The Debate on the Sustainability of Social Spending

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Abstract:

The economic and political debate in countries with older industrialization faces a progressive growth of social spending in relation to national products, generated by a concurrence of factors (aging of populations, low productivity in human services, moral hazard), which leads to propose reductions of social spending in favor of other resource allocations. Social expenditures, however, constitute an essential part of the "social pact" which historically united citizens in accepting equalities in political rights and inequalities in the command over resources. The question on the "sustainability" of the choices regarding social policies is open, with regards to the acceptability of economic inequalities and in relation to the ethical themes founded on the recognition of human dignity.

The debate on the sustainability of social spending

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1. Reasons behind social spending

1.1 An historical premise

"Social spending"[1] represents, from an historical point of view, the main answer – even if not the only one – which contemporary market-economy States with private property of capitals (and so, with private property of the means of production) have given to the intrinsic inequalities of such a form of social and economic organization[2].
Indeed, social spending occupies a significant role also in planned economies where the means of production are publicly owned, because in those economies the State acquires both the burden to maintain the unoccupied without fault[3], and a function to provide for the formation of "human capital" and for the essential services to the person (including housing). Yet in market economies, in comparison with planned economies, social spending is distinctively aimed (at least on a planning level) at reducing inequalities in the availability of goods and services, and so, it is entitled to bridge the representative democracy with universal suffrage, which assigns to each citizen equal power to decide (through elections), and the economic organization which, in turn, assigns to citizens unequal powers of "command" over real resources.
This work refers to social spending in market economies with private property of capital. A preliminary observation may show that in these economies, private accumulation of savings configures the alternative solution to at least some of the distributive issues which social spending tries to solve (i.e. to the risks of old age and disease, which impede to gain an earned income). The contrast between such alternative solutions – private saving or social spending – or between different combinations of the two solutions, is a relevant theme in current debates.
Economic history shows that in industrialized countries, and with the implied technological progress, productivity and employment growth lifted a relevant amount of people from a widespread condition of misery and general backwardness. The neo-classical economic theory, in its original formulation of the general economic equilibriums with their properties of optimality

1 Following the international literature, I define "social spending" both public transfers in money to households (retirement pensions, disability, survivor; disease and workers' compensations; tax reliefs and grants to households; unemployment benefits), and public transfers "in kind" (public healthcare, childhood and education services; public housing; political prices for some services; active work programs). See lately LINDBECK (2005).

2 Another important answer to market inequalities is the regulation of work contracts. On a higher hierarchical level, some constitutional laws state the equality of all citizens before the law, and include some merit rights, such as a right to work, to health and, naturally, to life.

3 The evaluation of individual responsibilities for the "state of need", that is of the legitimation to obtain the social benefit financed by society, is an important theme for social spending. A specific theme is the "moral hazard" which those who apply for a social benefit may eventually exert. These topics are considered in the discussion ahead.

(according to Paretian criteria: efficiency in production and trade), may be interpreted as a formal acknowledgment and normative settlement of the potential of production and development (these have been formalized in neo-classical models of growth) inherent to competitive market economy. But, during the industrialization process, while the economic development of advanced Countries was proceeding, creating abyssal gaps between their average per capita income and that of the more underdeveloped Countries, within industrialized Countries themselves new economic inequalities were rising and strengthening between social groups, not only related to income or property. The decision power over the dynamics and quality of development[4] were substantially committed to entrepreneurs who owned (or managed) the capitals.

Therefore, the economic development of industrialized Countries brought, within itself, a conflict on the distribution of income and rose a number of questions on the role of the labor factor – as important as the capital factor for production processes – in regards to the decisional processes about rates and quality of economic development[5].

The economic theory which – after the important critical contributions of classical economists – consolidated itself on the definitions of the ("optimal") conditions of efficiency in production and trade, and on the demonstrations of the existence of general equilibrium solutions, found itself forced to take note of the conflicts and inner disputes born inside "real" market economies. The economic theory tried to proceed toward two directions: the analysis of "market failures", searching for adequate public interventions to correct them (thus providing a justification to public intervention in the economy); and the explicit consideration of "equity" Equity would justify redistributions of wealth (the initial endowments of the economic agents in a general equilibrium model) and of income (correcting the "efficient" distribution based on the marginal productivity of factors).

Nevertheless, while in real societies the distribution of capital and income was becoming the main theme for social debate, the neo-classical theory found several difficulties at incorporating the distributive problem inside its logical and normative construction. Even accepting the validity of such a construction[6], which allows to analytically separate efficiency from equity (this is the 2° fundamental welfare theorem), it was evident that a resort to an extended mechanism of lump sum taxes and transfers, which is necessary to change the distribution, without hampering efficiency, encounters overwhelming practical obstacles. On the other hand, the (forced) resort to taxes, whuch are assessed on the results of economic acts (income production, saving, consumption, trade, etc.), introduces into the normative model distortions of the "efficient" behavior of economic agents, thus precluding "first best" solutions and requiring "trade offs" choices between efficiency and equity[7].

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4 The neo-classical economy assumes "consumer sovereignty" as a fundamental principle: consumers lead firms to those production and investment choices which correspond to their preferences, through the expression of their choices on the markets. But, considering more critically the evolution of the populations' "lifestyles" in industrialized countries, it appears that such evolution has been largely guided by technological and product choices made by firms, which offer the kind of goods and services that consumers will consequently buy (their choices being mainly limited to similar products supplied under market competition). Advertising, often referred to as a conditioning factor of consumers' choices, is only one of the aspects of such a process. Enterprises' investment programs are the real driving factor of the evolution in "lifestyles", because they bring on the consumption market those kinds of products and services decided by the firms.

5 Until 1990, the confrontation between the "block" of market economies and the block of Eastern planned economies made it relevant a choice between these two models. In the market economy block, social spending accomplished, historically, a function of orienting voters' choices in favor of the market system, because it represented the concrete possibility to combine political and entrepreneurial freedom with a reduction of inequalities, in a way to obtain an acceptable degree of social cohesion. The great expansion of social spending in Western European countries from the end of the 2° World War, that is from the time the competition between the two blocks arose, is its most visible historical expression. In the United States, the first, real stimulus to social spending came from president Roosvelt, as one of the answers to the "Great Crisis" which threatened to overwhelm the North American market economy.

6 A fundamental criticism to neo-classical formulation was developed by the so-called "neo-Keynesians" (and "neo-Ricardians") in the '50s and '60s: see for all J. ROBINSON (1956)

7 Such difficulties are widely recognized in MUSGRAVE (1959), author of the most consistent and comprehensive

Moreover, logical coherence imposes that, keeping within the neo-classical model founded on the hypothesis of rational behavior of agents, who maximize their utility functions, the criteria used to decide about redistributive actions must have an utilitaristic foundation. Logical and practical difficulties are known to exist in regards to the construction of an utility social welfare function. So, neo-classical theory – which still remains the most important analytical reference for the economic literature – seems inadequate to explain the redistributive issue. However this does not mean that individual utilitarism is useless in interpreting the behavior of economic agents and States (as discussed in more depth in the following sections).

1.2 Different approaches to "social equity"

Within the studies of "social spending", the most common critical observations on the explanatory and normative capacity of the neo-classical approach on distribution, pointed at its individual utilitaristic foundations. It has been argued, analyzing historical evolution, that the stimuli which fueled social redistributive claims are not ascribable to individual utilitarism (utility is function of income), but to political dialectics between social groups. Synthetically speaking, political parties which represented middle and low classes would have accepted a market economy with private property of capital, intrinsically generating distributive inequality, because they would have obtained redistributive policies in such a way to reduce those areas of greater poverty, and to offer to laborers a social network of protection against most risky events (old age, sickness, disablement and invalidity, survivors, unintentional unemployment). Moreover, they would have obtained the public provision, free of charge (or partially free) at the point of need, of a number of social services which are considered fundamental (especially healthcare and school). This historical-political approach seems to exclude the utilitaristic schemes adopted by traditional economic theory. But this is not necessarily true for all the trends of study in the field of political behavior of social groups. A relevant exception is represented by "public choice" studies, which look for the motivations behind the actions of specific social groups (governments, bureaucracies, political parties), through specific utility functions which include not only income, but also indicators of power and of "status": there still remains the hypothesis according to which each group maximizes its utility function. A significant extension is given by studies on the motivations of a median voter, to interpret and forecast electoral results and their relevance in regards to the choices of social spending[8].

Within those traditions which are defined in literature as "alternative" to utilitarism, much interest followed those which stress the role of "ideals", or universal ethical principles, as determinants of the redistributive demand. Between such principles, the ideal of "social justice" stands out since

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treaty of the neo-classical theory of public finance, which explicitly refers to the interferences of the distributive branch with the allocative one of the public budget. To the economist who, instead, denies the neo-classical distribution theory, it is logically wrong to search for redistributive "interferences" with the allocative processes, because distribution and allocation would be two logically inseparable components of the market economy's model (prices which direct allocative decisions of firms, are the same prices which are composed of the remunerations of factors: a change of the profit rate or of the wage rate, resulting from distributive conflicts, changes the structure of prices and therefore the related "signals" that market sends to economic agents to drive them to an efficient allocation of resources).

