

Inclusive Growth and the Welfare State

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Central messages

- The welfare state is now more important than ever
 - Increases growth and economic performance at the same time that it increases equality and equality of opportunity
 - Necessary in our democracy if economy is to remain open to the world and accept change
- Sweden was wise to have created a dynamic and effective welfare state
 - The challenge facing Sweden is to strengthen it and adapt it to the evolving 21st century economy
- Sweden was wise not to have joined the euro
 - Sweden must work to reform the EU, to *rewrite* its rules in ways which promote more growth with stability—with shared prosperity
 - Current rules impede growth with stability
 - Need for EU wide progressive income tax
 - EU has been doing a far better job than the US in fighting 21st century market power

Question of the welfare state is part of a broader debate

- Redefining the role of the market, the state, and “civil society”
- Major changes in our economy necessitate rethinking these age old questions
- Major changes in our understanding of economics and the economy

Inequality

- Society is marked by greater inequalities
- Greater understanding of the adverse effects of inequality
 - Political, social, *and* economic
 - **Economies with greater inequality perform more poorly**
 - **Multiple reasons: ensuring all individuals live up to their potential**

Inequality: origins and policy responses

- Greater understanding of the origins of inequality imply that 19th century justifications of inequality (“just deserts,” marginal productivity) are increasingly unpersuasive
- In many countries (e.g. US) rules of the market economy have been *written* to favor those at the top—especially in the last 30 of a century
 - Markets don’t exist in a vacuum; they have to be structured
 - Consequence is slower growth—partly because the “new rules” have also resulted in more short-termism

Implications: (a) Rules have to be rewritten again, this time to promote inclusive growth (b) Need for welfare state even greater

Twenty-first century welfare state is about achieving a just society and improving the well-being of ordinary citizens

- And **ensuring that the basic pre-requisites of a middle class life** (appropriate to the country's GDP) **are accessible for most citizens**
- Recognizing that markets, on their own, won't necessarily do this
- Focusing on **inequalities in initial distribution of assets, asymmetries of market power** (including those arising from asymmetries of information and associated with discrimination, past and present), **and market failures**
 - With special attention to those least able to fend for themselves
 - Especially children

The 21st century welfare state is more than a safety net/social protection

- A system of consumer, investor, and worker protection
 - Including a system trying to increase competitiveness and transparency of markets
- Investments in people
- Ensuring equality of opportunity
 - One can't have equality of opportunity within a society with large disparities in income and wealth
 - Ensuring ability of all to fully participate in labor market and have a decent standard of living
- Curbing abuses of power and exploitation

Multiple instruments and some new instruments

- Sometimes employing market mechanisms
 - Including those with strong incentives
 - Like EITC and Conditional Cash Transfers
 - But also aware of limits of market mechanism, recognizing the magnitude and extent of exploitation, and the difficulties of regulation
- More than just providing income (UBI)
 - Ensuring jobs—decent work is important part of a meaningful life
- Rejects “income” fetishism—cashing out benefits
 - Not a matter of paternalism

Power

- Recognizing asymmetries of bargaining power and the presence of market and political power
 - **Changing rules of the game** can change relative bargaining positions
 - Imposing constraints on market processes
 - Wages and hours, overtime
 - Family leave
 - Policies aimed at wage compression can be important
 - Strong unions can play an important role

All of the instruments relevant to reducing inequality should be considered part of “welfare policies”

Changing the distribution of market income

Changing the distribution of income after taxes and transfers

- **Both are essential**
- **More equality in the distribution of market incomes reduces burden of tax/transfer system**

(1) Improving the distribution of market income

- Distribution of market income can be thought of as a balance of centrifugal and centripetal forces
 - By increasing centripetal forces/reducing centrifugal forces one can create a more equal society
 - Helping poor saving as well as rich
 - Public Education

