Re-Theorizing the Welfare State and the Political Economy of Neoliberalism's Campaign Against It

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Abstract: This article seeks to frame neoliberalism's relation to the welfare state. At issue are competing views regarding the size and organization of the welfare state. The article presents a new theoretical framework that distinguishes between modes of production and financing of the welfare estate. The framework helps understand both comparative country welfare states and the goals of the neoliberal attempt to refashion the welfare state. The article then explores the political economy strategy behind the neoliberal campaign. It argues neoliberalism seeks to politically discredit the traditional welfare state and change the economic structure so that the latter becomes unviable. Economists have been active agents in this process.

This article develops the thesis that neoliberalism is engaged in a long-running campaign against the welfare state. At issue are competing views regarding the size of the welfare state and how it should be organized. In waging this campaign, neoliberalism seeks to politically discredit the traditional welfare state and change the economic structure so that the traditional welfare state becomes unviable.

The campaign has deep historical roots which go back to the founding of the welfare state. Its goal is not to completely eliminate the welfare state. Instead, it is to transmute the welfare state by shrinking it, and by turning it into a "profit center" for corporations, whereby corporations produce welfare state services previously produced by the public sector. That is to be done via elimination of rights and entitlements to welfare state services: freezing spending to ensure long-run decline in the welfare state's share of GDP and per capita spending, and privatization of production of welfare state services. Furthermore, this transmuted welfare state is to be funded out of taxes on labor income rather than capital income.

In making the argument, the article develops a new theoretical framework for analyzing the welfare state that distinguishes between "mode of financing" and "mode of production." That new economic taxonomy complements Gøsta Esping-Andersen's (1990) political taxonomy in which the political order determines the size of the welfare state.

The campaign against the welfare state is most clearly visible in the United States, but it is also discernible in the politics of most countries. An interesting feature is that the attack is not a politically partisan affair. In the United States, it has been pushed by both Republicans and New Democrats; in the UK it has been pushed by both Conservatives and New Labor;

and in continental Europe it has been pushed by both Christian Democrats and New Social Democrats. The political differences are more a matter of intensity and degree, rather than direction.

The bi-partisan character of the attack reflects the contemporary intellectual hegemony of neoliberalism which has captured both sides of the aisle of establishment politics. In effect, neoliberalism provides the intellectual rationale which serves as the coordinating mechanism. That shows the power of ideas.[1]

The article argues that mainstream neoclassical economics has been at the forefront of the attack. Some might claim that it reflects the temporary capture of mainstream economics by the Chicago School and others with neoliberal inclinations. My own view is that it reflects the inherent structure of mainstream theory. Though many mainstream economists defend the welfare state, defending it always involves struggling to find an economic rationale. That rationale is constructed in terms of market failure, which requires corrective state intervention. Thus, by starting with the fiction of an ideal market economy, even those economists who support the welfare state tar it as second-best from the outset.

If successful, the neoliberal campaign against the welfare state risks a fatal blow to shared prosperity. First, it will cannibalize the essential institution that saved capitalism from itself in the first half of the twentieth century. Second, it will lock-in the huge inequality and slowed growth that already afflicts contemporary capitalism. Third, it will block the expansion and upgrading of the welfare state that is needed to meet the twenty-first century employment and income challenges posed by intelligent robots and climate change.

The Welfare State: A New Theoretical Taxonomy

One way of conceptualizing the welfare state is through the lens of the Beveridge Report of 1942.[2] The report identified five "Giant Evils" in society: squalor, ignorance, want, idleness, and disease. As illustrated in Figure 1, the modern welfare state can be viewed as a response to those five evils.

The evil of idleness was met by a new commitment to full employment based on Keynesian economics and Keynesian macroeconomic stabilization policy. The evil of disease was met by an expanded commitment to public health care. The evil of squalor was met by a new commitment to public clearance of slums and public housing. The evil of ignorance was met by an expanded commitment to public education. And the evil of want was met by a variety of public income assistance programs, such as family allowances, unemployment pay, disability pay, and retirement pensions.

In his seminal book *The World of Welfare Capitalism*, Esping-Andersen (1990) proposed a political taxonomy that analyzed the welfare state according to political characteristics. The taxonomy consisted of three categories: liberal (e.g., United States), corporatist-statist (e.g., Germany), and social democratic (e.g., Sweden). The focus of Esping-Andersen's taxonomy was to explain size difference. Social democratic polities are argued to have the largest welfare state, liberal polities have the smallest, and corporatist-statist polities lie in between.

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[1] Neoliberalism is a political economy philosophy. The political dimension is that free markets are the best way of protecting freedom. The economic dimension is that free markets are the best way of providing economic prosperity. For a brief discussion of neoliberalism see Thomas Palley (2012, 9–20). In practice, neoliberalism ends up being a business friendly policy paradigm that rewards rent seeking, shifts income from labor to capital, and increases income inequality (see Galbraith 2008).

[2] The Beveridge Report is a UK government report, officially titled Social Insurance and Allied Services, published in November 1942.

Figure 1. The Modern Welfare State Viewed as a Response to Beveridge's Five Giant Evils

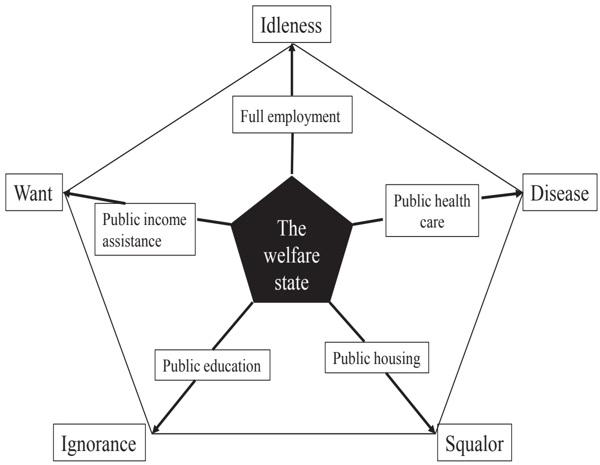
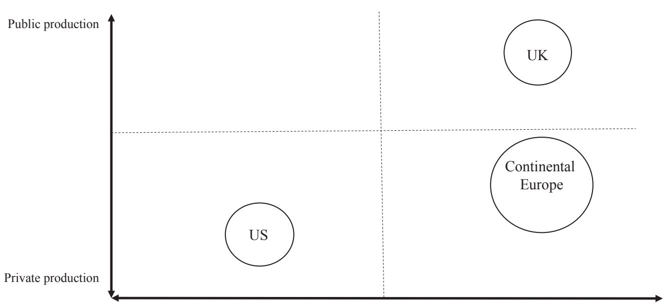


Figure 2 provides an alternative economic taxonomy. The critical characteristics are the ratio of public versus private production of welfare state services and direct public financing versus tax subsidized private financing of welfare state services. Mode of production concerns whether the public or private sector produces welfare state services, and a suggested measure is the ratio of public sector production of welfare state services relative to private sector production of welfare state services. Mode of financing concerns how services are paid for. That may be via direct payment for welfare state services produced by government, by direct payment for privately produced welfare state services, and by private payment for privately produced welfare state services that are subsidized either by grants to producers or by tax benefits to purchasers. A suggested measure of the mode of financing is the ratio of direct public outlays to tax subsidies and grants. This economic taxonomy can be applied to the different spokes of the welfare state, and countries have different mixes for different spokes.

Figure 2. A New Economic Taxonomy of Welfare States



Historically, the UK has had a high level of both public production and public financing of welfare state services. That is exemplified by the UK National Health Service (NHS) in which the government produces and directly pays for health care. However, in the neoliberal era, the UK's public pension system has been repressed in favor of tax subsidized private pensions. Most recently, Prime Minister May's government introduced Sustainability and Transformation Plans (STPs) for the NHS's forty-four regions that have been branded by health care workers as Slash, Trash, and Privatize plans.[3]

The United States has always leaned toward private production and tax subsidized private financing. For instance, after World War II the United States took a pass on public healthcare, which was initially left entirely to the private sector from which individuals either bought insurance or received it as a tax-favored employment benefit. However, in the 1960s the United States introduced Medicare and Medicaid whereby the government provided health insurance for the elderly and the poor, but healthcare production remained entirely in the private sector. Most recently, Obamacare (The Patient Protection and Affordable Care Act, 2010) has further increased government financing of healthcare, but production remains private.