8 Recently, the "aging" of the median voter attracted the attention of researchers. This aging process may lead to prefer – within the sphere of social spending – pension systems which favor old cohorts in comparison with younger and active groups. See for example: BERGSTROM, HARTMAN (2004). Using a sample of 24 countries, MILANOVIC (2000) tried to verify the hypothesis that the median voter evaluates his net gain from redistributions, and consequently how this affects redistributive policies. The hypothesis appears statistically weak, especially if only strictly redistributive expenditures are taken into account (that means excluding pensions). On the other hand, including expenditures in kind appears to strengthen it. The author also shows that the median voter's influence on economic policy choices in representative democracies is less direct than commonly believed.

ancient times. But a concrete specification of such a notion of “social equity” is not obvious[9].
A turning point in the theoretical approach to social policies took place in the '70s, when proposals to build a “social state” were already experimented in some countries with significant results. At that time in some studies, reasons of (partial) dissatisfaction arose with the practice of targeting social policies only toward economic objectives, in other terms the provision to every citizen of specific “primary” (or “merit” or necessary to the realization of equal opportunities) goods. Studies by Rawls, Marshall, Sen[10], marking a deeper conceptual parting from the welfarist tradition, highlighted qualitative aspects of welfare, which may be summarized with the assumption that every person (equality) has to be able to choose (freedom) his project of life, integrated into a social organization. Such a vision of social welfare, it has been pointed out, aims to the “human development” rather than to correct “market failures”. The objective of “human development” transcends the development of GDP, which in turn characterizes a product-oriented vision of welfare, and which still today imprints economic policies of economically advanced States[11].
A dignity for labor, going beyond its interpretation as a production factor, and a complete participation for everyone to social life beyond widespread situations of substantial alienation, all become final objectives of a social policy whose success is not measurable only in terms of GDP growth. Such a vision of “human development” assumes and incorporates previous demands for a distribution of primary goods and services to all citizens and the enactment of procedural equity rules, since it still remains necessary that everyone is allowed the instruments required to achieve one's life project. But the vision of social welfare defined by “human development” intends to go beyond such needs of social policy, toward an extension of individual capacity to promote his personal potential, and realize new levels of freedom inside social organizations. As such, this vision encompasses not only the “welfare” of the poor and weak social groups, but it proposes itself to every citizen to develop their capacities.

1.3 A critical evaluation of different approaches to social “equity”

An evaluation of non-utilitaristic motivations to social spending requires drastic simplifications and a synthesis of the enormous existent literature. I will therefore focus on the most qualifying aspects of the trends which encountered wider favor.
The historical approach which explains the evolution of social spending policies as a result of a dialectic between social groups, may be objected noting how such approach is insufficient to

9 A first question regards the distinction between “consequential” or “procedural” equity. The first type of equity considers redistributive results obtained from social policies, so the studies based on it share the presence of a wished level of economic equality: they can range from egalitarian social welfare functions (Rawlsian, maximin) until the “merit goods” thesis (Musgrave) and the “specific egalitarianism” (Tobin) which, instead, reduce the space of required equality to a given set of goods and services which should be supplied to everyone and financed by society (healthcare, education, goods which are necessary to live). “Procedural equity”, on the other hand, requires that society guarantees to all individuals equal opportunities to exert their capacities within social organization. It therefore implies both a supply to everyone of the fundamental services to cultural and professional education, and the enactment of rules to safeguard and promote social mobility and merit recognition. It may be stated therefore that both the adhesion to objectives of a consequential or procedural equity, require social spending programs, essentially destined to the sectors of education (also higher education) and work training, healthcare, and availability for everyone of primary goods and services. But, contents and instruments for such programs may differ, in relation to the chosen objective. The choice for consequential equity tends to formulate more invading redistributive programs in market economies (for example, taxes which distort economic incentives). The choice for procedural equity might be considered as an act of trust in the market, as long as everyone is allowed to express at their best their possibilities.

10 RAWLS (1971); MARSHALL (1973); SEN (1970; 1975; 1982; 1985; 1996; 2000; 2002).

11 See the intellectually provocative report on welfare by BOSI (2002).

construct a normative theory, and to recognize the political drivers behind redistributive interventions. But such an approach highlights that the root of social spending demands is found in the "pacts" which constitute state organizations, when those "social pacts" include inequalities between citizens inherent to market economies with privately owned capital, and thus they also include "corrections" (public interventions) to inequalities. A "social pact" is, by definition, an agreement between social groups and any agreement presupposes a definition of an equilibrium (or an arrangement) between conflicting interests (the analysis of classical economists identified the subdivision of social groups with different interests in capitalists, rentiers, and workers). In this approach, normative suggestions show a significance as they express a political choice (value judgment) in favor of a given set of solutions to the dialectics between social groups. The Marxian one, for instance, is an extreme choice because it requires the elimination of private property of capital and, as a consequence, of the capitalists and rentiers classes. Within the field of those who accept a private property of capital (safeguarded by the State born from the "social pact"), decisions on the amounts and forms for social interventions are entrusted to the decisional process of public budget formation. Under a normative profile, to ask – in a given country, in a selected historical time – more (or less) extended social interventions means to express distributive choices and so, a priority between alternative destinations of available resources.

It is just the case to note how such choices for public budgets, which reflect – within the limits of decisional processes in parliament-based democracies – the majority preferences of the "sovereign people", also reflect priority choices referable to individual utilitarism logics (think about the diffuse resistances by taxpayers-voters to give up higher fractions of their disposable income to finance new social expenditures. This theme is discussed later). Going back to the roots of the "social pact", a normative instruction may be found in the constraint which limits social spending reductions above the safeguard level of such a pact, because under that level the unfavored socio-economic classes might consider the pact broken (historical cases of revolutionary movements are known).

The historical-political approach does not allow to go beyond an investigation of the contents of the "social pact", and of possible demands of modification in regards to the evolution of existing social organizations. It does not allow to express "moral" judgments on the conflicting ideologies and interests, focusing instead on the historical outcomes of such conflicts and on the causes provoking those outcomes. Those who recall specific "ethical" (or religious) principles which, on the other hand, are supposed to guide human behavior, intend to go further and to provide an answer to the question why some people and social groups pretend a given organization of society is superior to the others. In the previous paragraph I reminded the recent "social justice" theses mostly applied for the proposition of social policies: the theses by Rawls, Marshall, Sen in particular (see note number 9), which configure "primary rights" (of "citizenship") for everyone to obtain a given set of goods and services, supposed to be required (but not sufficient) to realize the principle of "freedom" and the objectives of "human development".

Some economists underline the fact that those "principles", since they imply value judgments, are not analytically comparable between them nor with the principles of individual utilitarism, and for this reason the economic analysis should stop upon facing their statement (limiting itself to an examination of the economic effects of the provisions inspired by such principles). As a matter of fact, an evaluation of these principles and their implications appears mandatory when the motivations for social spending are sought. I will argue in the following discussion that an insight of such motivations is a necessary requirement for the evaluation of the "sustainability" of social spending[12].

12 As I am going to argue, if the conclusion is reached that social spending is – within some limits – an essential factor for the "sustainability" of the market economy system with privately owned capital, then social spending is – within those limits – "sustainable" by definition. The question turns upside down and asks under which level of social spending the risk of surviving for a given system, in a given historical period, may prove positive.

In case "value judgments" which refer to a (or a set of) ethical principle(s) of social justice are accepted, a number of difficulties arise and may impede to obtain, from such principles, concrete specifications for social policies operative choices.

A first difficulty, conceptual in nature, concerns the universality which by definition relates to ethical principles. Indeed such principles need to be interpreted as valid for the whole humanity, and not limited to restricted social ambits as opposed to the entire world population. To exemplify, if the application of these principles through social spending was limited to the number of most industrialized countries – building only in these countries for them universal and egalitarian welfare systems, aimed at protecting against social risks and poverty, and with a public provision of healthcare, education, housing and other primary services – but at the same time the majority of humanity was left in poverty and underdevelopment, the intrinsic feature of universality of these "ethical" (or religious) principles would be betrayed.

The reference to "sovereignty" of each State would not be appropriate to justify the violation of the ethical principle on an universal scale, because transfers of resources ("international aid") which most advanced States may provide to underdeveloped countries are subject to explicit choices of their public budget policy. In budget policies the allocation of transfers to poorer countries compete, indeed, both with alternative public uses (and between them, also the internal "social spending") and with private uses of the resources (as affected by the level of internal taxation). The scarcity of the "aid" from advanced to backward countries, in comparison with alternative destinations of private and public resources[13], is the demonstration that public budget policies of the advanced countries, even though they provide ample resources to the internal social spending, cannot be considered compliant with the "ethical" principles considered above, because they do not respect the essential principle of universality[14].

A second difficulty in translating "ethical" principles into concrete actions of social policy regards the quantification of such interventions, a fundamental moment of the expenditure choices because it requires a definition of the scale of priority for social expenditures in comparison with other uses of public and private resources.

