

A Post Keynesian Microeconomic Approach to Welfare*

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Abstract

This paper aims to propose a Post Keynesian microeconomic approach to welfare by disputing conventional wisdoms that ‘what is good for the business enterprise is good for the public’ and ‘what the state does is always good for the public.’ It is argued here that the provision of public goods and transfers by the public sector is designed and administered by the state to reproduce private business enterprises and, hence, to stabilize market economy by altering households’ wage and consumption. This argument requires that welfare be analyzed in close relation to distribution, business cycles, and capital accumulation in a social context in which conflicting classes do not get benefits equally as a result of public policy. The surplus approach is used to deal with such a complicated nature of welfare.

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1 Introduction

Post Keynesians have been reticent about welfare economics, although many efforts have been made on macroeconomic policy and the critiques of neoclassical welfare economics (see King 1995, 61). In the face of severe economic downturn in these days, in particular, we are urged to establish a theoretical framework to reconsider existing welfare programs, since the vast majority of the public, not the rich minority, has been suffered seriously from the ongoing economic recession.

While Post Keynesian economics has made significant contribution to the account of inherent instability of the capitalist system, it has not been successful in dealing with the issues in welfare. One reason may be that the changing structure of the capitalist system in close relation with the changing institutions and class conflicts has not been fully taken into account. More fundamentally, the conventional concept of the capitalist state as a benevolent steward has never been challenged. This concern is the starting point to endeavor to propose a Post Keynesian theory of welfare from a microeconomic perspective.

The present paper proceeds in Section 2 by evaluating the current state of the Post Keynesian approach to welfare and the welfare state. In doing so, built-in difficulties of proposing a coherent approach to welfare and the state are stressed. In Section 3, a Post Keynesian microeconomic approach to welfare is delineated based upon the surplus approach coupled with both the principle of effective demand and the input-output matrix. The main argument shall be developing in this section is that the standard of living (or material well-being) of the ruled class (the working class and the dependent class) depends upon the ruling class in the process of production, distribution, and accumulation. Private business activities pursuing enlarged profits or the public policy designed to promote private business activities does not necessarily improve welfare of the ruled class. The final section concludes the paper.

2 Current State of the Post Keynesian Approach to Welfare and the Welfare State

2.1 Welfare and the Welfare State

Welfare has a twofold meaning in a typical English dictionary: the well-being of people and a system of actions designed to improve the well-being. The first part of the definition normally refers to material (e.g. monetary income used to purchase goods and services) and non-material (e.g., satisfaction derives from consumption behavior) state of life. The second part of the definition implies that an action should be exercised to sustain/improve welfare that would not be achieved otherwise. Often the *status quo* without the action is called ‘market failure’ (in neoclassical economics) or sometimes ‘system failure’ (in many heterodox traditions). Whether it is a temporary disequilibrium in a market or a persistent and structural problem of the system, two views together imply that well-being is not guaranteed by the market system. For the purpose of improving well-being, thus, an action aiming at a particular end is to be initiated and undertaken. In the modern capitalist economy, it is the state that does this job—that is, the welfare state.

Despite the commonsensical understanding of the term, conventionally a discourse in welfare is reduced to numerical measures resulting from the operation of the market system at the aggregate level such as the growth in GDP per capita, unemployment rates, inequality indicators, and the like. In consequence, the ratio of government’s social security transfers (or any similar indicator such as medicare, medicaid, unemployment insurance, food stamps) to GDP normally refers to the state of the welfare state. These measures of well-being are based exclusively upon the notion of ‘material’ well-being which is assumed to be improved by enhancing the efficiency of the market mechanism insofar as neoclassical economics is concerned. Indeed, maintaining the subsistent standard of living via income or employment policy for those who are excluded from market exchanges is essential from a humanitarian point of view. The evaluation of well-being is, however, subjective and relative; that is, it relies heavily on value-judgement. Moreover, well-being is, in its nature, about the quality of life that is seldom represented by those material measures; nor does the increase in purchasing power necessarily mean that well-being has been improved (Durning 2006). One’s perception of own well-being is often defined vis-à-vis past experience and others’ well-being. Thus well-being is both historical and social matters too. A study, for example, shows that inequality and trust in social institutions (including

government) are highly correlated with personal well-being.¹

Then how do Post Keynesians conceive of welfare and the welfare state? To what extent would Post Keynesian approach to welfare be different from efficiency-oriented welfare economics? What would be the core methodological and theoretical basis for Post Keynesian welfare policy?

2.2 Post Keynesian Economics and Welfare

Post Keynesian economics has been developing based on core principles and conceptions such as the principle of effective demand, monetary production economy, historical time, fundamental uncertainty, and administered price. These cores are analyzed and articulated with the “aim to provide an outlet for strategies to enhance the general welfare” (The editors 1978, 7). This aim is too obvious to deny. Even most orthodox economists would take it for granted. But the way Post Keynesians approach to the issues in welfare is fundamentally different from that of neoclassical economics. In this section, the current state of Post Keynesian approach to welfare and built-in difficulties/problems are discussed.