Continental European economies have been positioned in between, but closer to the UK. For instance, in Germany, the government mandates and pays for healthcare, but the private sector produces it. In effect, the government produces healthcare insurance, while the private sector produces medical services. The same is true in Canada.

Though the economic characteristics of welfare states differ significantly, the scale of welfare states is large everywhere. This is shown in Figure 3 which shows social welfare transfers as a share of GDP, with countries grouped according to Esping-Andersen's (1990) political taxonomy. There are two bars for each country. One bar excludes employer-provided benefits; the other includes them.

Comparing the country bars shows the importance of taking account of mode of financing and production. Once tax subsidized employer-provided benefits are factored in, the U.S. welfare state is actually of similar size to the welfare state in the UK, Italy, and Finland. The United States gives huge tax subsidies to both private pension provision and private healthcare provision. The UK gives large tax subsidies to just private pension provision.

The mode of welfare state production and financing has important political economy implications. First, financing health care via the tax system provides a form of incomplete "shadow" welfare state that is financed via tax expenditures.[4] Instead of being universal, only those with access to privately provided health care get the benefit of the tax subsidy. Second, reliance on tax subsidy financing produces a less egalitarian welfare state because tax benefits are worth more to higher income earners. Third, tax subsidized privately produced benefits are disproportionately available to higher income earners. Fourth, tax subsidy financing inevitably promotes private production of welfare state services. Those political economy features and consequences are visible in the United States.

The big lesson from Figure 3 is that there is a plethora of welfare states. The thing they share in common is that they all address Beveridge's five giant evils. How they do it is quite varied, and how effective they are is also varied.

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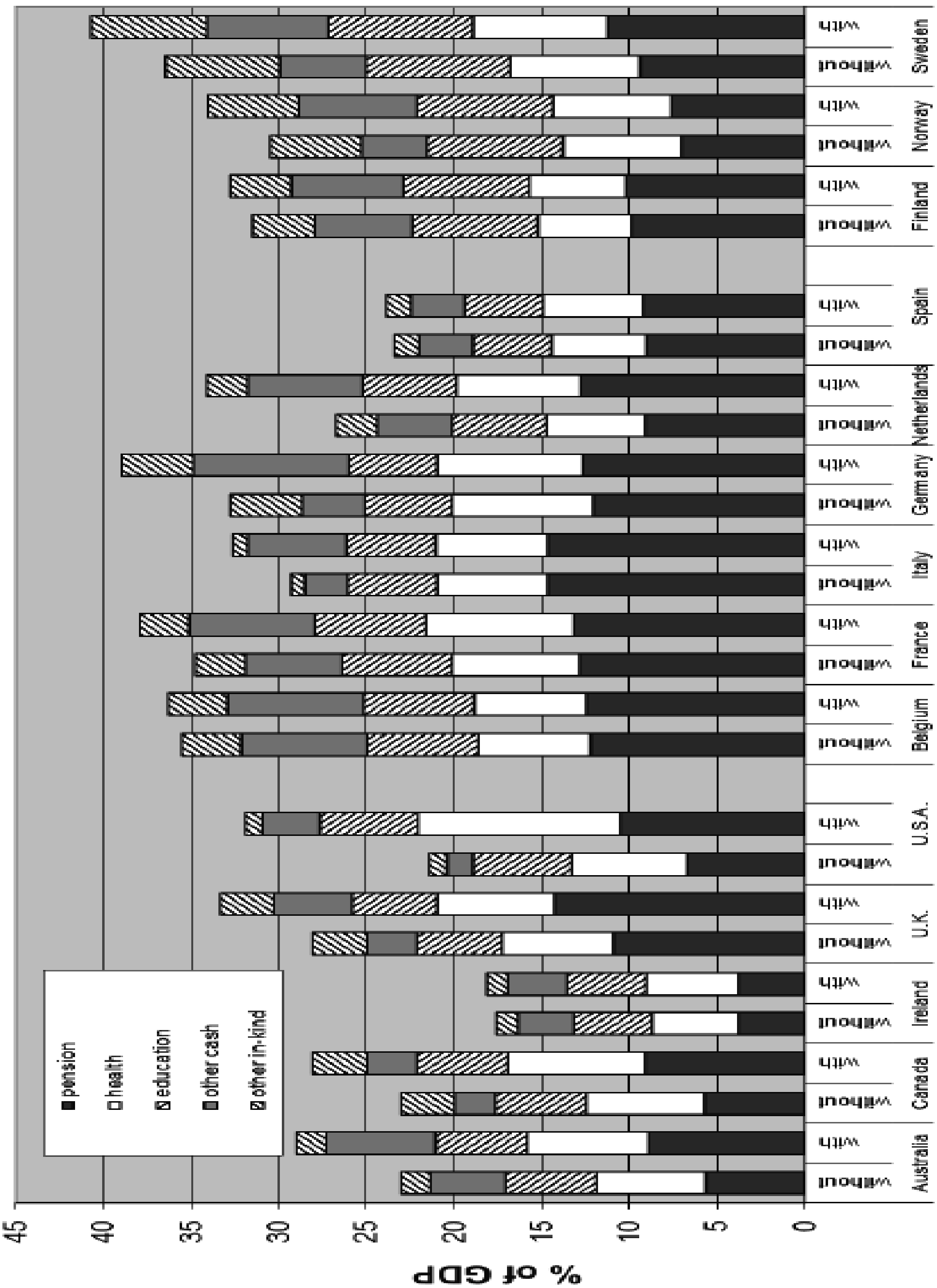
[3] See https://leftfootforward.org/2018/06/70-years-of-nhs-privatisation-is-a-race-to-the-bottom-the-nhs-needs-public-investment/

[4] Tax expenditures are deductions given to companies and individual tax payers that reduce their tax liability, thereby reducing tax revenues. Tax revenues are thereby spent; hence, the terminology of tax expenditures.

Figure 3. Social Welfare Transfers in 2001 as a Percent of GDP in 14 Rich Nations, "With" and "Without" Employer-Provided Benefits



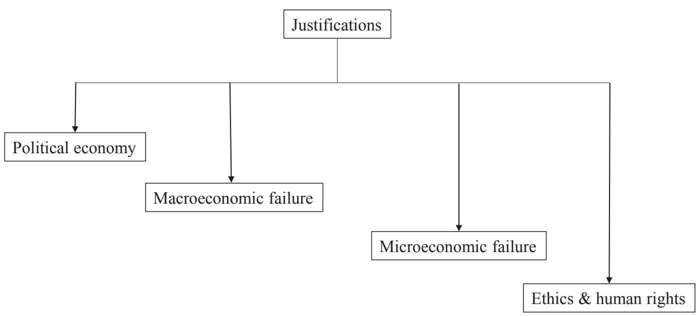
Source: Garfinkel and Smeeding 2015, 8, Figure 2

Economic and Political Justifications of the Welfare State

The justification for the welfare state is both economic and political. Figure 4 illustrates the four main lines of justification. The first is political economy, with the welfare state providing needed social stability that supports political and economic stability. That line of reasoning can be understood in terms of Karl Polanyi's (1944) notion of an embedded economy. Market arrangements are embedded within other institutions and relations, and the quality of those embedding institutions and relations determines the system's political and economic stability. Simply put, the logic of embeddedness is that people will tend not to respect and accept a society that does not respect and accept them.

Interestingly, there is a neoliberal analogue to this. James Buchanan (1975) argues law is a form of public capital. The welfare state can be viewed as a way of accumulating that public capital by promoting social allegiance and compliance. Lastly, Daron Acemoglu and James Robinson (2002) argue that the welfare state is the product of political change (i.e., democratic reform) aimed at forestalling political revolution. Their argument is that economic growth initially fosters inequality, which creates threatening political resentment. Political reform neutralizes that resentment, but also promotes inequality reducing economic reforms (i.e., the welfare state) which explains the Kuznets curve.

Figure 4. Justifications of the Welfare State



The second justification for the welfare state is macroeconomic failure, which draws on Keynesian economic theory. Recall, two spokes of the welfare state in Figure 1 were full employment (Spoke 1) and public income assistance (Spoke 5). Keynesian economics explains why market economies may not automatically generate full employment owing to macroeconomic failure. That failure creates a need for macroeconomic policy to push the economy to full employment and to stabilize business cycle fluctuations. The problem of unemployment, in turn, creates a need for income assistance. Welfare state provided income assistance protects individual workers and their families, and it also helps automatically stabilize macroeconomic activity by supporting aggregate demand in downturns.

