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The "Welfare State"

Economic Objectives and Financing

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Introduction

In the previous issue of "Industrial Relations", Maurice Tremblay devoted an article to showing the historical and sociological tendencies which have caused the "Liberal State" to gradually change into what is known as the "Welfare State". To him this latter appears as the State which undertakes, in addition to its traditional functions, to guarantee a minimum of social and economic security to its least-favoured citizens, by stimulating private economic activity and in making up for it when necessary. Perhaps it would be in order to point out more in detail the economic objectives of the Welfare State that the author indicated in this article and to examine the methods of financing set up in order to carry out this new economic policy.

We have the impression of proceeding with only a partial analysis of the ends and field of activity of the Welfare State, in limiting ourselves to the economic aspect of the advocated social measures. Subsequent essays will perhaps throw light on other important aspects of this welfare policy which the limited object of this article obliges us to put aside. It must not be concluded from this analysis that only the problems raised here are important and that once these are solved, this policy would be easy to apply. On the contrary, each discipline has its task to accomplish in order to overcome the difficulties to be met with in the carrying out of such a programme. But, its successful results are so evident and awaited with such impatience by the mass of citizens of modern democracies, that to be blocked by the secondary problems that arise, would be to betray the legitimate yearnings of the citizens and perhaps contribute towards their acceptance of a less desirable solution for their liberty.

The Welfare State has a double economic objective. First of all, maintain a high and stable level of employment and effective demand and secondly, stimulate national consumption by a plan of social security. In other words, to obtain maximum production of goods and services, in accordance with available productive resources, especially labour, then, to ensure a bigger part to the producing agents not favoured in this mass of goods and services.

All this economic policy is realized in a counter-cyclical budget where the outlays and incomes are synchronized with the different phases of the business cycle.

We shall analyse in turn these two objectives of the Welfare State. Then we shall study the problems raised by this counter-cyclical budget.

Fluctuating nature of capitalistic economy

What do we mean by stabilization of national income at a high level ?

First of all, we must define this concept of national income.

This represents the total of goods and services produced in a given period. These goods are produced either for future consumption, such as stocks of merchandise and products during the process of manufacture, for the producing of other goods, for example machines, tools, industrial and commercial buildings, or to satisfy human needs over a long period, as are public buildings, schools, *private* houses. These first three categories of goods make up what we call investments. Consumption includes goods consumed during the period in question as well as personal services. Therefore, during a given period, the national income is equal to the investments plus the consumption. In other words, the goods produced and services rendered are necessarily equal to that which remains unconsumed in the economic cycle plus the consumption in the period in question.

Why, then, should the authorities undertake to stabilize the national production at a high level ? Is not private initiative, that excellent motive force of liberal capitalism, sufficient ? It is to this first question that we must answer.

It has become commonplace to maintain that the Liberal State, in spite of the claims of its apologists, has known long periods of under-employment, that the operating statement of the economic activity showed a loss if compared with the maximum possibilities of the system. In fact, the cycle to which the economy was subjected, with its regular alternating periods of booms and depressions, left idle most of the time many productive resources: labour, machinery, plants, etc.

Why is an economy, which has profit and not service as its prime mover, necessarily thrown into these depressions which are the source of so many evils and which the modern states have set themselves the task of overcoming ?

It would be tiresome to outline all the theories that have been worked out to explain the constant variations of the economy in relation to the far-away position of full employment. However, it is easy to dispose of the under-consumption theories still very much in favour in certain popular and scientific circles. They explain the difficulty of the situation and the *constant progress* toward a depression by a temporary or permanent lack of effective demand for consumers' goods. These theories originate from a fact that can be readily verified, that of the fluctuating variation of the level of national consumption, but, they are not able to take account of the falling off of consumption without also taking account of the income of the former period. This, however, depends on the level of investments and consumption. From this point, we go around in circles, unless a major part of the investments do not depend on the level of consumption or on the level of income of previous periods. Therefore, however, we have a theory of under-investment and not a theory of under-consumption.

This theory of under-investment is the one which is most generally accepted to-day. It explains the variations in the income by basing itself on the investments which are not caused by changes neither in former investments nor in former consumption. These investments, which are called "autonomous", are made at a point so far away from final consumption that the latter cannot serve as a guide in the decisions to be taken in their regard, since these goods will be consumed only after several months or will serve to produce other goods which will themselves be consumed perhaps several years later.