Achieving the desirable state of well-being requires the evaluation of the *status quo* and the system of policy—the welfare state—that carries out the means to achieve the goal. The former involves ambiguity since there is no objective way to measure that an individual or a group is not enjoying sufficient welfare. The latter is not without difficulty since there are many (un)known tools to be selected and a great deal of uncertainty is involved with the effect of the policy. Not to mention, the decision by the state on the one hand is subject to the underlying political ideology which cannot betray the supporting group or class. The privileged class, on the other hand, is able to “buy privileged access to the state” (Levine 2008, 88) so as to maintain the *status quo*.

Given such an ambiguity and a difficulty, the issue of welfare in modern economics has been centered around the effect of welfare policy on economic efficiency, distribution, and employment. In doing so, welfare is often reduced to the matter of policy, that is, the *effectiveness of the government action which is designed to improve the operation of markets*. This claim also applies to Post Keynesian economics. A Post Keynesian theory of welfare is non-existent, although Post Keynesians have a lot to say about aggregate demand policy to improve welfare. However welfare policy

¹See “National Accounts of Well-Being indicators” created by New Economics Foundation, <http://www.nationalaccountsofwellbeing.org/>.

and demand policy are not to be confused: a demand policy may improve welfare by way of providing jobs and benefits, but it has never been sufficient to complete welfare.

When Post Keynesians speak of welfare policy, fundamental issues such as the concept of welfare and the state, the political basis of welfare policy, the adequacy of existing institutions, the power relation underlying welfare policy are rarely raised to think. Without the sound ground from which policies are derived, a policy suggestion can be confusing and misleading.

For example, many Post Keynesians support the employer of last resort (ELR) program as a sort of welfare policy since it would prevent the unemployed who are willing and able to work from suffering from the lack of healthcare, education, and housing. It is clear that ELR is not a workfare program since it is operating within the public sector. It will “supplement any sort of welfare safety net that is politically acceptable” (Wray 1998, 124). Apparently, ELR would increase the monetary benefits who are otherwise unemployed. However, it will help the private sector by providing a breathing room in the face of serious economic depression. Effective demand would be maintained at some point at which private business enterprises are able to keep producing goods and services. However, ELR does not ‘directly’ support who are not able and willing to work, and who need welfare more than others. ELR, moreover, does not touch the structural issues which are at the heart of welfare in the capitalist system and which are even observed by Adam Smith in the 18th century. Smith remarked that

Wherever there is great prosperity, there is a great inequality. For one very rich man, there must be at least five hundred poor, and the affluence of the few supposes the indigence of the many. The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possession. (Smith 1994 [1776], 766)

Besides the general problems in the Post Keynesian approach to welfare, there are some built-in difficulties that are relevant to the current discussion.

2.3 Pluralism in Political Positions

Firstly, a difficulty arises since welfare is essentially a political and moral issue. Post Keynesians reject naive positivism set forth by neoclassical economics and take Keynes's position that "economics is essentially moral science" (The editors 1978, 6). It is, however, hard to single out the political-ideological vision shared by most Post Keynesian economists. The political spectrum is so broad that any ideology fits into Post Keynesian economics, if not as conservative as the neoclassical (Eichner 1979, 17; King 1995, 198).² This results in a broad range of theory and policy as an embodiment of politics and ideology within Post Keynesianism (King 2002, 119).

Let us consider two distinctive political positions. 'Liberal' Post Keynesians,³ on the one hand, tend to believe that the democratically elected government authority is willing to undertake public policy to improve public welfare and freedom. That is to say, it is presumed that the democratic state, one of social institutions with legal power, is able to and willing to reconcile the vested interests of the ruling class and the interests of the ruled class. Since liberal policy is undertaken through the existing market system, this position further implies that the market system is still an efficient economic institution, if not the best, to provide people with incentives to work, spend, produce, and exchange.

On the other hand, radical Post Keynesians would argue that the capitalist system is inherently unstable (Minsky 1986), that the capitalist system would end up with the systemic stagnation along with the tendency of increasing monopolization and decreasing effective demand (Steindl 1972; Eichner 1976; Mott 1992), that the system itself should be replaced since the system does not guarantee full employment or the sufficient well-being of the public (Kalecki 1990 [1932]; Kalecki 1943), and that the state's public policy serves not the public but the business enterprise which governs market and society. The assumption that the state is politically neutral, or that 'what the government does is always good for the public' is fundamentally misleading in this line of reasoning. The primary concern of the modern democratic state is to protect existing social order, property rights, and the vested interests of the ruling class, not the interests of the public (Veblen 1904, 286, Veblen 1964

²King (1995) is a good reference to see how leading Post Keynesians understand their own and other Post Keynesians' approaches and how their political positions vary. See also Davidson (1972, 4, Table 1.1) in which Post Keynesians are divided into Keynes's School (Harrod, Lerner, Weintraub, and Davidson) and the Neo-Keynesian School (Robinson, Kaldor, and Pasinetti) in terms of politics.

