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**EFFECTS OF THE ECONOMIC CRISIS ON THE TYPES OF THE EUROPEAN
WELFARE STATES**

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1. Introduction

In point of the effects of the economic downturn – that was started as a US-generated financial crisis then by 2008 turned itself into a full-blown global crisis – on the European welfare states,⁶³ there is not a clear accordance among the economists yet. European welfare states have come under pressure since the 1990s as a result of demographic change, high public debt and low employment rates. While the economic boom of 2004-2008 provided some relief, now the increase in public debt, higher unemployment and prospective lower growth rates mean new burdens on states. However, these burdens unevenly spread across the different types of the welfare states. From the events till now we can already establish that the downturn has tried states with extensive welfare systems less than the liberal (Anglo-Saxon) ones. This can be originated to several factors and can be followed by several consequences. This article deals with this question looking for the causes behind the phenomenon and touching upon its presently foreseeable effects.

First, we will talk about the theoretical background of the typology of welfare states then we will display the changes in some macro economic indicators of the different types under the crisis; the causes behind them and the expected consequences, and last we will present some concluding remarks.

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⁶³ Defining welfare states is quite a difficult task but we could summarize – and this paper will intend to use – what is meant by that notion as welfare states ‘are committed to financial and intellectual well-being’ (good state of health, up-to-date literacy, employability in the modern economy, suitability to work, and convenient habitat and food) of their citizens and in favour of this they actively intervene in the economic processes’ (Szabó, 2006, p. 209). The notion of welfare states is also used in a wider sense. Many treat a model as a welfare state if the state provides wide range social services although not to all citizens. Moreover, others talk about Asian Welfare states (Taiwan, South Korea), and welfare states born prematurely (Kornai, 1993, pp. 113-143), which are the East European socialist countries before the transition. Nevertheless to really talk about a welfare state, it is necessary the measures to conglomerate to a coherent system and clasp the citizens’ whole life from the cradle to the grave (Szabó, 2007, pp. 317-318).

7. Four types of the European welfare states

More typologies of welfare states can be found in the literature⁶⁴. As all of the classifications, the following one obscures several differences inside the groups, too, but the claim of generalisation requires dispensing with these.

The newest typology of European welfare states (Boeri, 2002; Sapir, 2005; Pabst, 2009) uses four groups instead of the classical three by Esping-Andersen, dividing the corporatist-statist type into two parts (Boeri, 2002, pp. 3-4):

a) The *Nordics* (Denmark, Finland and Sweden, plus The Netherlands which is a hybrid between the Scandinavian and the Continental models and has recently moved northwards) feature the highest levels of social protection expenditures, and universal welfare provision based on the citizenship principle. Extensive fiscal intervention in labour markets, based on a variety of "active" policy instruments (trying to drive back unemployed people to the labour market with trainings and other programs), substantial tax wedges, and relatively extensive employment in the public sector also belongs to this model while unions' presence in the workplace and involvement in the setting and administration of unemployment benefits generates compressed wage structures. This type fits to the social democratic one by Esping-Andersen.

b) The *Anglo-Saxon* countries (Ireland and the UK) are closer to the Beveridgean tradition⁶⁵ and feature relatively large social assistance of the last resort schemes. Cash transfers are primarily oriented to people in working-age. Activation measures are important as well as schemes conditioning access to benefits to regular employment. On the labour market side, this model is characterized by a mixture of weak unions, comparatively wide and increasing wage dispersion and relatively high incidence of low-pay employment. This type suits to the liberal type by Esping-Andersen.

c) *Continental* European countries (Austria, Belgium, France, Germany, and Luxembourg) rely extensively on insurance-based, non-employment benefits and old-age pensions. Employment protection is stronger than in the Nordic countries so dismissal notice is more expensive. Benefit schemes rely on contributions on employment income, along the Bismarckian tradition⁶⁶. While unions' membership rates have been falling quite dramatically in the last 20-25 years, a strong unions' influence has been to a large extent preserved by regulations artificially extending the coverage of collective bargaining much beyond unions' presence. Corporatism (tripartite negotiations between the government, the employers' organisations and the trade unions) is important part of the institutional system of social dialogue. With the next, Mediterranean type, this group makes the corporatist-statist states by Esping-Andersen.