The immediate factors which affect the production of these goods are the interest rate and the marginal efficiency of capital. Now, as the quantity of these goods produced increases, the marginal efficiency or return on the invested capital diminishes, due to the lesser scarcity of these goods and the increase in price of the production factors. The interest rate should go down constantly in order to permit a sufficient margin of profit. However, this interest rate has rather a tendency to go up because of the greater demand for liquid capital necessary to finance these investments. Even a more liberal policy on the part of the banking system, could not permit the continuation of these investments at the same rhythm, as there is a theoretical limit to the lowering of the rate of interest and this limit is indicated by the risk element, risk which is necessarily incurred by the lender of capital.

On the other hand, there is no limit to the lowering of the marginal efficiency of capital, which might even be negative for a long period. So that after a certain period of prosperity, that is of large-scale investments, the marginal efficiency of capital falls below the interest rate and new investments cease, because of lack of sufficient remuneration. This sudden falling-off of autonomous investments has a magnified effect on consumption which in turn causes a falling-off of induced investments and so on, by a process of interaction, the economy is started toward a depression. The total production, or national income, decreases constantly until the marginal efficiency of capital is again greater than the interest rate, because of new inventions, discoveries, increase in population or simply the deterioration of present equipment and machinery. A new phase of prosperity takes place and so forth, indefinitely, consumption only following investments in this procedure but in intensifying it.

These autonomous variations in the investment level do not have any direct relation to the level of income and consumption. They are caused either by an excess or by an insufficiency of durable production goods. Other investments such as stocks of consumers' goods, private and commercial buildings, etc., maintain a close relationship with the variations in the level of consumption. Furthermore this influence of consumption on these investments is magnified and we call this the principle of acceleration.

As to the influence that the autonomous and induced investments have on the level of consumption, we call it by the name of "multiplier". These two combined principles explain how a given variation in the level of investments causes subsequent variations in the same direction in consumption and investments, therefore, in the national income.

Counter-cyclical budget

It is now admitted by almost all economists that private economy, under the capitalist system, is necessarily subjected to these alternate periods of boom and depression and that full employment is a condition very rarely attained and only then by accident.

Moreover, in referring to the preceding analysis, it appears that no policy of stimulation of the private sector would be sufficient to maintain the national income at a high level, since the constant fluctuation of the level of private investments is inherent to an economic system having profit as its motive power. For this reason the Welfare State must assume a compensative function in order to reach its objective of maximum utilization of productive resources.

The moment that public authority decides to intervene by following a rational policy in order to stabilize the economy at a level of full employment, a whole series of decisions have to be made. The first consists in forecasting in the most exact way possible, the level of private investments as well as the consumption that this will cause. Then, it is necessary to determine the national income that it is desirable to attain, taking into consideration the labour and existing productive resources. After this, the policy to be followed to reach this objective must be determined. I will not insist on the first two steps that must be taken which do not raise any particular problem for economists aware of modern techniques of analysis and forecast. I will spend more time on the economic policy itself which is of particular interest to us.

The best instrument for control of the economy of which the State disposes is its budget. Its action on private investments and consumption is now recognized everywhere. In the past, this budget, considerably enlarged by war expenditures and the ever-increasing number of services demanded from the State, far from contributing towards the stabilization of the economy increased the phases of depression as well as those of prosperity.

While it was considered necessary to balance the budget annually, the investment expenditures were curtailed at the same time as the private sector, thus increasing the downward movement, at the same time as the rates of taxation were also raised, taking away a purchasing power that was already getting scarce enough. In a period of prosperity, with greater income, expenditures were increased excessively, thus contributing towards the inflationary trend of prices and monetary revenues. At the same time the excess of purchasing power present in the business cycle was left there by keeping taxes at too low rates. The State was following a cyclical policy of the same nature as the entrepreneurs of the private sector who at least had the excuse of being obliged to balance their budget annually or find themselves in bankruptcy.

The principle which is the basis of the economic policy of the Welfare State consists in making public investments fluctuate exactly opposite to private investments, and to finance capital expenditures in such a way as to not go against these, at a time when investment opportunities are exhausted, at least for a certain period.

Three policies may be adopted. The first consists in not making any supplementary expenditure to stimulate private investments, but to make the normal capital expenditures that a State must necessarily incur to ensure a reasonable service to its citizens, at a time when private investments are falling off. This rather timid policy does not necessarily bring up the national income to a level of full employment but at least it has the advantage of being rational. The second consists in using capital expenditures to make up the difference between the private investment level and the national income of full employment, and as a consequence financing these expenditures by taxes at the time the national revenue is at its maximum. This second budget will be higher than the first, but would be balanced like the first over a period of 8 to 10 years. Finally, the third policy consists of establishing a capital budget separate from the budget of current outlays, which would be financed by borrowing and necessarily, would always be in deficit.

