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THE FISCAL CRISIS OF THE CAPITALIST STATE

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INTRODUCTION

It is now widely acknowledged that the long period of economic expansion that the Western capitalist societies enjoyed in the aftermath of World War II has come to a halt. Since the mid-1960s all of the developed capitalist societies have experienced greater economic difficulties in the form of higher rates of unemployment and inflation. Recessions have been deeper in the 1970s and early 1980s, and the periods of economic expansion have been characterized by higher rates of unemployment and inflation than were typical in the 1950s and early 1960s.

The principal way in which these economic difficulties have entered into sociological discussions has been through the 'fiscal crisis of the state.' Through the period of post-war expansion, government budgets rose steadily as all the developed capitalistic states took on greater responsibility for providing social services and economic infrastructure. Even with rapid economic growth, state expenditures as a percentage of gross national product (GNP) rose because of these growing state responsibilities. But the rise was slow enough that it did not create serious strains. Since the late 1960s however, the pressures for a continuing expansion of the state budget have intensified at a time when the overall rate of economic growth has slowed. The result has been a fiscal crisis as governments are unable to support their expenditures with revenues and are forced to resort to inflationary tax increases or deficit financing. The inflationary consequences of state growth have, in turn, generated profound pressures for cutting back or slowing the growth of state expenditures.

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Beginning with O'Connor's (1973) influential book,[1] which anticipated many later developments, the term "fiscal crisis" has become a standard part of the sociological lexicon. But O'Connor did more than label and diagnose the problem; he placed it in a sociological context. For O'Connor, fiscal crisis was not simply a problem of disproportion between government expenditures and revenues, but rather an indication of fundamental conflicts between the workings of the state and of the economy in advanced capitalism. In O'Connor's view, the legitimacy of the state in capitalist society rests on its capacity to provide a range of services to the population without raising taxation to a level perceived as oppressive. At the same time, however, the state is required to provide services to capital to aid the accumulation process. When the state finds itself unable to finance these different undertakings with available revenues, its managers are on the horns of a dilemma. On the one hand, they can risk a reduction in legitimacy by cutting back services to the population or by raising taxes beyond levels that are seen as fair. On the other hand, they can undermine the accumulation process by reducing services needed by capital or by raising additional revenues in an inflationary manner. O'Connor argues that this dilemma is symptomatic of a basic contradiction between democracy and capitalism; the only full solutions to fiscal crisis are (*a*) to replace democracy with dictatorship so that the state can reduce its responsiveness to popular pressure or (*b*) to eliminate private ownership of the means of production.

While O'Connor approaches these issues from a neo-Marxist perspective, his concerns have been echoed in the writings of prominent non-Marxist sociologists. Such writers as Bell (1976), Janowitz (1977), and Wilensky (1975, 1976), while skeptical of some of O'Connor's formulations, also see the fiscal crisis as a symptom of fundamental strains in advanced capitalism. Hence, while interpretations of fiscal crisis vary, the importance of the topic is widely recognized.

Three sets of issues are subject to dispute in the discussion of fiscal crisis. The first concerns the incidence and causes of fiscal crisis. While O'Connor argues that fiscal crisis is endemic to advanced capitalism, his own discussion is confined to the American case. Others have questioned both whether the concept has any broader applicability and whether the sources of fiscal crisis might be contingent and transitory rather than rooted deeply in the structures of late capitalism. The second broad set of issues focuses on whether the fiscal crisis is cause or consequence. Rapid growth of state spending may be the reason for slow economic growth in the West in the 1970s. In this case, fiscal crisis would be both symptom

[1]O'Connor (1973) is the subject of an extended discussion in Flacks & Turkel (1978), *Ann. Rev. Sociol.* 4:193–238.

and cause of the West's economic problems. However, the slow growth in the Western economies may result from factors exogenous to changes in state spending. Under this hypothesis, state spending has not been growing too fast; rather, the economies have simply been growing too slowly to finance necessary state growth. This would mean that fiscal crisis is simply a symptom of more fundamental problems that produce slow growth. The third broad set of issues are the political and social consequences of fiscal crisis. The three parts of this essay address these three sets of issues at length.

I. TOWARDS A FISCAL SOCIOLOGY

Exploring the incidence and causes of fiscal crisis leads towards a fiscal sociology—a systematic examination of "the principles governing the volume and allocation of state finances and expenditures and the distribution of the tax burden among various economic classes" (O'Connor 1973:3). But although O'Connor insisted on the importance of such a project, fiscal sociology remains in its infancy. Not only are there relatively few comparative studies of the growth of state expenditures, but even finding a workable definition of fiscal crisis is difficult.

1. Defining Fiscal Crisis

O'Connor fails to provide an explicit definition of fiscal crisis, but it is possible to draw out his implicit definition by contrasting his approach to that of a number of other analysts. In the period since the New York City fiscal crisis, a number of studies have sought to show whether other city, state, or local governments might experience comparable difficulties. Such studies generally proceed by constructing measures of fiscal strain for particular local governments by measuring the relationship between government expenditures, revenue, and debt (e.g. Liebert 1974; Aronson & King 1978). O'Connor's approach differs fundamentally in rejecting both the balance sheet approach and the unit of analysis used in such studies.

A balance sheet approach to fiscal crisis—one that focuses on an analysis of government budgets—tends to obscure the critical relationship between government and the health of the private economy. This relationship is recognized implicitly in much discussion of government borrowing. Government borrowing is generally seen as legitimate when it is used to finance expenditures that will serve over a period of time to expand the productiveness of the private sector, so that it would then be easy to retire the debt out of an expanded flow of state revenue. Hence, a government that was borrowing heavily but spending prudently might not be in fiscal crisis even though expenditures greatly exceeded revenues. Yet it is only one small step further to argue, as O'Connor does implicitly, that a government could be in a situation of fiscal crisis even when revenue and expenditures are in balance.

If, for example, a government sought to avoid an excess of expenditures over revenues by drastically cutting back on services that were necessary for the private sector, thus impairing the long-term productiveness of the economy, this also would have to be counted as fiscal crisis. Similarly, fiscal crisis would also exist where government measures to expand revenues to match expenditures have negative consequences for the private sector. One clear example would be a government that raised taxes sharply in response to a shortfall in revenues, thus producing a flight of business and middle-class taxpayers. Even if in the short term the increased taxes meant that revenues matched expenditures, the long-term erosion of the tax base would ultimately bring the fiscal crisis into full view. O'Connor, in sum, expands the notion of fiscal crisis to encompass those situations in which governments find it impossible to finance the expenditures necessary for maintaining the capitalist accumulation process without pursuing policies that either would damage the long-term health of the economy or impair the state's future capacity to generate adequate revenues.