d) The *Mediterranean* countries (Greece, Italy, Spain and Portugal), concentrating their spending on old-age pensions and allowing for a high segmentation of entitlements and status. Their social welfare systems typically draw on employment protection and early retirement provisions to exempt segments of the working age population from

⁶⁴ See for example *institutional and liberal types* by Richard M. Titmuss (1959), *residual and universal classification* by Harold L. Wilensky and Charles N. Lebeaux (1965), and *liberal, corporatist-statist and social democratic welfare states* by Gosta Esping-Andersen (1991).

⁶⁵ The Beveridgean schemes aim at preventing poverty and providing universal, means-tested benefits, and rely on taxes.

⁶⁶ Beside the contributions on employment income, these schemes are characterised by earnings related benefits with upper limit, and the statutory coverage is ranged to the insured persons below upper income limit. The income replacement rates are higher than in the Beveridgean schemes.

participation in the labour market and this leads to low level of employment. Also in this case, strong unions' influence has been preserved by practices (e.g., jurisprudence) artificially extending the coverage of collective bargaining. As a result, wage structures are, at least in the formal sector, covered by collective bargaining and strongly compressed in these countries.

In the next section the paper demonstrates the effect of the present economic crisis on the countries of these four types with some simple macroeconomic indicators.

3. Effects of the crisis on the individual types in numbers

The global economic crisis affects the funding of social security systems essentially via two channels (Busch 2010, p. 8): on the one hand, due to the higher unemployment, the expenditure of social insurance funds and the state is increasing, while on the other hand, their tax and contribution revenues are falling as a result of lower economic growth (or contraction). In this way, funding gaps generally appear in state social security systems and in the state budgets that are heightened by large credit-financed rescue packages in response to the economic crisis. This growing discrepancy between revenues and expenditures that is the growing budget deficit appears differently in the countries, it differs from welfare state type to type. In this section we display differences of the types in government deficit, and in the above-mentioned two underlying factors (namely the unemployment and the economic growth) affected by the crisis.

As we can see in Figure 1 before the crisis in point of the government balance Nordics and Anglo-Saxons were in the most advantageous position as they produced surpluses for several years. In the Nordic countries this could be considered a significant advance compared to the previous years due to the implemented radical reforms. In the Anglo-Saxon countries the traditional low level of state intervention resulted in balanced or near balanced budgets. In contrast, the Continental and particularly the Mediterranean countries ran deficits throughout the whole examined period due to the traditionally high level of and – because of the above-mentioned processes – ever growing state intervention. The crisis have rearranged this picture appreciably: budget balances declined already in 2008 but the really unfavourable high deficits appeared only in 2009 in all of the country groups. As compared to the 2007 numbers, the highest decline was shown by the Anglo-Saxons followed by the Mediterraneans, the Continentals and last the Nordics.

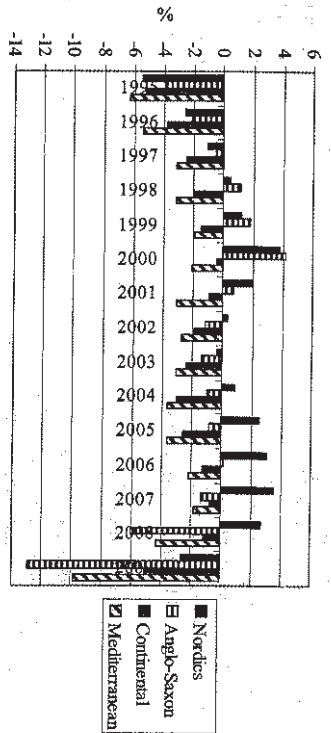


Figure 1.
Government deficit/surplus (1995-2009, % of GDP)

