



PHILOSOPHY OF ECONOMICS & POLITICS

LECTURE 19: THE WELFARE STATE

DATE **11 MARCH 2019**

LECTURER **JULIAN REISS**

Today's agenda

- * Today we are going to continue to discuss some results from *contemporary* political economy
- * Starting point, as in Dan Usher's work, is the question: in democratic capitalist nation, **why don't the poor milk the rich?**
- * I will discuss a selection of answers to this question, many '**Polanyian**' in nature, focusing on **redistribution** and the **welfare state**
- * Finally I'll discuss some recent work on '**the crises of democratic capitalism**'

The basic issue

- * As we have seen when we discussed Usher's defence of property rights, there is **a fundamental tension in democratic capitalism**:
 - * capitalism produces stark inequalities
 - * voting rights are distributed equally
- * So why don't the (many) poor use their voting power to dispossess the rich?
- * A simple answer (Przeworski and Wallerstein 1982): **radical redistribution would be met with massive resistance** (disinvestment, emigration, violence...) on part of the rich, so the (smart) poor won't try; but equally, the rich will consent to some redistribution to curb the threat of revolution

The 'Robin Hood Paradox'

- * Globally, there is a lot of variation of redistribution: U.S. reduces poverty by 13%, Sweden by 82%, respectively
- * Suppose that political preferences can be represented by a simple left-right dimension:



- * Then, if individuals are distributed normally or equally along this line segment, there will be a '**median voter**'
- * The median voter will tend to have below-average income as income will be distributed '**right skewed**'

The 'Robin Hood Paradox'

- * Assume also that taxes are proportional, that benefits are paid at a flat rate, and that there are efficiency costs of taxation
- * Under these assumptions, **equilibrium is reached when the benefit of additional spending to the median voter is exactly outweighed by the efficiency costs of spending**
- * Implications: **spending is higher** (a) **the greater the skew in the distribution of income**, and (b) **the greater the number of poor people who vote**.
- * (a) is rejected by the data — hence '**Robin Hood paradox**'
- * (b) means that the more franchise is extended to the poor, the more redistribution will there be

Varieties of Capitalism

- * After the collapse of the Soviet Union in 1991, there was a brief period of consensus among political economists that:
 - * capitalism is *economically* superior to socialism;
 - * capitalism is *necessary for* democracy;
 - * the *welfare state* supports the alliance between capitalism and democracy by protecting the disadvantaged through redistribution and regulation
- * (Of course today many on the left have abandoned the consensus...)

Varieties of Capitalism

- * In this climate, a new strand in the literature emerged, one that turned from the 'big questions' to **more detailed analyses of different socio-economic structures** within basically capitalist nations
- * One result of this literature are **typologies of different models of capitalism** (hence, 'varieties...'); for instance (Hall and Soskice 2001):
 - * the liberal market economy (UK, U.S., HK...)
 - * the co-ordinated market economy (Scandinavian countries, Germany)
 - * the 'Mediterranean' type.

Varieties of Capitalism

- * The 'VoC Approach' looks, for example, at different institutional settings that explain **specialisation** in different types of goods:
- * **Liberal market economies** tend to have small welfare states, weak employee protection, and because firms risk losing their employees to competitors, there is relatively little industry-specific human capital → mass production of low-quality goods;
- * **Co-ordinated market economies** tend to have much larger welfare states, stronger employee protection, and because firms can count on employees staying for many years, they can invest in industry-specific human capital → production of high-quality goods.

Varieties of Capitalism

- * Most exciting results: the interrelations among economic and political institutions in the different types of capitalism
- * See especially Torben Iversen's *Capitalism, Democracy, and the Welfare State*
- * One result:
 - * Because **proportional representation** electoral systems tend to promote left party dominance and redistribution, it enables workers to invest in specific skill acquisition in economies that rely heavily on workers with industry-specific skills (i.e., co-ordinated market economies).
 - * By contrast, in liberal market economies, **majoritarian electoral systems** tend to produce centre-right governments, small welfare states, and the development of general skills.

Varieties of Capitalism

- * The approach has more or less explicit **Polanyian** roots: it sees the welfare state as an essential means to preserve the market order in the light of the downsides unfettered capitalism can produce
- * The wider significance of the VoC approach is that it provides far more detailed and specific arguments for **how different socio-economic and political institutions interlink** in order to create a form of capitalism that is sustainable and successful
- * Note: what matters is that not (only) the creation of ‘good’ institutions but of institutions that fit into the existing context

Crises of Democratic Capitalism

- * The last hero of our module: Wolfgang Streeck
- * German sociologist and former director of the Max Planck Institute for the Study of Societies in Cologne
- * Author of numerous books, all critical of capitalism, some predicting its soon demise
- * His work is clearly **Marxian** in spirit
- * Streeck thinks that subtle approaches such as VoC **overlook the common elements among all, which result from the power differentials between owners and non-owners of capital**

Crises of Democratic Capitalism

- * In his analysis, the first three decades or so after World War II were characterised by **shared prosperity** and some **democratic control of the economy through regulation and redistribution**
- * The era was marked by a '**peace formula**' according to which the working classes accepted capitalist markets and property rights in exchange for political democracy, which in turn enabled them to achieve social security and a steadily rising standard of living
- * The competition of systems during the cold-war period was a distinct advantage for capitalism because 'Socialism and trade unionism, by putting a brake on commodification, **prevented capitalism from destroying its non-capitalist foundations** — trust, good faith, altruism, solidarity within families and communities, and the like'

Crises of Democratic Capitalism

- * This peaceful period came to an end in the early 1980s with the elections of Thatcher and Reagan
- * Streeck does not regard the '**conservative revolution**' as a mere temporary move (back) towards laissez-faire liberalism but instead as **a manifestation of underlying contradictions** that attempts at 'embedding' will not overcome
- * The main tension embodied in democratic capitalism is the simultaneous adherence to **two fundamentally different principles of resource allocation**:
 - * one operates according to marginal productivity
 - * the other, by social need or entitlement as determined by collective decision making

Crises of Democratic Capitalism

- * The crises of democratic capitalism:
 - * high inflation in the late 1970s;
 - * high unemployment in the early 1980s;
 - * exploding public debt in the late 1980s and 1990s;
 - * austerity and deregulation in the late 1990s and 2000s;
 - * the financial crisis of 2008
- * were all an expression of this tension

Crises of Democratic Capitalism

- * As the fundamental tension is inherent in democratic capitalism, **there are few reasons to believe that this sequence of crises in ever new variants is going to stop**
- * Like Schumpeter (and Marx), Streeck predicts the (soon-ish) demise of capitalism after a number of further rounds of crises.
- * However, he regards it as a Marxist prejudice that it should come to an end only when a new, better order is on the horizon
- * **Capitalism will disappear when it no longer keep its promise as a self-reproducing, sustainable, predictable and legitimate social order**