources. First and perhaps most importantly, was a general lack of enthusiasm on the part of member states for liberalizing their transport systems.[75] Although some member states were genuinely interested in expanding the scope of their road haulage industry, most notably the Dutch, the overall issue of integrating transport markets did not become pressing for the community as a whole until the 1980s. Given the diversity of the regulatory systems for transport among member states, as well as the value most member states placed on their road and rail transport industries in particular, the desire to protect and maintain the national transport regimes

[73] *Rome,* art. 74-84.
[74] *Rome,* art. 75 (3).
[75] Dieter Kerwer and Michael Teutsch, "Transport Policy in the European Union," in *Differential Europe: The European Union Impact on National Policymaking,* ed. Adrienne Héritier et al. (Lanham, MD: Rowman & Littlefield Publishers, 2001), 25-29.

outweighed the desire for integration, generally speaking.[76] However, this is not to imply that the member states were opposed to integration per se. Germany, which had the most regulated transport markets and accordingly was the most resistant to liberalization, was continuously open to the prospect of liberalization under the conditions that it occurred alongside harmonization of regulatory policies and practices.[77] Other member states with relatively high levels of protection and regulation for transport, such as Italy and France also adopted the German position. In other words, the debate within the Council was over the issue of market-creation and market-correction. Germany, Italy, and France insisted that if the CTP were to be established it would have to occur along the lines of positive integration.[78] The Dutch were especially opposed to this concept as they served to benefit the most from full liberalization given their highly developed road haulage industry and their central geographic location in proximity of multiple new markets. Although the challenge of positive integration at the Community level is not unique to the CTP, negative integration could not proceed in its absence of harmonization for roughly three decades.

The second challenge which initially undermined the development of the CTP was the practice of unanimity voting in the Council. *Rome* specifically states that all decisions regarding the CTP require unanimity within the Council "until the end of the second stage," thereafter all decisions on transport policy would be made using a system of Qualified Majority Voting (QMV).[79] The second stage which utilized the system of unanimity voting was scheduled to end in 1969.[80] However, disagreement over the issue of positive and negative integration in the policy development process of the CAP, more specifically the degree and locking in of positive integration, changed the voting structure to a system of unanimity indefinitely. This was the result of the Luxembourg Compromise of 1966 which

[76] Kerwer and Teutsch, 28.
[77] Kerwer and Teutsch, 32-34.
[78] Kerwer and Teutsch, 25.
[79] *Rome,* art. 75 (1).
[80] Kerwer and Teutsch, 28.

resolved the ‘open chair crisis,’ bringing France back into the EC and preventing the Community’s otherwise likely dissolution. Yet the practice of unanimity voting stalled integration for the following two decades to the extent that an agreement among *all* member states could not be reached. Indeed, for certain policy issues the supranational decision making process did proceed throughout the “years of impasse,” but transport was not one of these.[81] In 1983 Jurgen Erdmenger commented that “time and again the common transport policy has been the saddest chapter in the history of European integration,” thus illustrating the exceptional failure of integration in the area of transport as opposed to other sectors.[82] All the more perplexing is the fact that *Rome* singled out transport as a priority. This is specifically what European Commission President, Walter Hallstein, was referring to when he spoke of the “ironical side” of European integration in 1972.[83]

To think however, that the inability for the Council to develop a CTP over a period of roughly thirty years is ‘ironical’ is to overlook or at least to misunderstand the purpose and function of the national regulatory regimes. The German preference perhaps best illustrates this point and case, given that throughout the period of inaction Germany was consistently the least integrationist state. Although Germany never exercised its veto power in the area of transport policy, its position was well known by the other actors. Having already laid down the limits of what it was willing to accept, a German veto was not necessary to stall transport integration. The fact that a policy could not be agreed on in a deliberative process was enough to prevent a vote from reaching the Council floor. Given this consideration, it is not possible to disregard the practice of unanimity voting as a source of inaction even in the

[81] Handley Stevens, *Transport policy in the European Union* (Basingstoke: Palgrave Macmillan, 2004), 47.

[82] Jurgen Erdmenger, *The European Community Transport Policy: Towards a Common Transport Policy* (Aldershot: Gower, 1983), 89.

[83] Frank Schipper, *Driving Europe: Building Europe on Roads in the Twentieth Century* (Amsterdam: Foundation for the History of Technology & Aksant Academic Publishers, 2008), 12.

absence of the formal exercise of veto power. [84] In a policy-making process that respects every actor's vital national interests, and where there are only two options on the table—one of which is characterized by inherent conflict and disagreement[85]—the failure to reach unanimous consensus despite the priority awarded to transport does not appear to be a source of irony.

In 1985 the increasingly active European Court of Justice responded to a petition brought forth by the Dutch government, the European Parliament (EP), and the European Commission (Commission) against the European Council of Ministers (Council).[86] The claim of the petitioners was that the Council's inaction in the area of transport sector integration was a blatant violation of EC law given that *Rome* had explicitly called for the creation and implementation of a CTP and that an adequate amount of time had passed in order to do so. The ECJ's ruling, commonly known as the 'inactivity verdict,' agreed that the Council was indeed in violation of the Treaty by failing to establish a CTP, and demanded that this be achieved within a "reasonable period" of time.[87] Consequently, the wheels of integration were set in motion.

The development and implementation of the CTP was further accelerated and to a certain extent shaped by the publication of the Commission's white paper 'Completing the Internal Market' only weeks prior to the inactivity verdict.[88] Additionally, for the purpose of achieving the Single Market Program (SMP), the Single European Act (SEA) was passed which, among other things, changed the voting structure in the council from unanimity to QMV.[89] Together these changes overcame the German veto point within the Council.

[84] Adrienne Héritier, "Market-making policy in Europe: Its Impact on Member State Policies. The Case of Road Haulage in Britain, the Netherlands, Germany and Italy," *Journal of European Public Policy* 4, (1997): 547.

[85] Positive integration is inherently challenging given the diversity and complexity of pre-existing regulatory systems and need for harmonization.

[86] European Court of Justice, Case 13/83, Parliament vs. Council (22 May 1985).

[87] ECJ 13/83, 1600 par. 69.

[88] Kerwer and Teutsch, 32.

[89] Héritier 1997, 541.

However, internal market momentum and the introduction of QMV were of no help to overcoming the challenges of harmonization and positive integration.

