The Welfare State and the Market Economy: Which Way Ahead?

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ABSTRACT

This paper concentrates on the conservative challenge to the welfare state and the response of the supporters of the progressive social policy. The central question addressed is whether there is a major trade off between the pursuit of “social justice” and individual liberty. Would the society sacrifice her liberty in order to achieve a higher level of distributive social justice? We discuss whether the progression of the welfare state and the expansion of social expenditures have endangered individual freedom and democracy or have enhanced freedom and created a more universal system of rights as some liberal thinkers have argued. We further discuss whether the historical developments point to an ethical ground or the necessity of social policy as an integral component of a capitalist economy.

THE EVOLUTION OF THE WELFARE STATE IN THE CONTEXT OF CAPITALISM

It is ironic that the more universal notion of ‘social justice’ came into being around the middle of the 19th century, just when the more egalitarian concept of the “Poor Law” appeared to be defeated. This new sentiment is reflected in the following John Stuart Mill’s statement in Utilitarianism (1861): “Society should treat all equally well who have deserved equally well of it... This is the highest abstract standard of social and distributive justice; towards which all institutions and the efforts of all virtuous citizens should be made in the utmost degree to converge.” (Quoted in Hayek 1976, Vol. 2: 63)

The idea of ‘social justice’ matured and rapidly spread throughout Europe during the second half of the 19th century. This trend led to a major transformation in the perception of the morality. The notion of ‘social justice’ assumed a higher ground, at the expense of the old notion of individual morality as reflected in the “Old Whig” interpretation of Liberty. This is Hayek’s account of this story: “Social policy’ (or Socialpolitik in the language of the country then leading in the movement) became the order of the day, the chief concern of all progressive and good people, and ‘social’ came increasingly to displace such terms as ‘ethical’ or simply ‘good’. But from such an appeal to the conscience of the public to concern themselves with the unfortunate ones and recognize them as members of the same society, the conception gradually came to mean that ‘society’ ought to hold itself responsible for the particular material position of all its members, and for assuring that each received what was ‘due’ to him... ‘Social’ became more and more the description of the pre-eminent virtue, the attribute in which the good man excelled and the ideal by which communal action was to be guided.” (Hayek 1976, Vol. 2: 79)

Thus Hayek rather critically refers to the change of “the conscience of the public to concern themselves with the unfortunate ones and recognize them as members of the same society”. In fact, during the years of English Poor Laws (1349 - 1834), the society (the upper class) treated the poor as an entirely different class as if they were not a part of the same humanity. As William Quigley states, “Feudalism and church institutions significantly influenced the development of the English poor laws...In feudal times, work and poverty went hand in hand.” (Quigley 1996: 2) During the earlier centuries of the Middle Ages, “the peasants lived in a virtual state of slavery; they worked for the lord and in return received support from the lord, but in effect they were the property of the lord, who could dispose of them by sale or gift. Prior to the Norman Conquest, as many as two-thirds of the population existed in a state of slavery, though even within the slave population there were class distinctions based on the value of service to the manor. The Normans continued this practice for centuries, with evidence of the sale of servants even into the 14th Century. (Ibid: 2)
Looking at pre-market Feudalism as Cranston notes, serfs in England could not freely dispose of property, leave the service of the lord without permission, could not vote or stand for election and because they did not own property, could not serve on juries or be a magistrate. (Cranston 1985: 13-27) Feudalism continued to be based on the system of servitude. But, it offered a paternalistic system of economic security. As de Schweinitz notes:

“Under feudalism there could, at least in theory, be no uncared-for-distress. The people who would today be in the most economic danger were, in the Middle Ages, presumably protected by their masters from the most acute suffering. They were serfs or villeins, who by virtue of their slavery or of what F.W. Maitland calls their “unfreedom,” had coverage against disaster. Insurance against unemployment, sickness, old age was theirs in the protection of the liege lords.” (de Schweinitz 1943: 2)

Thus Feudalism provided an internal social stability that could never be achieved under capitalism. On the other hand, the inherent dynamism of capitalism cannot be matched with this condition of almost absolute level of internal social stability. This strict line separating the upper class and the lower class or, indeed, between the masters and the servants who had lost virtually all or most of the rights enjoyed by a free had to be broken with capitalism. But with the capitalist transformation, the laboring class would gain their relative freedom, but would lose their security. Thus capitalism from the beginning required a system of the social insurance and welfare provision to provide the laboring population with a minimum level protection against the phases of unemployment due to sickness, disability, and particularly economic downturns, which were deemed to happen frequently under capitalism.

