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KEYNES WELFARE STATE AND ITS CONTEMPORARY TRANSFORMATIONS

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Summary

Welfare state was the result of an attempt to alleviate the consequences of the Great Depression of 1929-33 and it's greatest development occurred in the period after World War II.
The father of the idea of state interventionism is John Maynard Keynes, but the origins of welfare state can be found much earlier in pre-capitalist societies. Keynes's welfare state had a fundamental role of redistributing income (the state regulates unequal market income distribution through certain redistribution policies and budgeting). However, in time the role of the state becomes much more comprehensive, tying together various sectors of economy with a variety of political and economic interests. The state takes over a whole array of non-economic functions (public services).
The crisis in traditional state interventionism began to be felt in the 1970s with causes that should be sought in the modern structure crisis that had afflicted the developed parts of the world at that time as well as in the steady increase in government expenditures.
Contemporary welfare state transformations are stimulated by technical progress. The goals, forms and mechanisms of state interventions are changing.
In these new conditions, the state intervenes less in the economic domain and more in other areas of social life.

INTRODUCTION

Welfare state is a specific form of state intervention with a basic goal of establishing economic efficiency in society founded on social stability of the widest strata of population. The state intervenes in the economy, implementing fiscal and intervention policies in order to act on the market income distribution and guarantee the entire population not only basic security and political rights but social and economic security. (1)

This is why welfare state is often thought of as the "state of all citizens". The idea of welfare state dates back to the late 19th century when in the most developed countries the notion began to spread that the state should create and develop social services with a purpose to provide welfare for all.(2)

Its implementation in practise began with introduction of compulsory primary education, advances in health care services, introduction of retirement plans, medical insurance, fixed lowest wage, introduction of social care for the poor and introduction of legal trade organisations, etc.

Many economic theoreticians have dealt with the issue of welfare, attempting to define more precisely what exactly the term involves. Let us mention A. Marshall for whom social welfare was the sum total of an individual's gratification. Marshall also realised the need to help the poor segments of society. These same issues had preoccupied another theoretician, A.C. Pigou, particularly in his book "Economics of Welfare". Pigou insisted that state of necessity had to care for the socially impoverished categories of population by transferring part of the national income from the rich to the poor.

In economic literature we find numerous definitions of welfare state, depending on the approach various theoreticians choose to take in dealing with this issue: do they take, as a criterion, the relation between state intervention and market, the effect of state intervention on social relations or the features of state intervention. However, a comprehensive definition should take into consideration all of the above criteria. (Familiar definitions by Brigs, I.Gough, R.Titmuss, C.Offe and others).

It is a well-known fact that welfare state experienced its greatest evolution and expansion after World War II. The economic depression in the 1930s and disastrous aftermath of the war had brought about a turning away from liberal capitalism as a possible social model in favour of state interventionism. Theoretically, it was the British economist John Maynard Keynes who had propelled this turning in the 1930s through development of a theoretical base for state intervention in the economy. Credit should also go to W.Beveridge who, in 1942, submitted his famous report on the social condition of the nation to the Parliament thus establishing British welfare state with elements that would later be adopted by many other developed countries.

In this paper I shall be dealing with Keynes's concept of welfare state and the changes this type of state has undergone in new circumstances.

KEYNES'S WELFARE STATE AND ITS FEATURES

Keynes's name is tied closely with the entire contemporary macro-economic theory. He exerted great influence on the study of national income and its components, as well as on the linking of economic theory with economic policies and practise. His views and contributions affected economic theory and policy in ways not seen since the time of A.Smith and D.Ricard, allowing us to speak of a true Keynesian revolution.

To the end of his life he was active as both a theoretician and a practitioner (He was professor of political economy at Cambridge, long-time editor of the Economic Journal and secretary of the Royal Economic Society. He was active in economic practise performing a whole series of important functions in public affairs). (3)

Like all great economists, Keynes too was the product of his time - the time of the Great Depression.

