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The Welfare State and Long-Term Economic Growth: Marxian, Neoclassical, and Keynesian Approaches

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The contradictory nature of the welfare state stems from its location at the interface of two distinct sets of "rules of the game." According to the rules of liberal democracy, formal political participation is universally extended, the rights of political contestation generally guaranteed, and claims on resources recognized on the basis of citizenship. By contrast, capitalism recognizes claims to resources and access to decision making, according to the ownership of property or the delegation of authority by property owners. Where these two games can be substantially separated, as in the liberal *laissez-faire* state, the contrast of the rules is of little immediate import. Where the games are overlapping, as in all modern capitalist welfare states, the long-term dynamic of the social order increasingly expresses the conflict between the regime of citizen rights and the regime of property rights. Whence the fundamental dilemma of the welfare state in liberal democratic capitalist society. On the one hand, when work is organized and controlled so as to offer few intrinsic pleasures, and where its rewards are distributed very unequally, any system of redistribution which provides access to an acceptable standard of living by dint of citizen rights, rather than the exchange of labor power for a wage in the long run, will tend to reduce both the hours of labor supplied to capital and the intensity of work effort. On the other hand, workers in liberal democratic societies are able to resist social arrangements which are thought to be contrary to common standards of fairness and decency—standards themselves deeply ingrained through the experience of liberal democratic processes. The forms of resistance—whether strikes, demonstrations, or a "bad attitude" toward work—may significantly retard investment and work effort.

It is due to this dual and contradictory set of effects that the post-World War II evolution of the advanced capitalists economies exhibit no overall growth retarding or promoting effects of the welfare state: some have experienced substantial redistributive expenditures and rapid growth (Denmark, Austria), others limited redistribution and rapid growth (Japan, Spain), and still others limited redistribution and slow growth (United States, United Kingdom).

During the early post-World War II period, the economic rationale of the welfare state was provided by a combination of Keynesian and "human capital" arguments. In the Keynesian model, economic growth is constrained by effective aggregate demand. State-sponsored redistribution policies thus may accelerate the pace of economic activity to the extent that they place additional income in the hands of families with relatively high marginal propensities to consume. In addition, human capital theory suggests that when oriented towards health and education, such redistributive programs contribute as well to the quality of the labor force, and hence the growth potential of the economy.

Neoclassical economics, which stresses the determination of the rate of growth by the incentives to save and to supply labor services, has never looked with favor upon the Keynesian analysis. With the apparent weakening of demand constraints on growth and the ostensible increase in the burden of financing social welfare programs, the neoclassical perspective has experienced a renewed respectability in macroeconomic thinking. Further, neoclassical economists are now more likely to stress the growth retard-

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ing and labor supply effects of greater economic security than the labor quality enhancing effects of social programs.

Despite the many insights of the neoclassical and Keynesian approaches, we believe they share several analytical weaknesses which preclude their understanding the general effect of the welfare state upon a major determinant of long-term economic growth: the increase in output per labor hour.

Output per labor hour depends upon the amount and quality of capital goods per worker, the quality of skills embodied in workers, the organization of the work process, and given these, the ability of the employer to elicit from workers a high level of work effort. This last factor, known in the Marxian literature as the "extraction of labor from labor-power," is consistently overlooked in both Keynesian and neoclassical theories.

While economists generally acknowledge the practical problem of "labor discipline," this issue cannot be treated analytically due to two systematic methodological errors common to traditional theories. The first, which we shall term *economism*, is the representation of the process of production as a set of technological interactions governed by the exchange of property claims in inputs and outputs. Economism involves obscuring the nature of political relations within the economy: while issues of power, participation, and conflict may occur in the capitalist economy, they are treated as peripheral to the structure and dynamics of economic life.

The second error, common to that small minority of neoclassical economists who do treat production as a social process, is to consider only the type of conflict arising due to the ubiquitous divergence of interest between the individual and the collectivity, and which is summarized as the "free-rider problem." This Hobbesian view of conflict is not wrong, but it overlooks the structural conflict of interest in the production process between capital and labor.

We believe that economism and the exclusion of class relationships in production preclude understanding, among other important pheonomena, the effects of the welfare state on output per labor hour, central to which are the power relations between labor and capital within the production process itself as much as within the larger society.