The dynamics of capitalism had a price tag: economic instability. Economic freedom, a central ingredient of the new capitalist system, did not arrive without high cost and was not necessarily welcome by ordinary people. “For we can see that economic freedom did not arise just because men and women directly sought to shake off the bonds of custom and command. It was also thrust upon them, often as a very painful and unwelcome change. For European feudalism, with all its cruelties and justices, did provide a modicum of economic security.”(Heilbroner & Thurow: 16) For the peasant in the Middle Ages, the margin between starvation and survival was slim. Famines were frequent, warfare and wolves were a regular threat, pests could repeatedly destroy a crop, as did other adverse climate and natural changes. The peasant lived an extremely austere and poor life. “However mean a serf’s life; at least he knew that in the bad times he was guaranteed a small dole from his lord’s granary. However exploited a journeyman, he knew that he could not be summarily thrown out of work under the rules of his master’s guild.”(Ibid: 16)

Capitalism brought about a degree of freedom for the laborers that did not exist before. That strict line separating the classes was broken and social mobility increased, allowing at times the poor to rise “from a station in life from which there had been almost no exit. But economic freedom also had a harsher side. This was the necessity to stay afloat by one’s own effort where all were struggling to survive.” (Ibid: 17) With the transformation of the society from feudalism to capitalism, the working population increasingly lost the minimum protection they received in the feudal manorial system. The first major effort to remedy this loss was the Elizabethan Act of 1601. While it did not repeal any prior laws and left many local customs alone, this act set the foundation and “provided the framework for the poor law for the next 350 years.” (de Schweinitz, cited in Cranston 1985: 15). The Poor Law of 1601 relegated the delivery of relief of the poor to the local Parishes. “The state filled the vacuum left by the elimination of the Church system of poor relief and adopted many of the same structures and procedures of that prior system.” (Quigley 1996: 16)

Thus the state provision of relief increasingly replaced what was provided by the feudal lord and the church in earlier times. While the state set the minimal national standards and coordination, relief of the poor remained primarily a local public responsibility. A major goal of this system was to keep the able-bodied poor people laboring. Nonworking poor people would be pitied, if unable to work; but if able to work, to be set immediately to work. The law set severe public punishment for those who refused to work. (Quigley 1996: 31)

In spite of its crudeness, harshness, and coerciveness (as compared to the modern welfare state policies), “the 500 years of English poor laws did represent clear progress over the feudal system of serfdom and show an evolution toward improved assistance for the nonworking poor. The laboring poor saw less progress, but ultimately they too were better off than under feudal times.” (Quigley 1996: 32)

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1 The notion that capitalism brought about a better life for the laboring population is challenged by a number observers of the Poor Laws era who have claimed that life in the feudal traditional society has been much more satisfying than life in early stages of capitalism. For example, Friedrich Engels
A major shortcoming in the underlying philosophy of the Poor Laws was its treatment of poverty as an individual failing rather than a consequence of economic or societal changes. There was, therefore, no effort to change or regulate the underlying economic and social conditions of poverty in the entire period preceding the formation of the welfare state in Europe and Northern America. Moreover, the poor were not treated as the members of the same society with the same rights and individual respect. Thus the social approach toward the poor and the lower class, in general, was still very similar to the feudal era in which the relationship between the lower class (the vast majority of people) and the landlords was based on servitude.

Is the Welfare State a Threat to Freedom and Democracy? The New Right Vision

In contrast to this perspective, the welfare state is based on a different outlook of the society. In the new system, “welfare is enshrined in law and viewed as a universal civil right for those deserving of it, in contrast to private charities and the “public charity” embodied in the English Poor Laws (their aid being viewed as gifts and humiliating to have to accept).” (Karlin 2009) Thus the welfare state, rather than being an infringement of the rights as Hayek and other right wing social thinkers would like us believe, represents an expansion of the same rights previously enjoyed by a small group of citizens to all citizens. As we discussed before, Hayek was critical to the welfare state as a threat to freedom and the infringement to the individual rights. In the Road to Serfdom, he expressed his concern that soft forms of collectivism would have a tendency of evolving into totalitarianism.

