

Political Economic Digest Series 23

Dear Political Economic Digest Series Participant,

Welcome to the twenty third issue of Political Economic Digest Series. In the last issue of Political Economic Digest Series we discussed about the concept of Flat Tax. In this issue, and the next issue (twenty fourth issues) we will be discussing about the concept of Welfare State and the argument for and against it. In this issue we will get the general concept of Welfare State and its history and against argument on welfare state. The twenty forth issue will cover reading on arguments for the welfare state. Similarly, the second reading is an essay by Tom G. Palmer "The Tragedy of Welfare State" which is in the book "After the Welfare State". We hope you'll enjoy this reading.

What is Welfare State?

In the strictest sense, a welfare state is a government that completely provides for the welfare, or the well-being, of its citizens. Such a government provides for its citizens' physical, material and social needs rather than the people providing for their own needs. The purpose of the welfare state is to create greater economic equality or to ensure at least a certain minimum standard of living for all citizens.

Types of Benefits Provided

A welfare state provides education, housing, sustenance and healthcare for its citizens. It also provides benefits such as pensions and unemployment insurance, and it provides equal wages through price and wage controls. This type of government provides public transportation, childcare, social amenities such as public parks and libraries as well as many other goods and services. Some of these things are paid for through government insurance programs, and others are paid for by taxes.

Systems Used

Most advanced nations are not true welfare states, although many provide at least some social services or programs. In some countries, these goods and services generally are available only to people who meet certain eligibility requirements. Those who meet the requirements, however, are entitled to these benefits. This type of system is frequently referred to as a "safety net" that is designed to help people who are in need. Most often, these systems will provide basic needs such as food and housing.

A welfare state is socialist in nature. It redistributes wealth by more heavily taxing the middle and upper classes to provide goods and services for the needy. Even countries that don't practice socialism, however, typically will offer at least some form of safety net. These programs might be available to individuals on a temporary or permanent basis, depending on their needs and circumstances.

Difficulties Experienced

One problem that has been associated with welfare states is the difficulty in creating an efficient system. Some countries are unable to provide equitably for all of their citizens. The rationing of goods and

services also becomes a problem when too many people depend on the welfare state to provide for their basic needs. Another problem is that many people who are capable of providing for them have no motivation to improve their lives because they can rely on the government to provide for them. This often breeds resentment by people who do work and are taxed more heavily to pay for the support of people who do not work.

Extracted from: <http://www.wisegeek.com/what-is-a-welfare-state.htm>

History of welfare states

Germany

Otto von Bismarck, the first Chancellor of Germany, created the modern welfare state by building on a tradition of welfare programs in Prussia and Saxony that began as early as in the 1840s, and by winning the support of business. In the 1880s he introduced old age pensions, accident insurance and medical care that formed the basis of the modern European welfare state. His paternalistic programs won the support of German industry because its goals were to win the support of the working class for the German Empire and reduce the outflow of immigrants to the United States, where wages were higher but welfare did not exist. Bismarck further won the support of both industry and skilled workers by his high tariff policies, which protected profits and wages from American competition, although they alienated the liberal intellectuals who wanted free trade.

United Kingdom

The United Kingdom, as a modern welfare state, started to emerge with the Liberal welfare reforms of 1906–1914 under Liberal Prime Minister Herbert Asquith. These included the passing of the Old-Age Pensions Act in 1908, the introduction of free school meals in 1909, the 1909 Labour Exchanges Act, the Development Act 1909, which heralded greater Government intervention in economic development, and the enacting of the National Insurance Act 1911 setting up a national insurance contribution for unemployment and health benefits from work.

In December 1942, the Report of the Inter-Departmental Committee on Social Insurance and Allied Services was published, known commonly as the Beveridge Report after its chairman, Sir William Beveridge, proposing a series of measures to aid those who were in need of help, or in poverty. Beveridge recommended to the government that they should find ways of tackling the five giants, being Want, Disease, Ignorance, Squalor and Idleness. He argued to cure these problems; the government should provide adequate income to people, adequate health care, adequate education, adequate housing and adequate employment. It proposed that 'All people of working age should pay a weekly National Insurance contribution. In return, benefits would be paid to people who were sick, unemployed, retired or widowed.'