But O'Connor diverges in another respect as well from those analysts who compare the fiscal records of different state and local governments. He defines fiscal crisis as a characteristic only of national societies, aggregating together all levels of government. This definition rests on two arguments. First, many of the important determinants of state or local fiscal strain lie outside the particular locality. For example, many of New York City's problems could be traced to such larger processes as the movement of industry away from the Northeast, the substantial in-migration of Blacks and Hispanics, and the relatively low level of Federal spending in New York State (Sternlieb & Hughes 1975; Hubbell 1979). Analyses that compare cities and states tend to assume that the determinants of fiscal strain are local; such studies obscure these larger dynamics. Second, local fiscal difficulties take on special meaning only in the context of national fiscal crisis. Local fiscal difficulties are endemic to capitalism because patterns of uneven regional development mean that there will usually be declining areas that have trouble raising adequate revenues. When there is no national fiscal crisis, such local difficulties can be eased by actions of the central government to redistribute resources in favor of those declining regions. However, when local difficulties coincide with national fiscal crisis, then the central government is hard pressed to devote increasingly scarce resources for solving the problems of declining areas. In sum, the "urban fiscal crisis" of the 1970s and early 1980s in the United States is a manifestation of national fiscal crisis precisely because the Federal government is not able to afford the funds necessary to bail out the cities.[2]

When these points are added to the insight that governments only run into fiscal difficulties when their level of spending grows faster than that of the economy as a whole, the result is a workable definition. Fiscal crisis is a condition of national societies where the expenditures of all levels of government taken together expands as a percentage of GNP fast enough to produce such symptoms as inflationary pressure, tax resistance, strong pressures for limits on government spending, and a pattern of fiscal pressure on state and local governments.

2. *The Problem of Broader Applicability*

This definition is deliberately general precisely because it seems highly doubtful that there is a highly determinate relationship between particular rates of state growth[3] and the mentioned consequences. For example, during World War II state spending rose dramatically as a percentage of GNP in many countries, but inflation was at times successfully held in check through wage and price controls, and there was little likelihood of tax resistance. Even under less extreme circumstances, a number of factors can intervene between rapid state growth and inflationary pressures. A particular structure of labor relations, for example, might make it possible to substitute state-provided services for wage gains for a period of time and thus reduce one key element of the inflationary dynamic.

Nevertheless, the definition still contains an implicit hypothesis—that faster rates of state growth will tend to correlate with inflation, tax resistance, heightened pressure for limits on state spending, and fiscal pressure on state and local governments. It should be relatively easy to see whether or not this hypothesis has general applicability to the developed capitalist societies.

First, however, it is necessary to show a trend towards a faster rate of growth of the state relative to GNP since the 1960s. For almost all of the OECD nations, the rate of state growth accelerated in the 1970s[4] (OECD

[2]Urban fiscal problems are dealt with elsewhere in this volume in the essay by Henry Levin on "Urban Finance."

[3]State growth should be taken to mean state growth relative to GNP.

[4]Note that state spending here encompasses both transfer payments and state purchases of goods and services. This measure is used because both require that the state divert resources from the private economy. However, transfer payments are not included in GNP, so that it is theoretically possible for the state's share of GNP to reach 100% while private control of accumulation continues (Gough 1979:80).

1977). Gough (1979) presents data for the United Kingdom that show an actual decline in state expenditures as a percentage of GNP from 1951 to 1961, probably because the 1951 level was abnormally high as a result of the large military spending for rearmament. But this was followed by a rise from 42.1% in 1961 to 50.3% in 1971 and a staggering increase to 57.9% in 1975.

The evidence for accelerating growth of state expenditures provides some general support for the usefulness of the definition, since at least the faster rates of state growth have occurred in the same period that has been marked by inflation, tax resistance, pressures for limits on government spending, and fiscal pressures on state and local governments. Unfortunately, few studies pursue the issue much further. One exception is a small study by Peacock & Ricketts (1978). For the period 1965–1972, they use regression analysis to examine the relationship between inflation rates and public sector growth for all of the OECD nations. Using changes in direct taxes and social security contributions as a percentage of GNP as a measure, the regression coefficient is 0.51 (Peacock & Ricketts 1978:133). The authors do not make too much of this finding, partly because of the possibility that the correlations could also be explained by "fiscal drag"—the tendency of inflation to push people into higher tax brackets and increase tax rates. Nevertheless, the finding provides some support for O'Connor's contention that rapid state growth generates inflationary pressures.

Yet it should be emphasized that this type of regression analysis might involve too stringent a test of the basic hypothesis. It might suffice to show, for example, that for a number of nations the average rate of inflation during a five-year period of more rapid state growth is higher than during an otherwise comparable five-year period of slow state growth. Similar tests could also be done for the other variables—tax resistance, pressures for limits on state spending, and fiscal pressures on state and local governments—although Wilensky (1976) makes clear how difficult it is to formulate reasonable indicators of the first two variables. Even then, a full test of the hypothesis would involve some aggregation of the four variables to see if the total score is higher in periods of fast state growth than in periods of slow state growth. When the matter is stated this way, it becomes easier to understand why little work has been done along these lines. The chances seem rather slim that the hypothesis would not be verified.

3. *The Rapid Growth of State Spending*

In analyzing the components and causes of the growth of state spending, O'Connor's argument provides a useful starting point. O'Connor divides state spending into three analytically distinct categories; for each category, he identifies dynamics that lead to expenditure growth. O'Connor's categories are not meant to be used for empirical analysis, since he argues that a particular concrete state expenditure generally falls into more than one analytic category. In fact, it is not necessary for O'Connor's argument that all three categories grow as a percentage of GNP; it is sufficient that, taken as a whole, state expenditures rise.

The categories are social investment, social consumption, and social expenses. Social investment is state spending that contributes directly to accumulation; it encompasses the provision of physical capital and human capital in the form of educated labor and research and development. Social consumption is state spending to reproduce the working class; it includes state spending to support collective consumption of such services as medical care and housing, as well as various forms of social insurance for the working population. Social expenses are those forms of state expenditure required to overcome the contradictions of advanced capitalism. This encompasses welfare expenditures to support marginal populations (other than retired workers) and military expenditures necessary to maintain aggregate demand and keep foreign markets open for exports.