³I would say most Post Keynesian economists are liberals. Such a position, as opposed to 'economic conservatism' (see Samuels 1994), may be called 'welfare liberalism' as defined by Hill (1964).

[1923], 37, O'Hara and Sherman 2004, 979). Moreover, as we have been noticing, not only business enterprises require the state to survive themselves (Prechel 2000, 153-155), but also the state's expenditure on public welfare has been limited by the interests of capitalists; from 1929 to 2007 the non-defense government spending as percentage of GDP has been set below 15.5% (at the maximum in 1975) (Baran and Sweezy 1966, 151-164; Foster and McChesney 2009).

Even public policy is ineffective and insufficient to improve welfare of economically marginalized and disadvantaged people. In contrast to the (neo)liberal creed, as history indicates, the capitalist state as a combination of administrative, legislative, and judiciary authorities, has always been in favor of capitalist class' interests (Samuels 1994, 668; Prechel 2000; Lee 2000; Henry 2007).⁴ A radical social welfare program, then, would pursue the transformation, rather than elaboration, of the organizational structure of capitalist economy. It would include, but not limited to, the control of the power of business enterprises and the change in the direction of public policy.

Contending political positions are concomitantly received by Post Keynesians. As noted above, Post Keynesians are well aware that economics is value-laden and hence their economic theory aims at a particular political end. Political and moral values vary within Post Keynesianism. This is not a destructive factor, although it often raises conflicts among Post Keynesian strands in terms of theory and policy. Rather, the absence of recognition of contending values in doing economics is a problem. By believing that economics is value-free science, neoclassical economists support and maintain the *status quo*—the present socio-economic order and the vested interests (Samuels 1988; 1994; Rosenberg 2001). Such a strategy has been successful in academia as well as in practice. This may be dubbed as the “failures of economic education and the successes of economic politics” (Samuels 1994, 670). By contrast, Post Keynesianism may be said to be the ‘successes of economic education and the failures of economic politics’ in the sense that Post Keynesian theory moves toward the uneasy reality instead of the mathematically tractable reality. By this very reason Post Keynesian theory has not been accepted widely in academia as well as in practice. It is imagined that a well articulated Post Keynesian theory of welfare, if any, would not easily penetrate into the dominant paradigm in economics and the domain of conservative policy, if it does not comply with the vested interests and the existing socio-economic order. This will continue until the socio-economic (and political) landscape changes.

⁴Such a view is consistent with Marx and Veblen. For instance, according to Veblen, “modern politics is business politics” (Veblen 1904, 269). This vision remains relevant and important in Sweezy (1942) and Baran and Sweezy (1966) which are influenced by Michal Kalecki as well as Thorstein Veblen (see, O'Hara and Sherman 2004)

Challenging the orthodoxy is, however, still important and necessary. The reason may be that an alternative theory is likely to affect the existing habits of thought (e.g., public attitude toward welfare) and thereby public policy. Some studies showed that “changes in public opinion often proceeded changes in government policy across a range of substantive issues,” rather than the other way of around (Gilens 1999, 24). So it becomes more likely that an alternative approach arrests the attention of the public and policy makers when the orthodox theory fails to explain the prolonged failure of markets (e.g., the on-going financial crisis in the U.S). Post Keynesians need not to be bothered by not being acknowledged by mainstream economists. More important thing is to keep developing a theory which reflects the changing reality and which speaks directly to the people for whom the proposed theory is politically supporting (see Stockhammer and Ramskogler 2008).

2.4 Absence of the Theory of the State

From a theoretical point of view, we may argue that to say about welfare from a Post Keynesian perspective, we need the theory of the capitalist state beforehand. Owing to pluralism in political positions, however, Post Keynesians have not come up with a unified theory of the state. It is more likely that multiple theories of the state are adopted as a basis of welfare policy. Currently, a theory of the state *de facto* has not been substantially developed since Keynes’s 1930s. Post Keynesians often assume that the capitalist state is a “benevolent purveyor of cradle-to-the grave security” rather than a “hostile oppressor” (Hill 1964, 395).⁵ Eichner sets forth that

The Keynesian revolution, though it marked a tactical retreat from laissez-faire, has required no significant modification of the prevailing liberal political philosophy. Although the state now has the additional task of maintaining the economy in a prosperous state, any government that is by its representative nature necessarily accountable to the electorate can be expected to achieve that goal by applying the well-known Keynesian remedies. (Eichner 1987, 702)

As a result of not questioning, but assuming the state as a benevolent purveyor given the structure of the society, Post Keynesians have mainly concerned about the management of aggregate demand so as to improve employment and income

⁵Stockhammer and Ramskogler (2008, 18, 23) also point out that there is no Post Keynesian theory of the state and the benevolent administrator is assumed in Post Keynesian macro models.

conditions and, in consequence, economic welfare. This is based on the rationale that aggregate well-being measured by per capita real GDP is highly sensitive to economic fluctuations. The improvement in the quality of life, the capability of individuals, and social justice are either assumed to be achieved through the government's 'good' policy. Therefore, on the one hand, welfare and the welfare state is reduced to fiscal and monetary policy. Full employment, on the other hand, becomes the primary policy target for both stabilizing the economy and enhancing individual liberty and social justice by way of better compensating the working class (Minsky 1986, 9; Moudud and Zacharias 2000; Bell and Wray 2004; Wray 2007). A fundamental issue of policy immediately stands out; is there any policy that satisfies all in the society? Or, is the state able to achieve full employment?