The basic assumptions of the report were that the National Health Service would provide free health care to all citizens. The Universal Child Benefit was a scheme to give benefits to parents, encouraging people to have children by enabling them to feed and support a family. One theme of the report was the relative cheapness of universal benefits. Beveridge quoted miners' pension schemes as some of the most efficient available, and argued that a state scheme would be cheaper to run than individual friendly societies and private insurance schemes, as well as being cheaper than means-tested government-run schemes for the poor.

The report's recommendations were adopted by the Liberal Party, Conservative Party and then by the Labour Party. Following the Labour election victory in the 1945 general election many of Beveridge's reforms were implemented through a series of Acts of Parliament. On 5 July 1948, the National Insurance Act, National Assistance Act and National Health Service Act came into force, forming the key planks of the modern UK welfare state. The cheapness of what was to be called National Insurance was an argument alongside fairness, and justified a scheme in which the rich paid in and the state paid out to the rich, just as for the poor. In the original scheme, only some benefits called National Assistance were to be paid regardless of contribution. Universal benefits paid to rich and poor such as child benefit were particularly beneficial after the Second World War when the birth rate was low. Universal Child Benefit may have helped drive the baby boom.

Before 1939, most health care had to be paid for through non government organizations – through a vast network of friendly societies, trade unions and other insurance companies which counted the vast majority of the UK working population as members. These friendly societies provided insurance for sickness, unemployment and invalidity, therefore providing people with an income when they were unable to work. Following the implementation of Beveridge's recommendations, institutions run by local councils to provide health services for the uninsured poor, part of the poor law tradition of workhouses, were merged into the new national system. As part of the reforms, the Church of England also closed down its voluntary relief networks and passed the ownership of thousands of church schools, hospitals and other bodies to the state.

Welfare systems continued to develop over the following decades. By the end of the 20th century parts of the welfare system had been restructured, with some provision channeled through non-governmental organizations which became important providers of social services.

The United States

Although the United States lagged far behind European countries in instituting concrete social welfare policies, the earliest and most comprehensive philosophical justification for the welfare state was produced by the American sociologist Lester Frank Ward (1841–1913) whom the historian Henry Steele Commager called "the father of the modern welfare state". Reforms like those instituted by Bismarck were strongly opposed by conservative thinkers such as the very influential English philosopher and evolutionary theorist Herbert Spencer who argued that coddling the poor and unfit would simply allow them to reproduce and delay social progress. Ward set out to systematically dismantle Spencer's arguments which he saw as delaying and paralyzing progressive government action. Central to Ward's theories was his belief that a universal and comprehensive system of education was necessary if a

democratic government was to successfully function. Ward's writings had a profound influence on a young generation of progressive thinkers and politicians whose work culminated in President Franklin D. Roosevelt's New Deal welfare state policies of the 1930s.

Oil countries

Saudi Arabia, Brunei, Kuwait, Qatar, Bahrain, Oman, and the United Arab Emirates have become welfare states exclusively for their citizens. All foreign nationals, including legal residents and legal long term employees are prohibited from partaking in the benefits of the welfare state.

Modern model

Modern welfare programs differed from previous schemes of poverty relief due to their relatively universal coverage. The development of social insurance in Germany under Bismarck was particularly influential. Some schemes were based largely in the development of autonomous, mutualist provision of benefits. Others were founded on state provision. The term was not, however, applied to all states offering social protection. The sociologist T.H. Marshall identified the welfare state as a distinctive combination of democracy, welfare and capitalism. Examples of early welfare states in the modern world are Germany, all of the Nordic countries, the Netherlands, Uruguay and New Zealand and the United Kingdom in the 1930s.

Changed attitudes in reaction to the Great Depression were instrumental in the move to the welfare state in many countries, a harbinger of new times where "cradle-to-grave" services became a reality after the poverty of the Depression. During the Great Depression, it was seen as an alternative "middle way" between communism and capitalism. In the period following the World War II, many countries in Europe moved from partial or selective provision of social services to relatively comprehensive coverage of the population.