There is also a macroeconomic justification for state provision of health (Spoke 2), education (Spoke 4), and housing (Spoke 3). Together, those constitute a huge sector of the economy. Having the state provide them creates a bloc of activity that is immune to the business cycle, which stabilizes the economy. That is the foundation of Hyman Minsky's (1986) argument regarding "Big Government" being an economic stabilizer.

The third line of justification is microeconomic market failure. Such failure is associated with externalities, public goods provision, and information failure. Additionally, market economies under-produce "merit" goods, which are goods that society feels should be available to all regardless of ability to pay (Musgrave 1959, 13–15). Those concerns are especially connected with health and education.

Health (Spoke 2) is a merit good. It also involves significant externalities owing to disease contagion. Furthermore, there is a severe information problem because health consumers are poorly informed, resulting in poor consumer discipline on health care producers. Lack of consumer discipline then results in inefficient provision as health care providers have an incentive to over-provide and over-charge. Health care provided via private insurance suffers from an incentive to deny care and under-provide, regarding both quantity and quality.

Education (Spoke 4) suffers from similar problems. Educated citizens confer an externality both by contributing to improved democracy, and by potentially conferring economic gains via transactions with others.[5] There are also information problems since an uneducated person may have difficulty identifying what is a good education and who are good educators, again resulting in inefficient provision. Additionally, there is the problem of capital market failure. Education is expensive and individuals may lack the resources to finance it, while capital markets may be unwilling to lend owing to default risks. Lastly, education is a merit good. It is especially necessary for children, and the state has a role to ensure that they receive timely education, especially given potential under-provision by parents and guardians acting *in loco parentis*.

There are also market failure reasons for income assistance (Spoke 5). Such assistance to children, the unemployed, and the elderly are merit goods. Income assistance can also be viewed as insurance, and private insurance markets may either fail to provide or only provide at excessive cost owing to problems of moral hazard, adverse selection, and information asymmetry. There are also macroeconomic risks which private markets cannot handle because they cannot be diversified away as they afflict the entire economy. Consequently, the risks can come due all at once and private insurers may go belly-up just when income insurance is needed. Lastly, insurance involves increasing returns to scale regarding risk diversification, and may also have significant fixed cost elements (e.g., data management costs). That creates a form of natural monopoly, which may be best countered via state provision.

Housing (Spoke 3) is also a merit good, but it is a highly contested area of welfare state provision as the market failure is not clear. What is clear is that there is a shortage of low income housing, which raises the question of whether the problem should be solved by low income housing subsidies or public housing construction. There is also a macroeconomic role for public housing construction as it can stabilize construction employment which is highly cyclical. Counter-cyclical public housing construction can also be cost-effective as houses are built when costs are lower.

The fourth and final line of justification for the welfare state is ethics and human rights. That line can be viewed as providing the original justification. Judeo-Christian ethical arguments were the original justification for state-sponsored "poor law" charity, which aimed to provide minimal sustenance and help maintain social order. In the mid-twentieth century, that ethical line of reasoning was supplemented by human rights discourse, whereby freedom from Beveridge's five giant evils was framed as a human right. The most famous statement of this human rights approach is President Franklin Roosevelt's economic bill of rights

[5] Education may produce multiplicative interaction effects whereby the economic value of my education is increased if you are also educated.

contained in his State of the Union speech, delivered to the U.S. Congress on January 11, 1944 (Roosevelt 1944).

Goals of the Neoliberal Campaign on the Welfare State

Together, Figures 2 and 3 help identify the goals of the neoliberal campaign on the welfare state. The neoliberal attack should be understood as a persistent process with the dual goals of down-sizing and changing the character of the welfare state. Down-sizing means imposing a liberal order smaller welfare state. Changing the character means adopting the U.S. model. The key features of the proposed neoliberal welfare state are:

(i) Reduced generosity of benefits, defined in terms of both money value and duration of benefits.

(ii) Replacement of "universal rights" to welfare state benefits with "means testing."

(iii) Shifting more welfare state production away from the public sector to the private sector, with an accompanying shift to tax subsidies for increased private sector production of welfare state services.

(iv) Financing the welfare state via taxes on labor income rather than capital income.

The push for reduced generosity of benefits is clear in the retirement income and retirement age debate. The push for means testing is evident in the welfare assistance, health assistance, and education assistance debates. The push for production shifting is evident in the debates over privatization of retirement income provision, privatization and voucherization of education, and privatization of health care. Lastly, the push regarding tax shifting is evident in moves to lower corporate taxes, capital gains taxes, and top-end income taxes, while shifting to consumption taxes.

An additional behind the scenes motive and goal of the neoliberal attack on the welfare state is to diminish unions. When welfare state services are publicly produced, the work forces tend to be unionized. Furthermore, given the de-unionization of private sector workforces, public sector unions now constitute the core of national union movements in many countries. Down-sizing the welfare state and shifting to private production of welfare state services both serve to diminish public sector unions.

Lastly, an interesting feature is neoliberal goals have evolved along the way. Early neoliberals, like Friedrich Hayek (1944), wanted to shrink the overall size of the welfare state as part of their opposition to government intervention. The new neoliberal corporate "predators" (Galbraith 2008) have a different goal, which is to privatize the welfare state and turn it into a profit center. Early neoliberals wanted to minimize the welfare state; contemporary neoliberals want to shrink and twist it, but not necessarily minimize it. However, the privatized welfare state must be paid for by taxes on labor incomes. Those multiple goals mean the neoliberal campaign is not just measured by whether the welfare state has been reduced in scale. Instead, it is measured by a vector of "character" outcomes.

The Neoliberal Counter-Revolution and its Origins

From its beginnings, the welfare state was resisted by business and financial elites. This was particularly true in the United States, and that resistance is captured in FDR's famous 1936 campaign speech at Madison Square Garden, New York. In extraordinarily eloquent language, FDR (Franklin D. Roosevelt) confronted the business community on its opposition to the New Deal and Social Security as follows:

> We had to struggle with the old enemies of peace—business and financial monopoly, speculation, reckless banking, class antagonism, sectionalism, war profiteering. They had begun to consider the Government of the United States as a mere appendage to their own affairs. We know now that government by organized money is just as dangerous as government by organized mob. Never before in all out history have these forces been so united against one candidate as they stand today. They are unanimous in their hatred of me—and I welcome their hatred. (Roosevelt 1936, 56)

In the speech, FDR goes on to confront employers who were trying to intimidate workers into voting against him and opposing the recently created Social Security program by putting antagonistic messages in their pay-packets.

In response to the New Deal, the U.S. business community launched a long-term campaign aimed at what it viewed as creeping socialism.[6] However, the economic success of the post-war Keynesian welfare state era (1950–circa 1980) kept neoliberalism in the shadows. That started to change in the late 1960s and early 1970s which saw a perfect storm that created the long-sought opening for the neoliberal counter-revolution. The outcome of that crisis is well known. There was a turn away from Keynesian welfare state economics, and neoliberalism was placed in the intellectual and political ascendancy.

The formal transition is widely identified with the elections of Prime Minister Thatcher in 1979 and President Reagan in 1980. Since then, the Keynesian welfare state has been persistently on the defensive. Measured in terms of share of GDP, it remains large and little changed. However, it has been chipped away at in important ways, particularly as regards political legitimacy. In economic policy, the triumph of neoliberalism is startlingly clear in the disappearance of aspirations to full employment; the disappearance of nationalization as a policy for dealing with industries where there are monopoly, externality or public good concerns; and the disappearance of planning and incomes policy which were once standard policy modalities. As noted earlier, the politics of this turn are complicated. It is not simply a matter of right beating left. Instead, social democrats have fractured, with right social democrats buying in to the philosophy of neoliberalism—albeit, a more compassionate variant.

From Phony Economic Crisis of the Welfare State to Real Political Crisis

The late 1970s neoliberal attack on the welfare state was framed in terms of an economic crisis of the welfare state. The welfare state was asserted to cause social and cultural decay, to create populations of dependents and shirkers, and to cause loss of economic dynamism and slower productivity growth. It was also claimed to be unaffordable.