Post Keynesian macroeconomic policy is effective and relevant in the economy where the less-than-full-employment and uncertainty are unavoidable. But macroeconomic policy by itself is insufficient to achieve goals such as full employment, enhancing economic growth rate, and reducing poverty (Eichner 1976, ch. 8; Eichner 1987, ch. 10; Henry 2007, 24). For instance, Kalecki (1943) pointed out that full employment would not be politically desirable from a capitalists' point of view since the increase in power of the working class would threaten capitalists' interests. What is often absent in Post Keynesian macroeconomic policy is, however, the consideration of politics. Economic policy is in its character the function of power relation, ideology, and political preference of the state (Samuels 1994, 668). Similarly, "[t]he benefits of public expenditure will roughly correspond to the size of the various voting blocs, with those voting blocs in turn reflecting the relative size of the different interest groups" (Eichner 1987, 702). So there is little reason to believe that democratic political system and resulting economic policy would serve the general public. Rather, insofar as welfare is concerned, the role of the state needs to be reassessed and taken into account in economic policy. More radically speaking,

It is necessary to assign the State the critical role of empowering the voices of those who are marginalized and disadvantaged. Its role, unlike what neoliberal theorists argue, should be to protect those who cannot protect themselves (Migone 2007, 194).

2.5 Macro Orientation and the Micro-Macro Synthesis

Well-being is an individual-specific way of life that leads to the self-made life. In making one's life self-made and meaningful, as discussed earlier, qualitative measures (e.g., capabilities, inequality, trust in institutions, supportive relationship, life

expectancy, environmental conditions) are no less important than purchasing power. The self-made life would not only ‘reshape the external world’ by doing creative work (Levine 2008, 17-18), but also be confined by socio-economic institutions—markets, the state, rules, conventions, and relations. Therefore, welfare requires both micro and macro accounts. In the modern capitalist economy, indeed, welfare is associated with the issues such as capital accumulation, business cycles, income distribution, inflation, economic growth, employment, public policy, market structure, relative class power or social relations/status, institutions, culture, education, natural environment, globalization. Especially in the U.S. where social safety net is weak, the majority of the public relies on the private sector. Well-being thus is sensitive to business cycles. In turn, cycles are, as far as Post Keynesian economics is concerned, mainly driven by unstable business investment which are circumscribed by businessmen’s expectations of cash flows, the degree of monopoly (or industrial structure), and market-specific institutional settings. This means that individuals’ efforts to sustain material well-being are dependent upon markets; but normal market operations do not secure material well-being of those who are disengaged from the market exchange. Moreover, markets are not self-adjusting; unstable markets make individual lives vulnerable, whether they are employed or unemployed (Levine 2008, 50). In this line of reasoning, the state exists not merely because of market failures, but because of its essential role in the social provisioning process—commanding production and allocation of particular goods and services (e.g., public goods), regulating income distribution (e.g., taxes and transfers), stabilizing markets (e.g., public investment, price controls), providing jobs, and issuing the state money.

When welfare is approached only from macro perspectives, the main issue becomes aggregate unemployment and income determined by effective demand, inflation results from increasing aggregate mark-ups, and the like. Speaking of inflation, Post Keynesians have advocated the regulation of wage rates (or aggregate wage mark-ups). It is suspected that this is not because they are anti-working class, but because they do not consider how individual business enterprises set prices that are reflecting expected profits (profit mark-ups), direct input costs (material and labor costs), and other production/management related costs (e.g., overhead costs, shop expenses, enterprise expenses) (see Lee 1998). The following episode directly speaks to this point.

I remember an exchange at the first conference on Post Keynesian economics sponsored by the University of Tennessee. At a lecture on Brazilian inflation, Basil Moore stood up and said, ‘Why don’t you just cut wages? That’s what inflation is all about.’ Fred Lee, much to his credit, then stood up in the back row and particularly screamed at Basil, ‘Why is Post Keynesian economics always biting into the wage, and why is it

always the worker that suffers from these policy proposals? You've got a mark-up in there too. Why don't you propose cutting the profit rate?' (King 1995, 59-60)

So we can conclude this section by stating that Post Keynesian macroeconomic approach alone is not sufficient to deal with welfare as well as unemployment, inflation, and growth, since there are important variables left behind: the structure of industry, pricing power of business enterprises, dividends and retained earnings, and collective efforts to change market institutions. In particular, regulation of markets as a means to provide goods and services at the socially desirable level—that is, the minimum requirement for maintaining individual well-being—is micro as well as macro issues (see Eichner 1987, 712-4). It thus is suggested here that welfare be understood by identifying and explaining the behaviors of agents (households, business enterprises and the state), structures of the economy, and causal mechanisms in a systematic and coherent manner in the light of social provisioning process. Such a framework would be consistent with the surplus approach coupled with the principle of effective demand and input-output analysis. This is the main argument that will be proceeding in the following section.