The activities of present-day welfare states extend to the provision of both cash welfare benefits (such as old-age pensions or unemployment benefits) and in-kind welfare services (such as health or childcare services). Through these provisions, welfare states can affect the distribution of wellbeing and personal autonomy among their citizens, as well as influencing how their citizens consume and how they spend their time.

Extracted from: http://en.wikipedia.org/wiki/Welfare_state#History_of_welfare_states

The Tragedy of the Welfare State

-Tom G. Palmer

Many approaches to the welfare state focus exclusively on the intentions of those who support it, or offer mere descriptions of current income transfer programs. This essay draws on the economics of common pool resources to examine the welfare state as a dynamic and evolving system, a "tragedy of the commons" that has created incentives for its own exhaustion.

The welfare state has something in common with fishing. If no one owns and is responsible for the fish in the lake, but one does own all the fish he or she can catch and pull out of the lake, everyone tries to catch the most fish. Each reasons that “if I don’t catch the fish, someone else will.” Each of us may know that catching lots of fish now means that the lake will be fished out, but so long as others can catch whatever I don’t catch, none of us have an incentive to limit our fishing and let the fish population replenish itself. Fish are caught faster than they can breed; the waters are fished out; and in the end everyone is worse off.

Environmentalists, economists, and political scientists call that the “tragedy of the commons.” It’s a serious problem and is at the root of a great many of the environmental crises facing the world today, from depleted ocean fisheries to air and water pollution and other problems. But it’s not limited to environmental problems. The welfare state operates like a commons, too, and the tragedy is unfolding as you read this. In modern welfare states, everyone has an incentive to act like the irresponsible fishermen who fish out the lake, except that the resource we’re plundering is each other. Each person seeks to get as much as he can from his neighbors, but at the same time his neighbors are trying to get as much as they can from him. The welfare state institutionalizes what the French economist Frédéric Bastiat called “reciprocal plunder.” Because we can plunder each other, people reason, “if I don’t get that government subsidy, someone else will,” and each have an incentive to exploit the resource to exhaustion. They justify taking government funds on the grounds that they’re “just getting back what they paid in taxes,” even when some of them are getting a lot more than was ever taken from them. Everyone has an incentive to take. This tragedy has a dimension not present in the case of the depleted fisheries: because we’re plundering each other, we not only spend resources to plunder our neighbors, but we also spend resources to avoid being plundered by those same neighbors, which makes us all worse off to that extent. Not only are we plundered, but we are increasingly being plundered beyond all sustainable levels. The result is exhaustion. It’s where we’re heading now with welfare states:

- Governments have promised so many benefits to so many constituencies; all at the expense of each other, that the systems are unsustainable, but none of the recipients want to give up their benefits. We might do so in exchange for lower taxes, but we don’t even get that choice. Governments can borrow the money and put the taxes off until later, that is, until after the next election, when they’ll promise even more, to be financed by more borrowing.
- The pensioner demands an increase in state pension payments and even argues that it’s just payback for what was paid in. Those pensions are financed on a “PAYGO” (“Pay-As-You-Go”) basis, meaning that the taxes taken from current workers are paid out to current recipients. Any surplus of taxes over expenditures is just “invested” in government bonds, that is, promises to pay out of future taxes. That’s all the US government’s “Social Security Trust Fund” is: a big “IOU” “nestled in the bottom drawer of an unremarkable government file cabinet.” There really is no “Trust Fund.” It’s a gigantic scam. Today’s young people are being forced to pay for their grandparents’ retirement, their parents’ retirement, and—if they have any money left over—they will have to finance their own. State pension schemes are indistinguishable in their structure from classic “pyramid schemes,” also known as “Ponzi schemes” or “Chain Letters,”

which require that the base of people paying in increases indefinitely; when it stops growing, the pyramid collapses. Governments can postpone the inevitable by printing money or by borrowing money, but it's just that, a postponement, and with each postponement, the situation becomes worse. You can hear the rumblings of collapse now.