O'Connor argues that social investment expenditures rise because of direct pressures of capitalists on the state for various forms of subsidy and because the increasingly social nature of the production process makes it absolutely essential that the state provide certain collective goods that cannot be provided by the market. Social consumption tends to rise because of the demands of the working class for an improved standard of living and because their employers prefer that the state pick up as much of this tab as possible. (An example is the support of a number of large corporations for national health insurance because the cost of providing health benefits to their employees has become prohibitively expensive.) Social expenses rise because capitalism is a contradictory system that tends to generate an ever larger surplus population whose protests force the state to respond with increased welfare. O'Connor suggests that current levels of military spending will be continued because of the needs of the US empire, because of the power of the major defense contractors, and because defense spending is a major mechanism for subsidizing technological advances.

Despite the analytic nature of these categories, they can be roughly compared against data on the actual developments of state expenditures in the developed capitalist societies. While O'Connor was basically right that current levels of defense spending would not be cut dramatically, defense spending as a percentage of GNP has fallen for almost all of the OECD nations since the 1950s (Wilensky 1975). Whether this trend will continue into the 1980s is, of course, another question. (On the pressures for increased military spending in the United States, see Block [1980] and Wolfe [1979].) Expenditures in direct support of capital accumulation are notoriously difficult to quantify, but Gough (1975) argues that they have been rising in all of the developed capitalist societies. If educational expenditures are included in this category (see Wilensky [1975] for an argument against education's inclusion as a 'welfare state' expenditure), then the rise has been quite dramatic, since Gough (1979:79) shows that in all OECD nations educational expenditures rose 38% faster than GNP between the early 1960s and the early 1970s.

Whether education is counted as social investment or not, it is clear that the major component of state growth has been in welfare and social service expenditures. (This category encompasses O'Connor's two types of social consumption as well as social expenses for the maintenance of marginal populations.) Wilensky (1975:30–31; 1976:111) provides data showing accelerating growth of social service spending (exclusive of housing) in most OECD nations from the late 1940s to the early 1970s. Gough (1979:77) provides illustrative data for the United Kingdom, showing that between 1961 and 1975, social service spending as a whole rose from 13.4% of GNP to 22.8%, while state spending as a whole rose from 42.1% to 57.9%. Gough (1979:79) also shows that during the 1960s the average for all OECD nations was that income maintenance expenditures rose 42% faster than Gross Domestic Product (GDP) and health expenditures rose 75% faster.

There are two major ways of analyzing these increases in social welfare spending—arguments that seek to locate the specific mechanics that have brought about increases, and arguments that have sought a contextual explanation for the steady expansion in the state's role as a provider of social services. Among those who seek to locate the mechanics of change, three sets of factors seem most important—the impact of pressure from social service recipients, the specific organization of the political system, and the role of state sector workers.

O'Connor reckoned that pressure from workers and welfare recipients would be the major factor in shaping the expansion of government social service spending, but empirical studies suggest a need to modify that hypothesis. Wilensky (1976) found that in nineteen rich democracies neither the size of the working class nor its strength (as measured by leftist voting or union membership) predicted welfare effort. However, Cameron (1978) did find a strong correlation between social democratic or left-party government and growth of the public economy (of which social-service spending was the most dynamic component). The divergence in the findings suggests that not working class strength alone, but the interaction between pressures from below and the specific organization of the political system determine the rate of growth of social service spending. Similar findings are suggested by studies that focus on differences in social spending among states in the United States (Friedland 1976; Hicks 1979).

Aside from the capacity of left parties to exercise governmental power, the other aspects of the political structure that have been found to be significant are the extent of electoral competition and the degree of centralization of government and of trade union federations. Piven & Cloward (1971) emphasized the factor of electoral competition in explaining the expansion of the welfare rolls during the 1960s, an argument given some support by Friedland (1976). The importance of electoral competition is also suggested by Tufte (1978) in his analysis of the political-business cycle—a tendency for economic expansion to occur in election years and for recession to be more likely in non-election years. Tufte's empirical substantiation of this pattern suggests that politicians are forced to be responsive to the economic demands of constituents. Furthermore, he uncovers a tendency in the United States for government transfer payments to reach maximum levels in the months before national elections, suggesting that the combination of pressures from below and politicians' seeking to retain office gives an upward bias to social service spending.

Cameron (1978) found a modest correlation between degree of government centralization and high levels of government spending. This is consistent with Wilensky's (1976) finding that a variable he calls "corporatist-technocratic linkages" (combining measures of labor union centralization and government centralization) did have a strong relation to welfare effort. The argument is that state managers in centralized polities tend to be more responsive to working class pressures, particularly when those pressures are exerted through a centralized union federation.

A final mechanism for increasing social service spending is the relationship between the wages and the productivity of state sector workers. It is central to O'Connor's argument that not only is there a secular tendency for the state's responsibilities to grow, but that the costs of providing even a constant level of state services also rise. This occurs because even though productivity within the state grows only slowly, state workers are able to win wage gains comparable to those of workers in the highly unionized sectors of industry. Here again, Gough (1979) provides some useful data. He shows that between 1963 and 1973, in all OECD nations prices for government services rose one third faster than the general price level, and he emphasizes the importance of public sector union militancy in producing this result. (See also Di Tomasso [1978] on the tendency of public sector workers to unionize.) Gough also attempts for England to separate out the effects of higher relative price rises from other factors that push up social service spending. He argues, for example, that of the 314% increase in spending for the national Health Service between 1965 and 1975, 27% can be explained by an actual expansion of services, 13% by shifts in the stucture of the population, 30% by higher relative prices, and the remaining 244% by general increases in the price level. But Gough also suggests that the impact of expanding services is probably more significant in other societies that institutionalized the welfare state later.

Contextual explanations of the growth of state social welfare spending are on a somewhat different level of analysis. Their logic is that the specific factors that produce the growth in social spending are less important than the overall context in which that change occurs. Such arguments are analogous to the explanatory strategy of Polanyi (1957) in his account of various forms of protectionism in 19th century society. Polanyi argued that the particular interests involved in pressure for specific forms of protectionism were less important than the recognition that such efforts at protectionism were necessary in order to save 19th century society from the self-regulating market.

