

Three Normative Models of the Welfare State

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Abstract. In order to work out an appropriate division of labor between the public and the private sector, we need a normative standard that tells us what the state *ought* to be doing. In order to be credible, this standard needs to be more than just prescriptive, it must provide the basis for a broader reconstructive theory of the welfare state. The problem, however, is that even among supporters of the welfare state there are several different theoretical reconstructions of the normative commitments that are taken to underlie it, all of which are in tension with one another. In particular, the three normative purposes most commonly cited as providing a justification for the scope of welfare state activity are equality, community, or efficiency. These give rise to a corresponding set of models, which I refer to as the redistributive, the communitarian, and the public-economic models of the welfare state. My objective in this paper is to show that the public-economic model of the welfare state, although the least popular among political philosophers, is actually the most plausible. Not only does it provide a superior account of the existing configuration of welfare-state activities, but it alone is able to explain why, in all Western democracies, state spending rose almost continuously over the course of the 20th century as a fraction of GDP.

Key words: communitarianism, distributive justice, efficiency, equality, public goods, welfare state, Wagner's law.

The basic picture of the federal government you should have in mind
is that it's essentially a huge insurance company with an army.
Paul Krugman

The current political climate across the Western world is marked by a general presumption against state involvement in the economy. This does not mean that the state should have no involvement in the economy at all, or that one cannot make for case for an extension of the state's role. It simply means that, for any particular good or service, the default assumption is that it should be provided by the private sector. By contrast, public provision, or even public involvement, is something that must be argued for. One must show why the private sector cannot do something, or cannot do it well enough, in order to even begin to make the case for having the state do it. This allocation of the burden of proof is well summed-up in the German Social-Democratic Party slogan adopted in 1959: "markets whenever possible, the state when necessary." There is however something misleading about this slogan, insofar as it suggests that the proper demarcation between public and private can be determined in a purely technical, or value-free fashion, based upon when state involvement is "necessary." What sort of "necessity" is being invoked here? Obviously it is not a metaphysical sense of the term, but rather a normative one. State involvement will sometimes be necessary in order to achieve the type of social outcomes that we aspire to achieve. But according to what standard?

This is where the need for a normative model of the welfare state arises. In order to work out an appropriate division of labor between the public and the private sector, we need a normative standard that tells us what the state *ought* to be doing. In order to be

credible, however, this standard needs to be more than just prescriptive, it must provide the basis for a broader reconstructive theory of the welfare state. It must provide an account of how the welfare state came to assume the economic role that it currently assumes. After all, the most compelling response to the question of what the state *should* be doing would be grounded in a perspicuous understanding of what it currently *is* doing, and why it is doing it. A purely prescriptive approach runs the risk of producing little more than a wish-list of things that we would like the state to do. A more sophisticated approach would be constrained by an empirically-informed understanding of what the state is capable of accomplishing, as demonstrated by its track record over the course of its development. Hence the need for a normative *model* of the welfare state; one that offers a reconstructive account of the normative purposes that are already implicit in the practices of the welfare state.

For the purposes of this paper I focus my attention on views that are widely taken to provide sound justification for the scope and nature of welfare-state activity, held by people who might loosely be described as “friends” of the welfare state.¹ In adopting this approach, I am clearly assuming that certain normative purposes have efficacy – that the nature and scope of welfare state activity is at least in part a consequence of the fact that these activities serve the purposes posited by the model. The relationship could be quite direct (e.g. some significant segment of the population might vote for a political party that supports a particular welfare-state program because they are committed to the moral purpose that it serves), or it could be more attenuated (e.g. a program might be adopted for reasons having nothing to do with a higher moral purpose, but subsequent governments might find it difficult to abolish because the way that it serves this purpose has created a constituency prepared to defend it).

The central problem, as I see it, is that even among the most enthusiastic supporters of the welfare state there are several *different* theoretical reconstructions of the normative commitments that are taken to underlie it, all of which are in tension with one another. In particular, the three normative purposes most commonly cited as providing a justification for the scope of welfare state activity are equality, community, or efficiency.² These give rise to a corresponding set of models, which I refer to as the redistributive, the communitarian, and the public-economic models of the welfare state. The first sees the central function of the welfare state to be the redistribution of resources, with the goal of making the outcomes produced by the market economy less unequal. The second considers the

1] Thus I will be ignoring purely “realist” views, which consider normative vocabulary to be epiphenomenal – at best irrelevant, more often obfuscatory, concealing the true forces underlying the emergence and reproduction of the welfare state. I will also be ignoring normative theories that attach negative valence to the posited purpose – such as those that consider the welfare state to be the expression of purely paternalistic moral concern (i.e. “the nanny state”), or a form of creeping totalitarianism (i.e. “the road to serfdom”).

2] For a clear articulation of the difference between “equality” and “community,” as values, see Cohen 2009.

central function of the welfare state to be that of imposing limits on the scope of the market, in order to resist the commodification of certain domains of interaction. The last model regards the welfare state as playing a role essentially complementary to that of the market. According to this view, the welfare state corrects market failure, either through regulation, subsidization and taxation, or the direct provision of goods and services.

Each of these models has some plausibility, insofar as each provides an intuitively natural account and defense of certain features of the welfare state. Yet when it comes to explaining the major set of welfare-state programs – health, education, and the social safety net – the three models provide accounts that are completely at odds with one another. This has a number of pernicious consequences. Most obviously, normative confusion can lead to a weak or inconsistent defense of these programs in the public political sphere. More troubling, however, is that it can generate confusion in the sphere of public policy, leading to reform efforts that have no chance of success, or resistance to reform based on misguided notions about why the programs are the way they are.

Determining which model provides the more plausible reconstruction presents something of a challenge. As Robert Goodin has observed, there is an enormous range of activities currently undertaken by modern welfare states, and any normative reconstruction will necessarily have to divide these up into ones that are considered essential, or “core,” and ones that are considered peripheral (1988, 5). But since the core activities will simply be the ones that best fit the normative model in question, each model will tend to be self-validating. (This is in part why Goodin adopts the purely prescriptive aim of providing “reasons for welfare,” i.e. arguments that can be given in defense of the welfare state, but not necessarily those that explain its configuration.) There is, however, one aspect of the welfare state that any plausible model should be able to explain, viz. its spectacular growth over the course of the 20th century. Unfortunately, many of the normative models are quite static in their orientation – they seek to explain why the state does what it does, but have no account of how it came to be that way. In particular, they have difficulty explaining the seeming inexorability of welfare-state growth, and in particular, why the political ideology of governing parties has had relatively little impact on this growth trend during the major period of welfare-state expansion (Lindert 2004, 11-15). My objective in this paper is to show that the public-economic model of the welfare state is the most plausible on these grounds. Not only does it provide a superior account of the existing configuration of welfare-state activities, but it alone is able to explain why, in all Western democracies, state spending rose almost continuously over the course of the 20th century as a fraction of GDP.

I. THE REDISTRIBUTIVE MODEL

The redistributive model is probably closest to what might be considered the received view of the welfare state among political philosophers. The market economy, according to this view, is extremely successful at producing wealth. The problem is that

this wealth winds up being very unequally distributed – or winds up being distributed in a way that violates widely shared intuitions about social justice. Thus the state intervenes, redistributing a certain amount of the wealth, in order to make the overall results of the economy palatable to a sufficiently large number of the people that the system remains stable. There are more or less egalitarian versions of this view, but what they all share in common is the idea that the central defect of the market economy is that it produces distributive outcomes that are in some way unacceptable (either because it creates too much inequality, or because it leaves some segment of the population unable to meet its basic needs, etc.)

This view has a prestigious lineage, from R. H. Tawney (1931) and Harold Wilensky (1975) to John Rawls (1999) and Ronald Dworkin (2000). In the background one can see the influence of Marx, with his insistence that distributive conflict – class conflict – is the central fault line in the capitalist mode of production, and that the pacification of this conflict is the central reason for the existence of the state. Indeed, before the triumph of “liberal egalitarian” theories in the 1980s, the dominant tendency was to regard “the welfare state compromise” as largely a concession in the direction of greater equality, on the part of a bourgeoisie seeking to stave off the threat of revolution from a restless working class. According to this view, the true interests of the proletariat lie in the creation of a classless society. The bourgeoisie, knowing this, have an incentive to “buy off” or “co-opt” segments of the working class, by providing them with enough of a payoff to motivate them to defend the existing order. This leads to the emergence of the welfare state: the bourgeoisie agrees to tolerate some seizure and redistribution of its wealth, while the working class agrees to tolerate ongoing exploitation and alienation, in return for the satisfactions of the consumer lifestyle. The state then winds up committed to a range of economic – in the broadest sense of the term – activities:

1. The working class must be given enough of a stake in the existing order that its members come to regard any sort of radical economic reform or seizure of property as an undesirable risk. This is achieved mainly through transfer payments (with perhaps state pension benefits being the best example), funded through a progressive income tax (O'Connor, 1971).
2. The state transfers just enough resources to those *outside* the labor-market (through welfare, workers' compensation, health care, subsidized tuition, etc.) to forestall any sort of radical political action on the part of those actors. As a result, the centrality of the market in determining the fate and fortune of individuals becomes more tolerable, and the radicalization of women, students, the disabled and the unemployed is forestalled (Piven and Cloward 1971, xiii).
3. The rate of exploitation must be limited, in order not to motivate radical resistance to the corporate system on the part of the population. Thus the state engages in regulation, and sometimes ownership, of natural monopolies. The state also imposes consumer protection, environmental, workplace safety, and similar forms of legislation, in order to protect the public from some of the sharper edges of marketplace competition.