3.2: The German Experience

The final design of the CTP established two distinct regulatory regimes in the road haulage sector: domestic transport and international transport. The international regulatory regime was highly liberalized aside from a minor element of fiscal harmonization. The overall impact of this fiscal regulation is largely irrelevant and was included in the final policy primarily as a means of appeasing Germany.[90] In the domestic markets however, the situation was quite different. Cabotage—the practice of allowing nonresident hauliers access to domestic markets was achieved, but the complete liberalization of Cabotage was delayed for a period of time.[91] Additionally, under the cabotage directive, each state is permitted to regulate its road transport markets in whatever manner deemed necessary so long as it does not serve to restrict access to the domestic market in a way which directly or indirectly disadvantages non-resident hauliers. As Knill and Lehmkuhl explain:

> Given its character as the functional equivalent of the principle of mutual recognition, the issue of cabotage turned out to be the toughest nut to crack in the process of European transport policy making. What could be observed was less a direct approach to harmonizing existing national regulatory regimes than an indirect strategy which emphasized the role of market forces in leveling out divergent legislation.[92]

Despite the fact that the initial phase of liberalization preserved the state right to regulate domestic transport markets and therefore did not significantly limit national autonomy, the introduction of cabotage did however severely limit state capacity. In Germany, the regulation of road haulage served several goals. First, it protected the domestic hauliers from external competition whereby preserving the overall industry. Second, it

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[90] Kerwer and Teutsch, 37.
[91] Héritier 1997, 541.
[92] Christopher Knill and Dirk Lehmkuhl, “The National Impact of European Union Regulatory Policy: Three Europeanization Mechanisms,” *European Journal of Political Research* 41, (2002): 269.

regulated licensing to assure the competitiveness of small firms and self employed hauliers. Finally, it utilized the issuance of permits to restrict long distance road haulage in order to promote the use of rail freight transport so as to protect and maintain the viability of the national railway.[93] Liberalization and deregulation destabilized the delicate balance achieved through the regulatory system. Even though the state maintained regulatory autonomy during the initial period of integration, the licensing of hauliers was not transferred to the host state, but remained in the hands of the home state.[94] This was due to the fact that the CTP included the scheduled liberalization of cabotage for completion within the community by 1998 and host state licensing would have been counterproductive to this goal. In the German case this was undesirable for two reasons. One the one hand, the regulatory system was largely based on permitting and licensing. Not only was this a means by which the operators were 'taxed' in terms of their network usage fees, but the licensing and permitting system of road transport also served as the primary protective mechanism for the national railway.[95] By controlling the number hauliers and the overall amount of road haulage within its borders, the German regulatory system was able to ensure that its national railway remain a competitive mode of transport. With the introduction of cabotage, Germany could no longer control the number of hauliers operating within the domestic market. Despite having maintained much of its regulatory autonomy, regulation of road transport was no longer an effective mechanism for increasing the sustainability of the national railway. On the other hand, if Germany were to maintain its regulatory system it would have disadvantaged its national hauliers as compared to foreign hauliers operating within its domestic market. Germany had but little option to liberalize its domestic haulage markets; maintaining the regulatory system would have served

[93]Christoph Knill and Andrea Lenschow, "Compliance, Competition and Communication: Different Approaches of European Governance and their Impact on National Institutions," *Journal of Common Market Studies* 43, no. 3 (2005): 595.
[94] Susanne K. Schmidt, "The Impact of Mutual Recognition—Inbuilt Limits and Domestic Responses to the Single Market," *Journal of European Public Policy* 9, no. 6 (2002): 939-940.
[95] Teutsch, 135.

no purpose other than to harm the domestic road haulage industry.[96] The German case illustrates, when harmonization is left to the markets, national regulatory autonomy is a rather ineffective mechanism for market-correction.

3.3 Comparing with France

As can be expected, Germany extensively deregulated road haulage with the introduction of cabotage. This deregulation went well beyond what was required by the CTP. In contrast, France, which had liberalized its transport markets in the years prior to the development of the CTP, underwent a process of re-regulation. The initial liberalization of road haulage markets was the result of an ineffective regulatory system.[97] Additionally, the reforms were introduced and the markets liberalized without opposition or resistance.[98] Consequently, when CTP came into effect, there were no significant contradictions between the French policies and the European principles.[99] However, liberalization of the domestic road haulage markets in the national economy does not have the same implications as liberalized markets in a European economy. Economic integration implies the loss of effective state control over the national economy. Property rights to domestic income streams still exist in the case of liberalized domestic markets in the absence of economic integration. In other words, social protection still existed in the road transport sector in France until the introduction of cabotage. With the implementation of the CTP and the scheduled liberalization of cabotage, "far-reaching re-regulation" occurred in the French road

[96] Teutsch, 142.
[97] Anne-Cécile Douillet and Dirk Lehmkuhl, "Strengthening the Opposition and Pushing Change: The Paradoxical Impact of Europe on the Reform of French Transport," in *Differential Europe: The European Union Impact on National Policymakin,g* ed. Adrienne Héritier et al. (Lanham, MD: Rowman & Littlefield Publishers, 2001), 112.
[98] Douillet and Lehmkuhl, 114.
[99] Douillet and Lehmkuhl, 101.

transport sector.[100] This re-regulation was for the purpose of reinforcing social legislation and the introduction of market-correcting reforms.[101] It was implemented to counter the negative social consequences of economic integration and liberalized markets—the loss of social protection that is.

In the road haulage industry, social protection was stripped away by the process of economic integration in accordance with the CTP. Immediately the state recognized the implications and adjusted accordingly to the best of its ability in both France and Germany. Prior to the introduction of cabotage, road haulage was a lucrative industry in Germany even with the expenses imposed the licensing and permitting of the regulatory system.[102] Given the fees imposed by the high level of regulation, road haulage was lucrative for the state as well, and these revenues were used for the maintenance of the national road network. The liberalization of cabotage changed all this. For instance, in the German case deregulation meant a revenue loss for transport infrastructure maintenance. Given that this is both a public good and vital to the national economic and security interests, maintenance can hardly be reduced, requiring additional funding from the general revenues pool. Furthermore, the domestic hauliers were forced to significantly reduce their rates in order to maintain their market share, yet this strategy was rather unsuccessful.[103] Even if protection was responsible for reducing the productivity and efficiency of the domestic industry, and the competition caused by liberalization improves this, the result is likely to be a decrease in prices rather than an increase in wages or profits.[104] So the liberalization of the German road transport industry is to the benefit of consumers at the expense of the industry itself and of course the state.