Ironically, one of the major contextual explanations for the growth of state spending is substantively quite Polanyian, though Polanyi is not cited. Cameron (1978) found a strong relationship between the expansion of the public sector and the degree of openness of national economies to international trade. The argument is that those nations with the highest ratio of international trade to GDP have the most rapid rates of public sector growth—i.e. the expansion in state social welfare spending is a way to protect the population from the economic fluctuations that result from a high level of dependence on the international market. Cameron suggests a specific causal mechanism to explain this linkage: High levels of openness to international trade tend to produce industrial concentration which, in turn, facilitiates centralized and strong trade union federations. Yet this hypothesis is less suggestive than the idea that the growth of state service spending might best be understood as a response to the pressures created by an open world economy.

A second line of contextual explanation is that whatever the proximate causes of the growth in state social welfare spending, these changes must be understood as part of the development of a service society. Increased social welfare spending is the harbinger of a society in which social services become the central loci of social and economic development (Hirschhorn 1979; Gartner & Reissman 1974). This line of argument is closely linked to the argument that the key factor in explaining the rapid growth in state spending has been "a revolution of rising entitlements" (Bell 1976:233) that has swept across the developed capitalist societies.

More so than the actual mobilization of political forces, it is this shift in the sense of entitlement that accounts for the upward trends in social spending. The increased sense of entitlement is itself an aspect of the emergence of post-industrial values (Inglehart 1977) that prefigure a different kind of society.

4. The Difficulty of Expanding the State's Share of GNP

There would be no fiscal crisis if the state could find a nonproblematic way to increase its share of the total national product. Hence any analysis of fiscal crisis must explain what prevents the state from expanding its share of resources. As O'Connor indicates, the state can expand its share of resources in only three ways—through generating profits, through taxes, and through borrowing.

A. STATE-OWNED ENTERPRISES As is well known, the United States is somewhat exceptional among the developed capitalist nations in its lack of state-owned enterprises. In many nations of Western Europe, state control of enterprise is quite substantial. This control creates the possibility that increasing levels of profit from state-owned enterprises could finance the state's growth. But as O'Connor notes, there is no evidence that this potential has been realized. Many state-owned businesses never turn a profit, since their major function is to provide goods or services that cannot be profitably produced on the market. When state-owned enterprises do turn a profit, "the surpluses are typically not available to the state treasury because the enterprises normally are not managed by government representatives, but rather by autonomous administrations" (O'Connor 1973:185). The generality of this pattern can be traced to the power that capitalists have to prevent the state from violating the normal understandings about the appropriate division of labor between state and business (see Lindblom 1977; Block 1977).

B. TAXES Increased taxation raises two problems—the possibility of inflation and of organized tax resistance. As mentioned earlier, if higher taxes can be passed on by employers and employees, in the form of higher prices and wages, the result is likely to be higher levels of inflation. The empirical issue of whether this passing along of the burden of taxation actually happens—the issue of the incidence of taxation—has been the subject of intense controversy within economics. Not surprisingly, the outcome of "empirical" studies depends heavily on the assumptions about economic behavior that go into them. These controversies cannot be reviewed here. Within the emergent post-Keynesian economic theory, however, it is widely accepted that changes in taxation can intensify conflicts among different groups for income shares leading to inflationary pressures (Asimakopulos 1979). Furthermore, even most neo-classical economists acknowledge that certain types of tax increases, such as payroll taxes, are likely to be passed through in higher prices, and the influential McCracken report (OECD 1977) mentions higher taxes as a cause of inflation.

The 1978 passage in California of Proposition 13, a tax cutting initiative, served to focus attention on the phenomenon of tax resistance. This is fortunate since despite O'Connor's emphasis on its possibilities, there has been relatively little investigation of contemporary organized tax resistance. Unfortunately, the fruits of this renewed interest are not yet available. (Some early analyses are contained in Blair & Nachmias 1979.)

One major exception is the previously mentioned study by Wilensky (1976), which attempts to account for the "tax-welfare backlash"—the shift in a segment of public opinion against increased taxes and welfare. Wilensky found in nineteen rich countries that this backlash had no relation to the absolute amount of taxation but was correlated with the form of taxation. Nations that relied heavily on visible taxes such as income taxes and property taxes engendered more opposition than those that depended on less visible forms of taxation such as the value added tax. Wilensky's findings also suggest that such highly visible forms of taxation as the property tax, which is often paid in a lump sum, are more likely to generate opposition than a tax that is withheld from income, which is perceived less as a direct outflow of money in hand. This argument helps to explain why the California voters who voted overwhelmingly for reductions in property tax in 1978 voted almost as overwhelmingly against reductions in state income tax in 1980.

A parallel line of inquiry has been pursued by an associate of Wilensky. Coughlin (1980) analyzed survey data from the 1970s for the United States and four EEC nations to assess public support for taxes and spending. He found that a survey done in 1975, a period of heightened concern with fiscal pressures, showed respondents in France, Great Britain, West Germany, and Denmark preferring improved health and social welfare programs (even if they required higher taxes) over tax reductions that might require service cuts. While the support was weaker in Great Britain and Denmark than in France and Germany, Coughlin's findings suggest continued majority support for the welfare state even in Denmark, where electoral support had been strong in 1973 for Mogen Glistru's "tax protest" party. Coughlin's findings for the United States are similar; by a small margin respondents in 1975 preferred increased government spending to a balanced budget.

Coughlin's data were collected in 1975, a year of sharp economic downturn, when concern with unemployment was likely to be stronger than anxiety about inflation. But the study is useful as a reminder that widespread support for social welfare spending remains a serious obstacle to the political effectiveness of tax resistance. There is a need, however, for much more research on tax resistance movements, on forms of local tax resistance such as defeat of local bond offerings, on how businesses effectively oppose increased local taxes, and on unorganized tax resistance—noncompliance with taxing authorities. In the interim, however, it seems reasonable to conclude that the inflationary consequences of increased taxation play a more central role in the phenomenon of fiscal crisis than does tax resistance.

