“Reform of a Modern Welfare-State through a Basic Income to Re-Start Higher Levels of Economic Growth”

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Abstract

This paper discusses the growth of social and corporate welfare in the United States and proposes that this rent-seeking has reduced recent levels of economic growth. We measure the actually-existing welfare-state and find that it is around 15% of the US economy. We then introduce replacing the Welfare State (federal expenditures and tax-breaks which go to certain people) with a Basic Income (which treats everyone the same under law). We find that this reform would increase the extent of the market and therefore improve incentives for economizing behavior. We thus predict an increase in economic growth with the correction discussed in the paper. We frame our argument using the seminal Anne Krueger’s “The Political Economy of the Rent-Seeking Society” (1974) and F.A. Hayek’s “The Use of Knowledge in Society” (1945) as published in the *American Economic Review*.

Objective for Research and Method of Paper

The purpose of this research is to show that we can replace the United States' welfare-state with something (a Basic Income) which will be *both* more equitable and as well will allow an increase in the rate of economic growth.[1] Some commentators believe that there is new economic status quo in the welfare-states of the "West[2]," where the West is faced with a "new normal" of lower rates of economic growth and higher rates of unemployment because of structural changes in the 21st century not least the Financial Crises of 2007-08 and the resulting Great Recession.[3]

In this paper we will propose that the reason for the economic stagnation in the United States is the way the redistributional safety-net has been constructed. We will then quantify this welfare-state and discuss its negative effect on the economy. Following this we will present the proposed Basic Income and explain how replacing the current welfare-state with a Basic Income will improve both the equality of the rule of law, and, will provide incentives for more economizing behavior in society. Incentives which allow increased levels of economic growth.

The Historical Growth of Social and Corporate Welfare in the United States

There was a debate over the ratification of the U.S. Constitution in the 1780s between the Federalists and the Anti-Federalists. The former wanted a "vigorous" central (federal) government whereas the latter were concerned that the central state would grow in relevance to the detriment of the sovereign states as chartered under the original Articles of Confederation (1776-1788). We find that the fears of the Anti-Federalists have been historically justified. We can see from the chart below (Chart 1) that the federal state was less than 5% of the economy at the turn of the 20th century and then to consistently above 20% from 2010 on (when federal transfers to state and local government are accounted for).

[1] This paper updates and extends Weber (2013). The GBRS will be the first time that I present my work on the Basic Income.

[2] For the purpose of this paper, and for simplification's sake, we are defining the West as the European Union, the United States and Japan. However how we define the West is unimportant as the findings contained herewith are limited to the specific case of the United States. That being said it is hoped that some of our findings can be applied to other welfare-states undergoing relative stagnation.

[3] See for example the *Economist* magazine (2012). Also as we write this paper we find central banks encouraging negative interest rates, this is unprecedented.