Source: Own construction based on the data of the webpage of Eurostat Statistics:

http://pp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database, accepted: 28. April 2010

Before and after the explosion of the crisis unemployment was the major problem in the Mediterranean countries (see Figure 2). The second highest unemployment rates were found in the Continental countries before the crisis but the downturn has resulted in only a moderate growth in this indicator. Before the crisis the Nordics had a relatively low rate of unemployment and after the development of the crisis after a slight increase they have reached the lowest rates. Here, the Anglo-Saxons show a sharp downfall again: after the lowest rates before, they have produced the second worst rates after the beginning of the downturn.

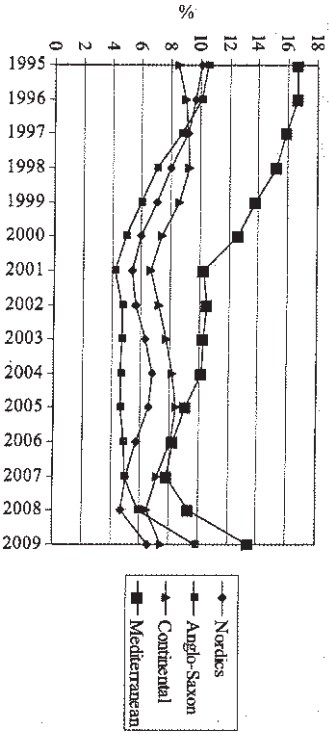


Figure 2.
Unemployment rate (1995-2009, % of population between 16-64)

Note: Unemployment rate is measured as a quotients (in %) of unemployed (those persons age 16 to 64 who are not working, have looked for work in the last four weeks, and ready to start work within two weeks) and the population between 16-64 years.

Source: Own construction based on the data of the webpage of Eurostat Statistics:
http://pp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database, accepted: 28. April 2010

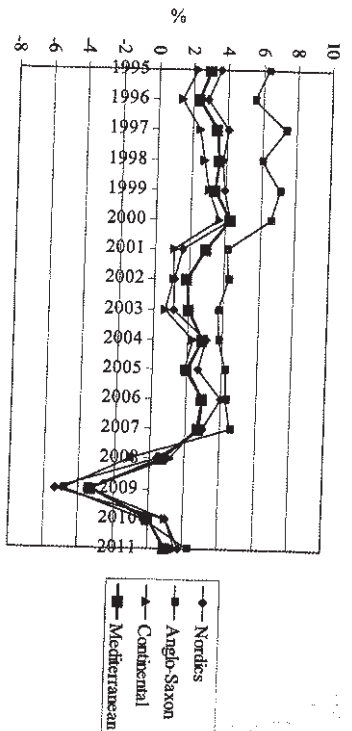


Figure 3.
Growth rate of GDP (1995-2011, in %)

Note: Numbers of 2010 and 2011 are forecasted by Eurostat.

Source: Own construction based on the data of the webpage of Statistical Datahouse:

<http://saw.ech.int/browse.do?node=2120796>, accepted: 28. April 2010, and the webpage of Eurostat Statistics: http://pp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database, accepted: 28. April 2010

It is clear from the Figure 3 that the Anglo-Saxon type performed quite well before the crisis in point of the economic growth while the other three types provide far lower rates (except in some years straight before the crisis when Nordics approached Anglo-Saxons). From 2008 this tendency has turned over: however growth of all groups has declined, the largest contraction can be experienced in the Anglo-Saxons and the Nordics.

Effect of the crisis is shown in relief in the next two figures (4 and 5) in which government deficit/surplus is plotted together with GDP growth rate then with unemployment rate, first in the period before the crisis then after the beginning of the economic slowdown.