C. GOVERNMENT BORROWING At the state and local levels, the major obstacle to an increased resort to borrowing as a means to increase state resources as a share of GNP is the power of the financial community to downgrade a governmental unit's credit rating. The New York City fiscal crisis presented a classic case of this power when a number of large banks refused to purchase any additional city debt. Short of this extreme action, the lowering of credit rating can discourage new borrowing because of the higher interest rates associated with reduced credit worthiness. Through such mechanisms, the financial community can exercise strong pressure for balancing revenues with expenditures and avoiding excessive debt. To be sure, the total quantity of state and local borrowing has increased dramatically in the United States, but there has not been a trend towards increasing resort to borrowing as a means to overcome a gap between revenue and expenditures.

Central governments have a much greater opportunity to engage in deficit financing, where borrowing is used to cover a shortfall in revenues. In some cases, where central banks have a high degree of autonomy, they can oppose government deficit spending by keeping a tight rein on the money supply and forcing a credit crunch. However, this degree of autonomy is rare. The major constraint against resort to ever-growing deficits as a means to expand government's share of GNP lies in the consequences of such a policy. Ever-increasing deficits strengthen inflationary pressures since they must be accompanied by a rapidly expanding money supply, which creates the classic problem of too much money chasing too few goods. Furthermore, an increasing level of government borrowing tends to crowd private borrowers out of the credit market, since government paper is a safer investment than corporate debt. Crowding out means both higher levels of interest across the whole economy, which can contribute to inflation, and the likelihood that certain types of productive private investment will not occur for want of financing. Lower levels of investment mean, in turn, slower rates of growth and hence more intense distributional struggles over the existing product, which also fuels inflation.

There have, however, been periods in which the total amount of public sector borrowing has risen dramatically for a time. Mandel (1978) argues that in response to the sharp economic downturn in 1974–75, the developed capitalist societies engaged in deficit financing with a vengeance. Between mid-1975 and mid-1976, the public sector deficits of the United States, West Germany, France, Italy, Japan, and Britain totalled some $175 billion (Mandel 1978:61). Gough (1979) discusses the same phenomenon in terms of the sharp rise in PSBR (public sector borrowing requirements) as a percentage of GNP in the 1975–76 period for Britain and other countries.

This was a temporary phenomenon associated with the economic downturn, but it was also a costly policy. It seems that the acceleration of inflation in the aftermath of the 1974–75 recession owes much to these rapid increases in government deficits and corresponding increases in the money supply. Hence, it seems highly unlikely that any nation would be able to pursue a rising PSBR to GNP ratio for any length of time as a means to increase government's share of GNP.

5. *Summary*

This brief literature review highlights how much research remains to be done in developing a fiscal sociology and in providing additional evidence for the existence of fiscal crisis as a widespread tendency in advanced capitalism. The whole issue of differential rates of growth in state spending across nations has only begun to be addressed, and sociological investigations of tax resistance and of the sources of inflation are scarce. The underdevelopment of this literature impoverishes both sociology and the more general political discourse. In the absence of a developed fiscal sociology, popular discussions of state growth tend to be dominated by the simplistic analyses of those who are determined to blame bureaucratic empire building for all of the ills of modern society.

II. FISCAL CRISIS: CAUSE OR CONSEQUENCE?

Explanations of the end of the post-war expansion fall into four groupings: theories of profit squeeze and excessive state growth; theories of the long wave; theories of resource scarcity; and theories of post-industrial transition. Some accounts combine elements of different theories, but this categorization is useful for locating the key arguments. Significantly, there is no particular relation between political position and choice of theory; there are radical and conservative variants of most of these theories. It is worth noting, however, that some still deny that any explanation of the end of post-war expansion is necessary; they see the economic difficulties of the 1970s as the result of purely contingent factors that will soon pass from the scene, leading to a new period of more rapid, noninflationary growth. While this view may ultimately prove correct, it seems significant that a more pessimistic view has become institutionalized: Most projections by economists from governments and international agencies see the 1980s as a period of slow growth for the developed capitalist societies.

A secondary issue is the dating of the end of the post-war expansion. The expansion gave way not to a depression as in the thirties but to a period of stop-and-go growth; inflationary periods of expansion have alternated with recessionary periods of dramatic increases in unemployment. Hence, different analysts, focusing on different indicators, have dated the transition anywhere from 1966 to 1974. The choice of the latter date suggests that the West's economic difficulties resulted from the oil price rise rather than from any inherent weakness in the Western economies. Otherwise, however, it seems to matter little whether one dates the end of the expansion to 1966 or 1970.

1. Theories of Profit Squeeze and Excessive State Growth

All of these theories begin from the premise that the rapid growth of state spending, particularly for social services, has had the effect of squeezing profits and thus discouraging new investment. The weakness of investment contributes to the tendency of the economy towards stagnation—the high rate of unemployment—and towards inflation. The latter tendency results because the slow growth of total social product intensifies distributional conflict over what is presently available, leading to a bidding-up of wages, prices, and taxes. In some versions, the profit squeeze is traced both to the increase in state spending and to the success of trade unions in bidding up wages more rapidly than productivity advances. The point is that the demands of workers and other groups have created a situation in which profit levels have been pushed down by wages and taxes needed to finance social welfare expenditures.

The strongest empirical support for this line of argument comes from data on the profit rate in the developed capitalist societies. Glyn & Sutcliffe (1972), Nordhaus (1974), and the OECD (1977) present data showing a declining trend in the after-tax profit rates beginning between 1965 and 1970 in most of the developed capitalist societies. Similarly, data on profits as a percentage of national income also tend to show a declining trend, as the percentage devoted to wages, salaries, and transfer payments increases. Needless to say, alternative explanations for these trends are possible, but they do provide support for the hypothesis of a profit squeeze caused by wage gains and state growth.

The radical variant[5] of this line of argument (Glyn & Sutcliffe 1972; Bowles & Gintis 1980) generally draws on an article by Kalecki (1943), who suggested that the success of demand management policies in pushing the economy towards full employment would tend to increase the leverage of the working class, enabling it to win ever greater concessions, resulting in a downward trend in the rate of profit. Kalecki anticipated the need of capitalism to resort to a "political business cycle" in order to decrease working class leverage through the periodic creation of unemployment. While contemporary radicals explain recent recessions in those terms, they also argue that such recessions no longer suffice to reverse the trend towards higher wages and social service expenditures. It is hypothesized that only a prolonged and severe recession would succeed in weakening the working class and reversing this long-term trend, but that such a prolonged downturn would create serious possibilities of a full-scale economic collapse because of the heavy debt burdens carried by many major corporations (Mandel 1978).