Hayek’s main point of reference the “Old Whig” ideas about liberty and democracy, emerged in the process of the seventeenth century “English Revolution.” John Locke, a leading British philosopher of his time, had lasting influence on the development of “Old Whig” political ideals in the English revolution. The “Old Whig” ideals have one over-riding theme: “Rule of Law.” And even “Rule of Law under a government is itself restrained by Rule of Law.” This means that the power of government itself is restrained by the rule of law. The system requires built in institutional safeguards to limit the power of the government and maintain individual freedoms. A major component of such democratic system is the majority rule. But at any given point of time, the majority rule is itself confined to the existing laws. This means that the rights of the minority are also protected by law. It is when it is contended that “in a democracy right is what the majority makes it to be” that democracy degenerates into demagoguery. (Hayek 1960: 7, 3) Thus even a representative democracy does not necessarily guarantee “liberty.” The “Rule of Law” implies the limited power of all branches of the state, including the legislative branch. (Ibid: 11, 4) The main practical safeguard against the abuse of authority proposed by him is the separation of powers.” (Hayek 1960: 11, 5)

The “Glorious Revolution of 1688” was the manifestation of these ideals. This revolution was the first attempt in modern times to address the question of how to oblige government to control itself. The objective was not only to limit the arbitrary power of the king, but also to oblige the parliament to pursue the rule of law. In spite of the safeguards, the ideals and hopes of the “Glorious Revolution of 1688” were tarnished in 1776: “…the British Parliament claimed sovereign, that is unlimited, powers and in 1766 explicitly rejected the idea that in its particular decisions it was bound to observe any general rules not of its own making. . . .this in effect meant the abandonment of constitutionalism which consists in a limitation of all power by permanent principles of government . . .” (Hayek 1979: Vol.3, p.2)

Thus, as Hayek points out, “it became generally recognized that for individual liberty to be preserved it was of the greatest importance that arbitrary actions by government should be prevented. During the revolutionary decades it also came to be recognized, from the events that transpired in the interim, that Parliament was apt to act just as arbitrarily as

in his famous book, “Condition of the Working Classes in 1854”, gives a rosier picture of the idyllic life of the cottage worker and his family as compared to life under capitalism in the eighteenth and nineteenth centuries England: “The history of the proletariat in England begins with the invention of the steam engine and of machinery for working cotton . . . before then the workers vegetated throughout a passable comfortable existence, leading a righteous and peaceful life in all piety and probity; and their material condition was far better than that of their successors. . . . Their children grew up in the fresh country air, and, if they could help their parents at work, it was only occasionally. . . .The young people grew up in idyllic simplicity and intimacy with their playmates until they married. . . .” (Quoted by Ashton 1954: 35-36)

Kindleberger (1974: 48) expresses his doubt about the validity of this evaluation: “there is surely a presumption that both the miseries of the 1830’s and the idyllic quality of traditional society are exaggerated. Much of our information of the period, as conveyed by Harriet Martineau, the Hammonds, Engels, et al, derives from evidence given before Royal Commissions, starting with the one which preceded the passage of the New Poor Law of 1834. That this evidence was biased is hard to deny. As Friedrich Hayek notes, it was given by landlords smarting under their defeat at the hands of the industrialists in the Reform Bill of 1832. . . .There were poor and poor laws well before the commercial revolution or the industrial revolution, and when there were crop failures, suffering was widespread. At all times life expectancies were short. (48)
the king, and that whether or not an action was arbitrary depended not on the source of the authority but on whether it was in conformity with pre-existing general principles of law. The governing principle throughout was that not the king, but the Law should rule.” (Hayek 1960: 11, 4)

Hayek’s criticism to the welfare state was gentler that other conservative commentators. Milton Friedman in *Capitalism and Freedom*, rejects the welfare state on paternalistic ground for “responsible” people, since it involves “the acceptance of a principle – that some shall decide for others. It undermines the “free man’s belief in his own responsibility for his own destiny.” Huntford uses a more dramatic language in his criticism to the welfare state. In his highly polemical book on the New Totalitarians, he emphasizes how Sweden is the most efficient among the totalitarian states because its population of slaves is not coerced, as in Nazi Germany or Stalinist Russia, but conditioned into acceptance of the collective will. (Huntford 1971)2

The New Right’s main moralistic challenge to the welfare state is couched in terms of “freedom.” In Goodin’s illustration of this position, “market transfers are, paradigmatically, voluntary exchanges.” On the other hand, “welfare state transfer payments, by definition, are collective, coerced, one way transfers.” (Goodin 1988: 306) In markets, both sides are, at least formally, ‘free to choose’ whether or not to enter into a transaction. In welfare states, neither has the freedom of choice, in one sense or another (Friedman and Friedman 1981; Friedman 1982).