3 A Post Keynesian Microeconomic Approach to Welfare

3.1 Theoretical Foundations

Among other things, in Post Keynesian economics employment takes the central position of welfare improving socio-economic policy. The principle of effective demand is the theoretical basis of employment and income policy in the context of the monetary production economy. The channel from effective demand to welfare through employment can be delineated in different ways. Fundamentalist Keynesians would argue for increasing purchasing power of the middle/lower income class by offering public jobs, setting progressive tax rates, reducing interests on capital assets, and socializing investment (Keynes 1936; Minsky 1986; Wray 1998). Kaleckians would emphasize controlling monopoly power of the business enterprise (that is, pricing, investment, and financing power) and availability of monetary resources so as to increase effective demand and welfare of the working class (Kalecki 1990 [1934]; 1971; Eichner 1976; 1987). The consideration of class conflict is indispensable to this approach, since the increase in the power of the capitalist class represses the increase

in real wage of the working class. Similarly, the conflict of class interests figures prominently in the Sraffian account of welfare through the determination of value, distribution, and accumulation. That is, the provision of social wage goods (in kind and in cash) would raise the real wage of the working class and reduce capitalists' profits. As a result, income distribution changes and effective demand builds up, as long as resources of the economy are not fully utilized (Eatwell and Milgate 1983; Cesaratto 2008).

These approaches together shed light on the Post Keynesian approach to welfare. First, welfare is not secured by markets embedded in monetary production economy. Goods and services are not produced and allocated at the socially desirable level. Market failure is the norm rather than the exception (I would rather say 'system failure'). Any capitalist economy has never achieved full-employment. Economic fluctuations can not be predicted or avoided. As long as such an inherently unstable system is to be maintained, the life of people in this system is vulnerable. So the system should be stabilized or modified in one way or another.

Second, the state plays an essential role not as an adjustor of market failures or benevolent purveyor of welfare, but as a facilitator of the system, who, more often than not, represents the ruling class of the society. The use of resources by the state is constrained by its political interests. The priority of welfare policy is to stabilize the system, to save the ruling class, and, eventually, to reproduce the system. The standard of living of the working class may be improved as a result of the progress in the accumulation process through the state actions enhancing effective demand. Consequently, the welfare state is a crucial part of the reproduction of the capitalist system.

Third, welfare is to be understood in the social provisioning process which can be characterized by monetary production economy, surplus producing economy, and circular production economy. Interactions among agents given the historically contingent structure of economy elucidate material conditions of the working class. Accumulation, distribution, and cycles are all closely associated with welfare. Indeed, such a process has nothing to do with Pareto efficiency or market clearing. Rather it is an open and historical process that is contingent on the institutional setting, power relations, and individual/collective efforts that form institutions and relations.

Then the present discussion gets into our main point: how would Post Keynesian microeconomics effectively analyze the changes in welfare? As hinted above, the surplus approach coupled with the principle of effective demand would be a pertinent method to account for welfare. The following analysis spells out the role of the

welfare state and the class conflict in the monetary production economy.

3.2 Surplus Approach

The surplus approach entails important features that are consistent not only with Post Keynesian principles, but also with the account of welfare in the capitalist system. Some notable reasons underlying the use of the surplus approach to welfare can be stressed.

First, it is a comprehensive analysis, as we will see more clearly below, in that in this approach all inputs are produced inputs that flow across sectors—i.e., the circular production economy, that the demand for surplus derives the whole system—i.e., the surplus production economy, and that the access to monetary resources is essential for agents to engage in the social provisioning process—i.e., monetary production economy. The participation in the social provisioning process by various social classes (workers, capitalists, and the state) can be systematically delineated in the determination of income distribution, prices, and output (Sraffa 1960; Eatwell and Milgate 1983; Cesaratto 2008; Roncaglia 2005, ch. 16; Lee 2007; Jo 2007, chs 2 and 6).

Second, it is an open system approach to the extent that technical conditions, institutional set-ups and class relations/conflicts set the course of the production of commodities (the mode of production), the distribution of income between wages and profits, the determination of prices, and eventually welfare of a particular social class (especially, the working class households). In other words, the central question of welfare is not about achieving the Pareto efficient allocation through free markets, but about designing the adequate institutional set-ups that would be likely to cause an intended outcome—escalating the standard of living or the reproduction of the system over historical time.