4. Finally, there is the post-Keynesian idea that the state must engage in various forms of demand management, in order to maintain the stability of the system in the face of endogenous crisis tendencies. Without constant growth, the (moderately) positive-sum character of the economy becomes zero-sum, which then exacerbates all forms of latent distributive conflict. (For example, during the cold war, it was often claimed that the state engaged in wasteful military expenditure in order to keep the economic pump primed, and that this was ultimately motivated by a need to pacify class conflict [e.g. Habermas (1975, 35)].)

The Marxian version of the model focuses very much on the interests of the parties involved, and tends to assume therefore that the bourgeoisie, through the medium of the welfare state, accepts the minimum level of redistribution needed to stabilize the capitalist system. The model is, of course, still organized around a conception of social justice – viz. the ideal of a classless society – it simply does not regard the welfare state as the *embodiment* of that ideal, but treats it rather as a *concession* in the direction of that ideal, adopted for largely prudential reasons on the part of the ruling class.³

There are, however, a variety of more moralized versions of this model, which share the focus on redistribution as the central activity of the welfare state, but claim that the objective of this redistribution is not merely to modify individual incentives in such a way as to preserve the stability of the system, but rather to satisfy a moral criterion required for political legitimacy. “Liberal egalitarian” views, in particular, consider the welfare state to be the institutional embodiment of a particular conception of justice along these lines (e.g. Dworkin 2000, 102-4).

The most persuasive foundation for this view can be found John Rawls’s work, particularly in his analysis of society as a “cooperative venture for mutual advantage.” According to Rawls, any such system of cooperation “is typically marked by a conflict as well as by an identity of interests” (1999, 4). This leads naturally to the suggestion that a theory of justice should contain two principles: first, an efficiency principle, which ranks the various possible social arrangements along the “common interest” axis, and second, a principle of distribution, which ranks the arrangements along the “conflict of interest” axis. This is complemented by the widespread intuition that, all things being equal, we should seek to *maximize* efficiency while *equalizing* with respect to distribution. The follow-up suggestion, which many people find irresistible, is that the market and the state are the institutional embodiment of these two different principles: that the market promotes efficiency, while the state renders the entire arrangement more equal, by reallocating initial endowments and adjusting final outcomes (in order to maintain what Rawls called “background justice,” which in turn confers a presumption of legitimacy upon all private contractual arrangements entered into by individuals). Thus the normative “logic” of the state is completely different from the “logic” of the market.

3] One can find a recent, particularly stark – although non-Marxian – formulation of this claim in Daron Acemoglu and James A. Robinson 2006, 23-31.

The most obvious evidence that supporters of this view can point to is the progressivity of the income tax system, combined with the fact that this progressivity is typically justified through appeal to some notion of “fairness.” The benefits that are then provided using this tax revenue are either available to all citizens equally (roads, postal service, national broadcasting, policing and fire services, public education, national defense, etc.), available in a way that is progressive with respect to income (welfare, unemployment and workers’ compensation), or else targeted at those who are subject to some disadvantage (health care, pensions, etc.). Ability to pay is almost never a criterion for the receipt of government services. The net result is a dramatic enhancement in the achieved level of distributive justice (e.g. because the state promotes greater equality among citizens, or because it sets a “social minimum” below which no individual is allowed to fall).

Finally, it should be noted that the so-called “rent-seeking” model of the welfare state is actually a variant on this view, insofar as it regards the power of the state to achieve redistributive transfers as its most important characteristic (Tullock 1981, 904-6). It is, of course, not a “normative model” of the welfare state in the sense that I have been using the term, since it encourages a view of the welfare state as a parasitic accretion on the otherwise healthy market economy. I mention it, however, because it shares with the social justice perspective an understanding of the welfare state as primarily redistributive in function, and has therefore tended to enhance the plausibility of the idea that the “logic” of the state is different from that of the market. The central characteristic of the state, on this view, is that it has the power to impose transactions on private parties. Thus the two views share an understanding of the primary institutional characteristic of the state, the disagreement arises only at the normative level: is the redistribution that goes on mainly good or mainly bad?

II. THE COMMUNITARIAN MODEL

According to the redistributive model, the economic role of the welfare state is organized around a set of core tasks that are fundamentally *different* from those that are carried out by the market. While the private sector produces, and is therefore concerned with efficiency, government redistributes, and is therefore concerned with equality. The most obvious difficulty with this view is that the state does many things that do not appear to be redistributive, and which seem in fact to be quite productive. States in various parts of the world own and operate oil companies, universities, police forces, hospitals, automobile insurance schemes, airlines, nuclear power plants, railroads, statistics bureaus, liquor stores, along with literally hundreds of other departments, bureaus, enterprises and agencies, all of which have employees doing work that is productive, and in many cases not all that different from what similarly situated employees in the private sector are doing. (Compare the case of a police officer patrolling the streets to a private security guard sitting at the front desk of a condominium or office tower [Heath 2008, 87-88].) Thus many theorists feel the need to provide some explanation for why the state is engaged in

the provision of so many goods and services. If the goal was merely redistributive, this could be achieved more efficiently through the economist's preferred method of taxation and cash redistribution; it is not necessary to have the state actually deliver the goods. Furthermore, state provision in certain cases has regressive consequences (such as subsidized higher education, where the benefits flow disproportionately to those in the upper-middle and upper classes), and so cannot be motivated entirely by distributive concerns.

One particularly prominent response to this line of criticism has been to suggest that the state is engaged in producing these goods and services out of a desire to impose limits on the scope of the market. This is why it is important that the state provide the goods, and not merely finance their provision through, for example, a voucher or transfer scheme. Michael Walzer (1983) has provided perhaps the most rigorous defense of this view, arguing that basic human needs should be satisfied through communal provision, in which everyone is guaranteed a share. The moral imperative to ensure the satisfaction of needs has the effect of blocking the "free exchange" (89) of the goods that satisfy them. Thus "needed goods are not commodities" (90) – or more precisely, they ought not be treated as such. The reason for communal provision, in Walzer's view, is not that it achieves greater equality. He states quite clearly that, although communal provision is likely to have distributive consequences, it is not *justified* through appeal to any particular conception of distributive justice (85). What determines the question of whether a particular economic activity should be discharged by the private or the public sector, according to this perspective, is whether commodification of that good or service is morally permissible.

I refer to this as the "communitarian" model of the welfare state.⁴ The central idea, as Michael Sandel articulates it, is that "certain moral and civic goods are diminished or corrupted if bought and sold for money" (1998, 94), and should therefore be provided by the state. In this way, the central function of the welfare state is to impose "moral limits on markets." It is able to do so because it constitutes a *nonmarket* institution capable of producing and delivering particular goods and services. Thus its function, as Goodin describes it, is "to supplant ordinary market mechanisms for certain limited purposes" (1988, 27). Consider the following, fairly typical articulation of this view (presented by Joel Bakan in his book *The Corporation*):

The twentieth century was unique in modern history for the widely held belief that democracy required governments to protect citizens' social rights and meet their fundamental needs. Essential public interests, and social domains believed to be too precious, vulnerable, or morally sacred to subject to corporate exploitation, were inscribed by law and public policy within protective boundaries. Human beings could not be owned and children could not be exploited, either as workers or as consumers. Institutions essential to human health and survival (such as water

4] There is some risk of confusion here, since Goodin uses the term "communitarian" in a different way (1988, 70). I might have referred to it as the "anticommodification" model instead, although that makes it sound less attractive.

utilities and health and welfare services), human progress and development (such as schools, universities, and cultural institutions), and public safety (such as police, courts, prisons, and firefighters), were deliberately placed beyond the corporation's exploitative grasp, as were precious natural domains, which were turned into parks and nature reserves (2004, 112-13).

Note the analogy to slavery contracts and child labor. The issue is not one of distributive justice, or of welfare *per se*. The standard view of slavery contracts is that they are prohibited, regardless of how much benefit both parties might derive from them, on the grounds that they are incompatible with human dignity. Or consider the case of organs for transplant. There is widespread agreement that the sale and purchase of human organs should be prohibited, not just because of the problematic incentive effects of such a market, but because treating parts of the living human body as commodities constitutes an affront to the dignity of the person. The moral stigma associated with buying and selling has very deep roots (recall Immanuel Kant's contrast between things that have a *price* and those that have *dignity* [1785 (1990), 51-52]).