A typical case is the healthcare policy, which supporters of the ethical principles (specific egalitarianism, citizenship rights, human development capacity) affirm should be directed primarily to the objective of satisfying the "needs" of health[15], in compliance with the criteria of universal accessibility, gratuity of the services at the point of need, of equal treatment of equal needs. But, how these "needs" are supposed to be quantified inside public budgets?

In the real world, the health "needs" are defined by medical decisions. Doctors make diagnoses and choose therapies[16], while the costs for operations express their production functions. In the abstract neo-classical world, the allocative efficiency is reached because it is supposed that all agents maximize their utility functions (their income) and that the prices of production factors are determined by their marginal productivity. Besides, all agents have at their disposal complete informations, they operate in absence of uncertainty and in perfectly competitive markets[17].

It is known that such hypotheses are not verified in the observable reality. The relationships between doctors and patients, pharmaceutical manufacturers and doctors, purchasers and providers,

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13 Currently E.U. States assign about 0.5% of GDP to developing countries.

14 An analysis of the forms of such aid to poor countries (in money, in goods and services, in transfers of technologies and know-how, in direct productive initiatives, in favorable trade and tariff policies, etc.), and of the choice of recipients (States, non governative organizations, and others) goes beyond the scopes of this work.

15 See for all OLIVER (2005), who reminds that Labour party in its electoral program in 1997, when it came back to government, affirmed that the only aim of medical policies should have been to satisfy health "needs".

16 In medical economics research it has been observed that also public healthcare systems which are inspired to the principle of "need" tend to put an emphasis on curing medicine, ignoring the stages of prevention and timely verification of pathology, in a way that makes successive therapeutic stages more difficult and costly.

17 It is known that the model of "efficient" general equilibriums requires more restrictive assumptions, which further complicate the transition from the abstract normative model to concrete programs of intervention.

are conditioned by asymmetric information, and a "moral hazard" is easily presumable. Even more important, conceptually and operatively, production factors prices (the remunerations for healthcare services operators, profits and wages of the enterprises) are not determined according to their marginal productivity.
The above-mentioned criticisms to the Paretian definition of efficiency make the quantification of social "needs" problematic, in the example of health "needs". Given the same amount of healthcare services, a new contractual agreement which rises wages and salaries for the operators of this sector, also rises the quantification of the "needs", and so, of the public expenditure which has to satisfy them. The "Baumol disease" is known, which brings to inflate public services costs having a social (redistributive) purpose, determining as time goes by increases of the fraction of income devoted to such social expenditures[18].
For these reasons, a reference to "needs" to determine social spending, as it should be derived from the above-mentioned "ethical" principles, appears for many concrete reasons (in the example provided for the healthcare policy), inadequate to quantify social policy interventions. This is an important limitation, because the question of the "sustainability" of social spending resolves substantially around those decisions related to the quantity of social expenditure, compared to the quantities destinated to alternative uses of the available resources.

2. Social policies: redistribution in money or in kind?

I recalled before that, independently of any conventional definition, social policies are identifiable because they aim at redistributive objectives, changing the distribution of real resources (of the powers to "command" over the uses of such resources) which would otherwise result from the actions of free markets and from the initial distribution of property rights. Social policies are, as such, bound to face a preliminary choice whether to adopt redistributive interventions in "money" or in "kind". It is indeed possible, with a decision exogenous to the market, to assign resources to the people who are supposed to have inadequate availability, by transferring money to them, or by offering them some goods and services at no charge at the point of need (financed by the general public).
Those economists who are convinced about the superiority of the decisions taken in competitive markets – where, accepting the many limiting assumptions on which the general equilibrium theory is built, solutions of an "optimal" equilibrium may be obtained – affirm that redistribution must be mainly done in money, so as the recipient may maximize his utility under a higher budget constraint. A redistribution in kind tends, on the other hand, to violate the basic principle of consumer sovereignty - which is fundamental for the neo-classical construction[19] - as free choices of consumers are mandatory requirements of an efficient resource allocation.
Indeed, in a neo-classical world a redistribution in kind may find a reason only as a form of intervention against "market failures", such as a presence of near-public goods, information asymmetries or moral hazard[20], or other imperfections of real markets depart from the purely competitive model. So, redistribution in kind remains in a position of theoretical inferiority in comparison with redistribution in money (which the 2° fundamental welfare theorem refers to). Under a normative view, the proposals of a redistribution in kind should be sustained by choices drawn from an utilitaristic social welfare function, while the usual non-utilitaristic motivations

18 See BAUMOL (1967); LINDBECK (2005); NIXON, ULMANN (2006).
19 See. MUSGRAVE (1959), pp. 13 and subsequents.
20 See the analyses by MUNRO (1992), and BLACKORBY, DONALDSON (1988) who, with regards to health services, show that under asymmetrical information and other assumptions, the redistribution "in kind" may result more efficient, under Paretian criteria, than redistribution in money.

(specific egalitarianism, etc.) to such redistributive actions would not be logically compatible with the utilitaristic neo-classical construct and with the “welfarist” criteria of defining efficient solutions[21].
The alternative approaches, assigning a higher priority to a redistribution in kind in social spending programs, start from the objection to the neo-classical theory assumptions, or to some qualifying aspects of it. They reject the idea that the economic agents' behavior (both public and private) only obeys to utilitaristic motivations, because in such a vision it is ignored the role of values such as the recognition of a centrality of the person in every activity, the altruism, the awareness to belong to a social organization, which are all fundamental drivers of the human behavior. I noted in previous paragraphs that the majority of those theories which consider economic decisions as founded (also) on non-utilitaristic motivations, result in prescriptions in favor of social spending in kind (healthcare, school and formation, direct assistance, programs for labor, provision at no charge or at political prices of some goods and services considered essential to the person).
A different objection to the principle of consumer “sovereignty” highlights the meaning of such “sovereignty”, since it would not be fully free, but instead conditioned by limited informations a consumer is able to obtain. This consideration to the conditioning effects of advertising on the real freedom of consumers choice dates back to the '20s and '30s, with the researches on market imperfect forms. Warnings about the inability of consumers to realize their preferences are already found in the classical economists[22]. More recent studies on information asymmetries have extended and deepened the reasons for doubting on the consumer “sovereignty” in many markets.
The neo-classical economist may answer back by observing that such causes of “market failures” and the proposition of economic and regulatory interventions to correct them[23], remain inside the Paretian logic and of the welfare economics. But the recognition of such market failures, which express imperfect consumer choices, may open the way to a social spending in kind, since it substitutes the allocative decisions of the consumer with those taken in public budgets.
When formulating the category of “merit goods”, Musgrave acknowledged they represented “deviations” from the basic principle of consumer sovereignty, and tried to reduce their importance and extension in his normative theory (which is explicitly neo-classical) of public finance[24]. The distrust against social spending programs in kind (public provision of goods and services) which is found in some literature and in economic policy debates[25], shows indeed deep theoretical roots. For many authors, consumer “sovereignty” is the demonstration that in systems founded on political democracy it is possible to realize an economic democracy through free competitive markets[26].

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21 The logical incompatibility between an evaluation of actions motivated by non-utilitaristic criteria and the evaluation of their effects under the Paretian criteria is already recognized in MUSGRAVE (1959), pp. 9 ,13, 21, 133-5. See also ARACHI (1993) and the authors cited in his work.

22 See the citation of SIDGWICK (1891) in STEVE (1976).

23 The establishment of “consumer unions” is an empirical sign of the lacking of informations to individual consumers.

24 MUSGRAVE (1959), as noted in previous note n. 19 and at p. 89.

25 An uncertainty is widespread and visible in political (and also of trade unions') authorities and leaderships of many countries, about the choice to assign to low and medium income rentiers new public transfers in money and higher fiscal reductions, or to give them benefits through social public expenditures in goods ans services (healthcare, education, public housing, political prices for some goods and services, etc.).

26 Policies for healthcare services in contemporary advanced societies offer some representative examples of the difficulties encountered when trying to reconcile a redistribution in kind with the principles rooted in mainstream economic theory. It may be noted that: still today (Spring 2008) the United States keep a privately managed healthcare system (even though corrected by public programs in favor of old cohorts and the poor); in other countries, and also in the E.U. (for example in Federal Germany), the health system is organized and managed according to the mutualistic model based on labor relations, and they accept that citizens with middle to high income opt out not participating in the mandatory social insurance. In those countries which chose the public healthcare model, universal and egalitarian, spaces are searched to let some freedom to consumer choices and occasions to introduce “near-market” forms: “tickets” are introduced to re-establish a relevance for income in consumer choices; complementary and supplementary private assurances are encouraged (a theoretical paradox may be seen in United Kingdom, homeland of the public healthcare service, where the majority of health economists follow the utilitaristic

It would therefore seem that the mentioned criticisms to the consumer "sovereignty" principle intended to highlight some limitations for its application to real world systems, rather than to question its fundamental role for determining resource allocation, which would substantially be governed by consumer preferences. Instead a deeper criticism, often overlooked in literature, does not accept that resource allocation decisions may be traced back to (free) sovereign consumer choices.