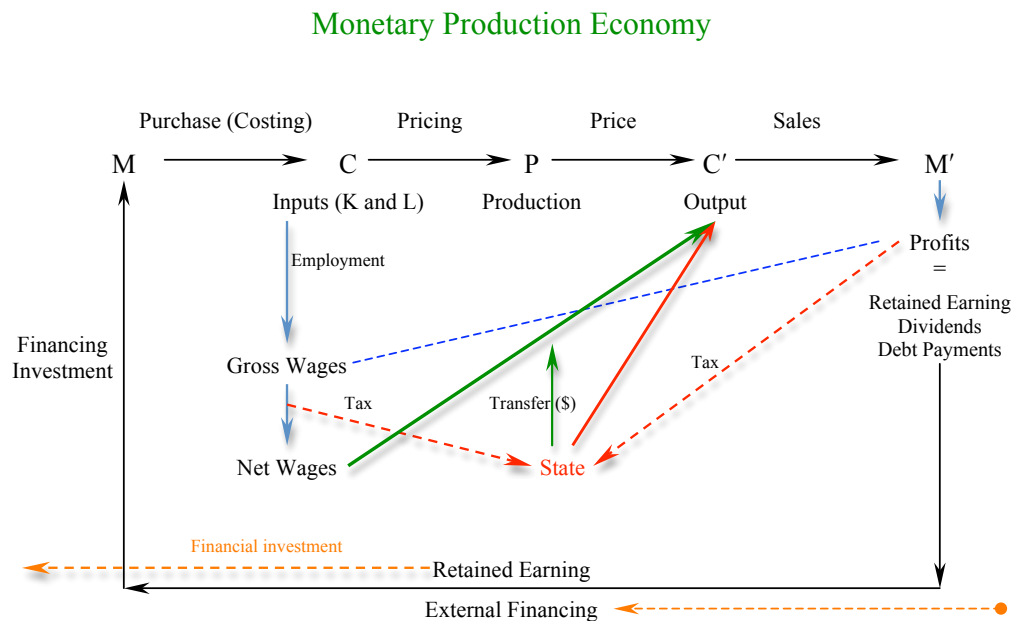
Third, it renders both micro and macro accounts of welfare possible, since the delineated system is not the aggregated sum of economic activities and relations (that is, a irreducible and indecomposable system). This means that individual well-being is conditioned by the structure of the economic system and the standard of living can be altered by regulating the distributive structure by the state authority or collective efforts by workers.

Finally, the surplus approach is consistent with the microfoundations of effective demand from a Post Keynesian perspective (Jo 2007, ch. 6). While the former

has been developed by Sraffians in the long-period context, the latter stresses the role of agency along with the causal mechanisms (e.g., consumption, investment, and government expenditures) confined by institutional set-ups of the capitalist economy and it does not necessarily lead to the long-period position of the economy.

3.3 Monetary Production Economy and Effective Demand

Consider a simple monetary production economy illustrated below in the figure. Starting from the north-west, it reads that the capitalist production process begins with money (M) to purchase inputs (K and L). The use of material and labor inputs, that is the quantity and the composition of inputs, are conditioned by both the technical condition of production (represented by technical coefficients and labor coefficients in Table 1) and capitalists' expectation of cash flows realized after the sales stage.



Employed direct inputs plus expenses associated with operating plant segments, running and organizing business enterprises (such as overhead costs, depreciation) constitute total costs of production. On the basis of the cost structure, then, capitalists determine the profit mark-ups over total costs or direct costs at the normal flow

Table 1: Input-Output Matrix

| | Ind 1 | Ind 2 | ... | Ind m | C | I | G | Total |
|---------|------------------|------------------|-----|------------------|--------------|--------------|--------------|-----------|
| Com 1 | $p_1 a_{11} Q_1$ | $p_1 a_{12} Q_1$ | ... | $p_1 a_{1m} Q_1$ | $p_1 Q_{c1}$ | $p_1 Q_{I1}$ | $p_1 Q_{G1}$ | $p_1 Q_1$ |
| Com 2 | $p_2 a_{21} Q_2$ | $p_2 a_{22} Q_2$ | ... | $p_2 a_{2m} Q_2$ | $p_2 Q_{c2}$ | $p_2 Q_{I2}$ | $p_2 Q_{G2}$ | $p_2 Q_2$ |
| ⋮ | ⋮ | ⋮ | ... | ⋮ | ⋮ | ⋮ | ⋮ | ⋮ |
| Com m | $p_m a_{m1} Q_m$ | $p_m a_{m2} Q_m$ | ... | $p_m a_{mm} Q_m$ | $p_m Q_{cm}$ | $p_m Q_{Im}$ | $p_m Q_{Gm}$ | $p_m Q_m$ |
| Wages | $w_1 l_1 Q_1$ | $w_2 l_2 Q_2$ | ... | $w_m l_m Q_m$ | | | | |
| Profits | $r_1 k_1 Q_1$ | $r_2 k_2 Q_2$ | ... | $r_m k_m Q_m$ | | | | |
| Total | $p_1 Q_1$ | $p_2 Q_2$ | ... | $p_m Q_m$ | | | | |

Note: p_i is the price of i^{th} commodity, a_{ij} : technical coefficient, Q_i : quantity, Q_{Ci} : volume of consumption, Q_{Ii} : volume of investment, Q_{Gi} : volume of government expenditure, w_i : industry wage rate, l_i : labor coefficient, r_i , profit mark-up, k_i : capital coefficient. The foreign sector (import and export) is not considered for the sake of brevity.

rate of output so as to ensure that resulting commodity prices lend themselves to sufficient cash flows necessary for the reproduction of the enterprise (Eichner 1976; Lee 1998).