[100] Douillet and Lehmkuhl, 116.
[101] Douillet and Lehmkuhl, 101-102.
[102] Schmidt 2002, 941-942.
[103] Schmidt, 942.
[104] Schwartz, 29.

The situation in which Germany found itself following the implementation of the CTP is nothing remarkable in and of itself. It is illustrative of the common dilemma that member states find themselves in when market-creation occurs without market-correction—that is to say, when integration takes its negative form. What is of utmost significance here is the process which is occurring on multiple levels alongside negative integration, competition, and the indirect reduction of state capacity. Prior to the implementation of the CTP the German regulatory system for road haulage established property rights to income streams for transport firms, their employees, self employed hauliers, small-businesses in the haulage industry, public employees of the national rail-service, and lastly, the owners and employees of the "quasi-public" railroad supply network. By opening its transport market to foreign competition, the German government was no longer capable of effectively utilizing the market as an instrument to achieve its social policy goals, namely social protection. It had lost effective control over its national economy and therefore could not guarantee for its constituency a right to the income streams produced from the domestic markets of the national economy.

Chapter 4:
Public-Service Social Protection & the National Railways

In some ways, public services have long constituted an 'outer ring of the welfare state', its outer lines of defense. For all the differences between social welfare and public service provision, there are significant overlaps between the two fields which allow many interesting comparisons and contrasts—and which also give rise to massive interaction effects, with public services in the pole position.[105]

4.1 Public Interest Services

Similar to the case of road transport, the retrenchment of social protection in the public interest services inevitably occurred because the state lost effective control over the national economy. But the implications of this change—in the public interest services—are much greater in the context of the welfare state. With the loss of private-sector social protection, the state's obligation to the provision and maintenance of social welfare is heightened at the level of the formal welfare state because the state's ability to provide this through market regulation is severely reduced. Employment is less secure, and even in the absence of unemployment, the competitive pressures of liberalized markets are likely to suppress income streams thus increasing reliance on the formal welfare state for redistributive transfers. The same holds true in the public interest services as well, but the process by which this occurs has much greater implications for the welfare state regime. In order to understand the extent of the interaction effects of social protection and the formal welfare state, it is necessary to assess not only how the loss of social protection changed the welfare state, but also how the process by which social protection was removed has affected the welfare state regime.

As illustrated by the case of road haulage in the private sector, liberalization and economic integration undermined the division of labor within the welfare state proper by removing one of its two primary elements—social protection. In the public interest services,

[105] Leibfried and Starke, 176.

privatization, liberalization, and economic integration serve this purpose as well. But privatization implies prior state ownership of the firms that provide these utilities and services. Therefore, to fully capture the implications of the retreat of social protection for the welfare state proper, as well as the effects of the *process* by which this has occurred requires an assessment of public ownership—the logic behind it, the reason for it, how it functioned, what it achieved, how it achieved it—and the role of the state after privatization.

Public interest services are generally characterized as public utilities and network services, as is the case in the postal service, telecommunications, energy, and the railways. Network services are public utilities require a network infrastructure for their provision. Throughout the 20th century, the state has until recently taken the lead in the provision of public utilities.[106] Given the socially desirable and politically salient nature of the services provided, it was thought that the state, not the markets, was the appropriate means of satisfying the public service goals of universal access, security, continuity, and affordability.[107] European national railways are a prime example of this. They have long been considered a service of public interest and their existence, operation and maintenance has always been primarily a social rather than economic concern. As mentioned in the previous chapter, the implementation of the Common Transport Policy changed the playing field not only for the haulage industry, but for the railways as well. Indeed they are both industries of transport; however, rail transport is practically absent from the initial CTP. In establishing the CTP a conscious decision was made by the community to exclude railways. Although this might appear surprising given that rail is one of the primary means of transport for both passengers and freight, the public-service character of the European national railways implied a level of valuation that was incompatible with the market ideology of the American railways for instance.

[106] Leibfried and Starke, 176.
[107] Héritier and Schmidt, 554.

4.2 The Public-Service Railways

In the United States a nation was built on the railways. It was vitally important for the functioning of the state and the development of a 'nation', but it was not a mechanism of nation-building. In line with American tradition, the railways were built by private individuals and firms referred to in modern times as the robber barons of the gilded age. Today, most of what remains of the once glorious American rail system can be captured by the overpriced commuter trains connecting a handful of major cities primarily in the northeast corridor. The pride of the American rail system has been shattered by its ghost towns and vacant lots. The only evidence that remains of the railways grandeur is the private wealth which it created, and which was largely accumulated by a handful of individuals. These famous last names are more often associated with money, power, and privilege—albeit philanthropically—not the railways that they built, as those have all but crumbled. As is true for both the rail and road infrastructures, they serve a military purpose. However, in Europe the states themselves built the railways and have remained mindful of their purpose in the provision of a public service and for the integration of the nation-state.[108] The notion of public service is based on the logic of social efficiency rather than a market-driven notion of the accumulation of profit. This is not to say that the public service logic of the national railways excluded considerations regarding the national economy; quite the contrary, the railways were instrumental to the state as a mechanisms of economic development and growth. However, this was in the context of the public interest, as it is commonplace in Europe for the state to provide public services related but not limited to collective infrastructures and the corresponding services that operate by means of such networks.[109] The national railways of Europe have operated with an ideology of public service, state

[108] Héritier 2002, 996.
[109] Ernest Barker, *The Development of Public Services in Western Europe 1660-1930* (Oxford: Oxford University Press, 1944).

responsibility, and socioeconomic obligation. Contrast this to the market making profit driven ideology on which the American railways were built—an ideology symbolized by Biltmore[110]—and it is all the more clear that the national railways of Europe were to serve the purpose of transport based on the principle of public service.

Surely, as the American case illustrates, the railways were a profit producing machine of unrivaled success in the nineteenth and early twentieth century. What this case also illustrates is that the railways were not self-sustaining: as other forms of transport became available, the railways became less competitive, lost their market share, and began to crumble. They have shriveled up to the point where their preservation is only possible through a lifeline from the state. Network services and the railway in particular are characterized by high sunk costs associated with the investment required to build an infrastructure and "rolling stock," as well as the recurrent provision of services at excess capacity.[111] For many services, the relatively high costs of rail transport reduce its competitiveness vis-à-vis other modes of transport. If left to the markets, the maintenance of national railways alone is a significant and challenging commitment to say the least. Now bring the public service goals of access, security, continuity, and affordability back into the picture. To begin with, they are somewhat incompatible for rail-service which is characterized by high network costs and a general lack of inter-modal competitiveness. In other words, the goals of security, continuity, and accessibility seem to reduce the viability if not altogether undermine the goal of affordability and vice versa. As the experiences of the European national railways attest, attaining the goals of public service has often required a continued investment into unprofitable infrastructure and the provision of services at rates

[110] Perhaps the most iconic symbol of American private wealth, Biltmore is the largest house in the United States. It was constructed by the railroad tycoon George Washington Vanderbilt II in 1888–95. The level of personal wealth accumulated through building and owning the US railways by Vanderbilt and other robber barons is unmatched in America to this very day.