The communitarian understanding of the welfare state is essentially an application of this moral intuition to the distinction between public and private sectors. One can see it quite clearly in the extension of rights discourse to include "social rights" (Marshall 1950). The most prominent line of defense of traditional negative liberties is that they are central to the dignity of the individual – that freedom of conscience, freedom of association and freedom of speech are preconditions for the exercise of our rational faculties. Many theorists have been inclined to extend this list to include the material conditions necessary for the exercise of these same faculties: food, shelter, clothing, and medical care, and to argue therefore that the core set of entitlement programs run by the welfare state should instead be understood as the articulation of a set of social rights possessed by the individual, the denial of which constitutes an affront to the dignity or autonomy of the person (Braybrooke 1987; Anderson 1993, 143-44; Copp 1998, 126; Hamilton 2003), or which undermine the values of democratic citizenship (Sandel 1998, 119).

As with the redistributive model, there are some "paradigm cases" where this intuition is quite plausible. In the case of police services, for instance, there is a very strong intuition that provision should occur entirely outside "the cash nexus." Not only is there an egalitarian intuition, which says that all citizens should be afforded equal protection, there is also what one might call the "anticommodification intuition," which says that the relevant service should not be charged for. Even if everyone had the ability to pay, it seems preposterous to suggest that people should be billed for calling the police in cases where they are assaulted or their property is stolen. Indeed, the ubiquitous police slogan, "to serve and to protect," is intended to suggest that officers are motivated by a sense of duty, rather than some lowly pecuniary interest.

Yet despite some clear cases such as this, the extension of the same intuition to other domains quickly becomes problematic. Insofar as there is a cogent defense of the communitarian view, the strongest argument no doubt hinges on the observation that

welfare-state benefits are typically provided in-kind, and that citizens are not entitled to “cash them in” for something else. This is a feature of the system that appears most incompatible with the liberal egalitarian distributive justice view (Satz 2010, 76). For example, a person cannot renounce his or her right to government health insurance in return for a one-time cash payment (even though this would not be difficult to administer in many jurisdictions with socialized medicine). The food stamp program in the United States takes this even further – beneficiaries of the program are typically cut off if they are caught trying to exchange these stamps for cash or other non-food items. One way of interpreting this is simply as paternalism (in the case of food stamps, for instance, a central objective is to stop people from purchasing alcohol). Another interpretation, central to the communitarian view, is that non-fungibility is central to the logic of state provision, and that this sort of “cashing in” is morally odious, comparable to a transaction on the “black market” for transplant organs.

It should be noted that, in the realm of political debate, this normative model of the welfare state is usually based upon fairly brute moral intuitions about which things should and should not be bought and sold. When the issue is pressed, the specter of people being denied access to the service because of an inability to pay is often invoked. Yet this confuses the issue of commodification with that of distributive justice. The communitarian is committed to the view that certain things should not be provided on a commercial basis even if everyone could afford them. Thus the question “what’s so bad about commodification?” (or perhaps “what’s so abhorrent, such that the state must control entire sectors of the economy?”) becomes extremely pressing.

Although several political philosophers have offered sophisticated responses to this question (see discussion in Satz, 2010), the standard argument in the public political sphere simply taps into a general unease with the role that pecuniary motives play in the private sector (either with respect to the profit orientation of corporations or the role that self-interest plays in motivating individual economic actors). The thought is that the public sector is able to neutralize these incentives: first, because the state as a whole is non-profit, and is explicitly committed to promoting the public interest, and second, because of an organizational culture, sometimes referred to as the “public sector ethos,” that encourages dedication to the public interest on the part of public-sector employees. Here is Walzer again:

Needed goods cannot be left to the whim, or distributed in the interest, of some powerful group of owners or practitioners. Most often, ownership is abolished, and practitioners are effectively conscripted or, at least, “signed up” in the public service. They serve for the sake of the social need and not, or not simply, for their own sake: thus, priests for the sake of eternal life, soldiers for the sake of national defense, public school teachers for the sake of their pupils’ education. Priests act wrongly if they sell salvation; soldiers, if they set up as mercenaries; teachers, if they cater to the children of the wealthy (1983, 89-90).

Thus the issue, for communitarians, often comes down to one of motive. In its crudest form, individuals in the private sector are regarded as acting egoistically, while those in the public sector are thought to act altruistically. The scope of the welfare state is determined by moral abhorrence at the thought that the provision of essential needs should be instrumentalized and subjected to the corrupting influence of ultimately self-interested actors.

III. EXCURSUS ON “BASIC NEEDS”

There has been considerable discussion in the philosophical literature about the role that the welfare state plays in securing the “basic needs” of citizens, and of the justificatory role that the concept of “need” can play in defending state provision of certain goods and services. (Frankfurt, 1984; Thompson, 1987; Braybrooke, 1998; Goodin, 1998) I have not, however, chosen to treat the “basic needs” framework as a distinct normative model of the welfare state, simply because it is not usually presented as a stand-alone argument, but is typically an indirect way of presenting one of the other normative models. Indeed, Goodin has shown very effectively that there is no stand-alone link between the concept of basic need and that of state provision, such that the former necessitates the latter. (1998, 27-50) State provision of basic needs, in-kind, is usually endorsed because it serves to promote greater equality or community.

Prima facie the basic needs framework lends itself to a communitarian reading. Goods are provided in-kind because the alternative, of giving people money and letting them purchase what they need, is morally prohibited. It is also sometimes felt that, before individuals can enter into the market on an equal footing, they must first be autonomous, but in order to secure this autonomy their basic needs must be met. (Panitch 2008, 177) Thus basic needs cannot be commodified because the type of instrumental interpersonal relations associated with the commodity form only become permissible once basic needs are met. There are, however, many reasons why someone who is concerned primarily with distributive justice might also think that the state should be in the business of providing for basic needs in-kind. First of all, it is important to recognize that a concern over distributive justice and even a commitment to the principle of equality often interacts with other normative commitments (or practical considerations) in such a way as to produce a commitment to “prioritarianism” (give greater weight to the welfare of the worst-off) or “sufficientarianism” (raise everyone to a certain minimum threshold) at the political level. (White, 2003) Rawls, for instance, was concerned to maximize the welfare of the worst-off representative individual. Philip van Parijs moves from egalitarian premises to a commitment to ensuring that no one is “dominated” in his or her endowment. (1995, 72-76) Elizabeth Anderson derives a commitment to meeting basic needs out of combined concern for equality and a certain form of neutrality. (1999, 317-18) Thus the desire to ensure a “social minimum” is a natural consequence of a very wide range of views on distributive justice, even those that might superficially seem committed to a

more strictly egalitarian outcome. A plausible specification of this social minimum is the point at which the basic needs of individuals are satisfied. Thus there is nothing odd about egalitarians focusing on basic needs, the only real question is where the commitment to in-kind provision comes from. Here there are several responses available. The first is simply a paternalistic concern that the beneficiaries of a transfer not spend it unwisely. The second is a concern about the incentive effects of tax-and-transfer schemes, and therefore a desire to isolate certain goods from the market so that they can be distributed more equally. (Tobin 1970, 264-65) Either way, the basic needs framework is simply a way of articulating what amounts to an egalitarian concern.

IV. THE PUBLIC GOODS MODEL

This brings us finally to what is often called the “public economic” or “public goods” view of the welfare state, according to which the basic role of the state is to resolve collective action problems. The “classical liberal” state creates the market economy through the institution of property rights and civil contract. The “welfare state” then emerges in those areas where liberal markets fail to produce optimal outcomes. This can take the form of regulatory agencies (in cases where the rules of marketplace competition need to be adjusted), state-owned enterprises (typically in sectors where efficient competition cannot be organized), and public services (in cases where a system of effective property rights cannot be instituted, or where the transaction costs associated with a system of voluntary exchange would be prohibitive). According to this view, the welfare state essentially does the same thing as the market – both are in the business of enabling mutually beneficial forms of cooperation to emerge – it merely organizes the transactions under somewhat different terms (Stiglitz, 1989; Barr 1998, 68-85). There is another reason this view is referred to as the “economic” model of the welfare state, which is that it is almost universally subscribed to by economists, yet receives only tepid endorsement from theorists in other disciplines.⁵ Political philosophers are not particularly enthusiastic about it for two reasons. First of all, the general objective of resolving collective action problems is often articulated in terms of a commitment to promoting “Pareto efficiency.” Efficiency was for a long time touted by the economics profession as a purely technical, value-free standard for measuring the performance of economic systems, not as a moral principle.⁶ This is rather self-evidently false, as Rawls and others took some pains to show (Rawls 1999, 59-63). Nevertheless, there is still a residual sense that Pareto efficiency is

5] Indeed, the neglect of this view among political philosophers is rather striking. Daniel Schapiro, for instance, in a survey of the literature, identifies three principles that are usually appealed to in defense of the welfare state: equality, basic needs, and community (2007, 32). Efficiency does not appear on the list.