The problem is whether consumer choices (subject to their budget constraints, in other words to the distribution of wealth) stem out of "innate" preferences, and to what extent, or instead those preferences are influenced or generated by the decisions of enterprises, which choose what goods and services to offer on the market. Behind the supply of goods and services, indeed, there are the decisions of enterprises as to what direction research should pursue (and be financed for) in order to provide new products, or modifications of existing products, and which investments are to be undertook to enlarge or innovate supply, until large-scale commercialization. Such decisions of the enterprises and their timing, reflect not only technological progress, but also a competitive action between firms and sectors, and they consider economic constraints of fixed capital depreciation and selling of inventories.

The production system aim namely at creating between consumers a consensus, necessary to convalidate production choices – from research to commercialization –, and this fact is much more relevant than advertising *strictu sensu*. Consumer tastes are (at least partially) oriented, molded, modified by firms which act, in their role of enterprises[27], also in the fields of mass information, free time activities and in those which are functional to handle social relations. A web of activities and interests, having objectives and constraints that are commercial in nature (as the invested capital must at least earn the market rate of return), operates to build, spread and make it prevail among consumers those "models and styles of life" which need, to be followed, those types of goods and services decided by the production system, which invested in them (anticipating necessary capitals to research, development, production, commercialization).

It seems to me, therefore, that the statement market economies would be dominated by consumer "sovereign" choices may point to one of the variables (the innate preferences) explaining resource allocation in contemporary market economy systems. But at the same time, the decisions of enterprises, proposing and realizing those goods and services which are functional to the "lifestyles" proposed and spreaded by the firms themselves, are equally, and even more, important defining variables. Such a complex system of decisions is completed with collective choices which influence resource allocation, either directly (public consumption and investment) or indirectly (through taxation and transfers in money, and also through regulation).

If such a complex decisional model of the use of resources in contemporary market economies is accepted, the statement that consumer sovereignty governs the allocation of resources in such economic systems consequently fails; and it also fails the corollary according to which public redistribution has to favor money transfers, in order to be compatible with the principles upon which the system is founded. Moreover, the criticism of "paternalism"[28] moved against public supply of goods and services does not prove valid, since it would substitute consumer sovereignty with the political process forming public budgets. In contemporary social organizations with market economy, the resource allocation is not traceable back to a single decisional set (the exogenous consumer preferences), but instead to a multitude of decisional sets, being significant also those of

approach).

27 They are, indeed, enterprises which invest private capitals and follow the rules of any other commercial enterprise.

28 The criticism of "paternalism" to social spending programs, which substitute public to consumer choices, has deep implications in regards to resource allocation, because it rises the question of democratic (substantial) legitimacy of the majority group's power to take the place of individuals in their consumer choices. The fear is also to legitimate, in such a way, the action of single groups of interest may try to manipulate the "paternalistic" role of the State in affirming their beliefs or interests about how citizens should operate their choices. See STIGLITZ (2005) pp. 69, 70.

enterprises and of public authorities.
Redistributive transfers in money leave the allocative decisions to consumers and, behind them, to the strategic choices of enterprises, which orient consumers toward those purchases which validate investment and production choices of the firms themselves. Transfers in kind are decided through political procedures, which are distinguished from consumer choices based on individual utilitarism, and from the strategies of firms looking for the profitability of invested capital. Both forms of redistributive transfers, in money or in kind, are legitimate candidates to be used within market economy societies.
This conclusion opens the way to a research of different arguments to be offered as a reference for choices of social spending policy, on which the debate is still alive today.

2.1 The "sustainability" of social spending in current debate

In an important contribution on this theme, Lindbeck[29] detects five fundamental factors which induced and allowed a relevant increase in social spending in developed countries[30], in the period between the end of the '40s and the first half of the '70s: (1) the constraint imposed by international economic interdependencies, which is still weak; (2) relatively small unit costs of production for human services provided by the public sector; (3) a favorable demographic ratio between active and inactive workforce, and the swift growth of labor productivity and, so, of the taxable economic base; (4) a low unemployment rate; (5) the still limited effects of tax wedges and "moral hazard".
From the '70s ahead, these factors would have affected more relevantly the economic systems' ability of developed countries to "sustain" social spending growth, until a point where they started to constitute bonds which today, and in the forecasts for future years, would bring the question to the governments - in dimensions which cannot be disregarded and with a time schedule which cannot be postponed anymore – about if, and how, social spending growth inherited by previous decades is still sustainable.
Lindbeck separates the above-mentioned factors between those which are totally or mainly exogenous to social spending processes (those are the factors marked with n. 1 and 2) and the ones with stronger endogenous features, meaning that they significantly reflect behavioral reactions of private agents to social spending processes (factors number 3 and 4), or are fully endogenous by definition (factor n. 5). Such a distinction between exogenous or endogenous factors threatening the "sustainability" of social spending is undoubtedly relevant.
Nevertheless, in this article I prefer to stress the distinction between factors which stimulate, demand-side, an increase of social spending, and factors which determine supply-side the capacity of the economic system to provide real resources required to satisfy demands (both potential and

29 LINDBECK (2005). In the vast literature analyzing leading (and limiting) factors of the remarkable social spending growth between the '60s and the '80s, see LINDERT (1996) where the main explicative models are reviewed. In an attempt to forecast future (up to year 2020) tendencies of social spending, the author underlines the impact of demographic growth and of "deadweight" factors represented by administrative costs and efficiency distortions.

30 As in Lindbeck's analysis, this paragraph substantially considers the experiences of Western Europe countries (E.U., before the new entries of former planned economy countries), omitting the peculiarities of the United States socio-economic system in comparison with Europe. Anyway, many of the considerations are still applicable also to the U.S.. A comparison of U.S. and E.U. redistributive policies is found in ALESINA, ANGELETOS (2003), where the influence due to different prevailing views on the causes of economic inequalities (whether they reflect different skills and labor commitment, or they depend from exogenous factors such as inheritances, social and political relationships, and also operative open-mindedness) are examined. It should be noted here that in a previous work, ALESINA, GLAESER, SACERDOTE (2001) highlighted how racial prejudice makes redistributive policies less appealing to large voting categories, because the poor are relatively more common within Afro-American communities. They also observe how the North American political system limits the rise of a party representative of the poorer classes (differently from the historical events observed in Europe).

effective) for social spending[31]. The incomplete capacity of supply, in a given historical moment, to satisfy (in real terms) social spending demands generates their "rationing", under usual schemes of micro- and macroeconomics theory.

I believe that the best starting point of this analysis is the interpretation of the concept of "sustainability" for social spending. Currently adopted notion, in literature and in public choices for budget policies, refers to a specific ratio between public debt and GDP which should remain substantially stable over a medium-long term. Indeed this is the notion of intertemporal "sustainability" of the public budget policy, such it is acknowledged by the E.U. and to which Member States bounded themselves under the "stability pact". It appears immediately applicable to social spending, because its notable growth in public budgets between '40s and '70s, and the levels reached by it (more than 60% of total public spending on average in E.U. countries and in the United States)[32], mean that a continuation of such a dynamics for "social spending" would run into the "sustainability" constraint of budget policy.

Since, on the other hand, those factors which contributed to social spending growth still operate in advanced societies (recently it added to them the effect of populations aging), the question of "sustainability" for public budget is more and more identified, in theoretical and political debates, with that of social spending "sustainability", since it is the most important and dynamic element of public expenditures. Moreover, this substantial identification between the "sustainability" of public budget and social spending, also reflects the widespread idea that the economic use of resources in production activities (private and public) is the requirement which allows to distribute a part of the domestic product to those who did not contribute to produce it (the receivers of social benefits). So, even in public budget policies the expenses devoted to sustain or accomplish investments and production of goods and services, would have a higher logical priority in comparison with redistributive social expenditures[33].

It seems to me that such a notion of "sustainability" of social spending should be carefully

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31 There are interrelations between factors of demand and supply, which I will point out later in the text, but the arguments I am going to discuss will show that this conceptual distinction is important, both for the analysis of "sustainability" and for implications to be drawn for public budget policies.