The question is whether there is a major trade off between the pursue of “social justice” and individual liberty. Would the society sacrifice her liberty in order to achieve a higher level of distributive social justice? A number of supporters of progressive social policy argue that, in reality, the growth of the welfare state has led to the expansion of freedom and the creation of a more universal system of rights for the citizens. Following T.H. Marshall, Zald (1985) argues that “the growth of the welfare state occurred not only through the development of new programs for reaching out to dependent populations, but also in the establishment of the rights of citizens to the program benefits.” Marshall considered social rights as the last phase in the progression of citizenship rights. In the first stage, civil rights such as freedom of contract, freedom of movement, and disposal of one’s labor, were developed. In the next stage, political rights such as right of voting, office holding, and political expression were established. Thus, the formation of social rights would constitute a progression in the development of individual rights, not a regression. Marshall also suggested that citizenship rights would extend beyond political, economic, and social inclusion and would include the ability to participate in the community as an emerging right. (Marshall 1965: 78-91)

Hence, for Marshall the transition from the Poor Laws to the welfare state is associated with the advancement of individual rights to a higher and more universal level. Rather than being a threat to the “Old Whig” ideals of liberty, the welfare state is associated with the expansion of rights, the formation of new category of rights that did not and could not exist in the earlier stages of the capitalist development. We should add that Marshall was not against the capitalist market economy, but held the view that the progression of civilized life would go beyond what the markets alone could provide. He did not see the aim of social policy as a radical economic or social transformation of the society, but a more modest reform. “The characteristically welfare statist approach is to opt for readjusting final distributions [primarily to relieve those in the most distress through direct provision of basic needs like food, shelter, etc], rather than altering the pattern of property rights in productive resources that gave rise to undesirable distributions in the first place” (Goodin 1998)

Goodin (1998) finds an ethical ground for at least a minimal welfare state, since it offers a device, shielding the poor and vulnerable against exploitation by those with discretionary power over the society’s resources. For him, “the problem to which the welfare state is the solution is the risk of exploitation of dependencies.” The exploitation can happen in “the course of interactions in ordinary markets” and “between benefactor and beneficiary in the context of old-style public or private charities”. Through its legislative rule, the state may mitigate the former by “removing a wide range of interactions from the market” and the latter by “tightly defining the legal rights and duties of welfare

2 Hayek’s teacher, von Mises, finds his position on the welfare state too soft:

“Unfortunately, the third part of Professor Hayek’s book is rather disappointing. Here the author tries to distinguish between socialism and the Welfare State. Socialism, he alleges, is on the decline; the Welfare State is supplanting it. And he thinks the Welfare State is, under certain conditions, compatible with liberty. In fact, the Welfare State is merely a method for transforming the market economy step by step into socialism. The original plan of socialist action, as developed by Karl Marx in 1848 in the Communist Manifesto, aimed at a gradual realization of socialism by a series of governmental measures.” (von Mises 1960)
claimants and welfare dispensers”. While the market is perceived to be a necessary part of the capitalist society, the market power would inevitably affect the distribution of resources and output. Then freedom from exploitation requires a Leviathan to control the worst ravages of dependency.

In a recent paper, Eileen McDonagh and Michael Tolley (McDonagh and Tolley 2009) argue that the attainment of “social rights”, as T.H. Marshall calls it, (far from being a threat to liberty) has enhanced the democratic participation of the populace in the democratic process. The promise of democracy is to include citizens in the rule of the state. This democratic inclusion, in the 18th and 19th centuries, “focused on extending civil and political rights guaranteeing citizens freedom from government encroachment and freedom to engage in political activity. Later on, in the 20th century, social and welfare rights were developed, expanding the democratic role of the state in society’s life. These rights “commit government to provide for basic subsistence needs, such as health care, food, housing, social security, and education, and to guarantee the right to work, ensure a safe work environment, and provide protection against unemployment and for labor union activities.” Thus as Putnam (1993) highlights, it takes more than just democratic institutions, processes, and basic civil liberties and political freedoms to ‘make democracy work.’ “A vibrant democracy depends on the character of the civic community, including certain political attitudes and behavior.” McDonagh and Tolley (2009) offer evidence for 28 OECD countries to suggest that “constitutionalized welfare rights, when implemented, advance the civic engagement and political participation of citizens.”