6] As my undergraduate economics textbook stated (approvingly), back in 1988, “Because it is possible to talk about efficient and inefficient allocations, but not about better or worse distributions of income without introducing normative considerations, much of economics concerns efficiency and neglects effects on the distribution of income.” (Lipsey, Purvis, and Steiner 1988, 478)

simply not “moral enough” to count as the core of an acceptable normative model of the welfare state. Goodin, for instance, adopts a very common way of speaking when he presents an invidious contrast between “*unfairness*” and “mere inefficiency” (1998, 170). He makes it clear that he considers the former a much more serious matter, from the moral point of view, than the latter. Yet it is not obvious that this should be so. The Pareto principle states that the transition from one social state to another constitutes an improvement if it does not make anyone worse off and makes at least one person better off. There are a variety of more “moralizing” ways of redescribing this. For example, violations of the Pareto principle create outcomes in which at least one person is made worse off, without anyone else receiving any sort of benefit. We might refer to this as “gratuitous suffering.” One way of formulating the Pareto principle would therefore be to say that it recommends the elimination of gratuitous suffering. From this perspective, inefficiency seems much worse than “mere inequality.” With redistributive transfers, even regressive ones, the loss to one individual is at least offset by the gain to some other. It is a win-lose transformation. Inefficient outcomes, on the other hand, are lose-lose. Thus inequality has a silver lining; inefficiency has none (Davis 1998, 65). The second barrier to the more widespread endorsement of the economic model of the welfare state is that it is often identified with view that the state should provide “public goods” in the very narrow sense that Paul Samuelson used that term (viz. goods that are “nonrival” and “nonexcludable” [1954]). Samuelson’s adoption of this definition, however, was driven by his desire to provide what he called a “pure theory,” it was not intended as a realistic description of what states actually do. Rightly so, because there are almost no public goods in the sense in which Samuelson used the term, and providing such goods constitutes an almost imperceptibly slight component of the actual activities of the welfare state. Samuelson’s influential formulation, however, has made it difficult to appreciate the generality of the “market failures” perspective, and how it can provide a unifying explanation for a superficially heterogeneous set of state activities. A better framework for understanding the economic theory of the welfare state is the transaction cost perspective, developed by Ronald Coase (1937) and further refined by Oliver Williamson (1985). This analysis begins by positing two elementary institutional forms that can be used to organize “transactions,” understood here as cooperative interactions between two or more individuals. There are markets, or more generally, private contracts, and there are hierarchies, or interactions governed by an authority. The benefits of these transactions take the form of collective action problems that are resolved. Thus, for example, two parties are able to achieve the advantages that stem from a division of labor if they are able to institute an orderly system of property rights and contract, which will permit them to exchange the fruits of this labor. They can achieve the same advantages in a “command and control” system if a superior authority assigns them each a specialized task, then distributes the goods that are produced. Coase initially drew this distinction in order to explain the success of corporations within the market economy. “Outside the firm,” he observed, “price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a

firm, these market transactions are eliminated and in place of the complicated market structure is substituted the entrepreneur-co-ordinator, who directs production” (1937, 388). The reason this arrangement makes sense is that, although each different mode of organization generates transaction costs, these costs differ depending upon the nature of the transaction. Sometimes markets have the advantage, other times hierarchies do. When firms are able to purchase generic inputs from suppliers, for instance, it is fairly easy to organize a competitive market, and so the transaction costs associated with the market form of organization will be relatively low. When firms try to purchase highly specialized inputs, production of which would require suppliers to make asset-specific investments (e.g. purchase of specialized equipment), they set themselves up as potential monopsonists (Williamson 1985, 32-35). This raises the cost of market transactions (a cost that includes the potential deadweight losses associated with suppliers not being willing to make such investments). Under these circumstances, it may make sense for the firm to produce these inputs “in-house,” or to take over the supplier and then simply direct its managers to make the needed investments. One way of describing this theory would be to call it a “market failures” theory of the firm (Shipman 1999, 290). Hierarchies are generally an inefficient way to organize production. Markets are often better. However, sometimes markets fail, in the sense that they do not correct all collective action problems. Of course, if the benchmark is Pareto-optimality, then markets always fail (because there are always transaction costs). What matters for practical purposes is that this failure is sometimes so egregious that it is possible to achieve a better outcome using a hierarchy to organize the transaction. Thus hierarchical organizations, like the corporation, succeed in precisely the areas where markets fail (and conversely, markets succeed in precisely the areas where hierarchies fail, because it is all about the *relative* effectiveness of different organizational forms). There are a variety of causes of market failure, but the four most important are incompleteness in the system of property rights (and hence the presence of externalities, both positive and negative), information asymmetries (and hence principal-agent, moral hazard and adverse selection problems), economies of scale (and hence varying degrees of imperfect competition), and finally difficulties in drawing up and enforcing contracts. Corporations are able to resolve some but not all of these problems. Their central limitation is that, while they can exercise great power over their members, ultimately they are voluntary organizations. This means that there are certain sorts of free rider problem that they will be unable to resolve. What distinguishes the state, in this context, is that it is the only organization in society that has the ability to impose its authority on anyone found within the scope of its territory. (This is a variation on Max Weber’s definition of the state as the agency “that (successfully) claims the monopoly of the legitimate use of physical force within a given territory” [Weber 2004, 33]. Joseph Stiglitz articulates this idea by saying that membership in the state is “universal” and “compulsory” [1989, 21] within the scope of its territory.) This characteristic – and this characteristic alone – gives the state a unique role to play in the economy, because it gives it the capacity to organize *certain* transactions in a way that will be much less costly than voluntary contracting, whether it

be on the market or within a firm. Of course, in the case of voluntary transactions, there is a strong presumption that the transaction will be efficiency-promoting for the parties involved (otherwise why would they agree to it?). In the case of state-imposed transactions, on the other hand, there is no such presumption. And indeed, state power can be used to effect redistributions, as proponents of the egalitarian model of the welfare state correctly observe. None of this changes the fact, however, that the state can use its authority to coerce free riders, and thereby eliminate some of the more recalcitrant collective action problems, in ways that have significantly lower transaction costs than any private remedy.

The economic model of the welfare state should therefore be interpreted as the view that the state should strive to resolve collective action problems in cases where it can do so more efficiently than other institutional forms. This analysis has considerable explanatory power, providing an intuitively natural account of at least the following set of state activities:

1. Control of natural monopolies. In cases where it is inefficient to have more than one supplier of a particular service (typically because of economies of scale or network externalities), then private markets will not be competitive. Examples include roads, sewers, ports and electricity distribution grids. The state can avoid the social costs associated with monopoly pricing either by assuming ownership of the supplier, or by regulating it (in particular, controlling the prices it can charge). It is important, in this context, to realize that the state sometimes has limited power to control its own managers (as Stiglitz [1989] observes). Because of this, regulated private ownership sometimes translates into more effective state control.

2. Control of imperfections in existing markets. The state takes a very active role discouraging production of negative externalities and encouraging the production of positive ones. This involves regulation of existing markets (e.g. banning leaded gasoline, imposing food safety requirements, regulating pharmaceutical products, etc.), imposing Pigovian taxes (e.g. carbon taxes), and subsidizing activities that produce useful spillover effects (e.g. education, public transit, scientific research, vaccination, weather forecasting, etc.). The provision of free or subsidized public education is probably the most significant program undertaken under this rubric. Beyond externalities, the state also tries to limit information asymmetries, particularly between producers and consumers (by imposing product warranties, regulating advertising, etc.).

3. Public provision. When the private sector is left to its own devices, many markets will simply be “missing,” in the sense that particular goods or services will not be provided at all (or not in particular areas, not to particular consumers, etc.), despite the presence of consumers who would be, in principle, willing to pay for them, and producers who would be, in principle, willing to provide them. In this case, the state can achieve efficiency gains by imposing taxes or fees, then using the revenue to provide these missing goods. Examples include pest control, national defense and certain types of police services, along with various types of insurance. Also, although public provision is the norm, there are cases where a private firm does the providing (e.g. prisons, military aircraft, mercenaries), in which case the state acts like a “market maker” in the private sector – raising revenue on one side, then making the (collective) purchase on the other. Finally, it should be

noted that the state sometimes opts for public ownership with the goal of controlling externalities – ownership of nuclear power plants and liquor stores is a good example.

