

## ***Social Provisioning and Social Unbalances on Capitalist Development***

Carlos Aguiar de Medeiros (*Federal University of Rio de Janeiro*)

### **Introduction**

Social provisioning brings political decisions to the core of the economic system. The modern welfare and social security system consists of two different social constructs, a defined-benefit public scheme of pensions (PAYG) and the provision of public services. The first system has a built-in mechanism with income growth but the second has not. As John Kenneth Galbraith showed in his analysis of the ‘affluent society’, in US there was a tendency for a ‘social unbalance’ separating the American area of private wealth from the area of poverty formed by the provision of public services. Social unbalance resulted from political conceptions of how society should work and who should pay for public services. We argue in this paper that since the 1980s social unbalance has increased in rich and middle-income societies.

In the section 1, we explore the different components of welfare system, in the section 2 we consider the connections between public services and investment, in section 3 we examine some reasons under social unbalance and section four concludes this paper.

### **Social Provisioning in Modern Economies**

A market economy can only survive by the existence of non-market. As Karl Polanyi (1957) pointed out, a market economy is embedded in institutions created to regulate the fictitious commodities of labor, nature and money. In the case of labor, as

considered by the classical theory of wages, the subsistence wage consists of a set of goods that cannot “fall short”, and part of this bundle depends on State money transferences and the access to public services. Consequently, social regulation of labor evolves in a permanent political and ideological conflict. The enabling myth of market regulation (William Dugger, Howard Sherman, 2002) assumes the existence of a mechanical determination of wages according to labor productivity but in fact, market regulation essentially means the power of money over social relations (Simon Clarke, 1988).

The modern welfare system works through two different major social constructs. A defined-benefit public scheme of pensions (PAYG) and the provision of public services (not necessarily non- excludable and non- rivalrous as health, education, transport, and housing). The United States social security system and the public health system in UK were the two most outstanding national experiences of these social constructs.

In a defined-benefit scheme of pension system, as shown by industrialized economies during the Golden Age (1950-1980) higher GDP and employment growth rate, higher will be the contribution made by the employers and employees to Government’s revenue. Economic growth and full employment creates the revenues necessary to finance pensions and to contain its burden on public spending (1). This system formed part of what Martin H. Wolfson, and David M. Kotz (2010) denominated the Regulated Social Structure of Accumulation (SSA). In these economies, the broad social question has been the great divide separating the population that was entitled to benefit from public pension and other transferences and the population excluded. In industrial countries, the majority of the labor force was included, however, this divide has always been present

between national and migrants labor. Since the 1980s, in the Neoliberal Social Structure of Accumulation, (SSA) (Wolfson, and Kotz , 2010) high levels of migration and precarious jobs enlarged this polarization.

In developing countries, this segmentation has been much greater. High levels of poverty and income concentration have been historically the consequence of a reality created by the exclusion of the majority from the redistributive mechanism of the State. As the Brazilian experience showed after the new Social Security system approved in 1988 and the Chinese Social Insurance Law introduced in 2010 the inclusion of the peasant and rural labor in the pension and other redistributive system has had great effect on the rate of income growth of the poorest households.

In the last decades public pension system has been under attack everywhere, particularly in US and in Europe. Liberal media, financial advisors and public officials have considered population-aging and increasing public debt the main factors behind the alleged pension actuarial crisis, an “impending Social Security crisis” as observed by James Galbraith (2008). In many countries, neoliberal policies have reformed pension’s system introducing market friendly innovations based on personal account in a defined contribution scheme. The system led by US and England favored financial capital (2). However, because of its redistributive mechanism it has been difficult politically to replace the PAYG system once it has achieved its public acceptance (3). This system showed strong resilience and in the majority of countries, a mixed system prevailed. Important exception occurred in Mexico during the nineties when under external crisis and pressures for liberal reforms brought about by the NAFTA agreement, the Government in a direction previously followed by Chile under Pinochet regime approved in 1996 a new Social Security Law replacing the PAYG defined benefit system by a defined contribution system.