Hayek’s criticism of the welfare state was, more or less, a milder extension of his sharp criticism of a centrally planned socialism. In the Road to Serfdom, “Hayek argued that planning could only lead to totalitarianism such as German fascism and Russian communism as a little planning always required more and more planning to fix the unintended consequences caused by the previous planning. Government planning also meant that there could only be one plan which led to the suppression of dissenters as enemies of the state and society.” (McCabe 2010) For him, the only desirable alternative to a planned system was a “free market economy.” He was very suspicious of the outcome of the welfare state transformation of a capitalist economy. For Hayek and von Mises, a society based on “liberty” and freedom could be achieved only through a “free market economy.” A major challenge to this vision came from Polanyi.

In his famous book, the Great Transformation: the Political and Economic Origins, Polanyi argued that fascism was the result of a push toward laissez faire, rather than planning. For Polanyi, the market system is not a natural order as Adam Smith and other classical economists claimed to be the case. Instead, he sees the market economy as a human invention that cannot be naturally blended with social life, since it leads to the full “commodification” of all the means of material life such as land, labor and money. Polanyi calls these things fictitious commodities as they are distinct from regular marketable produced commodities. The extension of commodification to all aspects of human (material) life, leads to the tension between economy and society. The tension results in a double movement. The logic of market intrudes further and further into people’s lives and causes severe social disruption. Society, in reaction, seeks protection from further intrusion through state action to limit some of the repressive elements of the market economy. Thus the state policies directed to alter the adverse effects of market on society’s social and economic life, far being from a destroyer of “liberty” can be a liberator of social and individual life from the tyranny of the market. Polanyi does not support the elimination of the market role and a full scale move toward central planning. Instead, he seeks a rather right blend between market and state policy to guarantee market efficiency and a higher level of equality that the rule of market alone can deliver.

Hayek and other supporters of “liberty” and “freedom” focus on revere and sacredness of individuality and individual freedom. What is missing from their analysis is the importance of a sense of community and its role in enhancing the democratic life. A number of more liberal minded authors have given a high value to “social capital” and civic activity as contributors to democracy and liberty. In Henry V, William Shakespeare suggested, “Trust no one; for oaths are straws, men's faiths are wafer-cakes, and hold-fast is the only dog.” As Quigley (1996) indicates in his review of two books by Francis Fukuyama and Robert Putnam, “Shakespeare may have had a blind spot, and that prosperity and effective democracy depend on the accumulation of trust, which they define as a form of "social capital” that results from individuals' willingness to work together voluntarily for the greater good.”

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3 It was James S. Coleman (1988) who first developed the concept of social capital in “Social Capital in the Creation of Human Capital.” He further elaborated this concept in Foundations of Social Theory.
Reflecting Max Weber, Fukuyama maintains that "there are ethical habits, such as the ability to associate spontaneously, that are crucial to organizational innovation and therefore to the creation of wealth" (Fukuyama 1995: 37). He confers to the three general paths that he believes, are needed for associating or sociability - family and kinship, networks of voluntary associations, and the state. A major question is how to increase the Stock of Social Capital? Fukuyama (1999:15) suggests that in fact the policy makers “do not have many obvious levers for creating many forms of social capital. Social capital is frequently a byproduct of religion, tradition, shared historical experience, and other factors that lie outside the control of any government.” He warns that “social capital, particularly when associated with groups that have a narrow radius of trust-can produce negative externalities and be detrimental to the larger society.” (Ibid: 15)

In his view, the best that the public policy can do to enhance the stock of social capital in society is through investment in education. This is because “educational institutions do not simply transmit human capital; they also pass on social capital in the form of social rules and norms.” (Ibid: 15) He adds that “one of the greatest safeguards against corruption is to give senior bureaucrats high-quality professional training and to create an esprit de corps among this elite.” (Ibid: 15) The state can also help with the creation of social capital through efficient provision of “necessary” public goods, particularly property rights and public safety4. This is important, because “people cannot associate, volunteer, vote, or take care of one another if they have to fear for their lives when walking down the street. Given a stable and safe environment for public interaction and property rights, it is more likely that trust will arise spontaneously as a result of iterated interactions of rational individuals.” (Ibid: 15)

Putnam's book has been called "a great work of social science, worthy to rank alongside de Tocqueville, Pareto and Weber,"(The Economist 1993: 96) as well as "seminal, epochal."(The Nation: 1993) Putnam recognizes that not all the consequences of civic engagement are positive. For example, uncivil societies or delinquent communities inherited from the past in the newly independent states do not make good partners in building social capital. Therefore, Putnam cautions that only those civic associations would promote democracy and freedom that support tolerance, equality, and respect for the rights of others. (Quigley 1996) Let us first start with his definition of “social capital.” Putnam (2000: 19) introduces this idea: “Whereas physical capital refers to physical objects and human capital refers to the properties of individuals, social capital refers to connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them. In that sense social capital is closely related to what some have called “civic virtue.” The difference is that “social capital” calls attention to the fact that civic virtue is most powerful when embedded in a sense network of reciprocal social relations. A society of many virtuous but isolated individuals is not necessarily rich in social capital.”