4. Social safety net. A set of welfare-state programs, including health care, old-age pensions, unemployment insurance and welfare are often grouped together and referred to as “the social safety net”. These are often described as “transfer programs,” which is potentially misleading, since they could just as easily be described as universal, state-run insurance programs (Moss, 2002). This is particularly obvious in the case of “single-payer” health care systems, where health care *provision* remains primarily private, but the state exercises a monopoly in the market for health *insurance*. It is also sometimes forgotten that both life annuities and defined benefit pension schemes are both essentially insurance products, and that most state-run pension schemes amount to the provision of this type of insurance on a national scale. The social safety net is, from this perspective, just a special instance of state provision in the face of missing or inefficient private markets. It merits its own heading, however, because it is often misclassified as a redistributive transfer scheme, rather than a risk-pooling arrangement.

The previous four points are what might be thought of as “bread and butter” public economics claims. There are a couple of other ways, however, in which the state can use its organizational resources to resolve collective action problems, which have received considerably less discussion:

5. Minority public goods. The most important “public goods” – in the non-Samuelson sense of the term – that the welfare state delivers are ones that benefit pretty much everyone in the society. There are certain goods, however, which stand to benefit only a relatively small number of people, but where the group is difficult to identify and for various reasons is unlikely to self-identify (Davis 1998, 83-84). Examples would include hosting the Olympics and sponsoring athletes, having national parks, funding art galleries, and promoting cultural heritage events. Partisans of state involvement often try to posit subtle externality effects that enhance the welfare of those who are not the primary beneficiaries of these subsidies, in order to defend against the charge of rent-seeking. A more forthright defense would simply be to admit that the state is catering to a minority taste in these cases – a taste that would otherwise not be satisfied, because of contracting problems among private parties – but that because the state caters to a very wide range of such minority tastes over time, everyone is likely to benefit at some point from some such activity. Thus the overall activity of “providing minority public goods” can be seen as a public good (Miller 2004, 142).

6. Governance failures. When discussing “markets and hierarchies” in the private sector there is a strong tendency to equate “hierarchies” with “corporations.” Private hierarchies are, however, organized under a surprisingly large number of governance structures. There are, of course, different types of corporations (most importantly, partnerships and limited liability corporations). There are also different types of cooperatives, along with “special purpose” corporate forms, such as condominiums, which are essentially consumer cooperatives. And finally there are non-profits. Part of the reason for this proliferation of governance structures is that the standard business corporation is sometimes not the most efficient *ownership structure* for a particular economic activity. (Hansmann, 1996) This is why certain types of economic activity are often undertaken by cooperatives (e.g.

insurance) and non-profits (e.g. universities, daycares). In many cases, however, state intervention is required in order to guarantee adequate levels of supply. This is particularly so in the case of non-profits, where private individuals typically lack any economic incentive to create them, but where, once created, they are able to resolve certain collective action problems caused by the governance structure of investor-owned firms.

These examples are intended to show that the characterization of the public-economic model that one finds in the literature is often too narrow, especially when it takes the Samuelson definition of public goods as its point of departure. When presented in its full generality, using a transaction-cost analysis, it is an exceedingly robust theory, in that it provides a unified account of regulation, state ownership and the social safety net.

V. ASSESSING THE MODELS

All three of these normative models are “reconstructive,” in Jürgen Habermas’s sense of the term (1996, 287), in that they try to articulate the norms and ideals that are implicit and play a structuring role in our practices. Thus the standard by which they should be assessed is that of expressive adequacy:

1. With respect to the major set of welfare state programs and activities, to what extent can the activities plausibly be described as serving the posited normative purpose?
2. Can a plausible story be told about the efficacy of these normative concerns, in leading to the emergence of the relevant institutional forms?
3. Does the model create the conditions for what Charles Taylor calls a more “clairvoyant” practice (1985, 111), i.e. does it enhance our normative self-understanding in a way that would allow us to more effectively achieve the goals that are implicit in our practices?

5.1 Problems with the communitarian model

As I have already suggested, the communitarian model is the weakest from this perspective, since it is not able to describe or capture much of the fine grain of how the welfare state works. For example, from the mere fact that a particular good is, as Bakan puts it, “too precious, vulnerable, or morally sacred” (2004, 112) to be subject to commercial exchange, not much seems to follow about the way it should be provided or consumed. One can see the problem quite clearly in the quotation from Walzer, cited above, where he lists a set of professionals who, in his view, are prohibited from engaging in market contracting for their services. Priests are supposed to work “for the sake of eternal life,” which prohibits them from “selling salvation” (1983, 90). Yet for some reason this does not require that they be employed in the public sector. Indeed, the only consequence that the focus on salvation seems to have is that priests must be paid flat salaries, rather than working on a fee-for-service basis. Soldiers, on the other hand, are obliged to work in the public sector. If they work in the private sector, even on flat salaries, they become “mercenaries” and

are condemned. With teachers, on the other hand, there is no prohibition on working in the private sector, or even on a fee-for-service basis (presumably tutoring is permitted). Walzer's only constraint is that public school teachers must not confine their attention to "the children of the wealthy" (1983, 90).⁷

One can see from the capriciousness of these strictures that Walzer is not really working out the consequences of his model, but is taking existing arrangements and providing a rationale for them. The problem is that the moral considerations he adduces are too vague to justify the specific arrangements that prevail, and which he appears to endorse. This is a common feature of communitarian thinking about the welfare state. For example, Maude Barlow and Tony Clarke have written and campaigned extensively against the commodification of water resources. Their central argument for keeping it in "the commons" is that it is "essential to life," and therefore is not just a "need" but a fundamental human "right" (Barlow and Clarke, 2002, 79-81). This requires that water be publicly owned, and that it be provided to all, without charge, by the public sector. Thus they vigorously oppose the privatization of water services, and in cases where it has been privatized, they call for nationalization. Yet this opposition extends only to water that is delivered to the home through pipes. When it comes to the bottled water industry, they express concern about environmental impact but do not call for nationalization. Why not? If water is sacred, then it should be sacred regardless of whether it comes in a pipe or a bottle. A market failures theory is able to explain the difference quite easily – it's not about the water, it's about the *distribution system*. Water pipes are a natural monopoly, which is why they should be owned by the state. Water bottles are not, and so, despite the various other public policy issues that they raise, there is no case for public ownership.⁸

Another aspect of the "fine grain" that the communitarian model has difficulty accommodating is the prevalence of purchaser-provider splits in the delivery of public goods and services. Indeed, communitarians routinely conflate two quite distinct claims: first, that the provision of a particular good should be publicly *funded* (guaranteeing, inter alia, that access will not be limited to those with the ability to pay), and second, that a particular good should be publicly *provided* (which is to say, provided by employees of the state). When Walzer talks about a moral imperative to "abolish the market" for a particular good he assumes that the two must go together. In his discussion of health care, for example, he claims that the requirement that health care be allocated in accordance with need "can

7] There is actually some ambiguity in his phrasing, such that it is not clear if he intends to prohibit all teachers from educating only the children of the wealthy, or just teachers who work in the public sector. The fact that Walzer spent his career teaching at Harvard and Princeton suggests that it cannot be the former. It is also possible that by public school he means grade-school, and so excludes himself and other university professors from the constraint.

8] Similarly, Barlow and Clarke raise no objection to the installation of water meters in private homes, so that individuals can be charged for the amount of water that they consume, rather than receiving it as a public good (financed through taxation). Most people on the left support such measures – for environmental reasons – despite the fact that it represents an important step in the direction of "commodification" of water. Again, it suggests that the concern is really about the distribution system, not the actual good.

be fulfilled only by turning physicians, or some substantial number of them, into public physicians... and by abolishing or constraining the market in medical care” (1983, 88). Yet apart from the U.K., this is not the typical welfare-state arrangement. Most public health care systems guarantee universal access by ensuring that care is publicly *funded* (through state-owned or regulated insurance schemes and grants to hospitals), but then rely upon the private sector (both for-profit and non-profit), in varying degrees, to provide the health care. Similarly, roads, government buildings, military hardware, and increasingly services such as garbage collection, are paid for by the government, but supplied by private contractors. Even more common are arrangements in which goods are provided by public sector employees, but are paid for privately by consumers. Prominent examples include (in many jurisdictions) postal service, electricity, natural gas, automobile insurance and, of course, water.

Again, this is an element of detail that can be explained quite easily from a market failures perspective. In many cases, the conditions that create the market failure will occur on only one *side* of the market: either the supply side or the demand side. Public provision with private purchase is an attractive arrangement when the failure is primarily on the supply side (e.g. natural monopoly); private provision and public purchase is attractive when the failure is on the demand side (e.g. non-excludability); and, of course, public purchase combined with public provision is best when the market is compromised on both sides. In principle, the communitarian model could provide an account that mirrored this one, focusing on which side of a transaction was morally odious. For example, Walzer’s central preoccupation is typically on the demand side, given that his usual objection to the market is that it is wrong for certain goods to be distributed in accordance with “ability to pay.” This could generate an argument for public purchase combined with private provision. Bakan, on the other hand, is more concerned with supply side considerations, believing that it is immoral for certain goods to be “subject to corporate exploitation” (2004, 112). Here one might imagine circumstances in which it was wrong to make money from selling something, but there was nothing particularly wrong with buying it, which might in turn justify an arrangement involving public provision combined with private purchase. A communitarian theory that developed a more nuanced account of why certain exchanges are prohibited – one that distinguished between supply side and demand side issues – might then be able to supply a more robust account of existing welfare-state arrangements.