This resilience found in Social Security system is not present in the other dimension of the welfare state formed by public service in health, education, public transport, and housing. Under chronic budget constraint, public services suffered strong pressures for privatization and market reforms.

### **Public Services and Public Investment**

In industrialized or in less developed economies there are two different variants of public services' provision. A universal system based on direct provision funded by taxation like the health care in Western or Eastern European societies, or a mixed system combining public with market supply of these services like the one prevailing in US and many developing countries as China, Brazil and Mexico. Both schemes depend (totally or partially) on public finance and they have no built-in mechanism similar to that observed in the pension defined-benefit system. As far as these services form part of subsistence wage their provision by the State is of great importance for real wage and for the competitive edge of the manufacture sector. Public service are not only complementary to private goods in the social process of consumption, they enhance the diffusion of the private goods and therefore their own dynamics of mass consumption society.

The definition and usual classification of public investment or overhead social capital makes the distinction of capital (investment) associated to a durable good and current (consumption) outlays. Public spending in education and health is normally included in general current outlays although the provision of public services in these and other areas of social infrastructure at an acceptable level of efficiency depends on the combination of two outlays.

A situation where underinvestment in social infrastructure prevails, as happens in modern capitalism, apparently contradicts the growth tendency of public sector spending to be ahead of GDP in the process of economic development, a stylized fact observed by Adolph Wagner (1883, 1890) (4). According to his analysis, the growing social spending was of paramount importance for this tendency. Nevertheless, this contradiction is only apparent. Despite public budget cuts, particularly intense in the 1990s, social spending did not stop to grow in absolute per capita value and even in relative terms in OECD countries, confirming the Wagner's Law prediction (5). Current outlays form the major share of public spending and consequently this overall ratio only imperfectly reflects the nation welfare since it may increase amidst an environment of underinvested public services. If in a country, public investment decreases and at the same time the population aging increases pensions spending, we may see a simultaneous increase in public spending and a decline in the welfare of the population. In all OCDE countries, the share of social spending in GDP, including UK and US grew in the last decades (5). The contraction imposed by budget constrains in American economy seems to be concentrated on physical public capital as observed by David Alan Aschauer (1997).

For less developed countries the great challenge is not only to keep the pace of public service according to GDP growth but the necessity of its physical expansion and quality improvement from a much lower level. Actually, little public capital at per capita basis is the most general dimension of underdevelopment and the shortage of social infrastructure and inequality in the access of public service explains most of the poverty.

### **Social Unbalance**

Although the relative low growth of public investment and the contraction of the “fiscal space” has been a reality in the last decades, an insufficient or inadequate public service in modern capitalism is very ingrained in its more general tendency. John Kenneth Galbraith in *The Affluent Society* published in 1959 developed some clues. In his analysis of American society at that time, he observed a remarkable contrast between private richness and the insufficient provision of public services (6).

In US, Galbraith depicted three main reasons for social unbalance; the first was the cultural and emulation behavior biased to individual consumption (7); the distributive issues and macroeconomics problems formed the second and the third factor he envisaged. Let us consider briefly these arguments.

*(a) The Prestige of Individual Consumption*

His argument can be simply expressed: since “*management of demand and emulative effects operate on behalf of private production, public services will have an inherent tendency to lag behind.*” (p 194).

In a similar perspective, for Thorstein Veblen (1899) the most important force driving private consumption is the status and ceremonial position conferred to the consumer. Galbraith considered that public services or social consumption did not have the same emulation forces and the same prestige as the individual consumption (in goods or services) had.

Albert Hirschman (1982) explored some reasons that can be useful for this point. Different from durable goods, in the provision of a service (financed by taxes or by fees) there is a high degree of variability in the quality acquired. In a developing country where social demands grow fast, there is a tendency for growing disappointment on public services. A drop on the quality is a common outcome of the expansion. The

problem here is not underinvestment but the slower increase in the provision of the service at the expected level of efficiency.