Figure 4 demonstrates very well that the whole group of the welfare states has moved to the left downward in the plane of government balance and growth rate (that is the shift of the intersection of the two gross line which represent the sample average of contraction) and government deficit has increased. But the position of the countries (at least in point of the two chosen variables) in relation to each other and to the average were the Anglo-Saxon which provided good performance primarily in the economic growth, and the Nordic which was good at the government balance; the two least performing groups were the Continental which showed more unfavourable picture than the average in the case of growth, and the Mediterranean which was worse than the average in point of government balance. After 2008 the strength of the Nordics and the Continentals has ameliorated, namely they perform better in both of the two variables, and the position of the Anglo-Saxons has significantly worsened, viz. they show below average performance in both two variables.

According to the Figure 5 the average unemployment rates have hardly changed under the slowdown⁶⁷. Before the crisis Mediterraneanans possessed the highest unemployment and that has remained after 2008, too. Before the slowdown the most favourable position in point of unemployment was held by the Anglo-Saxons but after the crisis they lost it and the unemployment has become a bit higher than the average. Nordics have shown an above-average performance, and Continentals have performed on the average before and after the crisis, too.

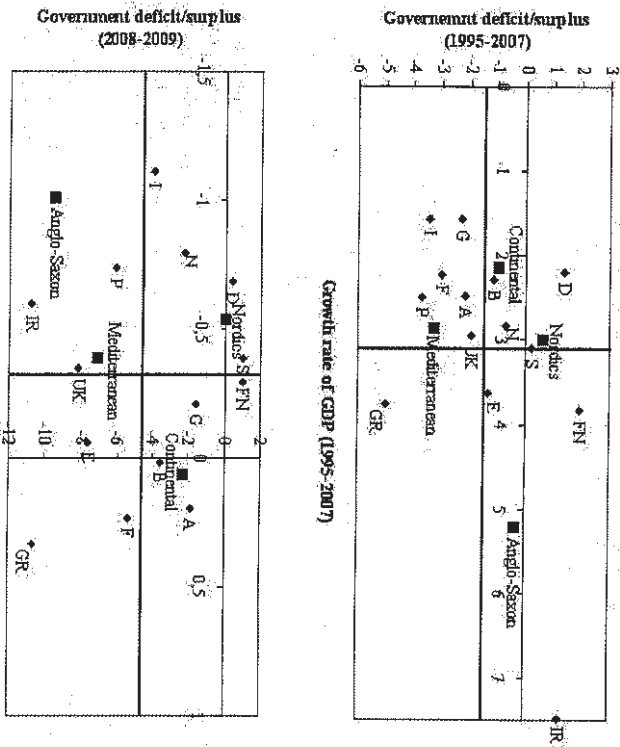


Figure 4.

Relation of government deficit/surplus and growth rate of GDP before and after the explosion of the crisis

Note: Numbers of 2010 and 2011 are forecasted by Eurostat. A= Austria, B= Belgium, D= Denmark, E= Spain, F= France, FN= Finland, G= Germany, GR= Greece, I= Italy, IR= Ireland, N= The Netherlands, P= Portugal, S= Sweden, UK= United Kingdom.
 Source: Own construction based on the data of the webpage of Statistical Database: <http://sdw.ecb.int/browse.do?node=2120796>, accepted: 28. April 2010, and the webpage of Eurostat Statistics: http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database, accepted: 28. April 2010