[111] Héritier 2002, 996.

below the costs of operating those services.[112] In short, the logic behind public ownership of the national railways was that the railways were to serve a public interest service, and the goals associated with which were best assured by, and the responsibility of the state, not the markets.

In the public interest services, social protection was achieved by means of state ownership of the utilities and networks services such as the post, telecommunications, electricity, and railways. Generally speaking theses firms were monopolistic and therefore freed from pressures of competitive market forces. This meant stable employment levels, and as with most public sector jobs, a very high level of job security. However, public-service social protection is much more than the stable employment and job security that is generally associated with public employment. Indeed the state owned public utilities and network services were organized as monopolies and were therefore able to shelter the income streams within these firms from the markets, but the primary purpose of state monopolies in the public interest services was not social protection. These monopolies were legitimized by the nature of the services they provided and the social valuation of these services.[113] The organizational structure of their provision was envisioned as win-win situation for state and society alike: the latter thought it the responsibility of the state to ensure the provision of these socially desirable services, and the former thought it politically salient to provide these services directly so as to achieve not only public service goals, but to incorporate into this the provision of social welfare at the same time.

Monopolies in the public interest services enabled the state to perform many of the functions of the formal welfare state outside of the practice of cash transfers from the national piggy bank. This took on the form of redistributive subsidization between customers and cross-subsidization between services both within and among the public interest service

[112] Héritier and Schmidt, 557-558.
[113] Adrienne Héritier, "Market Integration and Social Cohesion: the Politics of Public Services in European Regulation," *Journal of European Public Policy* 8 no. 5 (2001): 825-826.

firms.[114] In summary, “the market was contained not only by the formal welfare state, but also by direct state control of the production and distribution of politically salient goods and services. Most important among these were those public interest services that were generally provided by state monopolies.”[115] Beyond the public service goals, the system of public utilities performed redistributive functions of the formal welfare state through subsidization and cross-subsidization. Thus, social protection in the public interest services was mutually reinforcing with the provision of social welfare in the form of redistributive ‘transfers’ associated with the formal welfare state. Here again, the interaction, division of labor, and delicate balance between these two primary elements of the welfare state proper is evident.

4.3 Bringing Transport Back into the Railways

Returning to the transport element of the railways, it is apparent that their exclusion from the CTP was grounded in provenance of the railways as a public service interest rather than a merely economic concern. Yet as mentioned above, the CTP had a significant effect on the national railways and was a primary force—albeit an indirect one—behind the privatization and/or liberalization of the national railways. The explanation here follows Leibfried’s application of the domino effect:

> The welfare state, in a sense, is the last domino of the public service state that has not fallen, but since most other dominoes already did, the burden of proof for its legitimacy has now shifted to the last fully standing one. We have seen a transnationalization of the public-service state…and thus the loss of the welfare state’s protective outer skin.[116]

In the name of integration the ECJ toppled the first domino with the inactivity verdict, complemented of course by the supranational frenzy for the completion of the internal market

[114] Héritier and Schmidt, 557-558.
[115] Héritier and Schmidt, 554.
[116] Stephan Leibfried, “Social Policy: Left to the Judges and the Markets?” in *Policy-Making in the European Union Sixth Edition,* eds. Helen Wallace, Mark A. Pollack, and Alasdair R. Young (Oxford: Oxford University Press, 2010), 276.

by 1992.[117] The liberalization and privatization of the railways however, was not directly initiated in Brussels or Luxembourg. In 1991 the Council issued directive 91/440 which was the basis of the Common Railway Policy (CRP), but as Knill and Lehmkuhl point out, the Railway Directive was a "tiger without teeth."[118] As these authors explain, the Commission was well aware of the limits of the compliance approach based on the application of the articles governing competition in *Rome*.[119] As laid out in the treaty,

> Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.[120]

First and foremost, the application of the rules governing services of general economic interest (SGEI) to the national railways would have been a stretch. As discussed above, the states have always regarded their railways as a public interest service, not a general economic one. This was the reason that the railways were dealt with separately, outside of the larger CTP. If the competition rules of SGEI were to be forced upon the national railways via the supranational compliance approach it would likely have been contested as in violation of *Rome* itself. The railways were already broke and unprofitable. Cutting off state aid and subsidization would have deemed the public service goals impossible. The railways would be bankrupt, and left to the markets alone would not self-sustain.[121] Such a scenario is specifically prohibited in the text of the treaty quoted above, and the Commission recognized at least this. Certainly the Commission would hot have deliberately attempted to 'kill' the railways, but to the extent that their opinions about the effects of liberalization differed from

[117] Kerwer and Teutsch, 29.

[118] Christoph Knill and Dirk Lehmkuhl, "An Alternative Route of European Integration: the Community's Railways Policy," *West European Politics* 23, no. 1 (January 2000): 65, 67.

[119] Knill and Lehmkuhl, 70.

[120] *Rome*, art. 90 (2).

[121] Michael Teutsch, "Regulatory Reforms in the German Sector: How to Overcome Multiple Veto Points," in *Differential Europe: The European Union Impact on National Policymaking*, ed. Adrienne Héritier et al. (Lanham, MD: Rowman & Littlefield Publishers, 2001), 158-159. Citing: Regierungskommission, *Regierungskommission BundesBahn Bericht* (Bahn: unpublished report, 1991), 11.

the domestic consensus, their refrainment can be interpreted as recognition of the thin legal grounds on which the compliance approach would have rested.