All of these neoliberal charges regarding the welfare state were and remain false. The reality is the welfare state has been remarkably successful in reducing poverty and inequality. Its income insurance programs have helped dampen macroeconomic fluctuations. Its investment in education has increased growth. And its investment in public health has

[6] Angus Burgin (2012) provides a history of the rise of neoliberalism that includes coverage of the business community's contribution.

improved quality of life and increased longevity.[7] In sum, the welfare state represents a remarkably successful socio-economic institution, and it constitutes the bedrock of social democracy. It helped stabilize capitalism in the face of the socio-economic stresses of Victorian capitalism and the economic disaster of the Great Depression.

The macroeconomic success of the welfare state is shown in Table 1. The welfare state era (1950–2008) has seen faster growth with lower volatility than the pre-welfare state era (1871–1939). The neoliberal sub-period (1981–2008) saw growth slow relative to the period 1950–1980, but volatility also fell. The lower volatility was due to the fact that policymakers continued using Keynesian counter-cyclical stabilization policy, albeit no longer directed to achieving full employment. Additionally, disinflation gave policymakers the space to aggressively lower interest rates whenever the economy got into trouble, contributing to the so-called "Great Moderation"—the period of relatively stable growth that ran from 1982–2008.[8]

The data in Table 1 point to the sound macroeconomic performance of the welfare state era and the falseness of early neoliberal claims of an economic crisis of the welfare state. That said, today, there is a genuine crisis because neoliberalism has undermined the economic understandings that politically support the welfare state. A phony economic crisis has therefore been turned into a genuine political crisis.

The cruel irony is that this is happening at a time when the need for the welfare state is increasing. The harsh economic conditions the welfare state originally helped remedy are back. Moreover, those conditions promise to worsen owing to an aging population, continuing negative job and wage effects from globalization, and future negative job and wage effects from intelligent robots.

Table 1. Macroeconomic Performance in G6 Countries Before and During the Welfare State Era

	CANADA		FRANCE		GERMANY		ITALY		UK		US		G6 AVERAGE	
	Average Annual per Capita GDP Growth (%)	Standard Deviation of Annual per Capita GDP Growth	Average Annual per Capita GDP Growth (%)	Standard Deviation of Annual per Capita GDP Growth	Average Annual per Capita GDP Growth (%)	Standard Deviation of Annual per Capita GDP Growth	Average Annual per Capita GDP Growth (%)	Standard Deviation of Annual per Capita GDP Growth	Average Annual per Capita GDP Growth (%)	Standard Deviation of Annual per Capita GDP Growth	Average Annual per Capita GDP Growth (%)	Standard Deviation of Annual per Capita GDP Growth	Average Annual per Capita GDP Growth (%)	Standard Deviation of Annual per Capita GDP Growth
1871-1900	1.94	5.05	1.54	4.59	1.65	2.39	0.65	3.79	1.17	2.23	1.82	4.26	1.46	3.72
1901-1939	1.53	7.23	1.60	7.55	1.79	7.13	1.90	5.45	0.92	3.68	1.43	6.54	1.53	6.26
1950-1980	2.73	2.20	3.60	1.58	4.87	3.56	4.62	2.30	2.04	1.90	2.42	2.64	3.38	2.37
1981-2008	1.63	2.29	1.48	1.11	1.41	1.66	1.50	1.27	2.21	1.61	1.88	1.75	1.68	1.61

Source: Author's computation using Angus Maddison data, http://www.ggdc.net/maddison/maddison-project/data.htm.

[7] Irwin Garfinkel and Timothy Smeeding (2015, 14–20) concisely summarize these contributions of the welfare state.

[8] Now that the economic contradictions of neoliberalism have surfaced with the financial crisis of 2008, the crystal ball is unusually murky. Growth may fall further, but the implications for volatility are unclear. Stagnation (i.e., even slower trend growth) may be associated with even lower volatility. Alternatively, it could be associated with boom-bust cycles around slower trend growth, thereby resembling the pre-welfare state era (1871–1939).

The Slow Motion Neoliberal Assault: Body Blows and Whiplashes

The neoliberal assault on the welfare state has consisted of body blows and whiplash. The frame described in Figure 1 is still recognizable in the economy, but two of the spokes have been substantially abandoned. The other three are still in place, but the timbers are rotten in the sense that their political legitimacy has been degraded. One body blow has been the retreat from full employment policy. As shown in Table 2, there has been an increase in unemployment rates in the transatlantic economy since 1980. Milton Friedman's (1968) theory of a "natural" rate of unemployment was critical for this retreat. The theory was adopted by almost the entire economics profession. It says monetary policy cannot affect the long run rate of unemployment and there is no trade-off between inflation and unemployment. That provided policymakers with the justification for abandoning their commitment to full employment and shifting to inflation targeting.

Table 2. Decadal Average Unemployment Rates (Percent), 1961–2015

	1960-1970	1971-1980	1981-1990	1991-2000	2001-2010	2011-2015
UK	1.6	3.8	9.6	7.9	5.6	7.0
EU-15	2.2	3.9	8.5	9.4	8.0	10.3
US	4.8	6.8	7.1	5.6	6.1	7.2

Source: Statistical Annex of the European Economy, Table 3, Spring 2016.

The commitment to public housing has also been substantially abandoned and replaced with inclination to tax policy favoring private home ownership. The UK diminished its commitment to public housing with the election of Mrs. Thatcher in 1979, who oversaw the sale of a substantial portion of the stock of publicly owned "council" houses and cut back public housing construction. In the United States, tax policy has discouraged renting, and estranged working families from the cause of public housing via tax subsidies for home ownership. Everywhere, there has been a retreat from rent control. The pendulum has swung from excessive controls that undermined incentives to rent to belief that no controls are needed.[9]

The other three spokes of the welfare state have been subject to whiplash treatment that has eroded them, while still leaving them in place. Public income assistance continues, but the "right to assistance" and the "generosity of assistance" have been diminished. In the United States, the Clinton administration's 1996 welfare reform ended the "right" to assistance, and the value of assistance has not kept pace with either inflation or real per capita GDP growth.

Public education also continues, but it is viewed by U.S. private business as a major profit opportunity. In the United States, tertiary education has always had a significant private non-profit segment. Now, there is a growing for-profit segment, while public tertiary education has been subject to increasing fee requirements and reduced generosity of public

[9] Tax subsidized private homeownership undermines working and middle class support for public housing. First, house price inflation yields a private capital gain, which provides an incentive to own rather than rent. Second, financialization promotes ownership both by making available easier financing and by accelerating house price inflation. The capital gains benefit individual homeowners but viewed from a systemic perspective they have a significant element of robbing Peter to pay Paul. Housing is transformed into an asset market in which working people bid against themselves. Younger generations are squeezed for the benefit of older generations, while all are squeezed by higher interest rates that are needed to stabilize the economy in the face of house price inflation.

financial assistance. Primary and secondary education is also increasingly targeted, with private business hoping to take over entire school districts via contracting-out arrangements. Side-by-side, there is a continuing push for education vouchers that would enable families to opt-out of public school systems and pay for private schools with vouchers paid for out of the public school budget. The United States is the most extreme with regard to the attack on public education. However, it is also present in the UK, where significant fees have been imposed on public tertiary education and a small fringe of for profit universities has emerged.

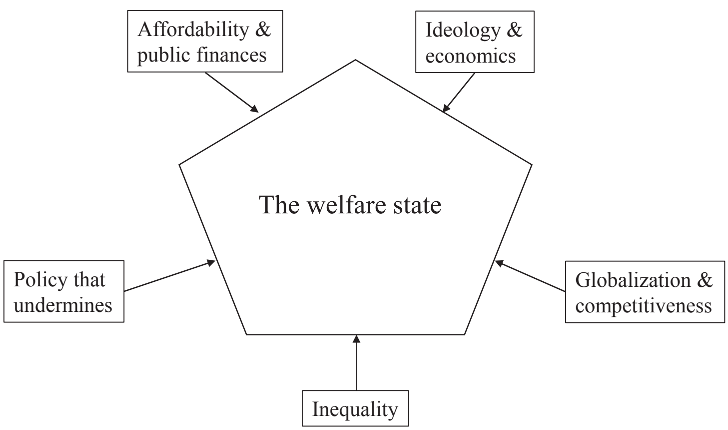
Public health care also continues, but everywhere it is increasingly subject to out-of-pocket charges. That holds for all types of public health systems, including the UK's publicly produced National Health Service. Health insurance based systems, be they public or private, also impose more co-pays and larger deductible exclusions. Those measures implicitly serve to shift the cost of healthcare on to labor incomes.