In sum, the radical argument sees the reduction of profit levels as a positive development, but the defense of the gains won by the working class and the poor during the long expansion requires a fundamental reorganization of society along socialist lines. And if steps are not taken in this direction quickly, the danger is serious that increasingly crisis ridden capitalism will lead, as in the thirties, to economic collapse, fascism, or world war.

Conservative variants of the argument change little more than the value preferences (Bacon & Eltis 1978; OECD 1977). Excessive concern with full employment and the foolishness of politicians seeking electoral advantage have led to overrapid growth in real wages and social service spending. Only a significant shift of income back towards profits will generate the new investment needed to overcome the tendencies towards inflation and unemployment. This argument has been given an added twist by Laffer's emphasis on taxation (see Wanniski 1978). According to Laffer, current rates of taxation are so high that they discourage initiative.

[5]As Van Parijs (1980) notes, part of the political appeal of the Marxist theory of the falling rate of profit was that it absolved the working class of any responsibility for producing the crisis of capitalism. The crisis had its roots in the internal structure of capitalism. The increasing resort of Marxists to profit squeeze arguments reflects the growing difficulties of defending the traditional standpoint. Only Mandel (1975) has made a serious effort to explain the end of the economic expansion in terms of the falling rate of profit, and he tends to subordinate that argument to the discussion of the long wave.

Hence, a sharp reduction in levels of taxation, particularly for the rich, would generate much more rapid economic growth. As is well known, other conservatives worry about the inflationary impact of such tax cuts, if not matched with spending cuts; but this argument is among people who share the same goal—the expansion of profits at the expense of wages and social service spending.

Both the radical and conservative variants of this explanation rest on the assumption that the obstacles to growth lie in the area of incentives for capital. If profits could be increased, then significant new investment would be forthcoming. There is little concern with the issue of where such new investments might be made, and whether there might be barriers to such new investment other than that of poor incentives. Furthermore, the problem of demand has been neglected. If income is shifted towards profits, consumer demand is likely to drop, creating a possible lack of purchasers for the goods and services produced through a new wave of investment.

A more satisfactory analysis is provided by Marxist writers who talk about capital's need to restructure state spending (O'Connor 1973; Gough 1979; Bowles & Gintis 1980). The idea here is not simply to slow the growth of state spending but to change its nature by increasing various forms of direct and indirect subsidies to capital while reducing the costs of delivering social services. If realized, this shift would sustain demand and contribute to higher rates of productivity growth and investment in the private sector. This in turn would generate faster levels of economic growth and make it possible for the state to finance its expanded activities with a constant share of GNP.

While this argument is useful for making sense of certain policy initiatives, it tends to downplay the obstacles to a successful pursuit of such a restructuring of state spending. Even if one assumes that resources could be diverted away from various forms of social welfare spending, it is no easy matter to use state spending to increase private sector productivity and investment. Success requires the state (*a*) to know which technologies and industries to underwrite and (*b*) to devise effective forms of intervention. Experiences in nuclear power, supersonic transport, and the French electronics industry (Zysman 1977) suggest that such state interventions have often been economically wasteful and counterproductive.

2. *The Long Wave Theories*

Long wave theories derive from the work of Kondratieff (1935), a Soviet economist active in the 1920s, who argued for the existence of economic cycles of a duration of 40–50 years. The shorter business cycles still operate during the 20–25 year upturns and downturns of the Kondratieff waves, but recessions are more severe during the downturn and recoveries are much weaker. During the post-war expansion, Kondratieff's cycles were generally ignored, but with the end of the expansion they have attracted increasing attention precisely because the post-war expansion can readily be explained as the first half of a 50 year Kondratieff cycle. (For a thorough and annotated bibliography, see Barr 1979.)

Again, the appeal of this type of explanation cuts across political and intellectual affiliations. Marxists, such as Mandel (1975), Amin (1975), Gordon (1978), and the group of researchers around Immanuel Wallerstein at the Fernand Braudel Center (Research Group 1979), have argued for versions of the long wave theory. But it was Schumpeter (1939) who did most to popularize the Kondratieff cycle, and in recent years Rostow (1978) and Jay Forrester (reported in ***Business Week*** [1979]) have proposed Kondratieff explanations. (Rostow's version differs from most other interpretations in that he sees the period starting in 1972 as the upturn of a new Kondratieff wave, rather than the downturn. For further discussion see Wallerstein [1979].)

Skeptics seek an explanation of and evidence for the regularity of a 40–50 year Kondratieff cycle. Kondratieff's own evidence rested heavily on price data. This makes it difficult to apply the theory in a period of seemingly permanent inflation. In fact, the data are suggestive rather than definitive, and it is generally acknowledged that much work remains to be done to make the argument empirically persuasive. In terms of the mechanics of the cycle, Kondratieff emphasized the role of technological innovation, expansion of the world market, and increases in the money supply, such as gold discoveries. This hardly amounts to a systematic explanation, but contemporary writers have attempted to push the argument further.

Mandel (1975) and Gordon (1978) tend to combine elements of the profit squeeze argument with an argument about technological innovation: Each Kondratieff upturn can be linked to a set of technological innovations such as railroads or the automobile-suburban complex; but during the course of the expansionary period, as labor gains in strength, profits decline and the new technologies reach their limits. The result is a long period of slower investment, during which, as in earlier cycles, wages and prices fall, while new innovations are being prepared that will cause the next upturn. Finally, a new expansion occurs on the basis of the introduction of new technologies and lower real wages. While this argument still does not explain the regularity of the proposed cycle, it does overcome some of the weaknesses of the profit squeeze argument.

In this argument, a new upturn depends on both a favorable turn in the profit rate and a new wave of technological change. This solves the demand problem, for in the early years of dramatic technological change—railroads, automobilization—the production of new infrastructure and new productive facilities absorbs enormous amounts of capital and can fuel expansion even when consumer purchasing power is restricted. The emphasis on technological change also suggests a quasi-psychological explanation for the regularity of the cycle. Such periods of dramatic technological change tend to reorganize social life in significant ways, including, for example, the patterns of urban life. It could well be that it takes a long period—15–25 years during which an earlier set of patterns no longer works—before the resistance to reorganization can be overcome. Perhaps it requires the maturation of a generation that grew up during the period of stagnation to fuel a new period of change.