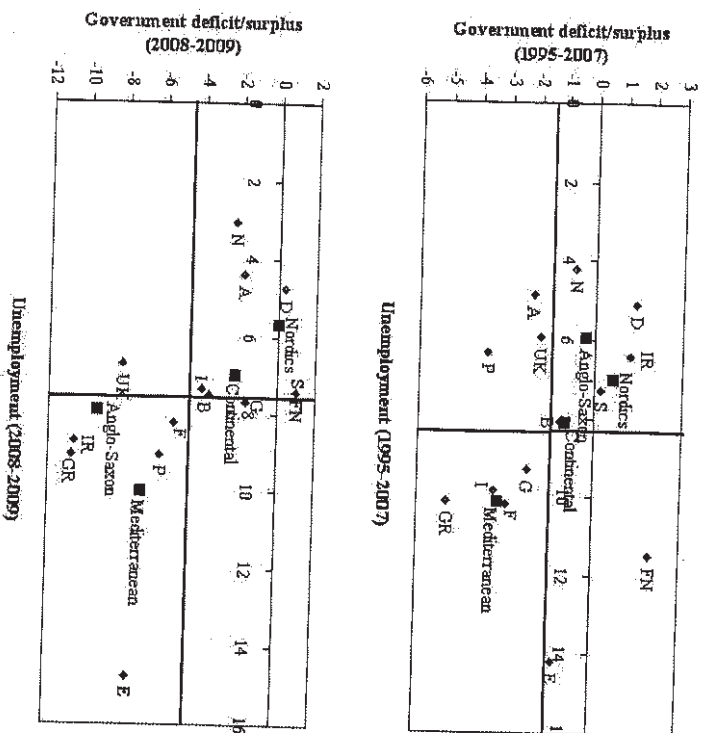


Figure 5.

Relation of government deficit/surplus and unemployment rate before and after the explosion of the crisis

Note: Numbers of 2010 and 2011 are forecasted by Eurostat. A= Austria, B= Belgium, D= Denmark, E= Spain, F= France, FN= Finland, G= Germany, GR= Greece, I= Italy, IR= Ireland, N= The Netherlands, P= Portugal, S= Sweden, UK= United Kingdom.
 Source: Own construction based on the data of the webpage of Statistical Database: <http://sdw.ecb.int/browse.do?node=2120796>, accepted: 28. April 2010, and the webpage of Eurostat Statistics: http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database, accepted: 28. April 2010

Main lessons of the above are summarised in the Table 1, from which we can easily pick out that the Nordic is the best performing model after the downturn, too, and the Mediterranean is the least performing one, however, performance of the Anglo-Saxon type has significantly declined and that of the Continental type has relatively ameliorated.

⁶⁷ At least regarding 15 year data series. Naturally average unemployment rate has increased in relation to the years straight before the downturn.

Relative performance of the welfare state types

Table 1.

	Before the crisis		Under the crisis	
	Government def./suppl.	Growth rate	Government def./suppl.	Growth rate
Nordics	*		*	
Anglo-Saxons		*		*
Continental			*	
Mediterranean				

Note: * refers to the performance significantly above average, - refers to the performance significantly below average.

Source: Own construction.

4. Potential causes and consequences

The Continental approach (based on a 'big-size' state with higher taxes, heavy regulation of product and labour markets, and also a generous social safety-net) has always been criticised by 'orthodox' liberals who have warned that a minor emphasis on free-market will lead – sooner or later – to less productivity of the economic system, less competitiveness in international markets and, ultimately, less economic growth and employment. In few words, the 'sclerotic' continental economy appeared to be overregulated and too dependent on state interventions. This was the prevalent opinion on the Continental model until the explosion of the full-blown global crisis which queried it (Secchi-Villafraña, 2009, pp. 1-2).

Rather, the crisis is bringing back to the surface recurring, if not old, questions on the liberal economic system about the presence of the state in the economy, market and government failures etc. These questions are not particularly original as they have been characterizing the capitalist system since its origins, but the depth and size of the current crisis are placing new emphasis on them. The downturn is stressing the limits and drawbacks of the Anglo-Saxon model while shedding light on the benefits of the Continental one (Secchi-Villafraña, 2009, p. 2). Reasons for this are as follows:

The crisis with economic slowdown brings in its train growing unemployment. But in the Continental and Nordic countries tough job-protection laws have slowed the rise in unemployment. Generous welfare states have protected those who are always the first to suffer in a downturn from an immediate sharp drop in their incomes and acted as part of the 'automatic stabilisers' that expand budget deficits when consumer spending shrinks (Europe's... 2009).