The great economic depression of the 1930s had disastrous consequences and it set in with a financial and industrial breakdown, an enormous drop in production, piling of goods and a price drop of raw materials, industrial and farm products. The problem of unemployment became acute (between 1929 and 1933 there were about 40 million unemployed in the capitalist world). (4)

The consequences of the Great Depression could not be overcome or dealt with in ways practised at the time, i.e. through self-regulation of the economic system. State intervention was inevitable. In his papers and books, particularly in his capital work, "The General Theory of Employment, Interest and Money", Keynes developed a whole range of ideas and proposals dealing with the issue of speedy recovery from the depression and prevention of similar disturbances in future, all of which was to be adopted by American president F. D. Roosevelt and the large capitalists and brought to life in the New Deal economic policy. Keynes had accurately observed the essential problems of his time: chronic unemployment, insufficient incentives for investing, insufficient consumption, contradictions between accumulation and consumption, etc. In the midst of his attention was the question of unemployment which was no longer an exception or a random occurrence but a permanent feature of contemporary capitalist society. For Keynes, unemployment is the consequence of insufficiently effective demand, i.e. insufficient consumption and insufficient investments. He attacked Say's law of market which claimed that supply creates demand. Keynes turned the idea around pointing out that it is the demand that will create supply.

The amount of income and with it the level of employment depends on the total (effective) demand which can be viewed as consumption (demand for goods) on one hand, and investments (demand for means of production) on the other. The people decide how much of their income they will spend and how much they will save. Keynes's basic assumption is that with the rise in total income, consumption will rise too, but at a rate lower than the rate of increase in income.

People, says Keynes, "are as a rule and on the average willing to increase their consumption as their income rises, but not in the amount of increase in their income" (5). Thus, the feature of modern capitalism is that consumption is less than income and increase in consumption is less than increase in income. The surplus of income over consumption is savings, which is not a function of interest rate (as was believed by classic middle-class economists) but rather a function of income.

In order to maintain a certain level of income it is necessary that savings be sucked into investment demand. Investment demand is determined by two factors: marginal capital efficiency (profit rate) and interest rate. If an investor is to make a profit, the interest rate must be lower than the marginal efficiency of capital. Marginal efficiency of capital (profit rate) drops with development of capitalism, while percentage of savings and interest rate remain relatively stable. As a result of drops in marginal efficiency of capital, investments drop too since part of the savings is not invested. The final result is a drop in total employment and national income. (The net result of this process is that savings and income equal consumption). Thus, according to Keynes, a balance is possible even in conditions of partial employment.

Keynes stated that full employment can not be realised only through the mechanisms of capitalist economy. Furthermore, it can not be maintained over a longer period of time. He sees the state as an inevitable factor of economic life. The state has to stimulate consumption or create investments to ensure full employment. Keynes pleads for increased consumption even when this increase is expressly unproductive.

"Digging holes in the ground which is financed from savings, will increase not only employment but also the real national income in useful goods and services" (6).

Implementing tax measures (personal income tax and taxes on corporate profits) the state can help redistribute national income and with that the level of total effective demand. Social assistance, unemployment assistance, etc. are state measures that will increase the income of those strata of society for which each increase in income means increase in consumption.

For Keynes, everything that increases consumption is positive. A decrease in consumption creates stocking up of goods because some goods can not be sold. The final outcome is falling employment and falling income.

Keynes is aware that due to effects of multipliers, the state will achieve much more if it acts in the area of investments rather than in the area of consumption. He proposes lowering interest rates to discourage savings and encourage investing. He also believes that the state must carry out other measures of monetary and loan policy: regulation of public debt, control of banking system and loans, the policy of balance of payments, rate of exchange, etc. Keynes offered a fundamentally new vision on how a capitalist state should function, trying to determine the limit to state interventionism. Public authority only needs to stimulate and complement private initiative, it should not at any cost compete with private capital.

The practical aspect of his proposals was quickly recognised and they were brought to life in the form of the state interventionist measures of New Deal (economic policy implemented by American president F. D. Roosevelt and involving public works, extending attractive loans to businesses and farmers, introduction of old age pensions, disablement insurance, unemployment insurance, price control for many products on the market).

The fundamental economic role of the state as envisioned by Keynes was in the beginning aimed at redistribution of income. By way of redistribution and budget policies, the state regulates the uneven market income distribution. However, later on the state assumes a whole range of non-economic functions (public services).