Rewriting the rules

- Rewriting the rules of the market economy to change the distribution of factor prices/incomes
 - Markets don't exist in a vacuum
 - Anti-trust and consumer protection policies may be especially important in preventing exploitation
 - Good labor legislation, facilitating strong unions and worker protection
 - Making sure that the financial system serves society rather than the other way around
 - Corporate governance and bankruptcy laws
 - Encouraging long term thinking
- Changes in these over last thirty years in most Western countries have played important role in increase in inequality and decrease in economic performance
 - Thought that liberalization and lowering taxes at top would so improve economic performance that everyone would benefit
 - In fact, economic performance weakened, and only those at the top have done well

Key role of macro-economics

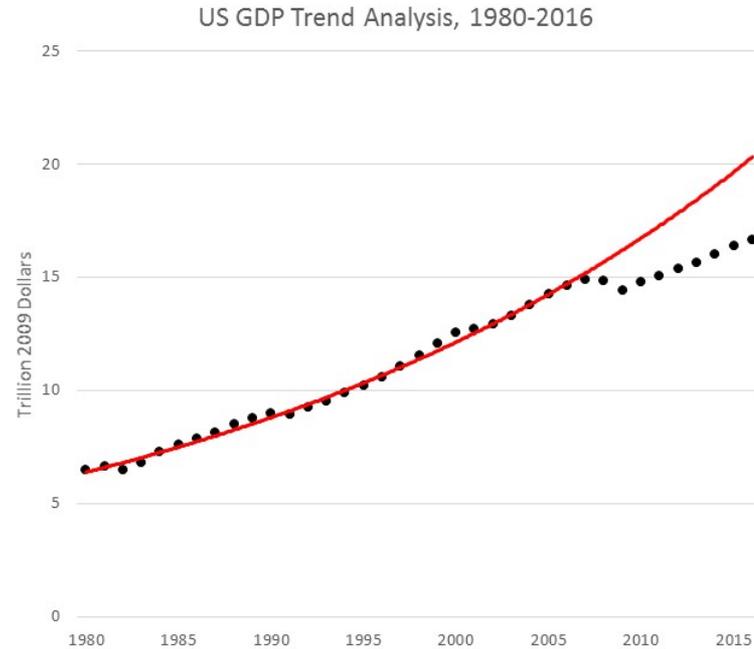
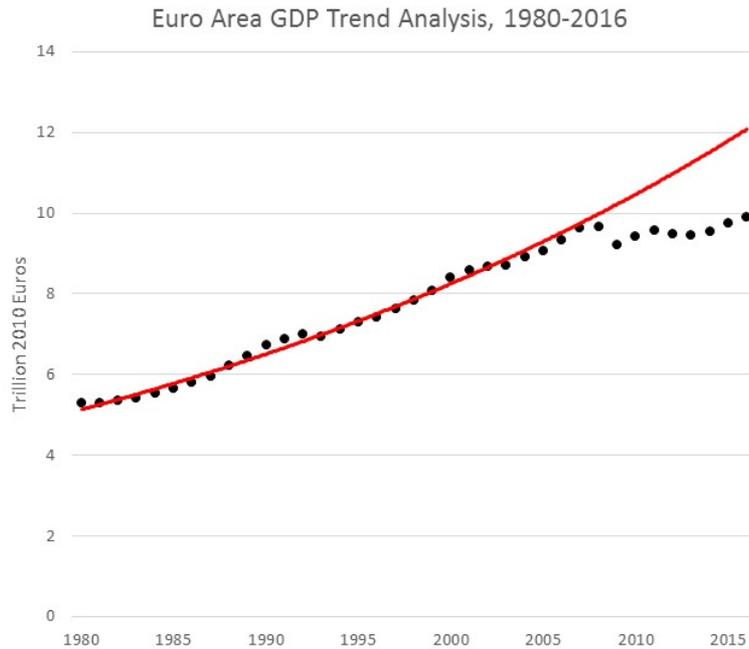
- Most important role of government is keeping economy at full employment—both for efficiency and equity
 - Markets on their own often fail to do so
- Sweden made right choice not to join Eurozone
 - Euro has not led to the kind of growth that was promised
 - Introduced rigidity which has led to a high level of average unemployment, very high level of youth unemployment, undermining growth today, jeopardizing growth of future
 - Central bank (ECB) is wrong to have a single minded focus on inflation
 - Dominant view anti-thesis of good economics: austerity has never worked nor has internal devaluation
 - Progress in creating requisite institutions has been very slow
 - Still opposition to Eurobonds, a Eurozone wide unemployment/stabilization fund, deposit insurance
 - High costs in delay