- The farmer demands a subsidy for his crops, which comes at the expense of taxpaying autoworkers; automobile firms and autoworkers demand "protection" from more affordable imports, as well as bailouts for failed firms. The trade restrictions raise the prices of vehicles for farmers and the bailouts for automobile firms raise the taxes paid by farmers. Autoworkers are plundered for the benefit of farmers, and farmers are plundered for the benefit of autoworkers. The cycle of reciprocal plunder goes round and round, with the vast majority of "winners" being losers after the cycle is completed. (Some, of course, who specialize in manipulating the political system and negotiating what Ayn Rand called the "aristocracy of pull," win much more than they lose. Politically connected Wall Street firms such as Goldman Sachs, mega agricultural firms such as Archer Daniels Midland, and others have profited handsomely from the aristocracy of pull.)
- We are boxed by tax systems into medical "insurance" systems (in the US payments for private insurance are tied to wages, while wage taxes finance "Medicare," and in Europe they are tied to taxes and in some cases to private insurers); this "third party financing" affects the choices available to us. Since such pre-paid "insurance" typically pays for routine care, as well as catastrophic events (like injuries from car accidents, being diagnosed with cancer, or falling sick), we have to ask for permission from the insurer, whether private or state, before we get treatment. More often than not "health insurance" is not really "insurance" although it's called that; it's pre-paid medical care, which creates incentives among consumers to overuse it, and incentives among insurance companies and governments to monitor consumers to determine whether we qualify for benefits. As consumers we can't exercise the same choices as customers that we exercise with respect to other important goods, so we are forced to act like supplicants, rather than customers, and increasingly medical care is rationed by administrators, rather than purchased by customers.

Benefits to particular identifiable groups are concentrated and costs are diffused over vast numbers of taxpayers and consumers, giving beneficiaries incentives to grab for more, while the plundered have little incentive to defend their interests. Each one thinks himself or herself lucky when he or she gets a benefit, but doesn't stop to think of the cost of the benefits to everyone else; when everyone acts that way, the costs become enormous. The poor suffer the worst, because a trickle of benefits may seem like a boon to them, when their very poverty is both perpetuated by the welfare state and deepened by the hidden transfers from the powerless to the powerful caused by protectionism, licensing, and other restrictions on labor market freedom, and all the other privileges and special deals the powerful, the educated, the articulate, and the empowered create for themselves at the expense of the weak, the uneducated, the voiceless, and the disempowered.

Immigrants are systematically demonized as “here to get our welfare benefits.” Rather than welcoming people to come and produce wealth, subjects of welfare states act to protect “their welfare benefits” by excluding would-be immigrants and demonizing them as locusts and looters. Meanwhile, political elites loudly proclaim that they are helping poor people abroad by using money taken from taxpayers to fund a parasitic international “aid industry,” dumping huge quantities of the agricultural surpluses that have been generated by welfare state policies (to subsidize farmers by guaranteeing floor prices for their products), and handing over loot to autocratic governments: in short, by internationalizing the welfare state. The entire process has been a disaster; it has undermined democratic accountability in developing nations, because the political leaders know that it is the foreign aid masters whose concerns must be addressed, not those of local citizens and taxpayers; it has fueled war lordism and civil war; and it has destroyed indigenous productive institutions. While citizen is set against citizen and citizen against immigrant in a vast system of mutual plunder (and defense against plunder), bureaucracies extend their control and both create and nurture the political constituencies that sustain them.

But mutual plunder is not the only salient characteristic of the modern welfare state. It has created one crisis after another, each an unintended consequence of foolish policies adopted for political reasons by politicians who don't have to bear the consequences of their policies. Two are gripping the world as I write this.

The Financial Crisis and the Welfare State

The financial crisis emerged at the intersection of human motivations and bad incentives. Those incentives were created by foolish policies, all of them traceable to the philosophy that it's government's purpose to control our behavior, to take from Peter to give to Paul, and to usurp responsibility for our lives. The seeds of the current crisis were planted in 1994 when the US administration announced a grandiose plan to raise homeownership rates in the US from 64 percent to 70 percent of the population, through the “National Partnership in Homeownership,” a partnership between the federal government and banks, home builders, financiers, realtors, and others with a special interest. As Gretchen Morgenson and Joshua Rosner document in *Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon*, “The partnership would achieve its goals by ‘making homeownership more affordable, expanding creative financing, simplifying the home buying process, reducing transaction costs, changing conventional methods of design and building less expensive houses, among other means.’ ” That extension to the welfare state seemed to sound so reasonable to many. Why should people not own their own homes just because they haven't saved for a down payment? Or don't have good credit records? Or don't have jobs?