Produced commodities (C') are sold to households, business enterprises, and the state with predetermined prices. Market exchanges result in business enterprises' gross profits (M') that are, in the main, used to pay corporate income tax, dividends, and debts.⁶ Remained net profits are retained in order to purchase capital goods (investment) for the expanded production. A part of retained earning is also used to finance investment on financial assets, which do not directly contribute to the expansion of productive capacity.

Employed workers get payed (or wage rates are determined) at the purchasing stage and pay personal income tax to the state. Remained wage income is used to purchase surplus goods and services. In the mean while, depending on the class status, some of working class households and the dependent class (e.g., retirees, children) get transfer payments in cash or in kind (e.g., social wage goods). Those who do not own the means of production are dependent upon the market and the state. To sustain their life, they must engage in the social provisioning process, especially, the production of surplus, which is governed by the private business enterprises and the state. Moreover, assuming the wage rates and prices of other material inputs are

⁶In this context, we may argue that the market, including exchanges and the production of commodities, is a “*process to clear debts*” (Henry 2003, 244, original emphasis), rather than a process to clear markets. Because a tax is a debt to the state and a dividend is a debt to a shareholder.

known before the production takes place, the rate of profits are determined by the demand for surplus goods.

The state figures in the monetary production economy as the tax authority who redistributes wages and profits, as a public consumer who takes up a significant part of surplus goods and services, and as the welfare purveyor who channels tax money into working class households and poor individuals/households. The redistributive role of the state renders the monetary production economy going and growing. Without it (that is to say, *laissez-faire*), the effective demand of the economy would be significantly in short of sustaining the economy as a whole. In other words, as Sraffians argue, effective demand is a “determinant of accumulation” and social expenditures by the state is an essential “component of effective demand” (Cesaratto 2008, 102).

More specifically, in the capitalist economy which systematically lacks effective demand, available material and human resources are not fully utilized. The state is able to raise the level of effective demand by means of its redistributive role. This does not cause crowding out resources available to private business enterprises. Nor does it harm private profits; rather increasing welfare spending and, thereby, consumption expenditure by households would generate additional profits due to the increase in effective demand and in the volume of surplus goods. If the state directly provide goods (i.e., public goods) with the public at lower prices than private business enterprises, the redistribution of income between wages and profits would take place since workers’ and dependents’ real income increases and private enterprises are not making any profits from those public goods. The provision of public goods would also create new demand for those goods, because private business enterprises are not willing to produce goods and services that are not profitable. Even some are able to access to those goods such as health care and education without limit (see Cesaratto 2008). This is possible since the state is able to set profit mark-ups for public goods as low as possible.

In a nutshell, effective demand (that is, expenditure decisions) determines employment, output, income, welfare, and the pace of accumulation in the monetary production economy. As we have seen above, four conditions set by private business enterprises and the state stand out in improving effective demand and welfare; 1) the private business enterprises’ willingness to expand the productive capacity, 2) the state’s willingness to transfer incomes between the classes, 3) the state’s willingness to spend its tax money on surplus goods, and 4) the state’s willingness to provide public goods at lower prices.

3.4 Practical Implications for Social Welfare Policy

The causal mechanisms described above highlight the crucial role of effective demand and distribution of income with regard to the changes in the standard of living of the ruled class. Such a welfare mechanism can be detailed by examining the roles played by private business enterprises and the capitalist state.

One received belief prevailing in the neoliberal era is that ‘what is good for the business enterprise is good for the public.’ This belief presumes that 1) the private business enterprise is the engine of the capitalist economy, 2) welfare of the public can be improved by private business activities, 3) the public policy designed to promote private business activities would improve public welfare, and 4) the growth of private business enterprises would enlarge the cake which is beneficial for the public.