32 See LINDBECK (2005), p.2

33 This argument should not be applicable to public social expenditures which, directly or indirectly, contribute to the formation and qualitative enhancing of human capital, which is a production factor: expenditures for education and professional training, for healthcare and for goods and services essential to a laborer's productive capacity. The investment productivity of resources (especially those devoted to education) redirected by redistributive policies to agents with higher credit-constraints is examined in BÉNABOU (2000). The author finds that, comparing a society with higher inequality and lower redistribution with another society which features lower inequality and higher redistribution, the forecast on which one will reach faster income growth depends on the combined result of two counter-balancing effects, that is, distortions to incentives caused by redistributions, and higher productivity brought by social investments. However, in the debates these distinctions are often ignored, and a dialectical shortcut is used according to which "it cannot be redistributed that which was not produced" (assigning all "redistribution" to social spending), and "the best way to help the poor is to make the national product grow adequately", because in this way redistribution is eased (on such arguments see also STIGLITZ, 2005, pp. 66 and subsequents). On the other hand, it may be presumed that, in the current historical period, the dampening of attention to the contribution many social expenditures give to the formation and quality of human capital reflects, more or less consciously, the observation that emerging countries in international economy, and especially in Asia (China, India and others), put the "competitiveness" of traditionally more advanced countries to the test, thanks to their lower labor costs (inclusive of social contributions). The relative backwardness of social spending in emerging countries and a lower quality of life for their laborers do not seem – currently – to impede that in those countries labor is exerted in conditions of very high productivity. Indeed, in such emerging countries those social expenditures which are more tied to the formation of human capital – i.e. for education, professional training and research – are strongly selective (aimed at forming future leading and technical classes in various sectors of activity) rather than "universal" as it is desired in E.U. countries (and, partially, in the United States). Lastly, the comparison between the contribution to national product of private employments of resources and that of public employments is made difficult by the fact that the former is evaluated at market prices, while the latter is evaluated at factor cost: on this theme see the exhaustive observations by STEVE (1976).

considered. The economic founding of the concept of "sustainability" is the technological frontier of possible productions, which imposes a rationing of potential demands, private and public, in a way to respect the supply constraint imposed by the availability of production factors (capital, labor, non-reproducible commodities "by means of commodities") and of known and economically efficient technologies. But, there are *n* combinations of utilization for production factors which respect the general supply constraint, so the "sustainability" cannot be the criterion for choosing between such possible combinations. The "stability pact" agreed between E.U. member countries is an explicit confirmation of the understanding of the economic meaning of "sustainability". The intertemporal bond for public budgets is, indeed, proportioned to the balance deficit (flux) and to the existent debt (stock), and not to the ratio between private and public consumptions, nor to the "social public spending" category. From a practical point of view, the E.U. "stability pact" imposes to member countries to finance public spending (of any kind) through a simultaneous reduction of private spending (increasing taxation), so as to globally maintain the utilizations (private and public, for consumption and for investment) within the bonds of production supply. The choices about dimensions and compositions of public budgets are left to the collective (political) decisions inside each individual country[34].

Thus said, nothing impedes that a single E.U. member country decides to have a higher ratio – in comparison with the E.U. average – between social spending and global public spending, and/or between them and national product, as long as the higher public social expenditures are financed with correspondent taxation (or, which is the same, with a reduction of disposable incomes for private uses), or with compensating reductions of other public spending categories.

Decisions about social spending policy cannot therefore be referred exclusively to the notion of "sustainability", which imposes the global bond of an equilibrium (at current prices, to avoid a rationing by inflation) between global demand and supply, but it does not offer choice criteria between the *n* possible allocative outcomes for production factors and their relative distributive structures. To exemplify using the same terms as current political debates: is it acceptable an increase of social spending financed by an increase of taxation of those private consumptions which are not strictly necessary? Is it acceptable to give up new social spending to finance a reduction of taxation on labor and capital incomes? These examples which have been taken from the observation of political debates around E.U. countries, may last a long time and lead to a rethinking on the priority scales effectively adopted in budgets formation, not only in regards to the dimensions of them (of the taxation), but also in regards to the destinations of spending decisions between different expense categories (even within the same "social spending" category).

In the view of the researcher in economics, and particularly in public economics, the weaknesses of the neo-classical normative theory arise (see previous paragraphs), even though it offers the analytical apparatus still prevailing in literature. It is known that the attempts to build a social utilitaristic welfare function met (until today) insuperable practical and theoretical obstacles, so the field of collective choices which determine dimensions and compositions of public budgets remains outside of the neo-classical model, and the same is true for the global structure of allocation and distribution of production resources throughout the system. On the other hand, the introduction inside the normative theory of "non-utilitaristic points of views"[35] on income distribution – such as "merit goods", "specific egalitarianism", "human development capacity"[36] - offer to public action

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34 With this formulation, the E.U. is also neutral in regards to public enterprise, as long as it respects market regulations.

35 See ROSEN (2003), pp. 98 and subsequents. FEHR, FISCHBACHER (2002), recalling the many contributions from previous authors (already in A. SMITH, 1759), vigorously criticize a tendency shown by a part of the economic literature to forget that in the fields of social choices, of negotiations and of incentives to market decisions, the selfish interest is not sufficient alone to explain agents' preferences. The authors propose the hypothesis that reciprocal fairness in such fields influence preferences more than traditional selfish motivations. See also FONG (2002).

36 See authors cited under par. 1.2.

perspectives which are not (individually) utilitaristic, but rather solidaristic and moral, and thus of a too general kind to be used as practical choice criteria for the dimensions and structures of social spending policies. That is, and again to exemplify, which criteria derived from such non-utilitaristic principles should be used to detect and quantify the limits between solidaristic redistribution and the legitimate claim of production factors to obtain satisfying real disposable incomes (net of taxation)?
Going out from the schemes of the normative theory of public intervention, the positive analysis of the motivations behind the impressing growth of social spending between '40s and '70s, and the analysis of subsequent preoccupations, expressed by scholars and political and economic operators, on the "unsustainability" of social spending, point out that the actual reference to "sustainability" became a way, only apparently technical, to recognize the existence of distributive conflicts in society between active-taxpayers and inactive-receivers of public social spending[37]. Worries about a possible worsening of such distributive conflicts certainly arise from the worsening of the (current and expected) growth rate of economies with older industrialization, because it enhances a "rationing" of demands.
But, the reference to the "sustainability" of social spending contains an implicit value judgment, that is in a scenario of relatively smaller availability of resources, public social uses should have assigned a lower priority than private consumptions, even in comparison with unessential private consumptions. Assuming a different value judgment, it would appear legitimate – keeping the same arguments – to refer to a "sustainability" of unessential private consumptions[38].

3. Choices for social spending policies

The slowing down of average growth rates in countries with older industrialization, together with an uncertainty on the expected evolution for future years, reflect the growing competition from emerging economies and the increasing pressure from international demand on relatively scarce product inputs (energy commodities and other primary commodities, and from a perspective point of view, some environmental resources). No technological innovations are yet on the horizon which may be comparable to those that, during the industrialization in previous century, allowed to keep at bay the "specter of stationary state" depicted by Ricardo.
It is therefore absolutely necessary, being forced to face current and expected lower growth rates for the general availability of goods and services, that the governments of advanced countries do care about favoring and stimulating increases in the average total productivity of factors, about directing resources to investments in innovation, about restructuring and converting productions, about rewarding labor productivity with proper wage incentives (net of mandatory fiscal contributions) while impeding a worsening of industrial relationships. With regards to such concrete preoccupations on technological and productivity growth and on qualitative enhancement of the production apparatus, it may seem unavoidable that social spending decisions are going to be determined, substantially, in a residual way.
But this approach to social spending does not seem correct to me, even if ethical and ideological

37 As I hinted before, not the whole social spending is, strictly speaking, ascribable to the "inactives", because a significant share of it is destined to form and increase human capital, which is a production factor.

38 In advanced societies, there is an ample set of unnecessary consumptions which could be reduced to free resources that could then be destined to different allocations, such as to social spending. The objection is that such a choice would hurt consumer "sovereignty", but this "sovereignty" expresses the wealth distribution, which is fundamentally exogenous to the neo-classical model, and it is widely considered by producers' policies, as described above in the text. A higher economic weight, in my opinion, is shown by the argument that possible reductions of consumptions of some unnecessary goods and services have to be carefully planned over time, as they involve significant reductions of the production activity for those sectors which provide them, and thus may bring negative consequences on income and employment in those sectors, during the transition to new allocative states.

reasons in favor of a solidarity and dignity of each person are to be put aside, to give absolute priority to objectives of national product growth.

I already observed that a share of social expenditures is destined to contribute to education and to the improvement of human capital, a production factor of great relevance for the "competitiveness" of industrialized countries which are partially (or nearly totally) lacking of energy and other primary commodities, and socially unable to compete with emerging countries in the fields of monetary cost of labor and of a wild exploitation of natural resources. Industrialized countries may find in their quality of human capital their most important weapon to retain a central role in international productive specialization, in such a way to keep (at least) the high standards of living reached today for their people.

It may be of interest to recall that one of the not strictly utilitarian principles of equity, which the scholars most convinced of a superiority of the market economy competitive model are mostly willing to accept, is the "equal opportunities" principle[39]. Indeed, it remains within the logic of the "efficient" competitive model to ask that all production factors are employed at their best capacity, in order to reach the technological frontier of productive possibilities. To achieve "equal opportunities", even with a multitude of possible specific interpretations of such principle, it is also required a social spending (in a context which includes social mobility and recognition of individual merits) to offer equal opportunities to those who would be excluded due to an insufficient (household or individual) income.