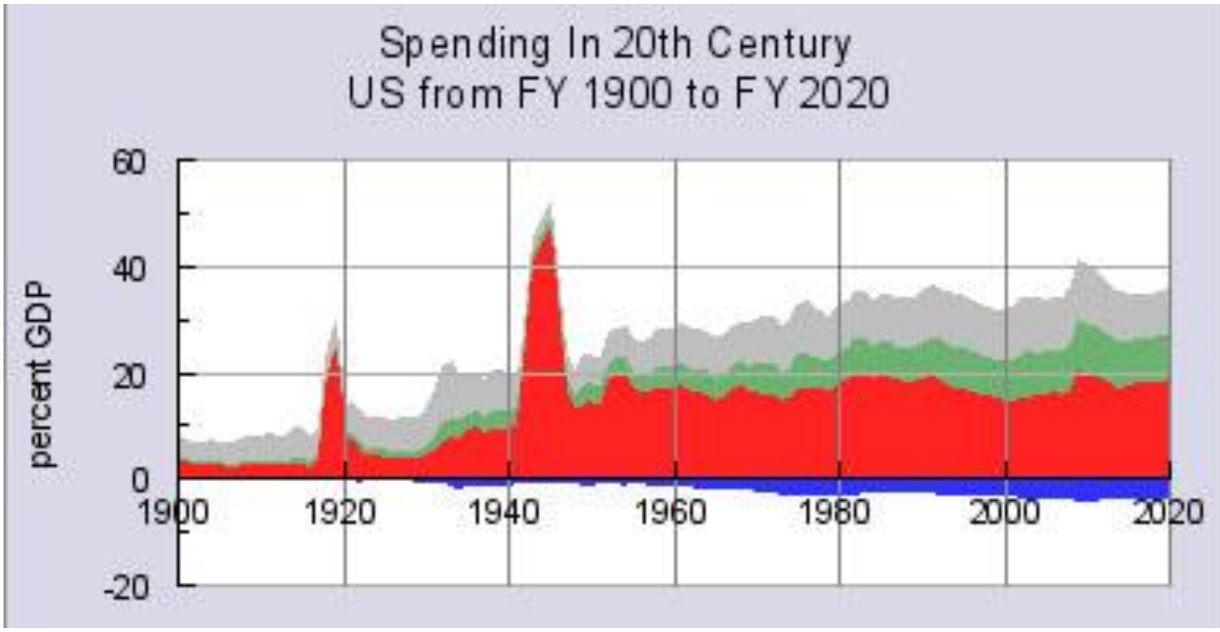

Chart 1: Trends in Government Spending. From Chantril (2015)

Grey (light grey): Local Direct Spending
Green (medium grey): States Direct Spending
Red (dark grey): Federal Direct Spending
Blue (shown as negative spending): Transfer to State and Local

We can verify this trend in fiscal federalism below (Table 1) where we find how the percentage of total government expenditures in the United States have almost consistently shown an increase in federal expenditures at the expense of non-federal expenditures. Therefore not only have total government expenditures increased in the USA but so has the federal percentage, both trends predicted by the Anti-Federalists.

Table 8. Percentage distribution of public expenditures by levels of government, 1902–1970 (Transfers allocated to donor level)

Year	Federal	Non-Federal	State	Local
1902	34.5	65.5	10.8	54.8
1913	30.2	69.8	11.6	58.3
1922	40.5	59.5	13.6	46.0
1932	34.3	65.7	20.6	45.1
1940	49.3	50.7	22.3	28.5
1950	63.7	36.3	18.2	18.1
1960	64.3	35.7	16.5	19.1
1970	62.5	37.5	19.4	18.1

Source: Tax Foundation, *Facts and Figures on Government Finances* (New York: The Foundation, 1971).

Table 1: Centralizing Fiscal Federalism in United States (Borcherding 1977, Table 8).

The Anti-Federalists also predicted that democracy in the United States under the new U.S. Constitution would degenerate from a country of patriotism to one of partisan politics. We have too seen this over time as the USA has devolved into an "us versus them" two-party political duopoly.[4] The U.S. Constitution has been used as an excuse for an ever increasing reach of the federal government as the Democrats and Republicans each interpret the constitution as they see fit in order to appease their special-interest electoral coalitions.[5] Each party then accuses the other of abusing the constitution in pursuit of their special-interests, meanwhile the growth and reach of government continues through the rent-seeking behavior predicted by the Anti-Federalists.[6]

Rent-Seeking, the Price Signal and the Market

Gregory Mankiw[7] writes in his best-selling economics text how people face trade-offs in society as to how scarce economic resources are distributed, between; 1) the efficiency maximizing market (which by definition creates inequality), or 2) the state, which is seen (by most) as

[4] The "Other" is specific to Western philosophy. We can conclude that this consciousness might help explain why the form of democracy established with the U.S. Constitution has led to the *us v. them* two-party political duopoly extant in the United States.

[5] Charles Beard describes how within one week of the first US Congress meeting there were more than 25 special-interest groups seeking protection from foreign competition.

[6] These accusations are also hypocritical in that the farm bill, which funds both food stamps (city-based "blue state" Democrats electoral support, a form of social welfare) and agricultural subsidies (rural-based "red state" Republican electoral support, a form of corporate welfare). Of course both the Democrats and Republics vote for the farm bill, sometimes with superficial reforms so that the politicians can be seen to be appeasing their electoral coalitions. This type of parliamentary voting behavior is called "log-rolling" in public choice economics.

[7] Mankiw is chairman of the Harvard University economics department and teaches the core first-year economics module.

reducing inequality. Mankiw proposes society “trades-off” some combination between 1) and 2). We have seen above that in the United States the trade-off preferences historically have been towards the state at the expense of the market.