Despite this consideration, and in contrast to the bottom-up approach of national consensus building for railway liberalization put forth by Knill and Lehmkuhl, it is considered here that the liberalization outcome of the railway reform process was in part the result of the top-down compliance approach.[122] Indeed, the reform process began at the national level, and was ongoing in most states throughout the latter decades of the twentieth century. However, the privatization and liberalization outcome of this reform process was initiated at the Community level. It began with the conflict over the development of the CTP—or lack thereof—which positioned the EP and the Commission against the Council, ultimately resulting in the ECJ's demand of treaty compliance backed up by the threat of direct effect. The response was the establishment of the CTP, the implementation of which liberalized national transport markets and led to the deregulation of road transport in the name of economic integration. Regarding the unfolding of this process in the case of Germany, Teutsch draws the conclusion that "EC rail policies did not initiate the German reforms, but they reinforced existing domestic trends."[123] The domestic trends being referred to here are the liberalization and/or privatization of the public interest services such as the post and telecommunications which had occurred in the years prior.[124] These processes were initiated by no other than the EC's supranational body itself.[125] In short, privatization of the railways was not initiated by the state; rather, it was caused by the domino effect of the top-down compliance approach to economic integration that had been initiated supranationally.

[122] Knill and Lehmkuhl, 65-88.
[123] Teutsch, 158.
[124] Herbert Obinger and Reimut Zohlnhöfer, *Selling off the 'Family Silver': The Politics of Privatization in the OECD 1990–2000* (Cambridge: Center for European Studies, 2005).
[125] Thatcher, 155-157.

4.4 The Domino Effect

Prior to the CTP and the liberalization of road haulage, the Commission was concerned with improving the competitiveness of the railways vis-á-vis road transport.[126] Obviously this was never achieved, and the CTP only served to decrease the railways competitiveness. If the states themselves were seriously interested in privatization, then logically this would have occurred prior to the implementation of the CTP and in sync with the momentum for the completion of the internal market. The states had made repeated attempts to improve the efficiency and competitiveness of their national railways, yet privatization did not occur in continental Europe until after the implementation of the CTP. This is because privatization was the least desirable option and it was not considered to be a viable solution to the problem.[127] For instance, in Germany there were sixteen major rail reform initiatives between 1949 and 1993, at which time the seventeenth reform scheduled privatization of the national railway for the following year.[128] The substantial number of reform initiatives is indicative of the desire to increase the competitiveness of rail transport. Furthermore, the German position regarding the CTP and road transport in particular is illustrative of the public interest service valuation of the national railway. Taken together, the logical conclusion is that privatization was by no means the preference of the state. Given the primary concerns of competitiveness and public service goals, if the approach to railway privatization was indeed bottom-up, then liberalization would have occurred prior to the implementation of the CTP as it was certain that road haulage liberalization would further undermine the sustainability of the railways. Because it did not occur until after road transport liberalization, the conclusion to be drawn is that privatization only became a viable option only when it was the only option. It became the only option because liberalization in

[126] Knill and Lehmkuhl, 69.
[127] Kerwer and Teutsch, 48.
[128] Deutsche Bahn, *The Railway Reform* (Frankfurt a.M.: Deutsche Bahn AG, 1994), 8.

other transport sectors undermined the delicate balance between social protection and the provision of socially desirable politically salient public services and the corresponding redistributive transfers associated with the formal welfare state. Maintaining public-service social protection in the railways was no longer politically feasible. Social protection was delegitimized by the newfound fiscal irresponsibility of its maintenance.[129] Privatization was not state-sponsored, but rather it was resisted until the political and fiscal costs of resistance outweighed the benefits.[130] The critical financial situation of the railways and their deficits became a serious threat to the public budget and an alarming political liability.[131] The German decision to privatize and liberalize was certainly deliberate: they were the deliberate response to an otherwise fiscally and politically disastrous train wreck. Given the public-service valuation of the national railway, such a scenario was neither socially desirable nor politically salient.[132] .

Privatization of the national railways has not meant that the state is simply relieved of its prior obligations. This is because privatization was not the result of, nor did it cause a valuational shift in the domestic view of national railways as a service of public interest.[133] Following liberalization in all EC countries, the state did not renege on its commitment to ensure the provision of rail service in accordance with the public service goals.[134] Therefore, privatization necessitated that the state continue to oversee and to re-regulate the railways so as to ensure the maintenance of public service goals. Unlike before, it is now required to do so in a profit conscious manner and cross-subsidization is no longer an option. Hence the dual challenge of privatization: balancing public interest goals with commercial interest.[135]

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[129] Teutsch, 171.
[130] Teutsch, 171. Citing: Regierungskommission, 12. The annual budget deficit of the German railway was predicted to more than double from 27 billion deutsche mark (DM) in 1991 to 64 billion DM in 2000, amounting to an operating debt of 417 billion DM over a period of less than a decade.
[131] Teutsch, 159.
[132] Teutsch, 159.
[133] Héritier and Schmidt, 589-590.
[134] Héritier and Schmidt, 558.
[135] Héritier and Schmidt, 559.

> The first goal of public regulation in the aftermath of privatization and/or liberalization is economic efficiency, that is to create and sustain effective market competition (market-making). Due to the specific features of infrastructure markets (market failures), the selling of shares or the abolition of market entry restrictions does not in itself create competition, but needs to be followed up by continuous public control…The second central goal or task of public regulation is to guarantee social efficiency: on the basis of a politically defined concept of 'public interest', regulation is required to correct or compensate for the undesirable results of competitive markets (market-correction), which is to satisfy social and political 'liabilities' and citizen entitlements traditionally associated with infrastructures services (for example concerning the scope and quality of service provision).[136]

The privatization of the railway and the introduction of the element of competition meant that Germany could only subsidize certain rail service lines that it deemed socially desirable, but were not profitable to the private rail-service operator.[137] This type of subsidization was allowed for the purpose of maintaining service to all geographic regions in line with the public service goals. Without state subsidization, certain services would have otherwise been eliminated since the public service goals also prompted the state to regulate pricing.[138] In other words, the private service operator could not simply implement a pricing policy based on the operation costs of services. In the case where markets were most fully liberalized, such as Britain, the conflicting goals of private profit and public interest are most apparent.[139] In both France and Germany, where the railways were either not privatized, or where stipulations provide the state with a legal mandate for subsidization in order to serve the public interest respectively, the conflict between private profit and public service goals is less pronounced.[140] Privatization and or liberalization of the national railways alone have not achieved the public service goals.[141] Where these goals are met in the aftermath of liberalization and privatization requires significant state subsidization, particularly in the larger countries such as France and Germany, and even with state subsidization, rail-services

[136] Burkard Eberlein and Edgar Grande, "Regulation and Infrastructure Management: German Regulatory Regimes and the EU Framework," *German Policy Studies* 1, no. 1 (2000), 50-51.
[137] Teutsch, 153-154.
[138] Héritier 2002, 1012.
[139] Héritier 2002, 1014.
[140] Héritier 2002, 1011-1016.
[141] Heritier 2002, 1013.

are still comparatively expensive as a mode of transport.[142] Although the British railway still relies heavily on state subsidies as well, a greater degree of liberalization and the subsequent heightening of the conflict between goals of profitability and goals of public service creates a situation whereby "in spite of a heavy passenger load, service operators do not add more carriages; or when, in the face of poor travelling conditions, large bonuses are paid to management, while there is little investment in new rolling stock; or when Railtrack, after a major accident, restricts speed and pays high shareholder dividends, instead of investing in new tracks."[143] A higher degree of liberalization in the railways—in terms of market creation, competition, and privatization—still requires state subsidization, and as the British case illustrates, is less likely to ensure the provision of services in accordance with the public service goals.[144] In short, State subsidization and financial obligations remain necessary in order to achieve public interest goals.