This contribution to the formation of a human capital and to "equal opportunities" allowing the most "efficient" use of all potentially available product factors, candidate a significant share of social spending to merit a higher priority between different (private and public) allocations of resources. But there is also another argument, applicable to all categories of social spending, which gives reasons for putting them on a high priority (if compared, for example, with unnecessary private consumptions) and even with regards to the objective – that cannot be disregarded today by European and other industrialized countries – of stimulating and favoring a productive growth of economy. I discussed this argument in a previous paragraph, where I noted that, at least in a majority of E.U. countries, large sectors of society consider social spending as a integral part of the "social pact" which resides at the base of the acceptance of market economy and public enforcing of private property of capital (both generating distributive inequalities in the power to command resources, in connection with an equality in political rights). This argument leads to conclude that social expenditures are a relevant factor of "sustainability" for the economic system organized as a market economy with privately owned means of production.

The acknowledgment of a high priority level for social spending in socio-economic systems as those existent in E.U. countries, does not authorize to underestimate the importance and urgency of reviewing some choices and procedures of social spending policies today. At the beginning of this paragraph I highlighted how, in current conditions of globalization and growing tensions in regards to the supply of relatively scarce commodities, advanced countries should commit themselves to policies aimed at stimulating and favoring innovation and the efficient use of production factors within productive processes. Such commitment should certainly be extended to social policies.

To this end, it seems appropriate to go back to the cited analysis by Lindbeck on the main factors which threaten the "sustainability" for social spending in E.U. and other industrialized countries. I already considered the effects of growing international interdependencies between economies in regards to the growth rates of such countries. These interdependencies also tend to rise the structural unemployment rate in traditionally advanced countries, and so they generate additional pressure on social spending demands, while the taxable wage base tends to shrink[40]. I believe the other factors of "menace" to social spending, as they have been pointed out by Lindbeck, merit further research in depth.

39 See MUSGRAVE (1959), pp. 19-20.

40 See LINDBECK (2005), pp. 3-7.

3.1 The rising costs in the supply of human services, or "Baumol's Law"

The assumptions upon which the well-known "Baumol's Law" (or "cost disease" for labor-intensive social services)[41] are still verified in current advanced countries. Generally speaking, it appears technically hard to stimulate (through more capital and new technologies) increases of productivity in the supply of human services. Productivity dynamics of industrial sectors and of modern corporate services appear swifter, currently and in perspective, and their wage growth also lifts the low-productivity wages of human services[42].
Lindbeck defines "fallacious" the argument, sometimes proposed during political debates, according to which an increase of productivity in industrial and innovative sectors, since it makes their taxable wage bases grow more rapidly, would allow a growing financing of the human service sector: "the intuitive reason is that a more rapid rate of productivity growth, and related real wage growth, in other sectors would, in fact, raise the wage costs for human services at the same rate as the tax base (still assuming the same path of wage rates in both sectors)"[43].
This objection by Lindbeck is unquestionable if the assumption is maintained that the entire increase of labor productivity is assigned to laborers, and that fiscal and contributive charging on their remunerations remains at a constant global tax rate. The assumption equals to assert the growth of labor productivity should be assigned so as to allow workers an increase of their expenditure capacity on private consumption markets. It is, therefore, a statement which contains precise "value judgments". It is ideally (and ideologically) bound to the thesis of "consumer sovereignty", based on the idea that an individual is the best judge of his interests. I already discussed many reasons to doubt this position[44], which finds origin also in traditional trade unions' claims risen by the will to avoid enterprises to take possession of a share of the labor productivity growth, which would thus increase their share of profits[45]. But this "trade-union approach" cannot forget that there is not only the choice to assign labor productivity growth to wages (and so, mainly to private consumption) or to profits, there is also the choice between private and public consumptions (or redistributive public transfers). The "value judgment" according to which, in current Western societies, allocative and distributive objectives satisfied by social spending are priority in comparison with "utilitaristic" (individual) objectives which are satisfied by many of the expenses for unnecessary private consumptions, are at least as equally legitimate as those value judgments which suggest the thesis of "consumer sovereignty" on the structure of resource uses.
Indeed, the strongest argument brought by union trades, in E.U. countries, is that workers of medium-low wage bands should not be the ones who finance the increasing costs for social services, through a cession of a share of the productivity rise ascribable to them. In this way, an issue on the distribution of taxation needed to finance social spending arises.
Under this profile, it is true that current fiscal policy trends in industrialized countries, and especially in the E.U., do not appear favorable to the "sustainability" of increasing social

41 BAUMOL (1967); BAUMOL, WILLIAM, BLACKMAN, WOLFF (1985).

42 The so-called "Baumol's Law" finds application also if a share of the human service, for example of the healthcare service, manages to take advantage of technological innovations (new pharmaceuticals or operative techniques) which rise the productivity rate: see BAUMOL, WILLIAM, BLACKMAN, WOLFF (1985); LINDBECK (2005).

43 LINDBECK (2005), p. 8.

44 Already in SIDGWICK (1891), cited in STEVE (1976).

45 As detailed in the text, trade unions also claim that "fiscal wedges" between gross and net retributions should be reduced (or kept constant) burdening other income categories (from capital, mainly hitting the "rentier" elements; or from self-employed jobs) with possible additional fiscal charges.

expenditures[46]. Even inside the E.U., some aspects of “fiscal competition between States” persist (these would be strongly reduced by political agreements between member States) in a way that motivates a preference for income taxation structures rather than capital and corporate (for its capital component) taxation. It may be noted that, if the reference is to social spending financing, taxation of income alone with progressive tax rates[47], which appears irrational according to the traditional logic of equity (horizontal and vertical), finds a rationale because it permits, at least (considering “impossible” to tax capital incomes more), to transfer resources to social uses burdening their financing to medium-high income workers, thus surpassing the objections brought forward to defend private consumptions of the lower incomes.
It falls beyond the scopes of this work to go into fiscal policy choices. It will suffice to highlight the following: he who expresses the judgment (political, or of value) that social uses of resources should have higher priority than some other uses for private consumptions, may point out that the State has at its disposal enough technical instruments, above all the taxation of unnecessary consumptions (or, also, a progressive expenditure tax) to induce a transfer of resources to social allocations.
A different question is if the majority electorates share, in the present historical period, such value judgments. Preferences of electorates are fluctuating over time, and frequent compromise solutions testify not only such uncertainty, but also a will to avoid dangerous political and social splits within each state.
I think there is another aspect to be made clearer in current debates around social spending. The affirmation of a “costs disease” is sometimes explained together with the argument that, in public labor-intensive services supply, there is an insufficient commitment to work, as it would lack the competitive whip which stimulates productivity and efficiency in private enterprises and threatens less competitive firms with the outlook of bankruptcy, or of dismissals (it would also lack a logic of professional promotions driven by merit evaluation). To address these issues some authors proposed, for those public sectors where it is applicable, the introduction of “internal market” organizations, in order to obtain freedom of choice of different “providers” for users/consumers, to define roles and opposing interests between purchasers and providers, and to force “providers” into a reciprocal competition. The attempts of this kind, which have been tried especially in the field of public supply of healthcare services, do not seem to give the expected results of higher productivity, allocative efficiency, innovation in technology and organization[48].
At the core of it, it was observed that the attempts to introduce a market logic into public sector clash against well-established (naturally and for self-interest) bureaucratic and dirigiste logics, favored (sometimes stealthily) by consolidated behaviors of political subjects. The crux of the matter is essentially political and cultural in nature, and related to a self-protection of particular interests: history shows that, for such aspects, cultural development is slow, even though in the long run it would appear to proceed, between discontinuities and some moving back. Analytically there is a point of contact with the problem of moral hazard (since laborers would simulate the work commitment agreed by contract), about which I discuss in the following 3.4.
Last but not least: a comparison between private sector productivity, measured at market prices, and the productivity evaluated for services payed by the State, is not strictly homogeneous. In current economic systems it is easily observable that market prices do not match the ideal Pareto-efficient prices (this is true also for those who accept the utilitaristic Paretian formulation and the distribution

46 The thesis of LINDBECK (cit.) appears therefore verifiable in observable redistributive and income policies. The element I would like to stress here is that a fiscal alternative, technically feasible, to the “Baumol's Law” do exists, even if today it is politically losing.
47 This is the solution adopted with the Scandinavian DIT, which today attracts favors and consensus from many authors of other E.U. countries.
48 See, within a very large literature on the subject: ANELL (2005) for the Swedish experience; OLIVER (2005) for the English experience; NICITA (2003); COMPAGNONI (2005); CREMONESE (2008).

theory based on the marginal productivity of factors). A large body of literature exists on the divergences between prices and private costs, and between prices and social costs[49].

3.2 Deterrent effects caused by taxation to finance social spending

In previous par. 3. I argued that choices between private and public allocations of resources are referable in the normative theory to value judgments, in concrete policies to contrasts in interests and collective evaluations which find mediations and syntheses through institutional procedures, and they end in public decisions which are accepted by electorates.

Many authors warned that, facing the relevant growth of public social spending in the second half of the previous century, the high taxation (both marginal and average) required to finance social expenditures may discourage decisions to work, to save, to invest in risky assets.