Ann Kreuger in “The Political Economy of the Rent-Seeking Society” (1974)[8] describes how as rent-seeking[9] increases there will eventually become an instant when the market stops working altogether.[10] As in above, we believe that it is the accumulated rent-seeking in the United States which can account for the “new normal” of economic stagnation. Additionally from Hayek (1945) we know that if the market price signal is not allowed to work, allowing the self-interest of economic actors with local and limited knowledge to freely exchange with each other creating value through “market clearing,” society will face a social crisis. As we will show below approximately 15% of the US economy is federal government expenditures for corporate and social welfare.[11]

Federal expenditures are politically-determined and not market-determined, representing both Krueger’s rent-seeking and Hayek’s price distortions. The resulting conclusion is that rent-seeking and price-distortions have created the “new normal” of economic stagnation.[12] Next we

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[8] We are using Kreuger (1974) and Hayek (1945) in this paper, both of these articles were chosen as one of the best 20 articles published in the first 100 years of *American Economic Review* by the American Economic Association in 2011.

[9] Rent-seeking in public choice economics describes how special-interest groups seek special dispensation under the law which ensures them above-normal profits (usually through some sort of competition limitation in favor of entrenched interests), this of course in exchange for campaign contributions. It costs around $2 billion dollars in electoral campaigns to be elected President of the United States. We can also consider social-welfare as rent-seeking, in this case ensuring the continuation of the duopolistic two-party political system in the United States where Democrat politicians rent-seek in their own favor.

[10] An example is warranted here (and note the present author is not a partisan Republican). The Affordable Care Act of 2010 effectively placed approximately 16% of the US economy under an uncertain federal mandate. The state has been involved in and has distorted the US healthcare market since the 1930s, however the ACA was a very big step indeed. Robert Higgs calls this type of political and policy risk, “regime uncertainty,” as entrepreneurs (wealth-creating risk-takers in whatever organizational form) are wary of both the attenuation of property rights and unknowable and changing bureaucratic mandates, and are therefore reluctant to invest no matter how low interest rates.

The increase in the purchase of healthcare insurance (successful rent-seeking on behalf of insurance companies) in the 4th Quarter of 2014 and the 1st Quarter of 2015 is what created the recent above “new normal” rates of economic growth in the United States. Marxians call this type of paper profit “financialization.” The solution to the inflationary US healthcare “system” is to reinstill the market process of the doctor-patient relationship by removing the third-party payer system. That is what this paper proposes through the implementing of a Basic Income and the dismantling of the social-welfare of the state as third party payer and the corporate-welfare of the ACA requiring people to buy politically-determined levels of insurance.

[11] Federal government expenditures are easily identifiable and therefore measurable. This paper does not intend to measure other forms of Hayekian price distortions such as the tens of thousands of pages of federal regulations, although we have mentioned that the ACA of 2010 creates non-market price distortions in approximately 16% of the US economy.

[12] One of the social crises caused by the current configuration of the welfare-state after the Financial Crisis of 2007-08 is a labor force participation rate which could be the lowest in US history.

prove our point that approximately 15% of the US economy is special-interest social and corporate welfare based on federal expenditures. We then propose a solution, the Basic Income, which will both remove the stagnation-causing price distortions and create a social safety net which treats everyone the same under law, and therefore is not based on the vagaries of electoral politics and partisan special-interests.

The Evolution and Measurement of the Welfare State in the United States

In the following analysis we create two categories, the "Basic Government" and the "Welfare State." The basic government is what most economists[13] would agree is the proper role for a social collective, the provisioning of services which cannot be provided through the market process. These obviously are "public goods," most predominantly national defense, a court of law and a means for negotiating treaties with other social collectives. The United States had this basic form of federal government for the first 60 years of its existence.

George Washington, who formed the first US Government in 1789, and his successors had the Departments of War (later the Department of Defense), Justice, State and Treasury until the creation of the Department of Interior under President Zachary Taylor in 1849.[14] Prior to this centralizing power grab, publicly-owned natural resources were managed in a local and decentralized manner by states and municipalities (local management of public resources reduces rent-seeking in that social relationships are more personalized than those managed centrally, we are less likely to take advantage of those we know). See Table 2 where we show Basic Government expenditures for the US Government in Fiscal Year 2014. We now add to this table the other categories necessary for calculating the size of the Welfare State in the economy.

We determine that the Department of the Interior is a form of corporate welfare in that it leases publicly-owned land to private corporations (of course some may argue that public green space is a social collective responsibility, but as stated this had already been occurring prior to federal government intrusion.)[15] Instead of explaining in detail how we classifying the federal state as special-interest welfare beyond the Basic Government, we will just give a few examples to illustrate the point generally.