Following the break-up of the German state telecom monopoly in 1989, the Deutsche Post in 1995 ended the longstanding practice of using the rail for all of its overnight transports, preferring road transport as the alternative. However, this cannot simply be attributed to the CTP and the liberalization of road haulage. Although the liberalization of cross border transport took effect in January of 1993, the decision on the introduction of cabotage did not occur until later that year, and in line with the German demands, its complete liberalization did not occur until 1998. Given the domestic nature of overnight post transfers via rail, deregulation and price suppression in the road transport industry does not quite coincide with timing of the Deutsche Post's decision. It seems more probable that this is illustrative of the effects of the privatization of the national railways, the implementation of

[142] Teutsch, 155. For instance, In Germany only 56% of the rail service operation is covered by fares.
[143] Héritier 2002, 1014.
[144] Héritier 2002, 1011-1016. Britain has a much more elaborate regulatory system as compared to France and Germany regarding the public service goals of the railways. However, according to Eurostat 2001 France spends a much larger share of GDP on subsidization: France, 0.45%; Britain, 0.19%.

targeted subsidization for the attainment of public service goals,[145] and the corresponding increase in commercial rail transport prices. Thus, the attribution of the decision of the Deutsche post to switch transport modes from road to rail, to either the liberalization of roads haulage or the privatization of the railways seems to be better placed in the latter given the timing of the decision and the sequence of these two processes. This however is not in conflict with the prior claim regarding the domino effect of economic integration. The German government deliberately stalled the complete liberalization of cabotage until 1998 so as to allow itself more time to adjust domestically in anticipation of the destabilizing effects of new market forces. Privatization of the railways was a response to both the pressures of liberalization and a calculation of their increase, as additional liberalization in the future was certain and locked-in. Moreover, the timing of the decision also coincides with the *Postreform II*, which in 1995 transformed the Deutsche post into a joint stock company, thus effectively privatizing the post.[146] The privatization of the state railway monopoly in 1994 did not reduce prices for commercial transport, and as discussed above, railway privatization meant that the state could no longer subsidize the rail-service in general. It could only subsidize specific routes in accordance with the public service goals. Without state ownership and subsidization the rail transport was no longer a competitive mode of transport for certain commercial services such as the post, thus decreasing the commercial revenue base of the railway, further undermining the goal of self-sustainability, increasing the operational costs of passenger services, and subsequently increasing the financial subsidization required of the state in order to maintain the public service goals and ultimately sustain the national railway.

[145] As opposed to general subsidization.
[146] Adrienne Héritier, "Public-Interest Services Revisited," *Journal of European Public Policy* 9, no. 6 (2002): 1006.

Chapter 5:
Changing the Dynamics: Integration, Welfare, and the State

5.1 National Constellations and Beyond

The research has focused on the forces and sources of economic integration in the analysis of the retreat of social protection and its interaction with the formal welfare state. In the case of private-sector social protection, it serves the purpose of buffering the formal welfare state. In the case of public-service social protection, although also a buffer here as well, it was established in an organizational structure by which redistributive functions of the formal welfare state were carried out. The analysis of the process by which social protection has been lost in the private sector and the public interest services, as well as the forces and sources of integration has provided a degree of clarity to the distinction between 'state-initiated' privatization and the domino-effect of top-down liberalization.

The discussion so far has relied heavily on the German experience of economic integration. The reason being is that German road transport was the most regulated in the community. Regarding transport policy, sustaining and maintaining the national railway was always a priority. The primary difference between the French and German cases is the extent to which the national constellations of market regulation and market containment were incorporated into the social protection regime and the balance between regulation and containment for the realization of public service goals. In France, the logic of '*service public'* dominates the operation and management of the national railway.[147] Similar to the German case, regulation of road haulage has been for the primary purpose of protecting the railway from inter-modal competition and economic crisis.[148] As Douillet and Lehmkuhl have noted, the French railway,

[147] Héritier and Schmidt, 565.
[148] Douillet and Lehmkuhl, 110.

> Has been characterized by a relatively high level of state intervention designed to protect both freight and passenger rail transport from intermodal competition using the policy instruments of regulation and nationalization. The goal of such protection was the fulfillment of public-service obligations and the state control of developments in the rail sector.[149]

As noted earlier, France liberalized its road transport sector prior to the CTP because its regulatory system was ineffective. Yet the French railway monopoly remained more effective than that of Germany due to geographical factors, and therefore was not nearly as dependant on road transport regulation for the sustainability and public service objectives of the railway.[150] In other words, the national constellations of the social protection regime--the balance between market containment by the state monopolies and market regulation in the private sector—differed, as did the destabilizing effects of economic integration, and the national responses. In France, privatization of the railway was not necessary given the overall effects of competitive pressures caused by the liberalization of road transport markets. In the German case, opposition to integration and liberalization without harmonization is explained by the central role that road transport regulation had in maintaining the competitiveness and sustainability of the national railway. Indeed, certain member states preferred liberalization such as the Dutch, which can be explained by their highly developed, efficient, and competitive road transport industry. The point to be made here is as follows. Regulation of markets in the private sector and the containment of markets by state monopolies in the public interest services enabled the provision of social protection and the provision of formal welfare state services and redistributive transfers in a manner that was mutually reinforcing. The constellations of the welfare state proper—the organization and interactions of social protection and the formal welfare state—varied at the national level. To rephrase, the balancing act between social protection and the formal welfare state by which the welfare regimes functioned were uniquely national. The division of labor between these

[149] Douillet and Lehmkuhl, 102-103.
[150] Douillet and Lehmkuhl, 110.

two elements of the welfare state occurred almost uniformly, but the organization, structure, and operation of the state monopolies and the regulation in the private sector was specific to the national interest. Likewise, the integration preferences and the destabilizing welfare state implications of liberalization and privatization varied from state to state and industry to industry. So the discussion here is not exclusively a German one; rather, Germany simply dominates the discussion when we consider the welfare state implications of economic integration in the transport services.