To the economist of neo-classical faith, any tax – with the exception of lump sum taxes – generate efficiency losses to economy, because they alter market prices for goods and factors which, in such model, have the task to send to economic agents the signals which drive them to Pareto-efficient choices. I already reminded how a part of the economic theory denies not only the practical relevance of this formulation (observed markets are far from the theoretic Pareto-efficient ones), but most of all, the logical validity of the distribution theory based on “efficient” relative prices upon which the neo-classical theory is founded. The statement according to which price distorting taxes cause allocative efficiency losses to the economy is, therefore, open to a number of criticisms.

From the point of view of positive analysis on the effects of taxation risen to finance social spending, it cannot be denied that the reduction caused by taxes of the expected remuneration of an agent, as his reward for an economic act (labor, saving, investment), may induce him to revise his choice to perform such act, or to perform it in different quantities from those initially planned.

To the social “policy-maker” this question presents itself in the form of a trade-off between social spending objectives and the keeping of incentives to economic activities, and at the time of intervention it becomes of utmost importance to know not only the sign, but also the dimension of possible deterrent effects. Unfortunately at present time we do not have at our disposal unequivocal and generally accepted estimates. As stated before[50], some doubts on the dimensions for substitution effects caused by taxes, couple with income effects (almost always of the opposite sign).

Between said doubts on the effects of deterrence, a conclusion which encountered ample consensus in literature regards public pension spending (generally financed by mandatory contributions on wages). It is stated that the passage from a “PAYG” system (repartition) to a “funded” system (capitalization) would increase the global supply of savings for the economy[51]. But, in a general equilibrium analysis, which appears necessary to analyze[52] the effects of structural modifications of the economic system[53], this statement is not immediately evident. PAYG systems were introduced to provide an answer to deep economic crises which put “funded” systems in the impossibility to accomplish their insurance functions: the “Great Depression” in the U.S., the consequences of the 2° World War in many countries which are today E.U. members (especially inflation which destroyed the real values of Funds' reserves). It is hard to imagine which evolution might have

49 The contributions by MYRDAL (1953; 1958) are to be recalled, and before, VON WIESER (1889).

50 See LINDBECK (2005), pp. 15 and sub.

51 See in particular FELDSTEIN (1971; 1995; 1996; 2005).

52 See LINDBECK (2005).

53 Such is a passage from a repartition to a capitalization system, as in E.U. countries the payment of pensions absorbs around 15%-20% of national income.

resulted for the economy, and for aggregated savings, if laborers' pension expectations had not been satisfied through the introduction of public PAYG, because the alternative might have been a socio-political crisis of the whole system.
The reasons for PAYG systems introduction cannot be forgotten. Indeed, the most balanced proposals on their substitution with “funded “ systems also include significant public interventions, in order to avoid new financial crises which would undermine (social) stability for the general system: rules and controls on the activities of assurance pension Funds, fiscal incentives to the accumulation of provident savings, the keeping of a public pension “pillar” in a way to guarantee a basic protection for those who cannot insure themselves properly because of insufficient incomes or limited periods of regular work.
Lastly, a point to stress is that while in the theoretical neo-classical model of balanced development the accumulation of saving translates, by hypothesis, in the accumulation of productive capital, in observable realities the conditions of disequilibrium prevail: the Keynesian lesson about the non-automatic transformation of saving into productive capital remains topical[54].
Moreover, a deterrent effect on labor supply is ascribed to social spending. In some cases, as with PAYG models and especially if they provide a defined benefit (a given substitution ratio between pension and latest wage, or an average value), this effect may be relevant and determined by the existence of clauses by law, which provide anticipated pensioning or pension ages that do not correspond to population aging any more. The answer to this is found in modifications of the law, taking note of the fact that the prolongation of average life expectancy should, rationally, bring to a prolongation of the working period.
In regards to the negative effects that subsidies (negative taxes) may exert on the unemployed (or on those who work marginally) who have the possibility to start a regular job, they belong conceptually to the field of “moral hazard” (on which see the following 3.4).

3.3 The aging of populations

One of the most frequently advanced arguments on the unsustainability of social spending, at trend figures, is the aging of populations, observed and expected for future decades on the basis of demographic projections[55].
It is said that the aging of populations forces governments to revise social spending policies, because their related legislations, designed and enacted when the ratio between active and inactive population was significantly higher than the current and expected ones, are not “sustainable” any more at current, significantly lower levels. These statements substantially hit pension policy choices and also healthcare policy, the latter in the sense that it includes long-term assistance and services to not (or partially not) self-sufficient elderly.
In brief, by highlighting the aging process of industrialized countries' populations (especially in the E.U.) the aim is to declare “Beveridge models”, which are universal, all-comprehensive of every necessary service to the “needs” and measured against needs, and financed by general taxation, as not “sustainable” any more, particularly in the next decades.
Many of the considerations expressed in previous paragraphs 3.1 and 3.2 may be extended to the consequences of demographic changes on the “sustainability” of social spending. There is no doubt that, in a framework of slower growth of national product, distributive conflicts become acute, not only between production factors (wages, profits, interests and rents), but also on the distribution of

54 BROADBENT, GRANDE, THOMPSON, ZOLLINO (2006) noted that in 2000 there had been, in many E.U. and OECD countries, an increase in savings among firms, which was only partially invested in productive assets, because it was mainly destined to financial operations or to an accumulation of reserves.
55 See EUROPEAN COMMISSION (2006, a and b).

production between active population, who participated to its creation, and inactive population because of malady or old age. The aging of population, since it increases the share of inactives and in need of medical and assistance expenditures, worsens this distributive issue[56].
But, this is not a problem which awaits a unique solution, nor a solution which is supposed to be preferred universally because of its objective superiority in comparison to the alternatives. Indeed, it is not an unchangeable rule the tendency to distribute the entire labor productivity growth to laborers in the form of higher disposable net wages (which presumably translate into higher private consumptions). Moreover, if the thesis here supported is accepted, that social expenditures are a fundamental part of the stability of socio-economic systems, also increases of capital productivity should contribute to their financing. The existence within real systems of extra profits and rents due to market imperfections may offer further opportunities to contribute to the financing of a growing social spending.
Of course, if a variable of the economic systems continues to grow over time, faster than fundamental real variables and of GDP, in the long run (or in the very long term, which is quite difficult to forecast) a level of "unsustainability" will be reached. But the crucial choice for economic policy is the time when to stop the growth of such variable, because in regards to social spending, arresting its growth at a given time means to freeze the obtained income distribution, in other words it means to pick a precise solution to the distributive conflicts. In its nature, this choice is not different from that of an income policy which fossilizes at a given time the share of profits and wages (often according to the argument that salaries, when they grow more than labor productivity, erode the share of profits). What is the distributive income solution definable as economically "sustainable"? The answer is not unique, because it depends on evaluations, in a given historical time and country, of the relationships (political, cultural, contractual, etc.) between parts of society.
The solution, currently supported by many authors, of a privatization (total or partial, with different grades) of public supply of pension transfers and medical services to old cohorts[57], configures one of the possible distributive solutions (still, not the only one nor the most preferred by everyone), being based on evident "value judgments". Equally legitimate – in the normative theory – appear those value judgments which assign a higher social priority to an employment of resources in favor of the old cohorts, to give them a dignified life and needed assistance, rather than employments in unnecessary and luxury consumptions, in speculative operations and in the accumulation – often fiscally privileged – of financial assets.
Positive analyses of recent and current historical experiences show that distributive conflicts find, in real systems, compromise solutions (and so, unstable over time) between clashing interests and claims which animate social dialectics. In E.U. countries, the approval encountered by proposals of "two pillars" pension systems, one pillar based on private assurance for those who can afford to pay adequate contributions to their expected benefits[58], and the other one, public, for those who do not have the income capacity required to "build" a future pension which is at least adequate to life needs, express the compromise solution between different "values".

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56 There are no technical shortcuts for the settlement of distributive conflicts. It is not a shortcut the passage of PAYG method to a "funded " one, because at any time national product must be distributed between actives and retired, and the (potential or effective) conflict on the redistributive choice exists independently of the existing pension model. A different question is if it is possible to demonstrate the "funded" model, in comparison with PAYG model, increases global accumulation of capital and so it contributes more to the development of national product: this issue is discussed later. It appears of great importance the statement by LINDBECK (2005), p. 12, according to which if, at a given time, the rules on pensions should substantially result in a loss of income for some social groups, "irresistible political demands for an overhaul of the rules may emerge".

57 See for all FELDSTEIN (2005).

58 Even within the ambit of PAYG model it is possible to introduce definitions of the pension treatment which are not correlated to the latest retributions with a fixed ratio, but instead determined according to the demographic trend and of the taxable wage base: an example is the "notional defined benefit" introduced in Sweden and later in Italy.

The contraposition between "value judgments" and the research for compromise solutions is evident also in medical policies: within "Beveridge" models a debate exists about spaces to be assigned to private assurance (and to "out of pocket" financing), to copayments for users, to a rationing of public provisions which are financed by general taxation. In the U.S. "privatistic" system, social pressures to enlarge the spaces of interventions of public programs (Medicare, Medicaid, SCHIP) are observed, and at least one political party asks for a substantial enlargement of the accessibility to healthcare services independently of personal income (and assurance). Within "Bismark" models, assurance and solidaristic components oppose and compose each other systematically[59].