In Britain people have felt more exposed. In the UK, GDP reduction is determined – to large extent – by a significant fall in domestic demand (-3.6%). Therefore, the limits of a small safety-net leading to a sharp decrease of private consumptions in times of crisis (-3.4% in 2009 and -1.5% in 2010) are crystal clear. In this context, it comes as no surprise that public consumptions will sharply rise in the next years (2.9% in 2010) as part of the huge fiscal stimulus measures announced by the UK government. These measures are estimated to account for a quarter of the forecast increase in public deficit ratio (from 4.8% in 2009 to the impressive 13% in 2010). This needs to be read as the attempt of the British government to counterbalance its modest welfare state (and the ensuing income squeeze for its citizens during the crisis) with new measures of public

spending (Secchi-Villafraña, 2009, pp. 2-3). This will also lead to an unprecedented increase in the UK debt ratio from 52% in 2008 to about 79% by 2010 (ECB, 2010).

The situation is rather different in Continental Europe. In this case, a strong welfare state already exists and automatic stabilisers – including unemployment benefits – are working at full speed, even if mechanisms, amounts and timing differ for each country. As a result, the trend of private consumptions is not expected to be negative.⁶⁸ This implies a minor need for increased public consumption and fiscal stimulus (if compared with the UK) with lower pressures on public accounts.⁶⁹ (Secchi-Villafraña, 2009, p. 3).

If we regard at the long term effects of the mentioned run of government budgets, we can make the following statements: Before the onslaught of the global recession, the countries with the most inefficient models (Continental and Mediterranean countries) had higher ratios of public debt to GDP, at 73% and 81% respectively, compared with 36% in the Anglo-Saxon countries and 49% among the Nordic countries. However, this will be reversed by the consequences of the meltdown: the size of the financial sector and the weight of real estate in the economies of Anglo-Saxon group are such that the ratio of public debt to GDP already exceeds the 80% mark.⁷⁰ (Palisi, 2009, p. 9).

So thus in sum we should note that the Continental and the Nordic model show better performance in the periods of recession as in these countries it is possible to rely on the already existing social safety net which makes burdens of the crisis less painful to the citizens.⁷¹ But this can be achieved at the expense of growing deficit and government debt that could be dangerous if the crisis drags on for a long time.⁷² If recovery is slow, higher unemployment could become persistent in these countries perpetuating higher welfare expenditures. So later, fiscal consolidation will be a major concern. Even so there is also a bit of a 'We told you so' attitude, as the Nordic model is more stable. The global downturn has reinforced Nordic scepticism over the Anglo-Saxon economic model associated with lower taxes, smaller government, freer markets and a smaller welfare state (Moskwa, 2009). On the political side, people will clearly perceive the potential superiority (and advantages) of this model and tend to favour and vote for parties supporting it.⁷³ (Secchi-Villafraña, 2009, p. 3).

⁶⁸ For example in France 0.3% growth is expected in 2010, while only a modest reduction is foreseen in Germany (-0.7% in 2010) (Secchi-Villafraña, 2009, p. 3).

⁶⁹ The French budget deficit for example is projected to rise to 7% in 2010 after 3.5% in 2008, while Germany will reach 6% in 2010 after 2.7% in 2008 (ECR, 2010). These figures are definitely above the limits of the Stability and Growth Pact (SGP) but they look low if compared with the skyrocketed British data (Secchi-Villafraña, 2009, p. 3).

⁷⁰ Britain's public-debt-to-GDP ratio will soar to 95% by 2015 and only drop back down to a sustainable 40% in 2023 with restored tax revenues and massive expenditure cuts (Palisi, 2009, p. 9). The systemic nature of the current crisis is contributing to emphasize the positive aspects of the European countries) allowed the Council to ease the Maastricht criteria with no relevant complaint by member states. But in case of an asymmetric shock (hitting a state or group of states) governments would reach similar exemptions, and ultimately, this would limit the benefits of the continental model since automatic stabilisers would not be allowed to work fully (Secchi-Villafraña, 2009, p. 3). According to Kenneth Rogoff and Carmen Reinhart (2009) it is not inconceivable that Europe will run an L shaped recession with a sharp decline and long stagnation instead of a V shaped one.