Traditional economics obscures the political nature of production by treating the contract between employer and employee as analytically indistinguishable from other exchanges of private property. Yet it is fundamentally different in two respects. First, the terms of the contract are incomplete, in that the worker does not agree to the delivery of a specific product. Indeed, if the exact product were specified (a repaired machine, for example), the contract would not be for wage labor, but for a labor *service*. Second, the payer of the wage has extremely limited disposition over the worker during the period of contract, in that the latter is prohibited from alienating the bulk of his or her civil rights; the capitalist possesses no formally sanctioned direct control over the worker other than the power to terminate the labor contract.

Consider the competitive capitalist whose output and hence profit depend upon an array of material inputs and services and labor. The cost of the material inputs and services is simply their market price; but labor itself (work) bears no such market price. Its cost depends jointly upon the price of labor power and the capitalist's costs of extracting labor from the worker once hired. The production process may thus be considered the unity of two types of relations: one the technical combination of inputs, including labor; and the other the process of transforming the employer's formal jurisdiction over the workers' time into the actual performance of labor.

Towards this latter objective the capitalist may employ a variety of strategies and instruments. These fall into two major categories, the first involving influencing the goals and objectives of workers (the "carrot" strategy), and the second involving optimizing the constraints placed upon the worker's behavior (the "stick" strategy).

The costs of the carrot strategy, which normally involves the development of a capital-labor relationship within which workers feel committed to the attainment of the goals of the enterprise, include the improvement of

working conditions, the guarantee of secure tenure of employment, a sharing in productivity gains, and a general ministration to the needs of workers. The Swedish and Japanese economies appear to have been characterized by highly effective though radically different carrot strategies over most of the postwar period.

The stick strategy also involves significant costs to the employer. For simplicity we limit these costs to two: those of direct supervision and the threat of firing. The cost of supervision includes labor and materials, and the adoption of technologies which yield efficient surveillance to the employer as a joint product. The direct cost to the employer of firing a worker is simply that of finding and training a replacement. But for the *threat* of firing to be effective, job loss must impose a cost upon the worker. This cost is basically the worker's current after-tax wage income minus the expected value of income should the worker be fired. For there to be a positive threat of firing, the profit-maximizing capitalist will in general pay a wage *above* the supply price of labor. The cost of the *threat of firing* to the capitalist is simply this differential. (See Bowles, 1981 and Gintis, 1976.)

By demonstrating that the labor market is characterized by a nonclearing equilibrium, this analysis explains a phenomenon ill understood in traditional economics: the persistence of a positive level of wages in the face of long-term unemployment. Traditional theory would predict, in this situation, a secular decline in wages. Yet clearly the lowering of the wages of employed workers to the workers' next best alternative would eradicate the threat of firing, and hence seriously weaken the employer's ability to extract work from his workers. Thus the maintenance of competitive wages above the worker's next best alternative even in glutted labor markets is far from an anomaly; it is a reasonable expectation generated from a theory which rejects the technical conception of the production process.

Now let us define *citizen income* as that part of the worker's consumption bundle supplied not through the wage, but through the state in the form of free or subsidized goods, social services, and insurance. What is the effect of an increase in citizen income, both absolute and in relation to earned income, upon the productivity of labor? We suggest three general effects.

First, there is a significant "macro carrot" affect, noticeable in numerous advanced capitalist countries in the postwar period: insofar as the growth of the citizen wage represents a quid pro quo for relatively harmonious capital-labor relations in production, the welfare state may enhance work effort. The strong negative relationship between strike incidence and the extent of social democratic participation in government is suggestive of this carrot effect.

A second and offsetting effect will be an increase in the cost of the "micro stick" strategy of the employer. To the extent that the welfare state and its associated Keynesian fiscal policies reduce the expected duration of unemployment, provide an income cushion for the worker, and compensate for the loss of wage income, there will be a general upward pressure on wages and the costs of supervision, as the relative cost to the worker of being fired is reduced, and hence the efficacy of a given wage and supervision level in achieving a high level of work effort is eroded.

A third and closely related implication concerns the impact of increases in state redistribution on the sensitivity of wages and work effort to the level of unemployment. The increase in the citizen component of income both lowers the cost of job termination to the worker, and reduces its variability over the business cycle. The continued efficacy of the threat of firing thus requires increasingly high levels of unemployment. A strong argument can be made that the reduced cyclical variability of wages—the oft-heard lament that recessions are no longer effective in diciplining labor—is traceable at least in part to the relatively rapid growth of citizen income.