Assumption 1 is less controversial since it is the profit seeking business enterprises that command material and labor inputs and produce surplus goods. That is to say, business activities are the material basis of the capitalist system. With regard to the surplus approach coupled with the principle of effective demand, however, the second assumption is not viable. Welfare or the standard of living of the public can only be improving if there is sufficient effective demand that rests on both private and public sectors. Moreover, as industries move toward monopolization, real purchasing power of the working class tends to fall, since commodity prices are determined by the business enterprises in favor of themselves. One may argue that private business enterprises offer workers welfare. However, such a ‘welfare program’ is designed not to improve workers welfare but to enlarge profits (Veblen 1904, ch. 3). In his historical investigation of the business enterprises, notably Harland Prechel (2000) writes that

large corporations set up programs to enhance harmony and morale to offset labor unrest (e.g., strikes, radical labor politics). This strategy was known as *welfare capitalism*: programs based on the belief that voluntary efforts by employers to improve the life and work conditions of employees contributed to a value orientation that encouraged self-betterment, loyalty, and cooperation. Programs to improve life conditions included educational and recreational programs, housing, plans for saving and lending money, and provisions for insurance pensions. Initiatives that focused on improving work conditions included safety programs, incentive wage plans, and apprenticeship training. Welfare capitalism was a paternalistic program based on the belief that these initiatives would encourage

woker loyalty and cooperation. Capitalists assumed that these programs would simultaneously create a better person and worker (Prechel 2000, 98, original emphasis).

The third assumption typically appears in the discussion of market failure in neoclassical welfare economics. However, from a Post Keynesian approach set out above, the state is not necessarily concerned about the improvement of welfare of the public. A more urgent concern of the state is to protect the existing socio-economic order. In this perspective, the state intervention is to placate markets, as business enterprises' welfare program is to placate labor unrest. Thus the state welfare programs are consistent with business principles. Or we can argue that what the state does is *not necessarily* good for the public.

The last assumption has no theoretical and historical ground. There is ample empirical evidence that fruits of economic growth has mainly gone to the ruling class. At the same time, inequality between the ruling class and the ruled class has been escalating. With regard to the relation between growth and welfare, two trends have been noticed. The one is that personally reported well-being has not significantly increased, even though the GDP per capita has increased markedly over time (Frey and Stutzer 2002, 8). The other is that in a country at a point in time, the higher income class enjoys higher degree of well-being than lower income classes (Glyn 2006, 178). Two events are not actually contradictory; as discussed earlier, well-being is not merely the matter of material conditions but also mental and social in its nature. If inequality of distribution keeps increasing despite of the persistent economic growth, the well-being of those who belong to the lower income class would not go up. So distribution is crucial in the account of welfare. In the monetary production economy illustrated above, equality of distribution can be improved if workers have greater bargaining power against capitalists, if the state is able to provide public goods at lower prices, if the state sets income tax rates progressively, if the profit mark-ups, dividends, retained earnings of private business enterprises are in control, or if markets are regulated for the sake of the working class (see Eichner 1976, ch. 8; Moudud and Zacharias 2000). However we well know that such a radical policy is unlikely under the democratic political system in which the ruling class is able to manage the state and the public. This is the central difficulty of welfare economics.

4 Conclusion

Welfare refers to the well-being and the sufficient standard of living of the public. We believe that welfare makes individuals' life self-made and meaningful. In the ever-changing capitalist economy, one's life is dependent upon private market exchanges. But markets are unstable and thereby life becomes vulnerable. Moreover, markets do not protect those who are excluded from market exchanges. Neither is the well-being of workers secured by the markets since the standard of living or real wage income is governed by the interests of profit-seeking business enterprises. Increasing power of the business enterprises through the concentration of industries holds down the real income of the working class and the dependent class. Goods and services are not provided at the socially desirable level due to the lack of effective demand. As such, welfare of the ruled class is severely restrained when their lives are left to the market mechanism.

The welfare state has thus emerged and taken important part in the social provisioning process. The state, through public policy, is able to increase effective demand and to redistribute incomes. But in the capitalist economy the state's primary concern is to protect existing social order, property rights, and the vested interests of the ruling class since those are the basis of the political power. That is, as Veblen remarked, "modern politics is business politics" (Veblen 1904, 269). Therefore, there is little reason to believe that what the state does is not always good for the public.

As far as Post Keynesian economics is concerned, however, the theory of the state is absent. As a result, it is conventionally believed that aggregate demand policy (income and employment policy) would improve welfare of the public and social justice. Such an approach is insufficient to deal with the issues in welfare, which involve both micro and macro analyses. It is argued that microeconomic structure of the economy, causal mechanisms driven by business enterprises and the state should be added to the account of Post Keynesian approach to welfare. Such an account can be effectively developed by the surplus approach coupled with the principle of effective demand and input-output analysis.

Following implications are drawn from the surplus approach. Welfare of the ruled class is dependent upon

- 1) the private business enterprises' willingness to expand the productive capacity,
- 2) the state's willingness to transfer incomes between the classes,
- 3) the state's willingness to spend its tax money on surplus goods, and
- 4) the state's willingness to provide public goods at lower prices.

More practical implications would be that welfare of the ruled class can be improved,

- 1) if workers have greater bargaining power against capitalists,
- 2) if the state sets income tax rates progressively,
- 3) if the profit mark-ups, dividends, retained earnings of private business enterprises are in control, or
- 4) if markets are regulated for the sake of the working class.

Such conditions are, however, hardly met, since it is not likely that two dominant agents in the capitalist economy—the business enterprise and the capitalist state would betray their own interests.

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