⁷³ In stark contrast to political instability in much of the rest of Europe, support for governments in Nordics has rebounded during the crisis (Moskwa, 2009).

But how long will this superiority last? The strengths that have made parts of Continental and Nordic Europe relatively resilient in recession could quickly erode as weaknesses in a recovery. For there is a price to pay for more security and greater job protection: a slowness to adjust and innovate that means, in the long run, less growth. The rules against firing that stave off sharp rises in unemployment may mean that fewer jobs are created in new industries. Those generous welfare states that preserve people's incomes tend to blunt incentives to take new work. That large state, which helps to sustain demand in hard times, becomes a drag on dynamic new firms when growth resumes. The latest forecasts support this prognosis that Britain could rebound from recession faster than most of continental Europe⁷⁴ (Europe's... 2009).

5. Conclusion

Some authors state that the economic crisis have proven finally that maintenance of the generous welfare systems is remunerative⁷⁵, while others (for example Pabst, 2009; Secchi-Villafranca, 2009; Moskwa, 2009) emphasises that the events have shown that the crisis affects states with less generous welfare systems more but after the hard days, disadvantages of states with generous welfare systems manifest again, so the Continental and Nordic models have to be reformed in these days but at the same time, starting from the experiences of the present crisis, Anglo-Saxon model needs to be transformed, too (and not to mention the Mediterranean type which has been the weakest one before and after the beginning of the crisis).

So the final conclusion is that the issue to be tackled is not the validity of the Anglo-Saxon model and its potential substitution with the Continental or Nordic one but the ability to limit its overindulgence in some fields (i.e. financial markets) and rigidities in others (i.e. welfare state and income distribution) by introducing some features of the other models, and viceversa⁷⁶. Both Anglo-Saxon and Nordic and Continental models have advantages but in different periods: the later ones perform better than the former in crisis periods, while the former performs better than the others in the periods of economic growth (Secchi-Villafranca, 2009).

According to Amartya Sen (2009) present crisis offers exceptional opportunity for politicians to deal with the dismissed long term problems because now citizens are willing to rethink their convictions. As a result of the slowdown, Anglo-Saxon countries are maybe willing to consider the drawbacks of their model namely that they 'too implemented' their model. That is they notice that getting regulation right matters as much as freeing up markets; an efficient public sector may count as much as an efficient private one; public investment in transport, schools and health care, done well, can pay dividends (Europe's... 2009). At the same time, Nordic and particularly Continental and Mediterranean countries are mature to accept some features of the Anglo-Saxon model. They can overstep their traditional social bias against the changes⁷⁷, so during the crisis they can change huge public expenditures (automatic stabilisers and fiscal

stimulus, too) to structural reforms, which are usually refused by people while now maybe they can be implemented easier than in an – although with lower rates – expanding economy.

Summary

The present economic downturn has tried the Nordic and Continental states with extensive welfare systems less than the Anglo-Saxon ones. This originates mainly in the automatic stabilisers which have been working with full blast with the effect of smaller decline in private consumption in the countries of the first type. As a consequence, demand for government expenditure and fiscal stimulus and so thus the pressure on public spending is less than in the Anglo-Saxon countries. However, the problems of big state return when growth starts up again, slowing down the recovery from the crisis for these states. Therefore all of the models require reforms and the crisis gives a golden opportunity for this.

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⁷⁴ Of course there can be huge differences between states.

⁷⁵ For example Craig Webster (2009, p. 2) explains the support of expanded welfare systems that when the economic crisis is over, the populations that emerge to rebuild are healthy and educated. Thus, strengthening human capital will assist when recovery takes place.

⁷⁶ Similar conclusion is drawn by Pabst (2009).

⁷⁷ We should note, however, that this overstep is not obvious as nowadays' Greek demonstrations have clearly shown.

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