The ascendancy of growth-inhibiting monetary policy in the United States, England, Germany, and elsewhere is doubtless a response to this situation. One of the major effects of the welfare state may thus have been to force capital to advocate growth-re-

tarding macroeconomic policies in the interests of maintaining its power over labor.

The neoclassical and Keynesian errors concerning the theory of investment exactly parallel their shortcomings concerning the labor process. In the neoclassical view, the supply of investment is determined by the supply of savings, much as the supply of work effort is typically assumed to be determined by the number of hours of labor hired. The Keynesian view, though quite distinct, is at one with the neoclassical in ignoring the political determinants of investment except insofar as these are expressed in movements of aggregate demand.

One of the major impacts of the welfare state may have been its ability to foster a favorable investment climate. Yet the importance of "labor peace" as a determinant of investment may easily be overlooked in those theories which adopt closed economy assumptions, which conceive of production as a technical relationship, and which represent the level of investment as determined either by savings or the growth of consumer demand. These shortcomings of the neoclassical and Keynesian theories are only symptomatic of their general lack of concern with the question of the evolution of the institutional framework of the economy and its characteristic power relations.

In short, the level of welfare expenditure is not simply a policy variable the effects of which can be gauged on the presumption that the institutional structure within which production and distribution takes place will remained unaffected. Rather the welfare state is an integral aspect of the reproduction of the entire institutional structure. The alternative to the welfare state is thus not simply less redistribution, but includes possible institutional transformation. The possible patterns of economic evolution consistent with the no-welfare-state option are thus widened to include chaos, stagnation, and the development of new and perhaps unprecedented economic systems.

Current advocates of cuts in the welfare state might do well to consider the effects of this broadening of possibilities and of the likely sharpening of class and other distributional conflicts on both the capitalists' propensity to invest (their so-called "animal spirits") and on their ability to extract work from workers without further allocations of both labor and social product to the wasteful task of simply policing the labor process and maintaining order. The attack on the welfare state appears to be moved by the illusion that the go-go economy of the early 1960's can thereby be retrieved. But the stagnant Eisenhower years or the tumultuous 1920's and 1930's appear to provide at least as likely scenarios.

A central premise of the now dominant neoclassical policy is the use of labor market clearing as the central means of economic stabilization. Yet a quite secure generalization of the historical experience of liberal democratic capitalist countries is that their working classes have quiescently accepted capitalist property relations only upon condition of severe curtailment of the operation of the "free market in labor." In short, labor has quite systematically pressed for carrot policies both on the economy-wide and the firm level.

In this light, the practical truth of the Keynesian model is *not* the rejection of the role of the rate of interest in eliminating an excess supply of savings, but rather the rejection of wage-rate flexibility as the means for eliminating an excess supply of labor, and high levels of unemployment as a corresponding means for disciplining labor. Keynesian economic policy, rather than representing merely a more or less adequate tool of macroeconomic policy, in fact embodies the principles of the "accord" between capital and labor which characterized the bulk of the postwar period, within which the carrot approach to labor discipline is affirmed and applied.

Yet the Keynesian strategy, as Kalecki pointed out less than a decade after the publication of the *General Theory*, is beset by inherent problems as a system of long-term management of the capitalist economy. The accord on which it is based structures capital-labor relations in a manner potentially adverse to the distributional interests of capital, and progressively weakens micro

carrot strategies of labor discipline. On the other hand, it is acceded to by labor at the significant cost of relinquishing in large part contestation over power in the economy itself. The accord is thus rendered tenuous and fragile in a situation of faltering growth potential of the economy. With a high level of citizen income and low economic growth, the social prerequisites of high levels of labor productivity are eroded, leading to a further reduction in growth potential, and eventually to a breakdown of the accord itself.

The resurgence of neoclassical policy, committed as it is to the restoration of labor market flexibility, reflects and accelerates the breakdown of this accord and the resulting polarization of economic interests so evident in the past decade. But this return to the strategy of the stick, unless accompanied by a considerable erosion of the democratic political process, is, if our argument is correct, as internally contradictory as the Keynesian carrot.

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