In sum, in terms of Figure 2, neoliberalism has fostered a global political inclination to move away from the original UK welfare state model toward the U.S. model. That is true for all spokes of the welfare state.

Contours of the Neoliberal Attack on the Welfare State

The contours of neoliberalism's slow motion attack on the welfare state are illustrated in Figure 5, which shows five sides of attack. These five sides are identified as: ideology and economics, globalization and competitiveness, inequality, policy that undermines, and affordability and public finances.

Figure 5. Contours of Neoliberalism's Attack on the Welfare State

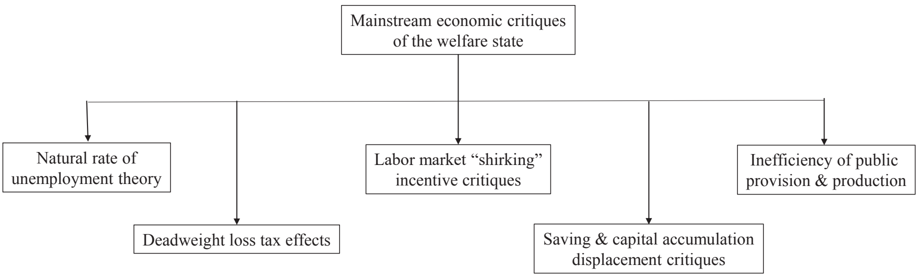


Ideology and the Attack on the Welfare State

The first line of attack has been ideology and is significantly rooted in mainstream economics, as it has developed since the late 1960s under the leadership of the Chicago School of Economics. That ideological attack aims to undermine societal support, thereby making the welfare state politically vulnerable.

The flavor of these mainstream economic critiques is captured in Figure 6. As already mentioned, the attack on the full employment pillar of the welfare state drew on Milton Friedman's natural rate of unemployment theory. Full employment policy is unnecessary because the economy is claimed to quickly and automatically go to full employment, defined as the natural rate of unemployment. The welfare state increases the natural rate of unemployment to the extent that it diminishes the incentive to find work.

Figure 6. Selected Anti-Welfare State Arguments from Mainstream Economics



A second mainstream critique is that financing the welfare state via taxes reduces employment and creates deadweight losses for society. The argument is that taxes distort prices, preventing equalization of true marginal benefits and marginal costs, thereby obstructing efficient production and resource allocation.

A third critique is that providing unemployment insurance and welfare assistance may increase unemployment and lower productivity by creating incentives for workers to shirk.[10]

A fourth critique is that providing public pensions discourages household saving, thereby reducing private sector investment and capital formation, which in turn reduces future output. The initiator of that line of argument was Harvard University's Martin Feldstein (1974), and the argument has been broadened to attack budget deficit financing in general, as budget deficits are characterized as negative national saving. That has contributed to undermining support for counter-cyclical fiscal policy.

A fifth critique is that the welfare state is an inefficient way of providing welfare services because public production is asserted to be inherently inefficient relative to private production. The critique of public production is part of the larger "government failure" argument which is also invoked by neoliberals to reject interventions to correct market failures. Contributions to that line of argument include inefficiencies resulting from bureaucratic failure (Niskanen 1971), regulatory capture (Stigler 1971), and rent-seeking (Tullock 1967; Krueger 1974).

The antipathy of mainstream economics toward the welfare state reflects the fact that the welfare state is an affront to neoclassical competitive general equilibrium (CGE) theory. If market economies really worked as CGE theory construes them, there would be no need for the welfare state. Consequently, CGE theory inclines believers toward intellectual antipathy to the welfare state. Though mainstream economics can construct arguments for the welfare

[10] This is an implication of efficiency wage theory (Shapiro and Stiglitz 1984). Welfare assistance and unemployment insurance reduce the deterrence effect of unemployment, requiring firms to pay more to elicit effort from workers. The resulting higher wage reduces the demand for labor.

state, its initial presumption is that the welfare state is unneeded. That ideologically-founded presumption explains why neoclassical economic arguments have figured so prominently in the neoliberal case against the welfare state.

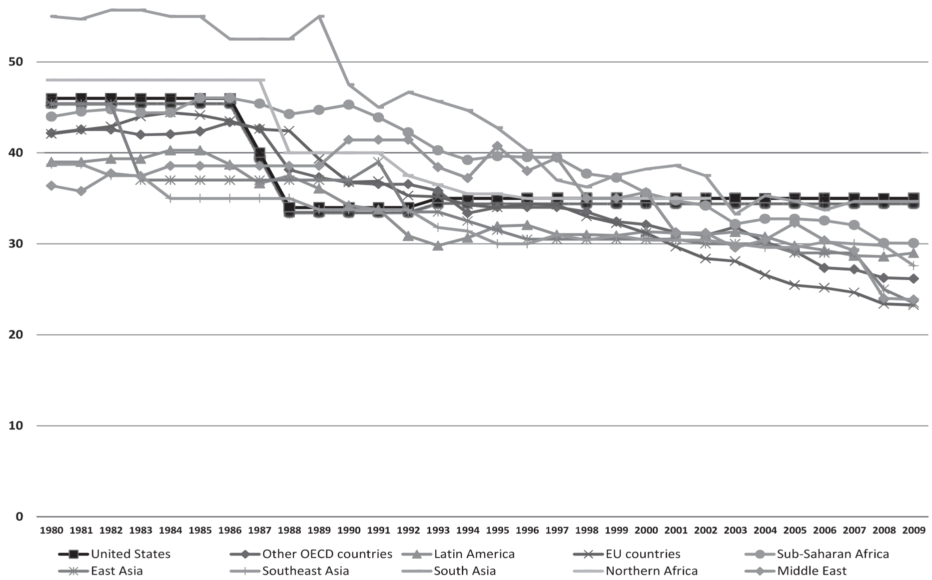
Lastly, these economic arguments against the welfare state link with a broader societal ideology that legitimizes economic inequality (Wisman and Smith 2011). According to Jon Wisman and James Smith, that societal ideology draws on both religion and economic theory, particularly neoclassical marginal productivity theory, which asserts factors of production are paid their economic contribution.

Globalization and the Attack on the Welfare State

A second line of attack has been globalization and its induced pressure for international competitiveness. Globalization creates competitive pressures to reduce costs, including costs associated with maintaining the welfare state. Ergo, by promoting globalization, neoliberal policy makers have implicitly put pressure on the welfare state.

This argument is made compellingly by Dani Rodrik (1997, 49–68), who has shown empirically that increases in globalization are statistically associated with decreases in social spending and government spending. There is also evidence that the tax base and tax rates needed to fund the welfare state are pressured by neoliberalism and globalization. This is shown in Figure 7, which shows how central government corporate tax rates have trended down in all regions of the globe during the neoliberal era.[11] Combining the pieces,

Figure 7. Central Government Corporate Tax Rates (%) by Region, 1980–2009



Source: Kumar and Quinn (2012)

[11] According to Manmohan Kumar and Dennis Quinn (2012), the logic behind this tax rate dynamic is a race to the bottom in corporate tax rates led by the United States. In their model, corporate tax rates are determined according to a Stackelberg equilibrium, with the United States acting as Stackelberg leader. When the United States lowers its corporate tax rates, other countries follow to stay competitive. President Trump's latest round of corporate tax cuts (signed into law in 2017) are therefore likely to trigger a global round of corporate tax cuts in response.

globalization therefore creates financial pressures on the welfare state via both the government spending and revenue sides.