For example the Departments of Education and Commerce are corporate welfare in that they train certain people to do certain things, things which may be helpful to some companies and industries and not to others (for example when the Democrats are in office, the DOE trains people - and funds research - for the "clean and green" energy industries whereas when the Republicans are in office it is "oil and gas" who get the rents). The Corps of Engineers is

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[13] Most but not all.

[14] "Throughout most of the Nation's history prior to the 1930s, the bulk of Federal spending went towards national defense, veterans benefits and interest on the public debt" (US OMB 2011).

[15] Local and decentralized management of public resources also reduces the Hayekian "knowledge problem" in that people on the ground are more likely to be prudent with their community's assets than are federal bureaucrats miles away, or on a short-term local assignment.

corporate welfare in that, again, instead of local management of natural resources, federal expenditures take from all taxpayers to the benefit of local (politically-determined) populations, such as those located near the nation's waterways. It should be obvious that Departments of Commerce, Energy, Environmental Protection[16], etc., all work the same way.

The same logic applies to social welfare. Money in the form of taxes is taken from (most) everyone and given to a few. Subsidized housing from the Department of Housing and Urban Development[17] has a big queue, how is it decided as to who gets the flats? HUD "red-lines" certain urban areas and directs below market cost mortgages to these areas…how is this decided? And then when these bad mortgages go under who pays for the HUD bailouts?[18]

Just one more example of social welfare, the Department of Transportation. The DOT takes everyone's tax dollars and gives it to politically-determined geographic areas (mostly urban populations), sometimes under the guise of "fiscal stimulus." These centrally-determined public works transfers are for initial construction, onward maintenance is often dependent upon local taxpayers. Prior to the New Deal of the 1930s and its massive Works Progress Administration,[19] public works spending was on the majority local, again with then more efficiency-based decision-making for collective resources.

Specifically we can spot the inefficiencies in social welfare (which we will find is 90% of welfare-state expenditure by the US Government, corporate welfare is 10%) quite easily. The statement below is borne-out by our analysis later in this paper, only the Basic Income is given to *everyone* in the economy (treating everyone the same under law, the ultimate form of justice according to some, present author included), not just the poor however measured by whom and when over what time period.

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[16] It is well-known that the US Government (specifically the Departments of Energy and Defense) is the largest polluter on the planet, or maybe it's the Chinese People's Liberation Army.

[17] Actually grants made by the social welfare federal agencies are more likely than not channeled through state and local governments, this of course creates local patronage for federal programs and as manifested at the voting box.

Replacing all welfare with the Basic Income would also reduce the state and local portion of expenditures for these by definition politically-driven programs. Although it is beyond the scope of this present paper to measure these potential efficiency gains, we can state that the positive effect on economic growth as these resources are freed-up for market allocation would not be negligible.

Additionally, there currently is a crisis of city government bankruptcy in the United States due to the defined-benefit pension and health plans of city labor union employees. Replacing federal welfare with a Basic Income would make a large proportion of city and state government employees obsolete.

[18] In addition to the taxpayers funding Fannie Mae and Freddie Mac (who report to the politically-appointed HUD administer), everyone who uses US dollars face devaluing living conditions through the recent more than half a decade long a Zero Interest Rate Policy (ZIRP) under modern central banking. Those with less disposable income are hurt most of all.

[19] Neumann, Fishback and Kantor (2011, 195) find that "the timing of relief spending is consistent with claims that the Roosevelt Administration used relief spending to sway elections."

> As O'Rourke has pointed out, there can't be any poor people in the United States. His proof is that if we take the total amount spent on poverty programs and divide it by the number of people in poverty, the income per capita is above the poverty line. QED. But the money is not reaching the poor (Munger 2015, 507).[20]

Table 2 reports the result of our classification of Basic Government and the Welfare State. For the sake of the conservative principle in accounting we are classifying the Military-Industrial-Security Complex as part of Basic Government despite President General Eisenhower's plea to be wary of the growth of this sector. The GSA and OPM provide services to both Basic Government and the Welfare State so we allocate the expenditures of these agencies accordingly. We also find the category "Misc. Independent Agencies and Offices" as resulting in net receipts to the US Government. The largest line items for these receipts are receipts from television air spectrum auctions (which are neither Basic Government nor Welfare State, and a program some believe should be privatized) and government agency transfers to retirement, healthcare and disability trust funds (which are not actually cash received by the US Government, rather ledger notations.)