In his book "The General Theory of Employment, Interest and Money" published in 1936, Keynes moved the emphasis away from the micro towards the macro level of economy. The focus is no longer on the economic subject - it has shifted to its surrounding factors. Equally, we are no longer talking about prices and wages but aggregates such as national income, total consumption, total savings, investments, etc.

Keynes's welfare state model reached its golden age in the 1950s and 1960s. High rates of economic growth that the West had achieved in post-war years along with relatively high employment and stable prices were a strong support for welfare state.

Welfare state has deeply transformed economic structure of modern capitalism. Familiar and often quoted welfare state models developed in Sweden, the USA and Great Britain. However similar they are, their objectives , mechanisms and scope of state intervention in economic and social sphere are still quite different. The Swedish welfare state model is the most comprehensive (social services are most developed there), while the British model is an attempt at creating a balance between market and state mechanisms of social intervention. The American model, however, has fewer protective measures than the British one.

THE WELFARE STATE CRISIS

Peter Drucker described welfare state as an "authentic 20th century contribution to the modern omnipresence of state". Through fiscal policies and nationalisation of public services the state has succeeded in establishing control over the great part of life in the society.

However, in the late 1960s and early 1970s traditional state-interventionist measures became less and less effective. Keynes's state-interventionist model was caught up in a crisis, particularly during the 1970s recession when welfare state was seriously shaken up. The oil shock (rapid price increase of oil on the part of the OPEC) generated inflation. The rate of economic growth was falling and unemployment started going up (so-called technological or structural unemployment). It became evident at the time that this type of state interventionism did not meet the requirements of contemporary scientific and technological revolution. Interventionism could not deal with some newly emerged phenomena such as the process of stagflation and slumpflation . This system of measures also proved inefficient in solving problems of global nature. Moreover, this model did not take into consideration the social and environmental cost of economic activity.

Reviewing Keynes's state-interventionist model in new conditions, J.K. Galbraith noted: "This is the fate of Keynesian revolution. As proved many times in economic theory, his model was suited to the times, but those times are gone and unfortunately the model is no longer viable."

For years, economic-political asymmetry was getting stronger, together with micro-economic dynamics and changes that were neither included by Keynes's theory nor practically dealt with. (7)

The welfare state crisis manifested itself mostly as the state fiscal crisis. If we are to analyse its causes, we first need to consider the structure of state expenditures.

The greatest single item in the total state spending is the expenditure for legitimation functions, among which the cost of maintaining the military is the highest. It is a well-known fact that these expenditures have in the post-war period marked a significant increase. There is a marked growth of military-industrial complex.

In the conditions of scientific and technological revolution, the state has taken over part of the costs of research and development. We could say that in these conditions state interventionism takes on new dimensions. Fundamental scientific research (space research, etc.) requires great investments. This research is carried out over long periods of time, it does not (always) provide immediately applicable results, and there is always a high degree of risk involved in the outcome of research. These factors make research costly, making exclusive corporate financing difficult if not impossible. State support in the financing is unavoidable. Since the state takes over part of the cost of research and development, in the conditions of the third industrial revolution the state assumes a wholly new role - the role of development.

Apart from this, the state also finances large industrial projects (e.g. construction of nuclear power stations, air plane construction, etc.) and stimulates development of new industries (robotics, computer science).

The third industrial revolution has brought about a faster pace of technological innovation in numerous fields of industry. Turn-over of fixed capital is shorter (due to faster amortisation) and so is the turn-over of circulating capital. Risks to large capital grow. Large companies encounter constantly rising costs of market research, advertising, etc. Due to these factors, there is a growing pressure on the state to ensure minimal fluctuations and high enough profits, even at the cost of permanent inflation.

The state has also taken over a whole range of non-economic activities (public services). Social development, particularly modern technological development could not advance without higher level of literacy and general education among the population, without organised health care services and without a general underlying economic infrastructure. These services are of common benefit as they provide welfare for all, but they do not generate immediate profits. The state can, through laws and regulations, implement fiscal policies (taxes, etc.) and so channel part of the income from other subjects to these subsystems.