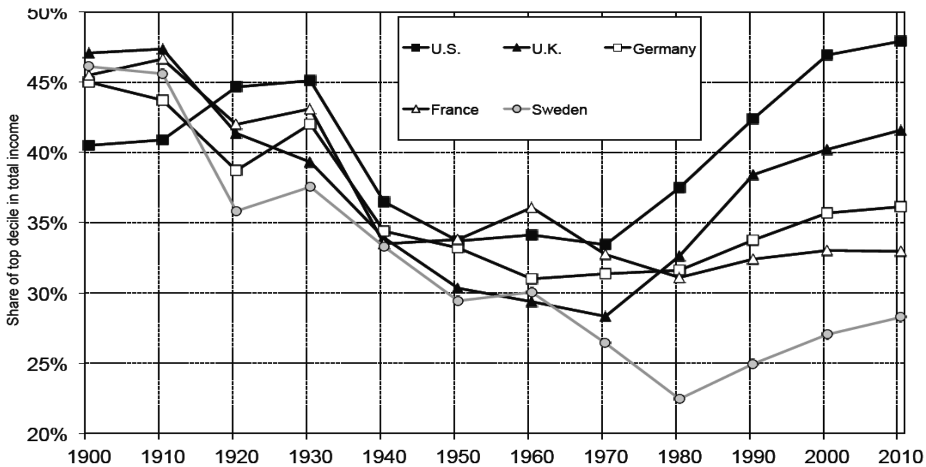
The process by which neoliberal globalization impacts and twists government spending and tax policy is complicated. Financial markets and capital mobility are at the core. The threat of financial capital flight and financial market instability pressures governments to impose spending austerity. Similarly, the threat of capital flight pressures governments to lower corporate tax rates to retain existing businesses and attract new investment. Lower tax revenues then cause budget deficits which financial markets dislike, creating additional indirect pressure on governments to cut spending and impose austerity. To the extent that reduced corporate tax revenues are made up, taxes must be shifted on to labor income via higher income taxes and consumption taxes. In this fashion, neoliberal globalization advances two dimensions of the neoliberal welfare state agenda: shrinking the welfare state and shifting the tax burden away from capital income on to labor income.

Finally, and more generally, globalization colors public discourse with a generic claim that the welfare state is unaffordable because it impairs "competitiveness" at a time when competitiveness is even more important owing to globalization. That framing sets up an implicit conflict, pitting the welfare state against jobs and prosperity.

Income Inequality and the Defection of the Upper-Middle Class

The third line of attack has been the increase in income inequality since the mid-1970s. Figure 8 shows Thomas Piketty's (2013) analysis of the top decile income share in Europe and the United States from 1900 to 2010. In Europe, the top decile share fell after 1910 through to 1970, and it fell especially rapidly in the period 1930–1950. After 1970, the trend reversed, and the top decile share started rising. In the United States, the decline in the top decile share only started after 1930, but it also reversed direction after 1970.

Figure 8. The Top Decile Income Share in Selected European Countries and the United States, 1900–2010



Source: Piketty (2013), Figure 9.7, p.323.

The importance of income inequality is that it tends to undermine upper and upper-middle class political support for the welfare state. First, the emergence of a significantly richer upper strata promotes "gated community" politics. The upper middle class opts out of the welfare state and purchases privately provided health and education services. That reduces their political commitment to the welfare state and can even turn it into political hostility. Why should we pay for a service we do not use?

Second, increased income inequality also gives the upper strata additional means to influence politics against the welfare state. They already had elite sociological influence. Now, they also have more money which is increasingly influential in contemporary politics.

Inequality automatically creates an incentive to opt out. That incentive has then been amplified by the neoliberal tax credit approach to the welfare state since tax credits are more valuable to high income groups. Additionally, tax credits create an adverse selection dynamic that further undermines political support for the welfare state. That is because opting out lowers the quality of the public system and stigmatizes it, which creates a further incentive for upper-middle class exit and further undermines political support. This dynamic is defended politically as "freedom of choice."

The implication is that inequality is inherently corrosive of the social democratic welfare state. By promoting inequality, neoliberalism has indirectly undermined the welfare state. These considerations provide yet another reason for containing inequality, and also point to the importance of keeping the upper-middle and middle class engaged with the welfare state. That requires defining the welfare state as a society-wide project aimed at creating a decent society, rather than a welfare and charity system for the poor and indigent.

Policy that Undermines the Welfare State

The fourth line of attack is explicit economic and social policies that undermine the welfare state. Once in office, neoliberal governments have pursued policies that undermine the welfare state, and those policies may even lock-out the possibility of restoring the *status quo ex-ante* (Palley 2017). That role of policy links with arguments already made. Thus, policy links to the role of post-1970s' mainstream economics which has both shaped public discourse and provided the justification for policies that implicitly undermine the welfare state.

To understand the role of policy it is necessary to distinguish between policies that directly and indirectly undermine the welfare state. An example of a direct attack on the welfare state, from the United States, is the 1996 *Personal Responsibility and Work Opportunity Reconciliation Act*, supported and signed into law by Democratic President Clinton. That act marked a significant break with the past by ending welfare as an entitlement, imposing work requirements, and imposing a lifetime benefit limit of five years. Those changes did nothing to diminish poverty but did increase the ranks of the working poor (Peterson 2000).

A second example of direct attack, again from the United States, is the promotion of charter schools. Such schools are rationalized on the grounds that they improve education by providing competition in the provision of education. However, they shift resources out of the public education system which is a significantly fixed cost system. They also tend to cherry-pick better students, as well as receive private foundation support. Then, in the event they out-perform the local public school, that is invoked as evidence against public provision of education services.

Globalization represents an instance where policy has indirectly undermined the welfare state. Though commonly thought of as inevitable, globalization has been policy-made both in terms of sequence and form. Thus, policy has affected the sequence of countries with which economic integration has been pursued, and it has also impacted the form of integration arrangements. Different country sequencing and form of arrangements would have dramatically changed globalization's squeeze effect on the welfare state. In the United States, the neoliberal design of globalization emphasized tying the U.S. economy to developing countries, especially Mexico and China.

Another instance where policy has indirectly undermined the welfare state is inequality. Inequality has been significantly policy created (Palley 2012, 141-161) by undercutting workers' bargaining power and strengthening the power of corporations and finance. By contributing to increased income inequality, policy has promoted the opt-out forces discussed above that have undermined social solidarity regarding the welfare state.

Tax policy is an area where policy has directly undermined the welfare state. As noted above, by promoting a tax-subsidized system that emphasizes private production of welfare state services (the U.S. model), neoliberal policy has fostered incentives to opt-out and undermined political solidarity with the welfare state.

Retirement income policy exemplifies these forces, and its effects reach beyond the upper-middle class into the middle and working classes. Over the last forty years, U.S. policy has explicitly promoted a shift away from collective defined benefit (DB) pension arrangements to individual defined contribution (DC) arrangements by expanding DC plan availability and providing generous tax subsidies. In DB plans, retirees receive a pre-determined guaranteed retirement income; in DC plans, retirement income depends on the history of individual contributions and the investment performance of individual contributors.

DC plans suffer from significant economic drawbacks.[12] From a political standpoint, they foster an individualistic opt-out mentality that may be riddled with false understandings. Thus, individuals may begin to identify stock market performance with macroeconomic performance: they may identify with the stock market and the interests of capital, even though wages are their principal source of lifetime income; and owning stocks and receiving monthly statements may create a distorted "bird in the hand" effect that detaches individuals from the distant prospect of a guaranteed lifetime pension paid by a DB plan or Social Security. Furthermore, retirees will be incentivized to only care about their investment performance, which will tend to disconnect them from the next generation and facilitate inter-generational conflict and division. On the other side, the financial sector is a large beneficiary since DC plan contributors pay large brokerage and advisory fees, and contributors' need to buy stocks drives up the price of stocks.

From a psychological perspective, DC plans foster a "go-it-alone" mentality that is the opposite of traditional group DB plans and national pension arrangements like Social Security. In effect, such plans may fundamentally change individuals' economic understandings and identities, promoting extreme individualism and a belief in "go-it-alone" policy solutions.

Putting the pieces together, the important point is that neoliberal policy is transformative at both the structural level and the level of individual identity and understanding. Structural

[12] These include inadequate contributions, poor individual investment performance, high fees that diminish rates of return, stock market risk, and the failure of individuals to do the cross-walk from wealth accumulated to implied future income.

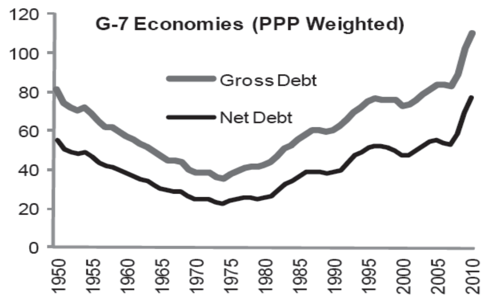
transformation limits the space for the welfare state, while transformation of people's social psychology and understanding undercuts political support. Neoliberal globalization represents a classic instance of structural transformation. Neoliberal retirement income policy represents a classic instance of policy that can transform people's social psychology and economic understanding.