[20] Part of the inefficiencies (and social injustice) in the current form of the welfare-state in the United States is in the salaries of the federal bureaucrats who manage (set prices for) the programs. Yoder (2013) reports that the median salary for US Government employees is $78,467 (2012 data). The US Census (2014) states that the median income ("nonfamily income" as opposed to family income based on multiple salaries) is $31,178 (2013 data). US Government bureaucrats make more than twice as much as do the rest of Americans. This in turn can explain the rise of the state, bureaucratic self-interest, as well argued by public choice economists. The Department of Health and Human Services has around 75,000 direct-hire US Government employees.

Another example of public choice in the management of the first 50 years of America's "War on Poverty" is that there is always around 15% of people in the United States below the poverty line, no matter how wealthy the nation becomes. For the state not to report this figure would mean an end to social welfare programs and thus an end to jobs which pay twice as much as most everyone else's.

A. Basic Government	**2014 (est.)**		**C. Social-welfare**	**2014 (est.)**		**E. Overhead**	**2014 (est.)**
Department of Defense--Military	571,882		Department of Housing and Urban Dev.	49,479		General Services Administration	-231
Department of Justice	32,652		Department of Health and Human Services	1,040,661		Office of Personnel Management	86,723
Department of State	30,505		Department of Education	68,991		**Total**	**86,492**
Department of the Treasury	612,782		Department of Labor	75,579			
Executive Office of the President	402		Department of Transportation	93,574		USG Spending (A + B + C + D + E)	4,116,050
Legislative Branch	4,912		Social Security Administration (On-Budget)	92,247		Government (A + B)	1,511,459
Judicial Branch	7,432		Social Security Administration (Off-Budget)	838,917		Welfare State (C + D)	2,518,099
Total	**1,260,567**		**Total**	**2,259,448**		Welfare State % of Total USG Spending	61%
						Welfare State Overhead Allocation	52,914
B. Military-industrial-security complex			**D. Corporate-welfare**			**Welfare State Plus Overhead**	**2,571,013**
Department of Homeland Security	45,034		Department of the Interior	13,172		**Government Plus Overhead**	**1,545,037**
Department of Veterans Affairs	146,357		Department of Agriculture	141,192			**4,116,050**
Other Defense Civil Programs	59,501		Department of Commerce	8,879			
Total	**250,892**		Department of Energy	31,026			
			Corps of Engineers-Civil Works	6,415			
			Environmental Protection Agency	8,412			
			International Assistance Programs	23,084			
			National Aeronautics and Space Admin.	18,104			
			National Science Foundation	7,409		Misc. Independent Agencies & Offsets	-232,955
			Small Business Administration	958			
			Total	**258,651**		Net Outlays	3,883,095

Table 2: Measuring Basic Government and the Welfare State (2014 data).

Below (Table 3) we calculate the size of the Welfare State in the US economy and find that the Welfare State is approximately 14.5% of the economy (if the decimals are removed it rounds up to 15%). We find that social welfare is 90% of welfare expenditures and corporate welfare is 10% of welfare expenditures.[21]

US GDP 2014 (A)	17,701,000	
Social Welfare Expenditures	2,259,448	
Corporate Welfare Expenditures	258,651	
Total Welfare Expenditures	2,518,099	
Social Welfare with Overhead (B)	2,307,070	90%
Corporate Welfare with Overhead (C)	263,942	10%
Total	2,571,013	100%
Social Welfare % of GDP (B/A)	13.0%	
Corporate Welfare % of GDP (C/A)	1.5%	

Table 3: Social and Corporate Welfare and the US Economy (Millions of US$).

Calculation of the Basic Income

Using US Census data we find that there are approximately 251 million people in the United States aged 16 and over.[22] As shown below (Table 4) When we divide the Welfare State expenditures per person in the United States by the population aged 16 and over, we find that we can replace the welfare expenditures (which go to *select* individuals) with a Basic Income of $10,231 which goes to *everyone* equally. We also find that the Basic Income is only 13% less than the “poverty level” of $11,700, a measure of poverty which we find above has continued to perpetuate itself for 50 years in the “War on Poverty.”

We will find in the next section however that the economic growth afforded by replacing politically-driven spending based on bureaucratically-set price levels (the Welfare State) with that of individual economizing behavior (the Basic Income) we can expect to re-start economic growth in the stagnant modern US welfare-state, growth which we then would expect to

[21] US GDP data is from bea.gov and federal government expenditure data is from Table 2.