5.2 Assessing the Profits, Costs & Losses

This research cannot comment on the net effects of economic integration on the overall provision of social welfare. This would require an evaluation and comparison of economic efficiency with social efficiency which is inherently difficult and subject to interpretation. If one were to make a speculation however, considering the German transport industry in isolation, it seems arguable that the tradeoff between economic efficiency and socially efficiency occurred at a net loss. However there is a conclusion to be drawn from the big picture about the tradeoff between economic and social efficiency that has serious implications for the state, and helps to explain the current challenges facing the welfare state.

Economic integration has throw-off the balance of the welfare state proper by limiting the state's ability to effectively control the national economy. The welfare implications of this are that twofold. First, property rights to domestic income streams produced via the national economy, for the most part,[151] can no longer be secured—meaning that the social protection element of the welfare state has been all but eliminated. Second, generally

[151] There is still public employment in the modern day civil services, and for instance, France did not privatize its national railway.

speaking,[152] the state can no longer viably or legitimately contain the markets through the use of public monopolies for the function and financing of redistributive transfers of the formal welfare state. In short, economic integration has occurred at a net loss to the state regarding the provision and financing of social welfare. This occurs in three ways. First, through the increased liability placed on the formal welfare state in the absence of social protection as a shelter for domestic income streams, the formal welfare state has been stripped of its outer layer and its buffer against the markets.

Under state ownership, the public interest services were sometimes times profitable, and this 'profit' was used for the cross-subsidization between services.[153] At the very least this enabled states to strategically subsidize certain types of services with others. For instance, lower electricity rates for municipal offices or schools could be financed by higher rates for commercial service. Or heating bills for seniors and low income families could be subsidized by the rates charged to the general population. This meant that not only was the transfer occurring outside of the context of the formal welfare state, it was oftentimes being externally financed through subsidization as well. Therefore, the second way in which the state has lost out in the provision and financing of social welfare is by introducing private firms and competition, the state is no longer able to perform redistributive formal welfare transfers directly at the firm level, nor is it able to finance this through subsidization. This responsibility has now shifted directly to the formal welfare state.

Last but not least with the privatization of state monopolies, the profit element was introduced into the provision of the socially desirable and politically salient public interest services. Prior to privatization, cross-subsidization was used either between sectors, for instance in Germany where the deficits of the post were financed by the profits of telecommunications, or between services, such as profitable inter-city rail-lines offsetting

[152] Here too, it is possible to point to the French railways as an exception.
[153] Héritier and Schmidt, 573.

unprofitable rural ones. Now the state must balance the economic interest of the shareholders with the social interests of its constituency. This requires substantial direct subsidization, as the case of the German rail illustrates. In other words, the state is subsidizing the operation of unprofitable rail-lines in the name of public service goals while the shareholders are accumulating wealth from the operation of profitable lines in the name of private economic interests. Here, the state's financial obligation occurs generally outside of the context of the formal welfare state.

5.3 Forces, Preferences, & Interests

Member state's either favored liberalization because it served to benefit a national industry of economic importance, or they resisted it because of its destabilizing effects on the delicate balances within the social protection regime. Given the domino effect of integration, the changing dynamics at the supranational level, and the divergent interests of member states, resistance was a relatively ineffective strategy and only worked insomuch as it delayed the process of liberalization, achieved limited regulatory compromises, and increased the window of opportunity for states to adapt and adjust their domestic markets, industries, and regulatory regimes so as to minimize the destabilizing effects that this would have on their national constellation. In Germany, road haulage liberalization went above and beyond what was required by the CTP, which is not to say that the German state was taking advantage of a supranational dictate to achieve a domestic policy goal, or to overcome resistance. The reason that markets were deregulated to the extent that they were was because road haulage regulation in Germany served the purpose of limiting the number of market entrants. Given the introduction and subsequent liberalization of cabotage, German regulatory system could no longer achieve this goal; it only served the purpose of disadvantaging the domestic hauliers. Likewise, France had already liberalized its markets in the years prior to the CTP's implementation, but found it necessary to re-regulate the markets so as to not disadvantage, and to minimize the harmful effects of economic integration on its domestic industry. There is a similar strategy here, occurring in opposite directions but towards the same goal: the minimization of social dislocation caused by the withdrawal of social protection. Moreover, recall that France was initially opposed to liberalization without harmonization in the road transport sector. Although France liberalized its domestic markets prior to the establishment of the CTP, re-regulation occurred alongside the creation of a single European market for road haulage. Both the French and the German responses and adaptations to the implementation of the CTP in the road haulage sector, especially given their initial resistance to integration without harmonization, illustrate the state's commitment to the provision of social welfare. Where social protection could not be preserved, the subsequent national responses, in whatever direction these might be, corresponds with the adjustments necessary to minimize the social dislocation that are anticipated or realized through the process of economic integration. The state has not reneged on its commitment to the welfare state. Quite the contrary, it has responded to the retreat of social protection so as to minimize the negative domestic implications of its removal.

The same holds true with the 1993 German rail reform and the subsequent privatization. As a result of reunification in 1989 and the dismal condition of the East German railway, the fiscal obligations of the state to sustain the national railway were all the more demanding.[154] Even though the CRP of 1991 gave state's significant discretion, the decision to privatize—going above and beyond what was supranationally required—was no less than a calculation of the market forecast which foresaw the competitive pressures of liberalization in other sectors as creating a financial situation that was neither fiscally responsible nor politically and socially acceptable. Privatization served several purposes.

[154] Teutsch, 159.

First, the state took over all of the debt from the national railway so as to offer the newly formed joint stock company the best prospects for success. Second, the state took on the responsibility of providing pensions and early retirement packages for all redundancies that occurred during the privatization process.[155] Additionally, it structured the system of subsidization to ensure that the unprofitable rural rail services would not be discontinued and the public interest goals would be achieved, while at the same time allowing the railway to remain afloat.