A deconstruction of neoliberal policy shows it does a mix of three things. First, it limits the space for the traditional welfare state and pressures that welfare state. Second it promotes the neoliberal conception of the welfare state in which welfare state services are privately produced and tax subsidized. Third, it promotes an individualist identity and understanding of the economy that responds to incentives to opt out and identify with capital.

Public Finances and the Unaffordability of the Welfare State

The fifth and final line of attack on the welfare state is that it is unaffordable, and it has destroyed public finances. Figure 9 shows G7 weighted public debt as a percent of GDP for the period 1950–2010. The debt ratio declines steadily through to 1975, but it then starts increasing. Something seems to have happened in the mid-1970s.

Figure 9. G7 Public Debt as Percent of GDP (PPP weighted), 1950–2010

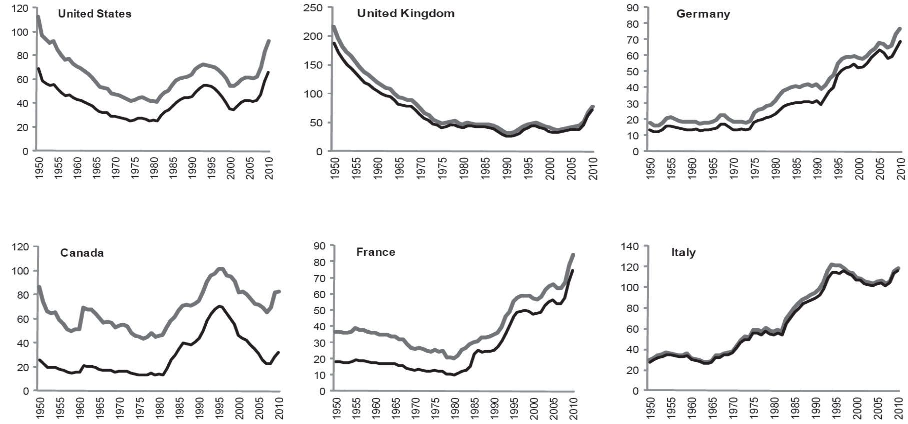


Source: Cottarelli and Schaecter (2010).

Figure 10 shows public debt for individual G7 country economies as a percent of GDP for the period 1950–2010. In all countries, the debt ratio is either flat or declining through to the mid-1970s. After that, there is an adverse trend direction change. There are three things to note. First, the change in trend occurs in all countries, suggesting something globally systemic is going on. Second, 1950–1970 was the political apogee of the welfare state during which it grew massively in size, yet the debt ratio declined. The debt-GDP reversal began with the first oil shock of 1973 which ushered in a decade of higher unemployment and budget deficits, and that was then succeeded by the neoliberal era. That sequence suggests it is not the welfare state that is the problem. Third, the figures show a sharp increase in the debt ratio after 2008, showing how the financial crisis and Great Recession damaged public finances. That damage to public finances was inflicted by the crisis of the neoliberal financialized economy, and not by the welfare state.[13] This evidence suggests it is not the welfare state that has been responsible for the deterioration of public finances in G7 countries.

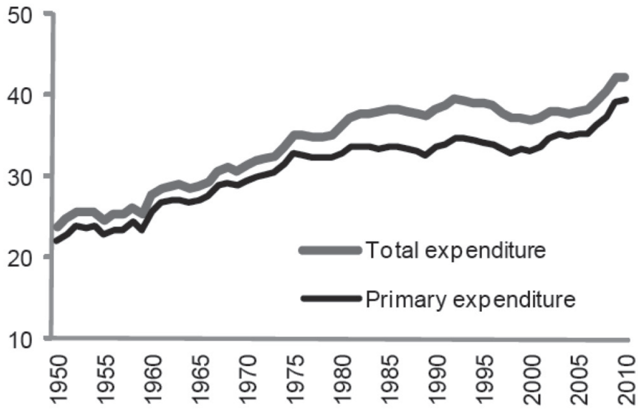
[13] In effect, the bail-out of the financial system transformed the financial crisis into a fiscal crisis. This was particularly true in Greece, Ireland, and Portugal. Even if bail-outs were the best policy response (which is very debatable), they still left a political legacy of public misunderstanding whereby the increase in budget deficits and public debt was misunderstood as reflecting government profligacy. Additionally, the recession caused by the

Figure 10. Public Debt as Percent of GDP (PPP weighted), 1950–2010



Legend: Gray = Gross Debt, Black = Net Debt
Source: Cottarelli and Schaecter (2010).

Figure 11. Government Expenditure for G7 Economies as Percent of Potential GDP (PPP weighted), 1950–2010



Source: Cottarelli and Schaecter (2010).

That raises the question what caused the reversal and worsening of public finances? Figure 11 shows government expenditure for G7 economies as percent of "potential" GDP for the period, 1950–2010. It gives a clue to what happened. First, primary expenditure rises through to the mid-1970s and then flattens as a share of potential GDP. That says increased primary expenditure was not the cause of the deterioration of public finances after the mid-1970s. Second, it has already been noted that after 1980 the unemployment rates went up and tax rates went down. That combination reduced tax revenues, which increased the budget deficit and the debt-to-GDP ratio. Third, Figure 11 shows the gap between total and primary

financial crisis, lowered tax revenues. That created a significant induced echo effect which further increased budget deficits and the public debt.

expenditures increases after 1980, which means interest payments started increasing as a share of total expenditures. Higher real interest rates, attributable to the Thatcher- Reagan disinflation, were therefore a significant factor. That effect of real interest rates is confirmed in Table 3, which shows average real interest rates shot-up between 1981 and 2000.

Table 3. Nominal Short Term Interest Rate, GDP Inflation, and Real Short-Term Interest Rate

		1961-1970	1971-1980	1981-1990	1991-2000	2001-2010	2011-2015
(1) Nominal short-term interest rate	UK	6.3	10.8	11.8	7.2	4.1	0.7
	EU-7	5.1	9.1	10.5	6.4	3.1	0.5
	US	4.3	6.9	9.1	5.3	2.6	0.3
(2) GDP price deflator	UK	4.4	13.7	6.6	2.7	2.6	1.6
	EU-15	4.4	10.0	6.4	2.5	2.0	1.2
	US	2.8	6.9	4.2	2.1	2.1	1.6
Real interest rate = (1) – (2)	UK	1.9	-2.9	5.2	4.5	1.5	-0.9
	EU	1.3	-0.9	4.1	3.9	1.1	-0.7
	US	1.5	0	4.9	3.2	0.5	-1.3

Source: Statistical Annex of European Economy, Tables 24 and 48, Spring 2016 and author's calculation.

In sum, a forensic economic deconstruction of the causes of the deterioration in public finances since the late 1970s shows it to be due to (1) lower tax rates, (2) higher unemployment which lowered tax revenues, and (3) higher real interest rates. The further deterioration after 2008 reflects the bailing-out of the banking system and the massive increase in deficits caused by the Great Recession. None of these factors is attributable to the welfare state. The welfare state is not the cause of the deterioration of public finances, nor is it unaffordable.[14]

Financialization and the Changing Character of the Attack on the Welfare State

Financialization refers to the increasing prominence and influence of finance in the economy, politics, and society.[15] It has played a central role in the neoliberal attack and, to the extent that financialization has been policy driven, provides another example of how policy has worked to undermine the welfare state.

The significance of financialization is that it has fueled and significantly changed the nature of the attack. Early neoliberals opposed the welfare state and sought to shrink it by cutting benefits and reducing access via measures such as means testing. Under the influence of finance, neoliberals still want to shrink the welfare state, but now they also want

[14] It is sometimes claimed that adverse demographic developments promise to make the existing welfare state unaffordable. It is true that aging populations will increase pension claims, but there are offsetting factors. The welfare state also supports the young via education, family assistance, and health care. The financial burden on the welfare state is determined by the "dependency ratio" which is the ratio of welfare state dependents to the working population. Dependents consist of young and old. The dependency ratio has actually decreased over time because of declining family size, while labor force participation has increased. A second reason the welfare state remains affordable is productivity growth. Since workers are more productive, it is as if the working population is growing faster measured in "effective" workers. That lowers the productivity adjusted dependency ratio which is the ratio of welfare state dependents to the effective working population. These issues are discussed in Palley (1998).