This does, however, raise an interesting question, which is why – factoring out egalitarian concerns about distribution and ability to pay – communitarians consider state provision less odious than private provision. Part of the answer lies in the fact that the communitarian model, unlike either the redistributive or the public goods perspective, places great stock in the “public sector ethos” (Davis 1998, 36-41) What makes the state distinctive, according to this view, is not just that it has superior powers of coercion (to redistribute, or to resolve collective action problems), but that its agents act on the basis of a different sort of *motivation*. Private corporations are motivated by profits, which

means that they can be expected to take advantage of consumers whenever they can. The state, on the other hand, is motivated by the public interest, and so is thought to be more trustworthy in dealing with morally sensitive transactions (e.g. when one party is particularly vulnerable, or where the production of negative externalities is a concern).

This argument must be handled carefully, in order to avoid the temptation to assume that, because corporations are trying to maximize profits, the individuals they employ must be motivated by self-interest, whereas in the public sector, where the primary concern is the public interest, civil servants are more likely to act altruistically. Both private corporations and the state are large bureaucratic organizations, whose employees are motivated by a very similar mixture of self-interest and moral constraint. Furthermore, no bureaucratic organization could function at all if its members acted in a purely self-interested fashion; it would fall victim to insuperable agency problems (Buchanan, 1996). Thus every organization, private or public, must be able to elicit a degree of cooperative behavior from its employees. In order to do so, it will typically use a combination of incentives and moral suasion. The latter often takes the form of an appeal to “shared values” or an organizational mission, such as customer service, shareholder value, respect for the taxpayer, etc. Probably the best way of understanding the public sector ethos is to see it as a set of values appealed to in the public sector, whose primary function is to overcome the agency problems that develop within *any* bureaucratic organization. As such, it is not fundamentally different from the sort of corporate culture that is cultivated in the private sector, it simply appeals to different motivational resources (e.g., the state can use nationalism to motivate its employees in a way that the private sector typically cannot).

Much more problematic, however, is the view that the public sector ethos gives the state distinct organizational capabilities, allowing it to achieve objectives that the private sector is unable to achieve, entirely because of its ability to elicit a greater degree of intrinsic, pro-social motivation from its employees. There are no doubt some highly specific instances in which this is true – the administration of criminal justice is probably the best example. Here it is essential to the proper functioning of the system that officers of the court be motivated by non-pecuniary concerns. Privatization of the system simply wouldn’t work, not because competitive markets couldn’t be developed, but because the buying and selling of judicial services would quickly corrupt the process.

There is, however, a tendency to generalize from examples such as this, and so to imagine that a doctor who works in the public sector will be less likely to perform unnecessary surgery than one who works in the private sector, or that a teacher who works in the public sector will be more concerned about the integrity of the curriculum, or that a railway ticket agent will be less likely to take advantage of a tourist, by selling him a more

expensive ticket than he needs, if he works for a state-owned enterprise.⁹ The assumption is that being an employee of an organization that is dedicated to serving the public interest will make the individual less likely to act in a self-interested fashion, and more likely to act in the public interest. There is, however, no logical connection between the two. It is mainly a question of organizational psychology whether the state, as a matter of fact, is able to motivate its employees – including high-level managers – to better serve the public. Unfortunately, the track record of states throughout the Western world is not particularly distinguished. Whatever differences there may be in the public sector, they are seldom enough to make a significant difference at the level of organizational competence (Davis 1998, 133-35).

Much of the motivation for the widespread expansion of state-owned enterprises in the wake of the Second World War was the belief that public ownership would result in better service to the public from these organizations. Thus Western governments became involved in a variety of enterprises where there was no obvious efficiency or equality reasons for intervention, such as airlines, railroads, mining and heavy manufacturing. The result of this experiment, however, was the widespread discovery that public ownership did not, in general, translate into better service to the public. In many cases, it did not even translate into effective public control (Lindblom 1980, 113). State-owned enterprises in competitive sectors of the economy often performed worse than private enterprises on any measure – not only did they lose money, but they failed to live up to their public-interest mandate as well. Furthermore, state-owned enterprises often formed powerful special interest groups within the state, and pursued their sectarian interests in a way that was highly detrimental to the public interest (Heath and Norman, 2004).

As a result, the late 20th century was characterized by the emergence of much greater modesty about the state's organizational abilities, and in particular, its ability to motivate its own employees to act in a public-spirited way. To the extent that it has been studied, empirical work on the public sector ethos suggests that it plays very little role in the motivation of low-level government employees. It is only at higher levels of the organization that it becomes detectable, and can reasonably be thought to play a significant role in the way that public organizations function (Pratchett and Wingfield 1996, 645). This is pretty much what one would expect from looking at the wage structure in the public service, which is quite flat by comparison to the private sector (with a higher floor and a much lower ceiling). Thus low-level state employees typically enjoy a wage premium over their counterparts in the private sector, whereas high-level civil servants suffer a rather significant wage penalty. This means that not only must the state rely more

9] The last example is from Evan Davis: "Did the old British Rail ticket-seller lie about which ticket to buy? In fact, the old British Rail did go to some trouble to disguise from travellers the existence of cheap commuter services that were slower substitutes for the British Rail Gatwick Express. Indeed, the company used to go so far as lying about the destination of trains... in order to herd people on to the service the company desired. In as far as the ticket-seller offered best advice, it was normally in contravention of his employer's desire" (1998, 56).

heavily on moral suasion to motivate its high-level employees, but there will also be a significant selection effect, whereby employees with stronger pecuniary concerns will be more likely to leave the public service once they reach a level at which their outside options become more attractive. Thus at the senior management level, the state is able to expect a fairly distinctive motivational structure amongst its employees, but at the lower level – the level at which most services get delivered to the public – the state functions in very much the same way as any other large bureaucratic organization.

Thus to the extent that the communitarian model does provide a coherent conception of what the welfare state should look like, the strategy for demarcating the public from the private that it recommends has been essentially abandoned for more than three decades. Contemporary welfare states are largely structured by the idea that, insofar as the state has a distinctive role to play in the economy, it is not because of the peculiar moral character of its employees, but rather because of its distinctive institutional powers, in particular, its power of compulsion. This power, however, can be (and is) used in two ways: the first is to redistribute wealth (and thereby promote greater equality); the second is to resolve free rider problems (and thereby promote greater efficiency). The first, of course, is the use that is emphasized by proponents of the redistributive model, while the second is the one emphasized by proponents of the public goods model. The central issue, in deciding between the two, is to determine which use of state power can plausibly account for the enormous scope of government activity, as it developed over the course of the 20th century.

5.2 Problems with the redistributive model

There can be no doubt that the state engages in some economic interventions that are aimed at promoting equality and some that are aimed at promoting efficiency. There is, furthermore, no contradiction in principle between pursuing these two objectives simultaneously, since equality and efficiency are compatible moral ideals (Stiglitz 1996; Heath 2008, 279-81). Thus there is nothing incoherent about a hybrid “redistribution and public goods” view of the welfare state. However, the amount of actual egalitarian redistribution that goes on in a typical welfare state is often dramatically overestimated. This is because many theorists treat the social safety net, which is essentially a set of government-run insurance programs, as a system of redistribution, and hence as governed by an egalitarian logic. This is quite misleading (Davis 1998, 86; Moss, 2002). There is, of course, a sense in which any system of insurance is redistributive, in that its net effect will be to transfer money from the lucky to the unlucky. But this is true regardless of whether it is public or private. Car insurance transfers money from those who don't have accidents to those who do, just as health insurance transfers money from those who don't get sick to those who do. In both cases, however, the logic of the redistribution is not egalitarian, but rather *assurentiel* (Ewald, 1986). This is reflected in the fact that, first, people voluntarily buy insurance, because the transaction is Pareto-improving *ex ante*, and second, there

is nothing to stop the transfers from being regressive with respect to income (Esping-Anderson and Myles 2009, 640).

