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 selections 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 in 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.
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
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
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**