I believe the acceptance by general public of solutions composing distributive conflicts (in this meaning I defined them as compromise solutions) may be eased by introducing in the debate, with more clarity, two observations and related proposals. The prolongation of the average life expectancy should be considered as a positive result, for society, due to economic and scientific progress, so it appears rational to charge its costs on society. It would seem equally rational that to the prolongation of average life expectancy, corresponds an increase of the pension age, because it would already slow down the effects of aging on pension spending dynamics.

The second observation leads to previous considerations on the choice between redistribution in money or in kind. The impression is that facing an aging of populations, European States were caught unprepared, not only (and maybe not that much) on pension policies, but also (and maybe more) on the correction of the organizational social structures to peculiar needs of the growing share of old age population. Personal assistance (both in individual and collective form) to the not fully self-sufficient elderly, choices on urbanistic policies, of transports, trade, spare time, were all designed and realized for smaller shares of old age population, thought as being stable over time.

I believe new meditations and choices, adequate to the aging of populations, are no less important than those on the financing of pensions and of additional medical services.

3.4 Moral hazard

Lindbeck[60] (2005) observed that moral hazard and deterrent effects of taxation are the most dangerous threats to social spending, because they rise the possibility that the welfare State cuts the branch on which it sits. And the author notes how in Western Europe about one-fifth of active population (between 25 and 64 years old) lives thanks to social benefits of some sort (including prepensions): "In today's advanced welfare states, the choice between labor force participation and benefit dependency is largely an issue of moral hazard".

When moral hazard is realized, social spending is quantitatively higher than what it would be justified by its objectives, while the taxable wage base is correspondingly lower. I would add the menace of moral hazard to social spending comes not only from such quantitative effects, but also from the discredit thrown at it in the eyes of the taxpayers-voters, who are more easily induced to accept the theses (the value judgments) of those who evaluate the redistribution, stated by existing social rules, as being excessive. Within the dialectics of conflict on income distribution, references to moral hazard, when it is presumed to be large[61], are a powerful weapon against the motivations

59 For the application in Germany of the "Bismark model", but with strong solidaristic corrections, see GRAF VON DER SCHULENBURG (2005). For a survey and comparison between healthcare systems of the industrialized countries see OECD (2004, a and b).

60 LINDBECK (2005), p. 3.

61 See LINDBECK (2005), pp. 16-20, and the references cited in it. See also FONG (2000) who states the relevant impact of prevailing beliefs on redistributive policy choices. The belief that poverty is mainly generated by factors which are exogenous to an individual's will, or the opinion according to which poverty is mainly tied to a lack of commitment to work or to other types of behavior, are possible explanations of the differences in social spending

behind a high social spending.
Many analyses are by this time available on cases of moral hazard observed in demands for social benefits, and so on possible measures to fight it. In brief, the conclusion is that the granting of some categories of benefits should be temporary, so as to be suspended when the recipient acquires again the capacity, or possibility, to work. The efficacy of some temporary clauses is, however, subordinate to the ability of the public body to enact recovery and requalification work programs, and of the economic policy to stimulate proper job opportunities. The efficacy of administrative controls is a requirement of such strategy against moral hazard. Controls become the main instrument when moral hazard is realized with the connivance of those who are supposed to verify the inability to work (i.e. doctors in charge), and to check the qualifications required to obtain a social benefit (such as true incomes, which often do not correspond to those fiscally assessed). In practice, it is evident how to "control the controllers" is always difficult (and costly), so the basic solution seems to be found in cultural progress of social sensitiveness (a theme for the ruling political classes and for mass media information).
Some authors underline that the quantitative limitation of granted social benefits (lower generosity) is a good antidote to moral hazard, because it reduces the incentives to live thanks to the social benefit rather than on labor. On the other hand, this choice risks to make social benefits insufficient for those who are truly forced into poverty not because of their choice (without fault), but for exogenous unfavorable circumstances.
Even better, a more extended use of transfers in kind, rather than in money, tends to reduce the area of possible moral hazard, because some of the services in kind cannot be transferred by the recipient to other people or to different kinds of consumption (for example, direct healthcare and assistance services cannot be transferred, excluding pharmaceuticals), and because services in kind may be declared non-transferable by law (for example, housing services through public housing)[62].
The case of prepensioning is often included in the moral hazard category. But, since in public pension systems the rules on pension ages are stated by law, the question lies on a collective (political) rather than individual choice. The law should set proper pension ages, and those who believe they cannot work until that age, for reasons related to health, should follow medical control procedures.
Administrative controls are imperfect, costly and prone to abuses. But, saying that for such reasons an indiscriminate reduction of social spending is preferable, neglecting the reasons which motivate such expenditures, not only ethical but also (and mainly under a historical profile) of social equilibrium, seems to me a "hazard" toward political and economic reactions that the giving up of

levels also according to ALESINA, ANGELETOS (2003), as already highlighted in previous note 30. This trend of research is based on the neo-classical normative theory, which justifies income redistribution between factors within a "perfect" competitive model as a function of their marginal productivity. Therefore, if real world economies work as described by the normative model, there is no need to redistribute incomes, since these would already be efficiently allocated by the market. A redistribution would only be acceptable for the agents' initial budgets, that means in real world, through a taxation of inheritances and taxes capable of affecting the "innate ability" of agents (see for example BOADWAY, 2004). For such reasons, if the prevailing opinion in a given society is that economic inequalities are mainly due to different levels of commitment of the agents (and not to differences in initial endowments) as it is verified under the hypothesis of moral hazard, that society will probably show less preference toward redistributive policies. As previously discussed in the main text, the same question is notably different if a not-neoclassical approach is considered according to which income distribution (even in a perfectly competitive model) is not legitimate by marginal productivity, but instead it expresses the outcome of social and political forces interaction. This question is relevant also to choose between pro-competitiveness labor market reforms. On the attempts and limits of such reforms, see the recent analysis by HOJ, GALASSO, NICOLETTI, THAI-THANH DANG (2006).

62 Some authors compared the effects of transfers in money with those in kind on health services, in a model which allows information asymmetries and moral hazard. The conclusions are that healthcare transfers in kind (a public supply of medical services) may result preferable, even according to Paretian efficiency criteria: see MUNRO (1992) and the authors cited in it.

social policy objectives may cause.

4. Conclusions

The existing worries about the causes which tend to increase – legislations unchanged – ratios between social expenditures and GDP in a great share of industrialized countries, and especially in the E.U., are certainly justified. In forecast scenarios which anticipate a slowing down of old industrialization countries' growth, the aging of populations, a positive elasticity of medical services demand to income, the low dynamics of productivity in the production of human services, are factors which tend to significantly rise the GDP share destined to recipients, to the detriment of the (not subsidized) actives and of the beneficiaries of other public expenditures. The expectation that such a disadvantageous process for active laborers is destined to last over time, at least in the short-medium term, suggests the possibility that new and more serious distributive conflicts may start. Moreover, it is argued that at current, already historically high levels of taxation, further increases to finance social spending would amplify deterrent effects on labor supply, on saving, and on investment and risk-bearing choices.

The common phenomenon of "moral hazard" for the beneficiaries of social interventions (the number of which may be growing over time because of a "learning by doing") would worsen the issues related to the control of expense dynamics, it would discourage recipients from entering back the active workforce, and it would place the "ethical and altruistic" reasons for the taxpayers' sacrifice (the burden to finance such social redistributions) in an unfavorable light.

These arguments have qualitative importance and quantitative weight. However, they must be compared to the motivations which gave impetus to social policies, as they also keep importance and weight. Within the normative theory, it has been a long time since "ethical" principles based on the recognition of a person's dignity – which must also be an economic dignity - have been opposed against the individualistic utilitarian approach. Positive analyses state the roots of social spending are found in the "social pacts", which united and unite citizens on the assumption of equality in political rights and acceptance of inequalities in the rights to command resources. But the acceptance of economic inequalities is conditioned to the taking on social policies objectives, which limit and correct such inequalities. Social expenditures, therefore, make market economy systems with public protection of private property of capital "sustainable".

Under modern conditions, the slower growth of countries with a consolidated industrialization and higher comparative qualities of life, and the expectations for a difficult recovery of growth rates observed in the past, impose to such countries a restructuring and rearrangement of their production systems, with a swifter innovation and diffusion of technological progress, severe restrictions to the areas of inefficiency and of unearned incomes. They also impose to innovate social policy formulation and management to obtain higher efficiency and better matching between interventions and real needs of the beneficiaries.

But, worse current and expected economic conditions for traditionally more advanced countries, do not require them to leave or significantly reduce (privatizing) the objectives of social spending, thus safeguarding *de facto* an increase of unnecessary private consumptions. The matter is to propose a choice for the scale of priority of available resources allocations. Such choices are necessarily founded on "value judgments", or political judgments, of which proposing scholars and policy-makers have to bear the responsibility.

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