In general, publicly financed services has less prestige than those market provided. Hirschman identify a cultural behavior. As it happens with the purchase of durable good, when a service is acquired by a direct payment, there is a presumption that the quality and performance is under the consumer's control and is implicit in the price paid. Any disappointment on these services is blamed on the individual choice, when the service is provided through taxes the disappointment is blamed on Government. Hirschman considered this perception groundless and based on common sense. (8)

In a hierarchical society, the social prestige conferred to the universal public service depends on the predominant group of users. In developed societies, this includes the traditional working class and the high middle and professional classes. If the high middle class migrates from public to private services – the exit strategy triumphs over the voice as put by Hirschman- the political prestige of public service declines. In developing countries as Brazil, where public service has been historically much more eschewed a similar process took place when strong massification occurred in the last decades. The inadequacy of capital outlays in social infrastructure and the fall in the efficiency generated a similar high-middle class exit from public to private services. They lost prestige, political voice, resources, quality, and the political pressures for its expansion and quality became weaker (9).

#### *b) Distributive Conflict and the Inflation Effect*

Galbraith (1959) highlighted two other reasons for this tendency, the distributive conflict and the effects of the inflation rate on the burden of the service.

Public services directly place a distributive question of who is to pay for these services. The expansion and modernization of public services depends on the level of public investment and this competes with other Government capital budget allocations. Unless there is, a particular finance bond tying GDP and public revenues with public services expenditure, economic growth does not translate automatically in higher investment in the provision of this supply. Thus different from the pension system where there is a political inflexibility to cut down expenses when GDP declines, in public services the mechanism is more indirect and depends on political decisions, particularly when the circumstance demands the creation of a new service and new capital outlays from Government budget. When GDP grows is possible to finance public spending without borrowing but when income declines Government is tempted to contain these expenses reducing either their physical supply or their quality. Even during the periods of higher growth, the creation of new public services or its enlargement places a distributive conflict of who will pay for them and open the debate over inequality. In American capitalism, this separates politically the liberals that support progressive taxation in order to reduce inequality and the conservatives that discord on taxes.

Under neoliberal SSA, this conflict became stronger. Lower GDP rate of grow reduced the revenue pie and the “corporate welfare” cut the public revenues or enlarged the public spending towards the rich. In this context, the containment of public debt as persistent anti-inflationary policy brought about strong pressures to limit public investment and for privatization. The triumph of the “sound finance” doctrine over the “functional finance” (Zdraka Todotova, 2013) in the predominant neoliberal SSA prevented the anti-cyclical rule of public investment. Moreover, in such a circumstance a number of tax concessions aimed to incite private investment has normally contracted the “fiscal space”.



This situation can be aggravated where sub-national's governments provide those services. Since these bodies do not have monetary authority, they depend on Central Government's budget to finance their debt and on sales or property taxation. In this case, unless they have extra budget revenues, as land leasing or equity selling such as the recent Chinese experience, or as the tax on Brazilian pre-salt oil extraction, the pressures are for higher taxes and federal transferences. This enlarged distributive conflicts between sub national governments and Central government. The difficulties are higher particularly when inflation rises. This causes an immediate pressure on wages and other public spending.

The resistance to increase the direct and progressive tax or to increase the budget debt may explain the tendency of these services to lag behind private production. This political resistance was strongly visible in US during the last decades when taxes lowered and budget constrained social spending. In his preface of the fortieth edition of *Affluent Society* written in 1998, Galbraith observed that the social unbalance in US has strongly enlarged in the last decades (10). Recently the "Obamacare" reform illustrates this point (11). Grounded on ideological values against public welfare and universal access this evolution contributed for a strong segmentation in labor market between migrant and American labor and for the polarization between high and middle class.