While such speculations are intriguing, the Kondratieff cycle remains unproven; the theory's main attraction is its emphasis on the connection between periods of economic expansion and a series of interrelated technological innovations—e.g. between the post-war expansion and automobilization. Yet this emphasis is a reminder that the era of cheap energy that made the automobile's centrality possible has come to an end. It becomes possible therefore to link the Kondratieff argument to resource scarcity arguments about the end of post-war growth.

3. Resource Scarcity Theories

Theorists of resource scarcity have sidestepped issues of capitalism's tendency toward crisis and focused instead on the impact of rising prices for resources. The major source of this argument was the Club of Rome's study, *The Limits of Growth* (1972), which argued that the West's economic growth could not be sustained past the end of the century because of resource scarcity and pollution. The quadrupling of oil prices shortly after the appearance of the Club of Rome report made it logical to argue that these limits were already asserting themselves—that the sudden rise of the price of oil was an expression of the pressure of population and industrial growth against limited supplies of petroleum. Since it was clear that the strain of the oil price rise was slowing growth in the developed societies (Fried & Shultz 1975), it seemed commonsensical that slower growth was a product of resource scarcity and higher energy prices. This argument was formulated most gloomily by Heilbroner (1975), who linked these developments with a trend towards authoritarian forms of rule.

Although the connection between the oil price rise and an impending oil scarcity is subject to controversy, many analysts who stress the political factors in generating the 1974–75 energy crisis acknowledge that the diminishing supply of easily recoverable petroleum will create growing problems by the end of the century (Commoner 1976). Hence the distance between formulations is not great. One could argue, for example, that the capacity of OPEC and the energy companies to bid up prices in the present is related to the likelihood of serious problems of scarcity later on. Then, the current energy crisis and the slower growth it entails would be an expression of ultimate resource scarcity.

The more serious problem with this argument is its lack of attention to the possibilities of adjustment within the developed capitalist societies. There are historical examples of societies that were able to continue economic growth after being cut off from traditional energy supplies. Why, then, have the developed capitalist societies been unable to respond effectively to the energy crisis through the development of alternative sources of energy? While an external shock like the oil price rise might explain a temporary setback to economic growth, it cannot by itself explain a long-term shift to slower growth. The latter must then be a result of certain kinds of institutional blockages that prevent effective adaptation by these societies.

4. Theories of Post-Industrial Transition

The analysis of such institutional blockages is central to the last set of theories, which treat factors emphasized in other explanations as symptoms of a more fundamental condition. This fundamental condition is a transition to post-industrial society that is not proceeding effectively. Post-industrial society, in this view, is based on advanced technology and the full development of social services; its realization requires fundamental forms of social reorganization, including the rearrangement of the relationships between work and nonwork that characterized industrial society (see Block & Hirschhorn 1979; Touraine 1971; Richta 1969; Sklar 1969). This reorganization has been effectively blocked by a complex of institutional interests, and the result is a kind of failed transition in which the old social and economic arrangements no longer work effectively at a time when the new arrangements have not been attempted on a scale sufficient to solve the problems of the old order. A failed transition does not mean that a successful transition is not possible, but that the delay in achieving the transition generates a range of contradictions in the present.

Two specific aspects characterize the failed transition. The first is the existence of institutional blockages to the appropriation of new technologies. This encompasses such factors as the capacity of vested interests to slow the development of alternative energy sources, the resistance of management (as well as unions) to technologies and forms of work organization that would restore conceptual skills to the workforce, and the absence of forms of social planning that would facilitate the development of new patterns of consumption.[6] These institutional blockages slow new investment and reduce economic growth. Second, the imminence of post-industrial transition generates new sensibilities and entitlements that undermine the old structures of productivity, while increasing the demands on the social product. As a result, efforts to increase productivity without new technologies tend to backfire, and demands for increased social welfare spending continue to rise. Taken together, these factors lead to an intensified conflict over shares of the existing product, producing fiscal crisis and inflationary pressures.

In contrast to theorists of the profit squeeze, theorists of post-industrial transition see little possibility of escape through austerity measures that shift income towards profits or through a restructuring of state spending. As Hirschhorn (1978) argues, such austerity measures tend to intensify the institutional blockages. For example, austerity in the social services tends to inhibit further those dimensions of programs that serve to enhance productivity in the private sector. Similarly, state spending cannot bring forward productive new investment without far more sweeping institutional changes.

The strength of this line of argument is also its weakness. The effort to explain the multiple problems of advanced capitalism in terms of a failed post-industrial transition provides an elegant way to synthesize a number of divergent lines of argument. Yet this type of argument is notoriously difficult to substantiate. How does one "prove" that such a transition is in process? Proponents of this post-industrial viewpoint retort by means of an analogy with the period of transition that gave rise to the industrial epoch: How, they ask, could one have "proved" in 1800 that a transition to industrial society was the source of many of the social contradictions of that period? There are limits to the usefulness of such analogies. The argument based on post-industrial transition needs further substantiation.

5. *Summary*

This brief review of arguments hardly resolves the issue of whether the fiscal crisis is cause or effect. It has been shown that there are a variety of explanations for the end of the period of post-war expansion, some of which make the growth of state spending causally central and some of which do not. It also seems clear that the differences among these positions cannot be resolved by some kind of straightforward empirical investigation. In fact, it seems likely that the political-economic developments

[6]Hirsch (1976) is relevant here in arguing that current patterns of consumption tend to create increasing conflicts over scarce positional goods with the result of increasing frustration rather than increases in actual welfare.

of the 1980s will determine which of these arguments will be developed further and which will be discarded.

III. POLITICAL AND SOCIAL CONSEQUENCES OF FISCAL CRISIS

Analyses of the consequences of fiscal crisis fall into two categories: macrosociological discussions and case studies.

1. Macrosociological Discussions

The starting point of most of these discussions is the recognition that the fiscal crisis of the state will mean an end to the period of continually rising standards of living in the developed capitalist societies. The state will be forced to slow the growth of social welfare spending, and anti-inflation policies will require slower or no increases in real wages. This reality, in turn, will dramatically undermine the legitimacy of modern states, which have come increasingly to rest their claims for legitimacy on their capacity to assure continuous economic growth. Fiscal crisis, in short, leads directly to legitimation crisis (Habermas 1975).