As Putnam (1995: 65) articulates, one of the barriers to the development of a market democracy in the developing or post communist countries is “the absence or obliteration of traditions of independent civic engagement and a widespread tendency toward passive reliance on the state. To those concerned with the weakness of civil societies in the developing or post communist world, the advanced Western democracies and above all the United States have typically been taken as models to be emulated.” However, as he points out, “the vibrancy of American civil society has notably declined over the past several decades.” As evidence to the past vibrancy of American civil society, he refers to Alexis de Tocqueville's account who found the Americans' propensity for civic association the most impressive element in making democracy work in his visit to the United States in the 1830s.

Dense networks of interaction probably broaden the participants' sense of self, developing the "I" into the "we," which, in his view, encourage the emergence of social trust and improves social communication and economic performance. Incentives for opportunism are often reduced, when economic and political negotiation is embedded in

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4 We should add that Fukuyama’s contribution (particularly in the past) has been, in part, shaped by his neoconservative background. As a key Reagan Administration contributor to the formulation of the Reagan Doctrine, Fukuyama played an important role in the rise of neoconservatism. He was active in the Project for the New American Century think tank starting in 1997, and as a member co-signed the organization's letter recommending that President Bill Clinton support Iraqi insurgencies in the overthrow of then-President of Iraq, Saddam Hussein. He was also among forty co-signers of William Kristol's September 20, 2001 letter to President George W. Bush after the September 11, 2001 attacks that suggested that the U.S should embark upon “a determined effort to remove Saddam Hussein from power in Iraq.” (Quoted from Wikipedia) Fukuyama has shifted his position on Neoconservatism and Iraq war since 2002. He voiced his growing opposition to war and the Bush administration’s militaristic vision. Moreover, he endorsed Barak Obama in 2008 presidential election, even though his position seems to be influenced more by his total disappointment with the Republican policy of the last years than his direct support of President Obama.
dense networks of social interaction. (Ibid: 67) In *Bowling Alone* (2000) Putnam followed up with a more comprehensive exploration of data sources. Based on this evidence, he was able to make convincing argument that there had been a fundamental shift in the realm of civic engagement and social connectedness, over the last three decades of the twentieth century. He shows that there has been substantial decline in Political and civic engagement as reflected in lower level of voting, political knowledge, political trust, and grassroots political activism. The declines are equally visible in non-political community life: membership and activity in all sorts of local clubs and civic and religious organizations have been falling at an accelerating pace. An evidence for the increased distrust is trend of employment opportunities for police, lawyers, and security personnel. While these indicators were stagnant for most of this century (indeed, America had fewer lawyers per capita in 1970 than in 1900), in the last quarter century these occupations boomed, as people increasingly turned to the courts and the police for quarrel resolutions.

**CAPITALISM WITH OR WITHOUT A WELFARE STATE?**

To summarize our detailed discussion of capitalism, democracy, and the welfare state, we address the following question: What should be the form of a society that can offer a balanced blend of economic efficiency, liberty and freedom, and social security for the population under capitalism? Can this society guarantee social justice without a major sacrifice of freedom and liberty as well as economic efficiency? Hayek has made at least two major contributions to our understanding of such a society. The first one is his notion of spontaneous order, a broad concept of “invisible hand” that goes beyond market relations and extends to all economic and social relationship that make up the spontaneous order of a free society. “The rules of a spontaneous order are abstract, normally negative in character, and long-term in application.” (Shenfield 1980)

What Hayek argues is that such a model of society works with only the limited knowledge that the society’s members have. On the other hand, the conducts of the affair of the alternative society, a society based on state planning, requires a degree of knowledge beyond the capacity of man to encompass. In spite of its advantage, this perspective, even in its ideal form, has its own limit, since cannot provide all the desired outcomes. At its micro level, this model of capitalism fails to provide public goods, an acceptable level of income distribution and a sustainable pattern of economic and social security. This society also faces the well-known macroeconomic cycles of boom and bust. Moreover, this model is only a partial match to the reality of modern capitalism, which has increasingly transformed into a capitalist society based on the role of what Alfred Chandler (1977) calls “visible hand,” formed through the power of a rising managerial hierarchy created for the emerging multi-unit business enterprises.