In the 2000s decade, the contrast among Brazil, China and Mexico illustrates the political dimension behind the provision of public service. In Mexico, no changes took place and the same reality of low per capita social spending registered in the 1990s prevailed. In a remarkable contrast, in Brazil higher tax collection, higher wages and social spending distinguished this decade. Public investment in social infrastructure grew as well though in a rate below the necessities and demands. In China, the growing social conflict that emerged from land expropriation, poor public health and income

inequality brought about a new Social Insurance Law and new investments in social infrastructure including medical cooperatives for rural population. As observed by Wang Shaoguang (2012), a Chinese welfare state is emerging and now when the need for food, clothing, housing and transportation and the demand for public consumption (safety, ecology, health) are the most important area for social improvement.

### **Conclusion**

Social provisioning brings the political dimension of income distribution to the center of economic analyses. We argue that the social unbalance, an unbalance between the supply of private and public goods long time ago examined by John Kenneth Galbraith, can be considered not only a persistent dimension of American capitalism but particularly a social reality much ingrained on the values and ideologies of a deregulated market society. In fact, it became strongly visible after the political changes brought about by neoliberal SSA and the triumph of the doctrine of “sound finance”. The “corporate welfare” has challenged the welfare state in industrialized countries in the name of efficiency and competitive edge but this social coalition has resisted at least in the maintenance of the pensions system and social transferences. Different from pensions and other social spending that is politically difficult to cut, the modernization and expansion of public goods in new areas or for new users depends on capital outlays and thereby are much more dependent on political decisions. But if those services have been constrained by public budget the transfer of the power to borrow from the public to private sector- what James Galbraith (2008) called Keynesian devolution – has had no such limit and large privatization or public subsidy to private investment in health, education or housing have increased everywhere.

## Notes

(1) “With predetermined levels of benefits and retirement conditions, the only means governments are left with to check the burden of pensions is by promoting full employment and growth. It pertains to the inner logic of a PAYG system of the defined-benefit type that the rate of growth of output cannot be treated as exogenous, or given, if the long-run balance of the pension budget is to be ensured”

Pivetti p. 6) pg 6

(2) As observed by Leo Panitch and Sam Gindin (2013) “There was no little irony in the extent to which the growth of pensions funds- one of the main products of US workers’ ability to secure retirement benefits under the class compromise in the postwar era- should have become one of the central pillars of the neoliberal financial order that accompanied the defeat of American trade unionism in the 1980s” pg 177

(3) “Although generous public pensions are hardly conceivable without a policy of fuller utilization of resources, it nevertheless remains true that a public retirement system...., by itself, to exert a positive impact on growth—both directly, by strengthening the propensity to consume and the demand for capital, and by tending to compel policy-makers to adopt an expansionary policy stance in order to check the burden of pensions on their constituency.”. (Pivetti, pg 10)

(4) See Peacock, A. and A. Scott (2000). The Curious attraction of Wagner’s Law. Public Choice, 102, 1-17

(5) See OECD, Social Spending Database, 2013

(6) “The schools are old and overcrowded. The police force is inadequate. The parks and playgrounds are insufficient. Streets and empty lots are filthy, and the sanitation staff is underequipped and in need of man,...Internal transportation is overcrowded

unhealthful and dirty. So is the air... These deficiencies are not in new and novel services but in old and established ones.” (Galbraith, 1958, p 186)

(7) “Synthesis and emulation are most persuasive in creating desire for simple physical objects of consumption or simple modes of enjoyment which require no previous conditioning of the consumer.” Galbraith, p 208

(8) Nevertheless, this was an important for privatization and neoclassical models of bureaucracy based on principal-agent relationship (Niskanen, 1973, Peacock, 1979) and for the ideological onset of public interest.

(9) In 2013, strong mass protest took place in the country initiated by a price increase of the São Paulo public transport. The social infra structure in education, health, housing and public transport was the main target of this political protest – led by middle, lower middle class- after a period of high-income growth, low unemployment, and decline in income inequality. The unbalance between public service and private wealth seems to fit perfectly well to the Brazilian recent evolution.

(10) According to him the American people are more than ever affluent in private consumption but the inadequacy of public services (schools, libraries, public recreation facilities, health care) are remarkable.

(11) According to Galbraith (2008) in contemporaneous US almost 50 million persons lack health insurance.

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