Thus the reason for the state to be involved in sectors such as health insurance cannot be the redistribution that occurs at the “front end,” in the way that medical services are delivered to the public. If there is an egalitarian reason, it must be at the “back end,” in the redistribution that is achieved by funding the system out of general tax revenues or payroll deductions, rather than charging individuals an actuarially fair premium. But if this sort of redistribution were the only objective, there would be no reason for massive state involvement in the sector. This follows rather closely from the idea that markets are best at delivering efficiency and the state at promoting equality. If this were true, then the best policy for the state to pursue, when confronted with any particular inequality, would not be to interfere with the way that goods are being traded, but would be to redistribute income so that the pattern that emerges out of the set of market transactions is less offensive to the egalitarian sensibility (Satz 2010, 76-79; Tobin, 1970). The only reason for state involvement, from this perspective, would be a paternalistic concern that individuals would not spend their income wisely. The easiest way to handle this, however, is not through state provision or purchase, but simply through the introduction of constraints on the fungibility of individual endowments. Egalitarianism, in other words, even when leavened with a generous dose of paternalism, tends to militate in favor of what Ron Daniels and Michael Trebilcock have called “government by voucher” (2005) – where most government-provided services, including health and education, would be privatized – not a conventional welfare state.

Indeed, conservative critics of the welfare state often recommend dismantling state health care systems and replacing them with a set of individual health savings accounts (Gratzer, 1999). If the objective of the system is redistribution (e.g. “to help the poor”), they argue, this can be achieved by having the state make a minimum deposit into each individual’s account, enough to cover a standard package of health care services. If the objective of the system is paternalistic (forcing people to purchase health care that they need, rather than something else), then this can be accomplished by having the balances in these savings accounts subject to various restrictions on use, and perhaps even replaced by vouchers. Either way, there is no reason for the state to get involved in running the health care system.

What the argument for health savings accounts misses is the very powerful efficiency arguments in favor of state-run health care systems. The problem with health care spending – what makes it quite different from spending on things like food and shelter – is that it is extremely unpredictable. It typically follows what is known as the 80/20 rule, viz. that 20% of the population accounts for 80% of the spending (Krugman and Wells, 2006). Thus the average person has no idea how much to save for his or her future health care needs. Saving the average amount required is almost guaranteed to result in under or oversaving. For example, one large study in the Netherlands (Polder, Barendregt & van Oers, 2006) showed a huge difference in the average cost of health care for individuals

in the last year of life (14,908 €) compared to other years (1102 €). Even more striking, however, was the standard deviation in final-year expenditure, which was 18,751 €. This means that even if (*per impossible*) every member of the population set aside a generous 34,000 € in order to cover the cost of end-of-life care, more than 15% of the population would still not have saved enough. This is what makes the case for pooling health care savings overwhelming.

The problem with health insurance is that it is subject to rather severe adverse selection and moral hazard problems (and therefore, huge administrative costs associated with attempts to *control* adverse selection and moral hazard). State health insurance schemes are able to achieve better results on both fronts, by eliminating adverse selection entirely and reducing moral hazard (unlike private insurers, who often face a collective action problem when it comes to investigating claims, a public insurer has the incentive to make sure that it is not being overbilled; see Heath 2001, 188). Indeed, if one looks at any serious proposal for a system of health savings accounts, there is usually a *public* insurance system underlying it, to cover “catastrophic care” or hospitalization. This is in recognition of the fact that forcing individuals to self-insure against extremely costly, unpredictable events is inefficient (i.e. lowers everyone’s welfare). And yet, when one goes through the numbers carefully, it soon becomes apparent that the insurance mechanism proposed is likely to wind up covering the bulk of expenditures in the system (e.g. Gratzner 2002, 296-97). Because of this, the “savings account” winds up being just a complex way of imposing a deductible on an insurance plan.

Thus one can see that the real driving force behind existing public health care systems is not a general concern about equality, but rather market failure in the health insurance sector. The “normative logic” of these systems is one of efficiency. The way that public health care systems are *paid for* is redistributive, and progressive with respect to income, but this is a property of the tax system, not the health care system (and the tax system is not a social program, it is the mechanism used to pay for social programs). Of course, socialized medicine systems are often defended through appeal to egalitarian principles in public political discourse.¹⁰ Furthermore, a lot of state intervention in this sector was initiated in order to achieve egalitarian objectives. Yet what keeps these systems going, what creates the political constituencies prepared to defend them against cuts, is the set of efficiency gains they create.

The tendency to misclassify social insurance programs as redistributive is quite firmly entrenched in the literature. It is even more common when it comes to pension systems, which actually do take money from one person and give it to another, and so seem like paradigm instances of the state redistributing wealth. For example, in *The Myth of Ownership*, Liam Murphy and Thomas Nagel discuss the U.S. Social Security plan as

10] Or quasi-egalitarian principles, such as solidarity. Indeed, one of the attractions of the “solidarity” language, as it is used in France for example, is that it is systematically ambiguous between equality and efficiency concerns, particularly when applied to social insurance systems.

though its central function was that of achieving an egalitarian redistribution of wealth. The reason it targets primarily seniors, they claim, is that redistribution of wealth toward those who have left the workforce creates fewer perverse incentives than redistribution that favors the working-age population. This redistributive intent is “somewhat disguised,” they claim, by the fact that “benefits are a function of contribution.” Nevertheless, “the program is clearly redistributive: low earners get back more than they put in, and high earners less” (Murphy & Nagel 2002, 183).

As a matter of fact, the extent to which the retirement benefit component of Social Security is progressive with respect to lifetime income within cohorts is subject to dispute (Fullerton & Mast, 2005). Much of the talk about “Social Security” as a whole fails to factor out the disability insurance program – which will obviously be progressive with respect to *lifetime* income, since it is intended to cover those who are forced to drop out of the labor-market prematurely – and the auxiliary benefit. The retirement benefit taken alone, which makes up the bulk of spending, is significantly less progressive than the other components of the system (Congressional Budget Office 2006, 4). There is, though, one respect in which the retirement benefit is obviously redistributive, viz. it transfers money away from those who die young and gives it to those who live a very long time. Indeed, one of the factors that diminishes the level of progressivity of the system as a whole is that the rich tend to outlive the poor, and the core function of the system is to redistribute from those who die young to those who live for a long time. This is because the retirement system in the Social Security program is essentially a defined benefit pension scheme, which is to say, a collectively purchased life annuity. And a life annuity is an *insurance product*, designed to protect individuals from the risk of outliving their savings (Moss 2002, 205-6). Just as people do not know how much they should save in order to meet their health care needs, they also do not know how much they should save in order to meet their need for retirement income. The risk is that one will live too long and thus fall into penury. Average life expectancy at age 10 in high-income countries is typically to age 80 or so, but the standard deviation is very high – close to 15 years (Edwards, 2009). Assuming retirement at age 65, this means that while the average person will have to save for only 15 years of retirement, more than 15% of the population will in fact be retired for more than 30 years. So again, there is a strong case to be made for pooling retirement savings, which is precisely what a life annuity does. The market for private life annuities, however, is subject to adverse selection problems, which means that there are efficiency gains to be achieved through public administration of such a program.

If one looks at the three major categories of welfare-state expenditure: health, pensions and education, there is a powerful efficiency-based rationale for each of these programs. That is to say, each of these programs corrects an important market failure (on education, see Haveman and Wolfe, 1984). This is not to deny that these programs have been implemented in a way that is intended to achieve a certain measure of redistribution as well. The point is that the redistribution does not explain why these activities are being undertaken in the public sector, whereas the efficiency arguments do explain this.

This is why the principle of equality should be seen as subordinate to the principle of efficiency when it comes to understanding these programs. The reasoning underlying the redistributive dimension is something like this: “these services must be provided by the public sector, because the private sector is unable to do so efficiently. However, as long as they are being done in the public sector, we may as well finance them in a way that is progressive with respect to income. This will allow us to carry about a measure of redistribution without suffering too much from the efficiency-equality tradeoff.”

VI. WAGNER'S LAW

Both communitarianism and egalitarianism, as I have attempted to show, fail to offer a plausible reconstruction of the dominant logic of the welfare state. Indeed, these accounts typically harbor significant misunderstandings of how welfare-state programs operate. And if this is true with respect to the “statics” of the system, it is ever more so when the state is considered from a dynamic perspective. One of the most striking features of the welfare state is its extraordinary growth over the course of the 20th century. Furthermore this growth pattern has largely confirmed what is known as “Wagner’s law of expanding state activity”, viz. that public-sector expenditure can be expected to increase as a percentage of GDP as a society becomes more affluent (Bird, 1971). Over the course of the 20th century, welfare state spending did not just grow along with everything else, but steadily increased its relative share of GDP. This tends to be taken for granted, but is actually hard to explain on either the communitarian or the egalitarian model.

One of the most striking features of this growth pattern, in particular, is that it was largely unaffected by the ideological complexion of the political party in power. With very few exceptions, the welfare state continued to expand – in some cases quite dramatically – under the custodianship of right-wing political parties that explicitly rejected both egalitarian and communitarian ideals. Conservative governments have often introduced changes in the *tax system*, in order to make income taxes less progressive, or else shift the burden of revenue-collection to more regressive taxes. But at the same time that the tax system was being made significantly less egalitarian (under, say, Ronald Reagan or Margaret Thatcher), state spending as a whole was still increasing, almost always at a pace that exceeded the rate of economic growth. If the core normative logic of the welfare state involved a commitment to promoting equality, or else protecting certain spheres of interaction from commodification, one would naturally expect to see a certain ebb and flow in the activities of the state, with expansion of state activity following the election of political parties who endorsed this moral vision, and contraction during periods following the election of parties who explicitly rejected it. And yet the actual pattern is not like this. If, however, one thinks of the major set of welfare-state programs as public goods, in the broad sense of the term, then it is easier to see why they are so notoriously difficult to cut. When a redistributive program is eliminated, those who had been winners in the transfer can be expected to resist, while those who were losers will tend to support the initiative.

