2. Theories about the Role of the State[1]

Summary

The main purpose of this chapter is to present, albeit briefly, the philosophical underpinnings of three main theories of the state, whose corollary three different approaches to the role of public finance. These theories can be labeled the Minimal State, the Welfare State and the Imperfect State. Current political debates ultimately are anchored in one way or another to these different conceptions of state or a combination of them.

One of the central issues of any modern mixed economy (capitalist or so-called socialist as China) is the role and relative importance of markets on the one hand, and the public sector, on the other.

The first advocates of the Minimal State (Adam Smith, David Ricardo, Jean Baptiste Say), who wrote between the late eighteenth and mid-nineteenth century, did so at a time when the restrictions to the movement of goods, people and capital were enormous given the current standards. The desire for a minimal state, with little public spending and low taxes was seen as a necessary condition for economic growth that would be provided by self-regulated markets. In short, these authors argue that the state's role is essentially to provide a defense against attacks from foreign countries, security and internal peace through the implementation of the rule of law and the infrastructures needed for any private investment. Budgets should be, as a rule, balanced and the main source of funding should be taxes. The use of public debt was clearly doomed unless it was warranted due to exceptional circumstances such as the need to fund wars. This is what is called the classical approach to public finance. From the philosophical point of view the main architect of the modern perspective, that the redistribution of income should not be a function of the contemporary state, is Robert Nozick. This author gives a justification for the fairness of the operation and performance of the markets and that public interference in their functioning should be minimal because economic inequalities, not generated by theft, fraud or extortion are morally defensible since they result from free choices of economic agents.

The perspective of the Welfare State had its heyday between the 40s and the

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60s of the twentieth century, and is far away from the previous perspective. Although recognizing that the markets are powerful tools for allocating resources, they are not self-regulated, as shown by the great depression of 1929 in the U.S. that quickly spread to Europe. Also markets are not entirely fair because processes tend to reproduce social inequalities. Those who, by birth or luck, access to greater wealth, better schools, better atmosphere, have a greatly increased probability of having greater success in the market place. There is, thus, a reproduction and sometimes an increase in inequalities. In this sense the defenders of the Welfare State advocate a more pro-active public sector, especially in the redistribution function which aims at ensuring that all individuals have access to a minimum income, to a range of other primary goods necessary for their formation as autonomous citizens (education, basic health care, etc.) and that risks associated with a set of social contingencies (unemployment, illness, etc.) are covered. The role of public finances is now much more interventionist, because public spending is not only towards the allocation function (public goods, externalities, etc.), but is also intended to the redistribution function. This leads to a greater weight of public expenditure on GDP, as well as a higher tax burden, accepting these authors, different ways of financing expenditures (tax, debt and money creation). The deficit is not considered a problem and should be used for stabilization purposes, namely an anti cyclical fiscal policy when the economy is in recession. These ideas were inspired by Keynesian economics in the 40's and were implemented in economies having grown strongly in the 50s and 60s.

The ideas of the Imperfect State, a state that ceaselessly grows, a kind of monster devouring resources, are already old (Thomas Hobbes), but have had one recently renewal with different arguments. In the history of economic thought the theories about the failures of government were developed mainly in the 60s to 80s. Several factors may contribute to these failures. On the one hand, the trend to win votes with increases in public spending and tax cuts suggests that the deficits (revenues below expenditures) are endemic of democratic regimes. Moreover, political economic cycles are manifest because politicians tend to aggravate deficits before the elections and take the tough measures after. Additionally, the existence of asymmetric information between parliaments that approve budgets and the administration that implements them, associated with a selfish behavior of bureaucrats who pursue larger budgets, causes public spending well above optimum levels. Finally, interest groups may also explain certain budgetary measures that are difficult to justify from the standpoint of public interest. A corollary of these government failures, in the framework of democratic institutions, is the need for having fiscal constraints (budgetary rules) either embodied in the Constitution law, in Treaties or simply in super-majority acts of parliament, in order to constraint politicians’ behavior so that they serve the public interest aligned with a long-term perspective and not merely electoral myopic short-term objectives. From the point of view of public finance, constitutionalism recommends, federalism, to diminish the power of the executive, general redistributive rules, to avoid rent seeking, a somewhat smaller state (20 to 30% of GDP) to promote economic growth. Currently, if we assume “modern public finance” as the one used in most European Union countries, we may recognize characteristics which are typical of the interventionist Welfare State (social security, use of public deficits with stabilization purposes, etc.), but also has some elements of constitutionalism as illustrated not only by the Stability and Growth Pact (Chapter 15) but also by rules framing the preparation of the budget laws (Chapter 12).