Second is Hayek’s emphasis on the interdependence of law and liberty: a classical liberal conception of liberty and freedom, based on the rule of law. In spite of his stress on the limits of human knowledge, he displayed a profound faith in the power of ideas and institutions. In contrast to other conservative scholars, “Hayek emerges as a figure squarely in the liberal tradition when one considers his confidence in the power of public ideas, his commitment to an ever wider extension of liberal institutions, and his faith in human progress.” (Macedo 1999: 289) Thus, the rule of law and spontaneous order are the two indispensable pillars of Hayek’s social system. According to the classical liberals, the requirement for a free society is the enforcement of law by government agencies, while abiding by the limits of a higher constitutional law. Even the parliament is strictly expected to abide by the constitution. Hayek’s version of classical liberalism is clearly based on the central features of spontaneous order, the rule of law, individual liberty, and limited government.

Hayek was against the development of any form of the welfare state. “He argued that to talk of ‘social justice’ is absurd, and to try and promote a just distribution of economic rewards is utterly misguided.” (Macedo 1999: 292) In his view, the economic rewards are the outcome of a vast unplanned system. It is the market exchanges that determine the pattern of rewards in a market economy and this pattern is the result of interaction of innumerable individual decisions, and these results are often quite arbitrary. “Success or failure in the market may depend partly on effort, skill, and merit, but they often depend crucially on luck and unforeseeable events, and the actions of other people in far-flung corners of the globe.” (Cited in Macedo 1999: 292) ‘Social justice’ is necessarily empty and meaningless, because no
one determines the relative incomes of people, and no one can prevent their incomes from being ‘partly dependent on accident” (Hayek1978: 68–69).

Now the fact that no individual or entity is responsible for inequalities in market distribution of income does not imply that the society cannot remedy such undesirable outcomes. Judith Shklar (1990) argues that the notion of social justice is not in response to the error of some individual or entity in bringing about high distributive inequalities. Rather, it is based on the idea that it is justified to collectively intervene if the members of the society choose to do so through democratic means. Such interventions do not need take the form of a wide-ranging economic planning, but the form of relatively modest designs of social programs such as education, health care, unemployment insurance, housing, or even a livable income that are universally accessible to all eligible members of society. Shklar (1990) argues that we, indeed, need some positive justification not to make any effort to improve income inequalities or offer a minimum safety net against the calamities of the blind market forces.

Shklar makes a distinction between misfortune and injustice. In her view, the line separating misfortune from injustice is a political choice and not a natural given condition (Shklar 1964: 5). What might be considered as misfortunes in the past such as certain forms of disease and infant mortality, can be the injustices of today. With the advancement of science and technology, the means for preventing such diseases and conditions become available and can reasonably be carried out by officials and administrators. Thus if such measures are not undertaken, then the misfortune of the past becomes the injustice of today. “An earthquake is a striking example here: lack of technological know-how, official incompetence, lack of adequate social organization, and social corruption can transform this quintessential natural misfortune into a paradigm example of the failure of social justice.” (Benhabib 1994: 4) Once again, her position is the opposite of the social passivity of Hayek that we should leave with the outcome of the invisible hand, “since no one determines the relative incomes of people, and no one can prevent their incomes from being ‘partly dependent on accident.’” Shklar rejects the position of submissiveness to “invisible hand”, arguing: “It seems to me that this is a poor argument because it is evident that when we can alleviate suffering, whatever its cause, it is passively unjust to stand by and do nothing. It is not the origin of injury, but the possibility of preventing and reducing its costs, that allows us to judge whether there was or was not unjustifiable passivity in the face of such disaster. Nor is the sense of injustice irrelevant.” (Cited from Benhabib 1994: 4)