With a Pareto improvement, on the other hand, the outcome is win-win, and so there is no “natural” constituency there to press for its elimination, the way that there is with a win-lose outcome.

If indeed the function of the welfare state were to take certain domains of social interaction and have them “inscribed by law and public policy within protective boundaries,” as the communitarian view has it, then it is difficult to see why state spending should not remain constant over time, or even constitute a diminishing share of the national product. This is particularly so in cases where the protected domains are interpreted in “basic needs” terms. Once basic needs – say, food, water, shelter and security – are satisfied, one would expect economic growth to constitute primarily expansion of the sphere of discretionary wants. Thus one would expect the state sector to *shrink* as a fraction of GDP over time. Even if one interprets “basic needs” in relative terms, so that the list of needs or the quantity of goods required to satisfy them expands as overall wealth increases (Goodin 1998, 181), this still would lead us to expect the state share of spending to remain at best constant.

One can see the same sort of problem with egalitarian theories. If the purpose of the welfare state is to redistribute wealth, in order to redress inequalities produced by the operations of the market economy, why should the fraction of wealth that it seeks to redistribute not remain constant over time? The answer cannot be that the state starts out modestly, then works its way closer to the egalitarian ideal. If this were so, then one would expect to see more ebb and flow in spending, corresponding to the level of commitment to egalitarian ideals in the governing party. So why the seemingly inexorable growth in spending?

The public goods perspective, on the other hand, has a simple explanation for the expansion of the welfare state. Indeed, Wagner’s Law is sometimes formulated as the claim that “the income elasticity of demand for public goods is greater than unity” (Yousefi and Abizadeh 1992, 100). This is actually not a formulation of the law, but rather a proposed explanation for it – one that presupposes the correctness of the public goods framework. Unpacking things a bit, the view is as follows: the state taxes people in order to provide public goods. As people become wealthier, they want to spend an increasing fraction of their income gain on public goods, and so, to the extent that the state is responsive to public preferences, growth in per capita GDP will lead to an increase in state spending as a fraction of GDP.

One feature of this view that is worth drawing attention to is the fact that it actually asserts the opposite of the “basic needs” view, which says that the job of the state is to ensure that everyone has the basic goods required for a decent life. If anything, these sorts of basic goods (food, clothing, shelter) are the ones that the *market* does a good job of providing. What the state provides, by contrast, are goods for which there is relatively low demand at low income levels, which is precisely why the demand for state services increases disproportionately with gains in income. One can see this trajectory very clearly in developing nations, where at early stages of growth the population puts enormous

emphasis on consumer durables (refrigerators, bicycles, televisions, mobile phones, etc.), as well as food (particularly meat) and housing, all of which are delivered quite efficiently by the market. It is only once these “basic needs” are satisfied that people begin to worry about various “quality of life” issues, such as sanitation, water and air quality, health care, and insurance of various types – all of which are goods best delivered by the state.

This increased demand for public goods is sometime an indirect effect of other preference shifts. For example, an increased taste for leisure – understood broadly, to include also time spent in school and in retirement – will generate increased demand for public goods. Increased life-expectancy will have the same effect. (Harold Wilensky suggested, many years ago, that “if there is one source of welfare spending that is most powerful—a single proximate cause – it is the proportion of old people in the population” [Wilensky 1975, 47].) This is because many welfare-state programs engage in what Gøsta Esping-Andersen and John Myles call “horizontal redistribution,” (2009, 640) viz. reallocation of income over the individual’s own life-cycle. This characterizes not only social insurance programs such as health care and pensions, but a lot of education spending as well (insofar as education generates higher employment earnings later in life). As income increases, it is natural that individuals would want to engage in more horizontal redistribution, and because many of these transfers are mediated by the state, it will show up as increased demand for the relevant set of social programs.

Another important consideration is the fact that private goods tend to be the “low hanging fruit,” when it comes to organizing production, simply because markets have such low transaction costs. Even if the public sector has lower transaction costs than the private sector when it comes to delivering a specific service such as mass transportation, there may be close substitutes, such as private transportation, that have lower costs still. Thus production and consumption will initially be focused on these private goods, and it is only with increased satiation in these areas that the transaction costs associated with the public good will begin to seem like a price worth paying. The significance of negative externalities (such as congestion and pollution) will also tend to grow over time, not always because the absolute magnitude of their effects increases, but also because their relative significance increases, simply because they remain unchecked, while the marginal value of increased consumption of private goods declines.

Finally, it should be noted that with increased wealth comes a relative decline in the consumption of material goods, and increased consumption of what Fred Hirsch referred to as “positional goods” (1976). This is codified in the form of what I call Hirsch’s Law, which states that “as the level of average consumption rises... the satisfaction that individuals derive from goods and services depends in increasing measure not only on their own consumption but on consumption by others as well” (2). Thus wealthy individuals spend an increasing portion of their income on goods that are valued for the positional advantage that they confer: status, exclusivity, style, design, beauty, trendiness, hipness, or location (in real estate). The satisfaction generated by consumption of these goods is zero-sum in the aggregate. This decreases the relative value of these goods, as a

class, compared to public goods, which tend to be non-positional (in particular, when they are supplied universally) (Frank 1999). The overall effect, again, will be a shift towards increased state spending as the society becomes wealthier.

This is not intended to be an exhaustive list of the reasons for the growth in welfare-state spending over the course of the 20th century. These are simply examples of different mechanisms capable of generating the phenomenon observed by economists, viz. that “the income elasticity of demand for public goods is greater than unity.” The more general point is that positing a shift in demand of this sort provides a far more plausible account of the dynamics of the welfare state than any explanation available within the framework of either the communitarian or the redistributive model.

VII. CONCLUSION

In this paper, I have been using the concept of a “normative model” of the welfare state as a way of injecting an element of “facticity” (Habermas 1996, 287) into the “reasons for welfare” debate. Rather than focusing on the purely prescriptive task of thinking up arguments in favor of some idealized set of welfare state programs, my goal has been to identify the normative considerations that have motivated, and in a sense are embedded in, existing welfare-state arrangements. The purpose of this exercise is not only the usual one of improved accuracy and self-understanding, but also the pragmatic objective of enabling better judgments to be made about where the public/private boundary should fall. These boundary questions are extremely complex (e.g., Stark, 2009), and so it is important to have a clear, consistent criterion for adjudicating them. Current political discourse, however, tends to be governed by a hazy amalgam of the communitarian, egalitarian, and public-economic perspectives.

The advantages of having a single, clear model can be seen quite easily in the area of health care (where there are an enormous number of difficult boundary judgments to be made). Commitment to a communitarian model of the welfare state has tended to favor what Evan Davis calls the “traditional public sector model,” where goods are both paid for and provided by the state. In the case of health care, this suggests that the health system should function as a single, vertically integrated service provider, with physicians working as salaried state employees. Contracting out of even minor services will seem problematic from this perspective. This is a highly inflexible arrangement, one that imposes very significant efficiency losses. The temptation then is to retreat to an egalitarian position, and argue that some contracting out is permissible, as long as the principle of equal access to timely, quality care is guaranteed. The problem then is to explain why *all* services should not be contracted out, or in other words, why socialized medicine systems should not be abolished entirely, with individuals being given an income supplement or voucher that they can use to purchase care. It is simply impossible to explain what is wrong with such an arrangement without pointing to the problem of market failure in the health insurance sector. And yet once this has been pointed out, then there is nothing further

that needs to be said, in order to make the case for a socialized medicine system. One can appeal to egalitarian principles in deciding how this system should be *financed*, and how much cross-subsidization within the plan should be allowed. But the boundary between public and private with respect to service delivery can be drawn entirely through appeal to efficiency considerations.

Thus the public-economic model of the welfare state provides both the best theoretical reconstruction of the existing configuration of welfare-state services, as well as the most useful set of principles to guide any proposed expansion or modification of these services. Indeed, the usual complaint against it is not that it lacks explanatory adequacy, but that it is not “moral enough” to count as a guide to policy. This is, as I have attempted to show, largely a consequence of a misunderstanding of the Pareto principle. There are of course *features* of the welfare state that are best explained in terms of promoting equality, or resisting commodification. But the public-economic model is the only one able to provide a rationale for public provision of the “big ticket items” – health, education, pensions – as well as to explain the dynamic that produced the extraordinary expansion of state activity over the course of the 20th century.

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