Modern welfare institutions (social policy in labour force market, industrial relations, etc.) are becoming increasingly more state regulated. It needs to be pointed out that expansion of state functions requires expansion of the apparatus needed to perform these functions. Bearing all this in mind, it is evident that modern "welfare state" is not only all-embracing but it is also expensive; state spending is permanently growing.

Constant increase in state spending forces us to consider the fiscal crisis of the state, caused by steady pressure on the state to increase spending on one hand, and limited budget on the other. State expenditures (for maintenance of high employment and demand) are financed from taxes, deficit and public debt. As these are not accompanied by profit-making production, their financing leads to inflation. (It is a fact that the state can not permanently keep raising taxes as this would cause political resistance). Moreover, frequent tax policy changes bring with them an undesirable element of uncertainty that may cause dropping interest on the part of corporations to promote modernisation and technological progress. State spending was able to generate high employment as long as there was private capital expansion (i.e. as long as productivity in private sector was growing). The 1970s recession shrank the expansion of private capital.

If state spending grows too fast, it will stimulate the process of real depression. In the 1970s this depression was manifested as a deep structural and many-fold depression assuming world-wide dimensions. Firstly, it was manifested as energy crisis (prices of oil and other sources of energy reached an all-time high) and as environmental crisis that would eventually grow into a long-term movement. Unemployment was on the rise, etc.

Events of the 1970s were in some way a parting with a well-rounded system of a mature industrial epoch. Little by little, the foundation on which it had grown started to vanish: mass machine production, Taylorian work organisation, bureaucracy (huge managerial and administrative apparatus, etc.). The "un-massing" process began, marking a creative breakdown of a mass society.

It is understandable why Keynes's state-interventionist model that sprang out of the Great Depression began showing its weaknesses in modern conditions.

In mid-'70s and particularly early '80s there was a rapid rise of neo-liberalism (neo-conservatism) (8).

CRITICISMS OF WELFARE STATE AND NEO-LIBERAL APPRAOCH

The concept of welfare state has met with a lot of criticism, particularly from the monetarists. Various critics mainly proceed on the assumption that market is a better mechanism than state institutions in serving public interests and that state interference in economic processes should be minimised. They claim that causes of crisis in welfare state stem from too many forms of planned (prescribed) state interference in the economy, thus multiplying administration. Furthermore, they blame the state for falling savings, too many social taxes, etc. Taking away part of the profits and channelling them into social security, the state is responsible for lower profits and therefore lower motivation on the part of businesses.

In opposition to the welfare state concept, in the late 1970s and early 1980s the idea of liberal (so-called minimal) state became popular again favouring as little state interference in economic processes as possible. The emphasis is again on private property, private initiative and operation of market laws, etc. The foundations of neo-liberal thinking can be observed in the work of the Nobel Prize winner Friedrich Hayek, a spokesman of the famous Austrian school of thought. Hayek believes that economy should be free of state interference. Furthermore, he thinks that private property and private initiative as base for free competition are the only way to ensure rational and successful economy.(9)

The founding father of monetarism Milton Friedman (a Nobel Prize winner) and the founder of the famous Chicago school of economics is also a great supporter of free market and private enterprise. In his book "Capitalism and Freedom" he proves that free exchange economy among private companies is the only form of organisation that actually respects an individual's right to freedom. Only in this type of economic system could economic activities be co-ordinated without compulsion. (10)

Friedman goes on to say that state is necessary for safeguarding individual freedom, law and order, for guaranteeing the viability of private contracts, for promotion of competition, etc. The state should engage in activities directed against technical monopoly, it should set the legal minimum wage and legal maximum prices, etc. However, its "scope of authority must be limited, as concentration of power in the hands of politicians is also a threat to freedom". (11) In an ideal society, the state should provide framework for free individual action.

The essence of Friedman's contribution to economic theory boils down to the notion that monetary measures have a concrete effect - they are a guide to successful economy. Friedman and the monetarists complain that Keynesians view wrongly the place and role of money in the economy. The cheap money policy results in an increase of monetary mass that causes an artificial drop of interest rates in order to stimulate investment, all of which is harmful because it leads to inflation. The monetarists are of the opinion that primary role of state policy is to keep a lid on the inflation by firm control of the monetary mass.