Of course this is not the whole picture, but it is enough to make the following case: The process of economic integration has not been driven by national desires to trim down the welfare state. The combination of various national constellations of market containment and market regulation with various national interests and preferences should have provided stalemate, and indeed they did. Thirty years of inactivity in the area of transports integration attests to this. However changes at the supranational level overcame this and set the process of liberalization in the services in motion. Once the liberalization of markets began the spread of markets could not be contained. Certainly, member state's directed it along the way, but each one only to the extent that liberalization and further integration served their national interest and did not destabilize—or the benefits are perceived to be greater than the destabilizing effects—of the national constellations. For instance, road transport in the Netherlands, prior to the implementation of the CTP, was no less regulated than the continental average. But the Dutch recognized the economic importance of this industry, its relatively high level of development and efficiency, and the comparative advantage it would have on a European market. The Dutch sponsorship of the inactivity petition, German resistance followed by deregulation beyond what was supranationally required of it, or the French strategy, shifting from resistance to liberalization to re-regulation: not one of these

[155] Teutsch, 153-154.

appears to illustrate a state that is trying to retrench the welfare state or a shirking renege on its commitment to the provision of social welfare. What all three cases do however illustrate is a national response to the process of economic integration that is tailored to the interests and welfare of the domestic constituency.

It is not that European integration has not impacted the provision of social welfare. Indeed, social protection has largely been withdrawn. The liberalization of markets and the opening of national economies are to blame for this—and yes, the member states played a role in this process. However, in creating an economic union the community explicitly ascertained a division of labor between the national and supranational policy realms and responsibilities. This was based on the principle of mutual non-interference with the critical divide being that between the economic and the social. Moreover, the separation of powers in this arrangement of multilevel governance was not a simple trade-off. Or to put it differently, the first stipulation of economic union was national autonomy over the welfare state. As *Rome* illustrates through and through, states were by no means willing to compromise their social welfare regimes for the purpose of economic integration. The creation of an internal market was supposed to be a market for trade in goods and services of general economic interest. Public interest utilities were explicitly exempt from economic integration and the sphere of the supranational. Setting aside the neoliberal bias of Brussels and the activist stint emanating from Luxembourg, the case at hand is illustrative of both the resistance of the left and the strategy of the right: once markets are created—once they have become unleashed that is—they are difficult to contain. It is not contested that the supranational played a pivotal role, that is undeniably so. The reason to set aside the supranational preference is because as the case of the German railways illustrates, once the wheels of liberalization were set in motion, neither the bias of Brussels nor the activism of the ECJ were all that necessary to keep the process rolling. Germany could not threaten to pull out of the community because it disagreed with privatizing and liberalizing its railway because this was never demanded of it. The greater force of integration is not the state and it is not the supranational, although when these two forces are largely in sync this is perhaps not the case. The greater force of integration is the challenge to contain the *spread* of markets once they have been unleashed. In other words, the role of the supranational cannot be overlooked, but even more importantly, is the fact that the markets did much of the job of integration requiring relatively little dictate. In the public interest services and the services of general economic interest with which they interact, the markets spread especially fast as they destabilize the balance of the national constellation between market regulation and market containment, wiping out social protection in the process and drastically altering the structure of the welfare state.

The loss of effective control over the national economy increased the liability of the formal welfare state and likewise the financial liabilities of the state. The introduction of the profit element in the public interest services meant that the state had to take on past debt as well as the future financial obligations of the formal welfare state associated with unemployment, early retirement pensions and redundancies, and lower overall employment levels. It also meant shifting the practice of redistributive subsidization between service users to the responsibility of the formal welfare state's redistributive transfers between the state and its constituency. Lastly, it meant the elimination of cross-subsidization and the requirement of direct state subsidization for the provision of socially desirable and politically salient services and the attainment of public service goals by which their provision is governed.

Chapter 6: Conclusion

This study has traced the retreat of social protection, the process by which this has been withdrawn, and the response of the state insomuch as it pertains to the provision of social welfare. The focus here has been on the process by which economic integration has changed the internal structure of the welfare state and the implications of this on the ability of the state to sustain it. Understanding how economic integration effects the welfare state requires tracing the process of integration as pertaining specifically to the provision of social welfare, recognizing not only how this changed the provision mechanisms, but also understanding how the state has responded and adapted. Where it implies the retreat of social protection, the process is seems to be initiated supranationally, but is supported by various member states insomuch as it serves their national economic interest conditional on the stipulation that the economic benefits of integration outweigh the social dislocation that is caused by the changes integration implies to the various national constellations of the social protection regimes. The research illustrates that the liberalization and privatization of markets and monopolies respectively—which make up the national constellation of the social protection regime and serve the purpose of the provision of social welfare—once initiated, occur in manner that can best be described by and most accurately resembles a domino effect. This is due to the delicate balance of national constellations between the containment and regulation of markets, and the subsequent mutually reinforcing arrangement between the dimensions of the welfare state proper: social protection and the formal welfare state. In failing to recognize the multidimensionality of the welfare state and the subsequent disregard of the social protection mechanism of the provision of social welfare the conventional diagnoses have not given enough credit where credit is due.

The conclusion drawn here is that the process of liberalization and the inability of the states to contain the *spread* of markets once they are unleashed is a driving force of economic integration. The reason that markets have spread, and the reason that social protection has been withdrawn so sequentially is attributed here to the delicate balance between market regulation and containment and the purpose which this serves with regard to the mutually reinforcing interdependencies of social protection and the formal welfare state as distinct yet complementary elements of the welfare state properly understood. Once the markets infiltrated the social protection regime, social protection was thrown off-balance and to varying extents, it will begin to fall like dominos.

In short, European integration has affected the internal structure of the welfare state and the mechanisms by which the provision of social welfare has traditionally occurred. The state preferences as well as the domestic responses are reflective of the national constellations of the social protection regime. Where the national preference was characterized by resistance—that is where liberalization and or privatization disturbed the national constellation to the point of social dislocation—the states have responded accordingly to minimize the harmful effects of integration. The states have therefore sustained the welfare state status quo to the best of their abilities. The implications of this are increased financial obligations and liabilities both within and external to the formal welfare state. Lastly, by overlooking social protection and the national constellations that made this possible, the literature has to some extent misplaced the responsibility, national preference, and the role of the supranational whereby not recognizing the driving force of integration as the unleashing of markets and the subsequent challenge of containing their spread—specific to the national constellation and the provision of social protection by means thereof. Given the national commitments to the welfare state, it doesn't so much matter by whom the bell was rung; once the markets were 'opened' the state foot the bill both internal to and external to the formal welfare state.

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