Why not make homeownership “more affordable” through “creative financing”? Government agencies, such as the Federal Housing Administration, and “government-sponsored enterprises, such as the Federal National Mortgage Association (“Fannie Mae”), were directed to convert renters into owners by lowering down-payment rates, drastically lowering lending standards among banks, increasing the amounts of money going into the home market by buying and “securitizing” more mortgages, and a host of other measures. It was a bipartisan effort at social engineering. The Federal Housing Administration under the Bush administration offered loan guarantees on mortgages with zero percent down payment rates. As Alphonso Jackson, acting secretary of the Department of Housing and Urban Development,

gushed in 2004, “Offering FHA mortgages with no down payment will unlock the door to homeownership for hundreds of thousands of American families, particularly minorities.” He added, “We do not anticipate any costs to taxpayers.”

The US government deliberately and systematically undermined traditional banking standards and encouraged—in fact, demanded—increasingly risky lending. Risks that turned out well would generate private profits, and risks that turned out badly would fall on the taxpayers, for “a banker confronted with these new relaxed requirements could off-load any risky loans to the government-sponsored enterprises responsible for financing home mortgages for millions of Americans.” Private profits and socialized losses characterized the intersection of welfare statism and cronyism.

Home prices went up and up and up as more and more money were pumped into housing. It was like a party. Everyone was feeling richer, as the prices of their homes sky-rocketed. People took out “adjustable rate mortgages” to buy homes bigger than they were able to afford, because they expected to sell them before interest rates went up again. Credit was easy and Americans took out second mortgages to finance vacations and boat purchases. More and more houses were built in anticipation of ever-rising prices. The result was a housing bubble of enormous magnitude. People bought houses to “flip” them and sell them to the next buyers. Meanwhile, government financial regulators worldwide rated as low-risk what were in fact high-risk loans, including both government debt (bonds) and mortgage-backed securities. German banks bought Greek government debt and banks in the US and all over the world bought mortgage-backed securities that they were led to believe were guaranteed by the US government.

The interventionist policies of the US government to make homeownership more affordable, expand “creative financing,” and destroy sound banking practices were coupled with the arrogance of global government financial regulators who were sure that they knew the real magnitudes of the risks—and market participants risking their own funds did not. The result was that the global financial system was poisoned with risky loans, bad debts, and toxic assets, with disastrous results. Mortgage defaults rose as interest rates rose, and those “low-risk” mortgage-backed securities that institutions had been encouraged to buy turned out to be not so low risk, after all. Savings were wiped out, home owners found themselves unable to pay mortgages, financial institutions crashed and burned, and economic output fell. Numerous distortions of incentives caused by the entire system of intervention in both housing and financial markets are to blame, but without the policy of the American welfare state of “making housing more affordable” and “creative financing,” the financial crisis would not have happened. The global financial train wreck was the outcome of one bad policy piled on another; it was a train wreck set in motion by the welfare state.

The Debt Crisis and the Welfare State

While governments in the US and some European countries were frantically pumping up a gigantic housing bubble, the explosion of spending on welfare state programs for retirement pensions, medical care, and many other programs has plunged the governments of the world into a debt crisis. Much attention has been focused on the huge increase in government debt, and it has indeed been staggering. At the same time, those numbers are small when compared to the accumulated mountains of unfunded

liabilities, that is, promises that have been made to citizens and on which they are relying, for which there is no corresponding financing. If a private firm was to mislead the public and its principals about the magnitude of its obligations, as governments systematically do, the officers of the firm would be imprisoned for fraud. Governments manage to exempt themselves from sound accounting practices and deliberately and systematically mislead the public about the obligations they are loading onto the shoulders of future taxpayers. Governments find it easy to promise today to pay money in the future. But the future is arriving very fast.