[15] Greta Krippner (2005) and Gerald Epstein (2004) were early contributors to the concept of financialization. David Zalewski and Charles Whalen (2010) argue that financialization is associated with a rise in income inequality across countries. Thomas Palley (2013) provides a comprehensive economic analysis of financialization.

to privatize it and turn it into a profit center. They recognize that the welfare state is here to stay, so they now want to profit from it.

This reorientation grew out of the privatization movement. Privatization is the standard neoliberal approach to dealing with state assets and activities, and it emerged as a response to the industry nationalization programs of the 1940 and 1950s. Initially, privatization was framed as denationalization, and it is associated with the UK and Europe which had extensive nationalized industries. In the 1980s and 1990s, European finance made significant profits from denationalization, both from fees for organizing the sell-offs and from subsequent appreciation of share prices.

Finance has now expanded privatization to include traditional government services, including provision of public goods. Infrastructure can be sold-off to private firms who charge user-fees. Government activities can be contracted out to private firms, and such contracting-out is at the center of finance's approach to the welfare state. Education and health care can be contracted out to private firms, prisons can be contracted out to private prison companies, and pension schemes can be contracted out to private investors. The weak form of pension privatization has public retirement income schemes investing in private financial assets, with investment decisions taken by private managers in return for fees. The strong form abolishes collective public retirement income schemes and replaces them with individual plans in which each contributor is responsible for their own investment performance.

As part of promoting the privatization agenda, finance has supported think-tanks selling the message of privatization, the inefficiency of public production, and the benefit of tax subsidies. In the United States, it has lobbied for the privatization of Social Security, privatization of prisons and public infrastructure, and so-called "school choice" whereby public funds are diverted to pay for attendance at privately operated schools. Finance has also promoted the shift away from group DB pension plans to individual DC plans.

Finance earns enormous one-time fee income from organizing privatization transactions. After that, it stands to benefit from capital gains and permanent fee and interest income from managing and financing the privatized arrangement. Finance gains from privatizing the retirement system, from increased student borrowing, from increased prevalence of tax subsidized private health insurance, from privatization of existing infrastructure, and from tax incentives aimed at increasing private investment in new infrastructure. However, the reality is that generic claims about the inefficiency of public provision and production and the efficiency of private provision and production are false. Instead, inserting finance as a middleman in the provision of government services is a recipe for higher interest costs, higher administration costs, and costly frauds and defaults.

The Role of Third Way Social Democrats

The attack on the welfare state was initiated by neoliberals, and the commonplace story line is that it has been a partisan affair for which social democrats (defined to include the U.S. Democratic party) bear no responsibility. That story is false. As neoliberal economic thought has become the ruling paradigm, a significant segment of "Third Way" social democrats have supported the attack, albeit as junior partners.

Earlier, it was argued that neoliberal globalization is one line of attack on the welfare state, as it pressures both spending on the welfare state and tax revenues to finance it. Yet, many Third Way social democrats have endorsed neoliberal globalization, both in Europe and the United States. German social democrats have been strong supporters of neoliberal globalization owing to Germany's strong export industries and persistent trade surplus. In the United States, President Clinton signed NAFTA and also established permanent normal trading relations with China, thereby making way for China's entry into the World Trade Organization (WTO).

Likewise, financialization has been significantly driven by policy that has pushed financial deregulation and approved the shareholder value maximization model of corporate governance. By increasing the power of finance, financialization has facilitated the attack on the welfare state. Yet, many Third Way social democrats have supported policies that have promoted financialization. For instance, some of the most significant U.S. financial deregulation occurred in the 1990s during the Clinton administration.

Finally, Third Way social democrats have also been supportive of a neoliberal retirement income policy that has encouraged adoption of individually-owned defined contribution (DC) plans. Yet, these policies foster extreme individualist economic understandings and identities that are antithetical to the traditional welfare state perspective.

The bottom line is that Third Way social democratic politicians and governments have supported policies that have changed the economic structure in ways that have put the welfare state in jeopardy. By supporting such policies, they have assisted the neoliberal attack on the welfare state. The irony is that in doing so, they have assisted in transforming the understandings of their own political base, moving it away from support of collective welfare state solutions toward neoliberal individualistic solutions. In effect, they have assisted their own political decline and the decline of public support for policies historically identified with social democracy.

The Welfare State: Quo Vadis?

The welfare state is one of the great social innovations of the twentieth century and was critical in addressing the "social question" and the problem of economic depression after World War II. Had capitalist society failed to address these matters, it is quite likely a different political order would have emerged.

For the past forty years, the welfare state has been under continuous slow-motion neoliberal attack. That attack is sophisticated and multi-dimensional, resting on ideologically founded criticisms drawn from mainstream economics, misrepresentations about affordability, policies that intentionally undercut political support for the welfare state, and pressures created by neoliberal globalization. Rebuffing the attack will not be easy given that public understanding is now significantly contaminated by neoliberal thinking. Once a bad idea grabs hold, it must often be lived through and proved to fail before it can be abandoned. On the other hand, history speaks clearly to the need for and success of the welfare state, which may prevent the worst.

Though the attack has weakened the welfare state and undermined political support, there still remains an institutional and policy framework that is clearly recognizable as the welfare state. The danger is not that neoliberalism will kill off the welfare state. Instead, the danger is that it will succeed in implementing a minimal and mean welfare state. That would be a profound blow against shared prosperity and social democracy.

As regards shared prosperity, the original welfare state is an essential part of an embedded market economy, and it is further warranted by the return of income inequality. It also needs to be expanded to meet the coming employment and wage challenges posed by intelligent robots, so that the promise of technology is realized in the form of shared prosperity rather than mass unemployment and gross inequality.

As regards social democracy, the mean minimal welfare state undermines the welfare state as an ethical political project. It is an ethical project aimed at creating a "decent society." It is a political project aimed at making market capitalism politically viable. In the language of Polanyi (1944), the welfare state is a way of embedding the market system so that it produces socially acceptable outcomes that are politically stable. Viewed in that light, the welfare state is part of a social contract between citizens that fosters social solidarity. In contrast, a minimalist means tested system stigmatizes the welfare state and undermines social solidarity.

That reveals how the neoliberal campaign on the welfare state is both economic and political. The economic goal is increased profits. The political goal is reduced social solidarity. The strategy is to downsize, privatize, and tax-shift as far as possible. The danger is not only do neoliberals succeed, but they push so far that they disembed the market system and recreate conditions that Polanyi (1944) blamed for the rise of fascism in the 1930s.

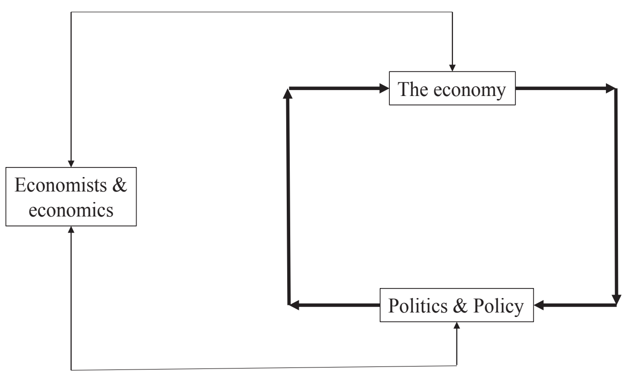
Postscript: Lessons for Economists

A last set of insights from this study of the neoliberal attack on the welfare state concerns economics and economists. Figure 12 illustrates the interaction between the economy and politics and policy. Economists tend to focus on the economy and tend to neglect the loop connecting the economy to politics and policy. That neglect has major consequences.

First, it promotes misunderstanding of the economy, which is not a natural order. Instead, the economy is significantly shaped by politics and policy.

Second, economists misunderstand politics and policy which are treated as exogenous factors. In reality, those factors are shaped by economic agents whose respective powers are impacted by the economy.

Figure 12. The Influence of Economics on Politics and the Economy



Economists also misunderstand economics and their own impact. That misunderstanding is captured by the far left-hand side loop in Figure 12. Economists view themselves as objective outside observers of the economy. The reality is economic ideas are a powerful shaping force that impacts the economy, politics, and policy. The neoliberal attack on the welfare state provides a case study of that. Economics, therefore, shapes the very thing it purports to objectively study. Furthermore, economists are members of society and are shaped by those shaping forces. In other words, they are influenced by their own ideas, including neoliberal ideas.

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