Other supporters of restricted state interference in economic processes are rationalists Robert Lucas, Thomas Sargent and others. One of the essential views featured in their thinking is the theorem on inefficiency of politics. Information available to the creators of state policies is no better than the one available to the individuals, so that any real decision can have no new effect on private decisions. For example, in case of an expected inflation, economic subjects can (since they have a multitude of cheaply available information) balance the expected with the real rate of inflation. The only truly efficient measures would therefore be unexpected measures. Similar case in point is fiscal policy: reduction in taxes will have no effect on savings or motivation.

One of the reactions to excessive state intervention was also the supplyside economics . In opposition to Keynesian approach which was geared at demand, the spokesmen for supplyside economics. (M.Feldstein, I.Kristol, O.Ekstein, G.Gilder and others) put a stress on supply and production. They supported lower taxes for private capital in order to increase savings, investment and labour supply. On the other hand, the drop in budget revenues brought about by lower taxes could be compensated for by increasing tax platform as it is to be expected that the number of economic subjects will grow and so will their income. They also favour a narrowing down of the state's social role (reduction of social transfers, reduction of unemployment benefits, etc.)

The above ideas were implemented in practise in the 1980s during the Reagan administration. (Similar economic policy was also carried out in Great Britain by M.Thatcher.) During this period taxes were greatly reduced in order to stimulate businesses at the expense of consumption.

The policy attempted to bridge the gap between public and private sector in favour of the latter. At the outset, these measures had given positive results (inflation was reduced and employment went up). However, the outcome was not what it was expected to be - instead of going up, the rate of economic growth went down, and instead of a balanced budget there was an increase in budget deficit.

The supporters of public choice theory (J.Buchanan, G.Tullock, R.Coase and others) are also very sceptical about the state's ability to deal with economic and social problems. They believe that these problems should be transferred to private sector or local authorities and that state spending should be restricted by constitution.

The turn towards (neo) liberalism in mid '70s and early '80s was a logical reaction to excessive state intervention in all areas of life and, particularly, in the economic domain. Faced with the alternative of choosing between intervention and market, economic policy decided in favour of stronger market mechanisms. In modern conditions, however, it is impossible to talk about pure state intervention cases as opposed to pure market. It is always a mixed case of both (still, there is cyclic resurgence of periods with stronger state intervention as opposed to market and vice versa, which is related to cyclic shifts in modern-day economy.)

NEW TRENDS IN STATE INTERVENTIONISM

Present-day conditions have brought about numerous and far-reaching changes in material production (owing to technological advances) that have transformed welfare state.

New technologies are changing industrial production and the consequence of these changes is the need for new organisation and management of production processes. The emphasis is on flexibility (fast adaptability to changes) and organisational networking rather than on hierarchy. In the networking process, people talk to one another, exchange ideas, resources and information. (12)

The management must make sure that the company and each individual member grows and develops in harmony with the needs and changing situations. (13) Managers are required to be permanently adaptable to the new and to changes.

There is a clear trend towards individualisation in all spheres of social life. New techniques and technologies cancel out the fundamental feature of earlier industrial production - its mass aspect.

Scientific and technological revolution has completely altered all forms of human activity. But in these altered conditions the forms, objectives and state intervention mechanisms are changing too. State interventionism assumes new dimensions. It grows in the area of scientific-technological development, so we can talk about the state's function in development. To be more exact, this function involves planning, organising, financing and control of scientific research while generally it involves a set of measures implemented by the state to alleviate the consequences of rapid technological development.

In the economic domain, the stress is more on the functioning of market and market laws (faster development of technology makes competition more acute).

Economic privatisation is more and more present, i.e. the role of state ownership in modern capitalism is less significant so that efficiency in production can go up in the areas of former state-run forms of production.

Peter Drucker believes that modern economy is becoming more and more transnational and less and less dependent on individual national states. (14)

In transnaitonal economy there are four dominant units. The state is one of them. However, Drucker says that power is transferred more and more to another unit - the region - the European Community, North America, tomorrow perhaps to the Far East region gathered around Japan. Thirdly, there is a real world economy of money, loans and investments, organised on information that recognises no national boundaries. Finally, there is the transnational company that treats the whole developed world as one single market. Transnational companies conduct their business with planet as a single space witrhout economic or political barriers.