Economists Jagadeesh Gokhale and Kent Smetters calculated (rather conservatively) in 2006 that the total federal budgetary imbalance for the US government in 2012 would be about \$80 trillion. The budgetary imbalance is defined as “the difference in present value between what the government is projected to spend under current law on all expenditure categories—entitlements, defense, roads, and everything else—and what it is projected to receive in taxes across all revenue accounts.” That was in 2006; Gokhale is currently updating the numbers, which he predicts will be higher. As Gokhale wrote, “Add the likely health-care cost increases associated with the new health-care law and this number is probably too optimistic, but we won’t know until my project nears completion. For Europe, I estimate an overall imbalance of €53.1 trillion as of 2010. That is, 434 percent of the combined annual GDP of twenty-seven EU countries of €12.2 trillion. That is also an under-estimate because the projections are made only through 2050 (unlike the US projections, which stretch into perpetuity).”

That means that those promises cannot be fulfilled and will not be fulfilled. Taxes would have to rise to astronomical levels to fund even a fraction of the current promises. Governments are far more likely not only to default on their acknowledged debts (bonds held by creditors), but to repudiate the promises made to citizens for pensions, health care, and other benefits. They have been lying to their citizens for years about their finances and the lies are made explicit when the promises are broken because they cannot be fulfilled, as we are seeing unfolding before our eyes in Greece. One way to repudiate their promises is to turn on the printing presses and pay them with piles of paper money, with more and more zeroes added to each note, which is to say, the currencies in which the promises are redeemed would be dramatically devalued. (Inflation is especially harmful as a means of dealing with debt, for it both distorts behavior and falls disproportionately on the poor and those unable to shield themselves from it.) The welfare states we know may be collapsing in slow motion in some countries, rapidly in others, but they are collapsing all the same and, as always, the burden will fall mostly on those lacking the political connections and the sophistication to avoid the consequences.

Many people indignantly respond to such facts by citing their intentions, in disregard of consequences. “Our aim is to help people; we did not deliberately aim to crash the world financial system by intervening into markets to make housing more affordable and lowering banking standards, nor did we intend to bankrupt our country!” they say. As the philosopher Daniel Shapiro quite aptly noted, “Institutions cannot be adequately characterized by their aims.” The best aims in the world, if combined with bad incentives via the wrong institutions, can generate terrible outcomes. The intentions of advocates of the welfare state are irrelevant to the outcomes of their policies. Most “political philosophy,” as it is commonly practiced, is about comparing one intuition about right and wrong with another. That, frankly, is not very helpful to the task of creating institutions that work, that are

sustainable, and that are just. For that we need much more than the mere comparison of intuitions; we need history, economics, and sociology, and political science, not merely moral theory divorced from practice.

The Future Is Imperiled, but Not Lost

The welfare states of today are directly responsible for the two great economic crises that are gripping the world: the global financial crisis that has turned economic growth rates negative in many countries and wiped out trillions of dollars of asset valuation, and the debt crisis that has rocked Europe and threatens to bring down some of the world's most powerful governments, currencies, and financial systems. Even the best of intentions can generate terrible consequences when implemented through perverse incentives and institutions. The story is not all doom and gloom, however. We can get out from under the welfare state and its crushing debts, humiliating bureaucracies, and reciprocal plunder. It won't be easy and it will mean summoning the courage to stand up to special interests and manipulative politicians. But it can be done and it must be done. Those who have demonstrated in the streets against "budget cuts" (usually merely cuts in the rates of increase in spending) are demonstrating against arithmetic. You can't keep adding negative numbers to negative numbers and get a positive sum; the numbers don't add up. We need demonstrations in the streets on behalf of reason, of fiscal responsibility, of cutting back the state, of freeing and empowering people to decide their own futures. We need a rolling back of the state's powers so that it is limited to protecting our rights, not attempting to take care of us. We need clear-eyed decision making about the capabilities of the state. We need an end to the welfare state.

For more information on Welfare State click the link below

<http://www.youtube.com/watch?v=EHjVxmJrpHo>