[22] To calculate the 2014 population aged 16 and over we start with the latest US Census data (from 2010) and find that 78.8% of the US population are in this age bracket. Then we use Google Public Data to find the estimated population for 2014 and apply the US Census age bracket percentage to the Google estimated population. The US Census says on their website that their data should not be used to make population comparisons between periods, it is for this reason we used Google data and not US Census data for 2014.

eliminate the difference between the poverty level and the Basic Income level. Importantly this reform means not just some are receiving a safety net but that all are.[23]

2014 US Federal Welfare State Expenditures (A)
$2,571,000,000,000
2014 Population Aged 16 and Over (B)
251,293,200
Basic Income to Replace Welfare State (A/B)
$10,231 Per Year Per Person
US Poverty Level (2014)
$11,700 Per Person

Table 4: Calculation of Basic Income and Relative to US Poverty Level.

Economic Growth and Ethical Justifications for the Basic Income

The logic applied is quite simple. Above we found that the welfare-state in the United States is just less than 15% of the US economy. Most social welfare (90% of welfare) is given in the form of pre-set vouchers or subsidies, specifically for food, housing, utilities, transportation, healthcare, etc. This type of social safety net (which goes to only those eligible as deemed by discretionary fiat) reduces economizing behavior in that it removes incentives from the recipient to trade-off individual preferences between these categories, therefore the recipient spends amounts pre-determined by the political-process and bureaucrats rather than through subjective economic decision-making based on personal preferences. This creates waste and lethargy and reduces the economic growth afforded by economizing behavior. Too the amount of subsidies and grants given the recipients of corporate welfare are determined through rent-seeking rather than profit-seeking market behavior, also removing distributional efficiency.

If we were to replace these price rigidities (to some people) with a Basic Income (for everyone) we would expect to see an increase in economic growth, and, therefore a reduction in the social crises of the "new normal." Replacement of welfare with a Basic Income would free up around 15% of the economy to engage in market activity.[24] Below (Table 5) we learn that US government expenditures are 23% of the US economy, meaning that the extent of the market is

[23] Some analysts find that a basic income would encourage growth-creating entrepreneurial behavior by limiting downside risk.

[24] Mankiw finds that 84% of economists agree that replacing vouchers with cash would improve economizing behavior.

77% (ignoring local and state government price distortions). With the addition of the Basic Income (14.5% of the economy from Table 3 above) replacing the welfare-state, the extent of the market is now 91.5% of the economy. If we accept that the "new normal" level of economic growth is 2% (as opposed to 3 or 4% real growth prior to the Great Recession) then welfare reform with a basic income would allow a 2.4% rate of economic growth, an increase in the rate economic growth by 20%.[25]

2014 US GDP (A)
$17,701,000,000,000
2014 US Government Expenditures (B)
$4,116,050,000,000
US Government % of the Economy
23% (B/A)

Table 5: Calculation of US Government Share of the Economy.

If we replace the rent-seeking welfare-state with a Basic Income we would also expect to see an increase in the quality of our behavior to each other. Society will no longer be one in which we expect to gain at the expense of our fellow man through taking advantage of them by skewing the rule of law. Under a Basic Income everyone would be treated the same under law, equality under law. A corollary to this is we recommend that everyone be treated the same under the tax code (special tax breaks being a big part of rent-seeking).[26] As noted we find that the US Government portion of the economy is 23%, therefore everyone would pay the same tax rate for the federal income tax, 23%.[27]

[25] If the current extent of the market is 77% allowing for a 2% growth rate, then a 91.5% extent of the market would afford a 2.4% rate of growth (77/2 = 91.5/x, where x = 2.4), an increase of 20% ([2.4 – 2]/2 = 20%).

[26] In addition a simplified tax code would make a lot of the U.S. Internal Revenue Service's almost 90,000 employees redundant.

[27] Or, we can remove welfare altogether and pay a 8.5% federal income tax for Basic Government (23% US Government share of the economy minus 14.5% Welfare State = 8.5% Basic Government).

In Conclusion

In this paper we have shown the growth of the United States federal government from one of basic government drawn from the ashes of the American Revolution to one which is of a majority social and corporate welfare. We have posited that the growth of this statist intervention has prevented the market from working in the distribution of society's scarce resources in the most efficient manner. We are thus facing a "new normal" of lower than historic levels of economic growth. Replacing welfare programs which are given to categories directed by state discretion (to *some people*) with a Basic Income (to *everyone*) would result in an increase in the rate of economic growth of around 20%.

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