There is also the new transnational environmental science since environment, like information, knows no national boundaries. Essential environmental needs such as protection of atmosphere or world rain forests can not be dealt with by laws of a single country. These issues require a common (transnational) policy. (15)

In organisation of modern societies the state will intervene less in the economic domain than has been the case up to now. It is to be expected that interventions will be felt in other areas of social life such as development, social and environmental issues.

In the social policy domain there is an evident tendency to transfer part of the social functions from public to private sphere, i.e. to make the system of social affairs as independent as possible and as competitive as feasible. Secondly, a smaller part of state functions in this domain could be taken over by a variety of non-profit associations based on solidarity and self-help (people should be stimulated to look after themselves more and be less dependent on the state). The third option is the one that involves a minimum of state intervention in the social domain.

Free enterprise is today the most significant component of development. To sum up, the stronger market mechanisms have brought about changes in welfare state.

CONCLUSION

Regardless of the changes it has encountered and is still encountering, welfare state is a corner-stone of modern civilisation.

Keynes's welfare state as a model is not suited to the conditions of modern post-industrial society and this is why it is undergoing transformations we have discussed in this paper.

However, the notion of welfare is always a current one and has always inspired people in their quest for a better way of life. The need for a healthier and more humane life, for education, environment protection, urbanisation, etc. is very much present today.

Modern-day combination of state intervention and market mechanisms has perhaps been best described by Samuelson when he said that "he was a supporter of an economy with a heart, meaning that he accepted market but that democracy had to modify its extremes". Government regulations have to soften the crude individualism of market-oriented business. In areas were economy needs the social role of the state to make life more humane, it is necessary to restrict the market game and replace it with state intervention. (16)

NOTES

See: Economic Lexicon, Leksikografski zavod Miroslav Krle_a and Masmedia, Zagreb, 1996, pp. 157.

This was the objective of the British Fabian Society (founded in 1883) and the German Society for Social Policy (founded in 1872) which propagated measures of state economic and social policy aimed at harmonising class interests and promoting a harmonious development of society.

Keynes came early into contact with economic theory through his father, professor John Naville Keynes, and even more so as a disciple of Alfred Marshall.

In the United States alone, one fourth of the labour force lost their jobs. (For more details see Robert L. Heilbroner, Lester C. Thurow: Economics Explained (Ekonomija za svakoga), Ma - te, Zagreb, 1995, pp.33.

J.M. Keynes: General Theory of Employment, Interest and Money (Opæa teorija zaposlenosti, kamata i novca), CKD, Zagreb, 1987, pp.70.

J.M. Keynes: Ibid., pp. 13

Quoted from A. Puliæ: Informacijsko dru_tvo i ekonomija, Privredni vjesnik, Zagreb, 1990, pp.63.

Term neo-conservatism is used more in the USA, while in Europe neo-liberalism is more common; both terms refer to the same thing.

His ideas about a spontaneous, self-originated order generated from endogenous factors as opposed to the one generated by exogenous factors were presented in Hayek's work Law, Legislation and Liberty, 1973. See also Hayek's The Constitution of Liberty, 1960, The Fatal Conceit: The Errors of Socialism, 1989, The Road to Serfdom, etc.

See: M. Friedman: Capitalism and Freedom (Kapitalizam i sloboda), Globus and Školska knjiga, Zagreb, 1992.

M. Friedman: Ibid., pp.13.

John Naisbitt believes that network organisations are one of "ten new directions in development that are changing our lives".

John Naisbitt: Megatrends (Megatrendovi), Globus, Zagreb, 1985, pp.200

P. Drucker: New Reality (Nova zbilja), Novi liber, Zagreb, 1992, pp.204

P. Drucker: Nova zbilja, Chapter: Transnacionalna privreda - transnacionalna ekologija.

P. Drucker: Ibid., pp.104.

Quoted from: D. Buvač: Ekonomika sa srcem (Economy with a Heart), August Cesarec, Zagreb, 1990, pp.215.

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