The first policy would still leave many workers inactive and would necessitate relief to unemployed which is not a cure, and which it is preferable to replace by public works. The third policy is based on a very pessimistic theory of the possibilities of private investments that is difficult to accept, i.e. Hansen's stagnation theory. According to this theory, investment opportunities, as Capitalism progresses, will gradually diminish to the point where public investments will take a larger and larger part of the national income. These expenditures could not be financed by taxation but would have to be through borrowing.

The second policy, which is based on a budget over a period of 8 to 10 years, seems to be the most widely accepted. It includes a programme of public expenditures, especially public works, and an appropriate method of financing. Let us analyse briefly these two aspects of the counter-cyclical budget.

These public outlays set up two fundamental problems, the value and the nature of these works. These two problems cannot be solved independently from each other. In fact, if it is taken into account of the effect that these public works cannot fail to have on the level of private investment and consumption because of the double relation of the "multiplier" and the principle of acceleration, the amount spent on public works could be less than the difference indicated by the forecast at the start. If the multiplier is 2 and the acceleration 1, these expenditures could be only half of the amount that it would have required to compensate for a difference. This multiplier will be that much larger as from the sums received in revenues by the workers engaged in these public works, a small proportion will be saved, hoarded or used to pay off former debts. Furthermore, the higher proportion that wages are of the expenditures, the higher will be the multiplier. Therefore, works which require lots of labour and little capital, would be those which would have the most effect in stimulating consumption, income and employment; those which would have the highest multiplier. Consequently, in addition to the direct benefit of the works to the community, it is necessary to take into account the effect on the economy of the expenditures thus made.

This programme of public works requires also that we give consideration to the needs of the different economic regions, as well as the possibility that it offers to suspend it rapidly, in the case of recovery of private economic activity.

The other element of public expenditures is made of social security, of which the benefits are not adjusted to the cyclical fluctuations, with the exception of those of unemployment insurance, but of which the effect on consumption and through this on investments, is evident. These expenditures furnish a supplementary income to citizens whose marginal propensity to consume is very high and this stimulant to economic activity may contribute very much to our reaching of a higher national income.

As far as the methods of financing which are available to public authorities are concerned, they are of three kinds: a) Public or bank loans; b) Individual or corporation income tax, capital tax and succession duties; c) Taxes on consumption.

The influence on consumption and investments of these various methods of financing is very different. Taxes on consumption, because of their retrogressive character, hit hardest on the poorest social layers, consequently just where the marginal propensity to consume is the highest. A lowering of rates and a wider exemption for certain products, in a period of depression would have a tendency to stimulate consumption strongly. These taxes, because of the deplorable effect that constant variations of rates and of their extension to new products cannot fail to produce, should not be adjusted to cyclical fluctuations. Furthermore, the importance of these taxes tends to diminish constantly and thus serve as a supplement to social security.

Individual and corporation income tax, capital tax and succession duties have a direct influence on investments of durable and semi-durable consumers' goods, and on industrial products. It is therefore these taxes which must fluctuate in the opposite direction to the economic cycle and serve to finance the major portion of the supplementary public expenditures.

As far as bank loans are concerned, because of their strong inflationary influence, they may be used to advantage at a time when private investments are at a minimum on the condition that they are repaid at the time when the private national income is at its maximum.

Public borrowing showed itself during the last war, as a powerful method of holding down the inflationary tendencies of the economy at a time when the productive resources of a country are fully employed. In fact at a time when the demand for consumers' goods is too high, these public loans may serve as a method of absorbing an excess of purchasing power. On the other hand, in a period of depression, these loans cannot very well reduce consumption which is already at a very low level. Their effect is then rather to make idle savings serve for productive investments for the community. Another part of public capital expenditures may be financed in this way. As to how to determine in what proportion each of these methods of financing should be used, it would appear to be rather difficult. A whole series of factors which it would be too long to analyse must guide the public authorities in their choice.

Conclusions

To sum up this brief outline of the economic objectives and financing of the Welfare State, it may be concluded that the private sector of capitalist economy is necessarily subjected to these alternate periods of prosperity and depression, which rarely allow the attainment of a level of maximum utilization of productive resources. The State, which undertakes the responsibility of furnishing work for all must organize its budget in such a way as to stimulate as much as possible private investments and to compensate for them when they show themselves insufficient.

Based on a factual analysis of the development of the capitalist economy and on the recognition of the ever-increasing importance of public expenditures and income on the private sector of the same economy, the economic policy of the Welfare State represents the only formula, in our opinion, that can reconcile these two fundamental values of any political democracy, liberty and security.

It is much easier to be critical than to be correct.

Disraeli

* * *

There is nothing little to the truly great in spirit.

Dickens

The greatest riches are not to need riches.

Chrysostom

* * *

No man can sincerely try to help another without helping himself.

J.P. WEBSTER