Yet this emergent crisis of legitimation also has consequences that intensify the underlying problems. The obstacles to expanded state spending tend to break down allegiances to political parties, since these can no longer deliver the goods or hold together a diverse constituency around a program of economic growth (Gold 1977; Wolfe 1978; Poggi 1978). But as the political party system breaks down, so too do the normal mechanisms for aggregating and moderating interest group demands. These interests tend to press their demands more insistently on politicians who are often unable to resist effectively since they lack the backing of a stable party system. The capitulation to interest group pressures only intensifies the fiscal pressures and prevents the pursuit of policies that might serve a more general interest.

These trends are summed up by Janowitz (1977) as a breakdown in the mechanisms of social control. At precisely the moment when greater discipline is necessary to divide scarce resources in a rational and effective way, the political system loses its effectiveness as a source of discipline. At this point, the analysis of legitimation crisis often converges with a discussion of the hedonistic culture of advanced capitalism (Lasch 1978). The concern with personal happiness that characterizes the consumer society comes into conflict with the need for discipline in a period of slow growth, and there is no longer a solid cultural basis for the demand that individuals sacrifice in the interests of society as a whole. Such demands only serve to discredit those who utter them and further weaken the legitimacy of the political system.

As with the analysis of profit squeeze, this general diagnosis is shared by theorists of quite divergent perspectives—Habermas, Wolfe, Poggi, Janowitz, and Bell. Differences emerge, however, in the ultimate evaluation of this situation. Theorists on the left tend to see the combination of fiscal crisis and legitimation crisis as opening the way for a broadly based popular assault on capitalist institutions. Thus far, however, there has been little discussion of why this assault has not yet manifested itself despite close to ten years of fiscal crisis. Other theorists emphasize the emergence of new value systems that will allow the developed capitalist societies to discipline themselves effectively. But whether of the left, the right, or the center, analysts of this situation tend to end their accounts with exhortations to the public for more rational behavior.

2. *Case Studies*

Some of the most interesting studies of the consequences of fiscal crisis examine a particular institution or policy area in depth to see how fiscal crisis interacts with other kinds of institutional pressures. Studies such as these work on the principle laid out by Molotch & Lester (1973) that certain kinds of disruptions of the normal course of events give the sociologist a window into social structure. Periods of crisis make it easier to see how certain kinds of institutions work or fail to work. For some writers, the fiscal crisis has provided just such a window.

Scull's (1977) exemplary study along these lines examines the trend in the United States towards decarceration of various deviant populations, particularly the mentally ill. After rejecting various other explanations for the shift towards deinstitutionalization, Scull argues that the triumph of the community treatment perspective owes most to fiscal crisis. By transferring the deviants from expensive institutions to communities where they are sustained through the welfare system, considerable savings are realized. Scull uses this argument to show why a supposed reform in the interests of the deviant has served only to shift the physical location of the oppressive treatment of the deviant.

Several interesting case studies examine governmental agencies. Benda (1979) analyzes the way the Federal government responded to the fiscal difficulties of the Post Office Department through the 1970 reorganization. He uses the case study as a way to understand policy formation, stressing that the state does not respond passively to pressures from outside, but plays an active role shaped, in part, by interests within the state apparatus. Heydebrand (1979) analyzes the impact of fiscal crisis on the administration of justice. Similarly, Cohen & Goldfinger (1975) analyze the fiscal pressures on the French social security system as a way to understand both the forces that block fundamental reorganization and the inevitability that such reorganization will ultimately come about.

The vast majority of case studies concentrate on the impact of the fiscal crisis in the cities. A number of works, both academic and journalistic (Newfield & DuBrul 1977; Auletta 1979; Alcaly & Mermelstein 1977), have examined the genesis of the New York City crisis, illuminating the role of business power, and particularly the banks, in shaping the crisis. The timely appearance of Caro's monumental biography of Robert Moses (1974) contributed greatly to the understanding of the forces that had shaped New York City's development since the 1920s.

Other studies of the urban fiscal crisis focus on the effects of reductions in government spending and employment intended to bring expenditures in line with income. These analyses (Piven & Cloward 1977; Hill 1976) tend to be descriptive, showing that the urban poor and racial minorities generally suffer most from reductions in government services and employment. Political strategies have been suggested by which the victims can resist these cutbacks—e.g. Piven & Cloward's (1977) advocacy of civil disobedience as a means to oppose cutbacks. They invoke the self-reduction campaigns used in Italy, in which people refused to pay fare increases on public transportation as a way of resisting increases in the costs of services. Because such efforts to resist the impact of fiscal crisis are relatively recent, there appear to be few studies of the successes and failures of such movements.

CONCLUSION

It is striking how little sociological attention has been devoted to the broad set of issues this topic encompasses. Only a relative handful of sociologists have grappled with the nature and genesis of fiscal crisis—a surprising result in light of the importance of the phenomenon. One possible explanation is that the confidence in economic growth and the basic soundness of the developed capitalist economies dies slowly; it will take another few years of serious economic difficulties before the mindsets that originated in the long post-war prosperity give way to a focus on the problems of a new epoch. While one might expect sociologists to be especially aware of and willing to reevaluate their domain assumptions, the existence of a time lag before a set of issues is taken seriously is understandable. However, a less comforting explanation involves the academic division of labor. Far too many sociologists have come to accept the claims of economics to exclusive mandate over such issues as fiscal crisis. In such a view sociologists are responsible for studying only non-economic behavior (a very narrow category for some economists). Acceptance of this view has grave costs, both for the pursuit of understanding and for the discipline of sociology.

First, the discipline of economics has been unable to account adequately for the growing difficulties of developed capitalist societies. Much of the useful work has been done by economists marginal to the discipline—Marxists, institutionalists, post-Keynesians. Mainstream economists, by and large, have been preoccupied with either abstract theoretical issues or blatant apologetics for powerful economic interests. Even such publications as *Business Week* bemoan the failure of the discipline to come to terms with the problems of stagflation. Second, for sociology to abandon its claim (or let it die for lack of use) to the analysis of "economic" phenomena is to renounce its own heritage and impoverish its capacity to analyze social life. It needs hardly be reiterated that those figures who are now recognized as the classical figures in sociology did not refuse to grapple with certain issues because they were "economic." Even more importantly, Karl Polanyi's (1975) insight remains true, that industrial capitalism is an historically unique society in which the economy is no longer embedded in social relations, but in fact exercises great power over them. As long as this is true, sociology has little choice but to bring those economic factors into the center of its analyses.

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