As we mentioned before, Hayek has already acknowledged that market does not guarantee equal outcome for equal effort: “Success or failure in the market may depend partly on effort, skill, and merit, but they often depend crucially on luck and unforeseeable events…” (Cited in Macedo 1999: 292) But what Hayek fails to acknowledge is that in addition to randomness, there are built in structural inequalities that would bring invariably unequal outcomes for equal efforts. Shklar insists that our responsibility as a society to address the unjust outcomes. Accepting in principle the market allocation of resources, does not imply that the society has no right or option to interfere to remedy some adverse outcomes. As Macedo (1999: 293-294) suggests “it is not up to us how the market allocates rewards, but it is up to us how we respond to that allocation. It is possible that some egalitarian forms of achieving social justice may provide wrong incentives or undermine the character of the recipients of the aid. But this does not mean a wholesale rejection of any notion of social justice as an “absurdity” as Hayek tends to do. In fact, Hayek himself provides the logical basis for going beyond the classical liberals’ notion of market and the accommodating role of state. Unlike conservatives, Hayek is not averse to evolution and change.

In general, he considers himself a liberal. And he considers his version of liberalism (classical liberalism) quite distinct from both conservatism and socialism. Hayek seems to be fascinated with the liberal desire for change and progress: “Liberalism is not averse to evolution and change; and where spontaneous change has been smothered by government control, it wants a great deal of change of policy.” (Ibid: 2) In reality, the position he takes acquires more and more similarity to the conservative obstructionist view that he did not like originally. Even though, he has praising words for the liberal inherent tendency toward change and progress, it is not clear what type of change he is suggesting and what direction he foresees for the future of his beloved liberal society. In fact, Hayek’s vision of a progressive and forward-looking liberalism seems to provide an appropriate basis for the newer transformations in the state and society.
But Hayek himself is very skeptical of these changes and, in reality, he sticks only to the “ideals” of the Old Whigs and perhaps the Founding Fathers of American constitution. For Hayek (1988: 10) even moral traditions are the product of cultural evolution rather than the deliverance of reason. The question is, then, whether there are any components of our social system that should be protected against social evolution. Are there any principles of justice that are universal and should not be subject to the evolutionary process as a whole such as the pattern of economic distribution? Hayek does not seem to believe it is a good idea to adhere to the notion of absolute moral principles, if they are not selected by social evolution. He thinks that the society should, in reality, hold on to those moral values that are selected through social evolution, even though they appear as no more than “unreasoned prejudice,” and that evolved moral traditions “outstrip the capacities of reason” (Hayek 1988: Chap. 4).

There is, then, no reason why we should not accept the development of the welfare state as the outcome of such evolutionary process. According to Hayek, the evolution of a spontaneous order is not simply an unplanned order but a freely adapting order governed by the primacy of individual liberty. “Evolution works by allowing free individuals to adapt, but the political system should remain constantly true to certain basic values, such as the equal right to individual liberty, the security of privacy and property, and freedom of association, all of which are importantly guaranteed by an impartial and regularly administered rule of law.” (Macedo 1999: 297)

Thus the evolution of social programs should not be considered to be in violation of Hayek’s principle of social evolution to the extent that they do not pose any threat to the basic values of individual liberty and equal rights, governed by the rule of law. In fact, one can argue that these programs, far from being a threat to individual liberty, are extension of freedom and liberty to the extent that are achieved in response to social needs and through a democratic process.

As Macedo (1999: 300) articulates, “it is this faith in the attractiveness of the principles of liberty honestly stated that is Hayek’s greatest legacy. That legacy lives on not only in the contagious hopefulness of Hayek’s best writings, but in the hearts and minds of millions who have been touched and inspired by those writings.” The experience of the soviet type regimes shows that these qualities should not be sacrificed for any valuable social ideals. There is, however, no convincing reason to think that to pursue of social justice and response to the basic economic and social needs of the population, through democratic process, should undermine the principles of liberty and freedom. As Jeffrey Sachs (2006b) states in a short essay on “Welfare States beyond Ideology”, “von Hayek was wrong. In strong and vibrant democracies, a generous social welfare state is not a road to serfdom but rather to fairness, economic equality and international competitiveness.”

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5 There is, however, a strong liberal principle that distinguishes Hayek from the conservative supporter of “liberty” and his own right wing supporters: “When I say that the conservative lacks principles, I do not mean to suggest that he lacks moral conviction. The typical conservative is indeed usually a man of very strong moral convictions. What I mean is that he has no political principles which enable him to work with people whose moral values differ from his own for a political order in which both can obey their convictions. It is the recognition of such principles that permits the coexistence of different sets of values that makes it possible to build a peaceful society with a minimum of force.” (Ibid: 4) What a liberal democratic society needs to maintain individual liberty is the rule of political principles rather than the rule of absolute moral value, which may eventually endanger democracy and freedom.