Real GDP is just recovering to earlier levels



Source: IMF World Economic Outlook Database, April 2017

Euro area has performed much more poorly than the US—even though the crisis originated in US



● Real GDP — Exponential trend based on 1980-98

Many policies which increase equality of market income also improve growth

- Important supply side measures
 - Family friendly policies allow greater participation in labor force
 - Better infrastructure “crowds in” private investment
 - Better education systems ensure that everyone lives up to ability—ensuring full use of country’s scarcest resource
 - Better education and active labor market policies enable individuals to move more easily between jobs—creating a more dynamic economy and ensuring better use of workers
 - Also important to ensure opportunity of gainful employment for older individuals who are able and wish to work
 - Better education system and investments in technology are basis of long term growth
 - Markets invest too little in basic research
 - Most important innovations have been financed by government

(2) Changing incomes after tax and transfers

Important role of redistribution—including progressive taxes and circumscribing tax evasion

Access to and costs of basic necessities of a middle class life

- Children's education
- Home ownership
- Retirement
- Health care
- Decent work, with decent pay

Technology, globalization, and distribution

- Only if a country has in place a strong welfare state (described above) will citizens be open to having an open and innovative economy
 - Globalization, on its own, can have very strong adverse effects on income distribution
 - Evident in US and many other countries
 - Predicted by economics
 - The natural discontent with globalization will be taken advantage of by demagogues, like Trump
- Protectionism is almost the inevitable consequence

Elements of 21st century system goes beyond existing system

Especially in the US which has much to learn from successes elsewhere

- **Programs aimed at elderly**
 - Social security—income protection for the aged
 - Public insurance provides insurance against contingencies that private annuities don't
 - *Public option for supplementary coverage*
 - *Fiduciary regulations for private supplementary coverage*
 - *In many countries, evidence of extensive exploitation, excessive transactions costs*
 - *Nursing home care*

Programs for children

- Especially important for poor—who cannot be blamed for their situation
 - Pre-natal
 - **Pre-school**
 - Nutrition and health
 - Compensatory education systems
 - Income support for low income parents

Programs to guarantee full access to labor market

- Anti-discrimination
- Active labor market policies
- Child care and family leave
- Transportation policies
- Full employment policies

Other basic elements of a middle class life

- *Health care as a right*
 - Policies aimed at behavioral changes
 - Availability of nutrition
 - At the minimum, “public option”—option for single payer system
- Housing
 - ***Public option for housing finance***
 - In US, government still underwrites almost all mortgages
 - Open question about how best to provide housing for low income individuals
 - **Innovative mortgages**
 - Income contingent, fixed payment with variable maturity and fixed real interest rate
 - Danish mortgage system

Higher education

- Access to higher education and life-long learning should be a citizen's right
 - Income contingent loans (as in Australia) , or
 - Low tuition
 - Choice has implications for intergenerational equity

Social protection systems

- Provident fund, combining multiple risks
- Insurance cum income contingent loan program

Concluding remarks

- Globalization has, in many ways, increased the need for a modern welfare state, but at the same time, reduced the fiscal capacity to provide it
 - Tax competition
 - Europe needs an EU wide progressive income tax
 - Is a welfare state viable today?
 - Need to reframe the discussion—welfare state is even more important—it is in fact *necessary* if our societies are to remain open
 - Question is, how to best design it/redesign it
 - Changes in economy necessitate it taking on an even greater role than in the past
 - But we have also learned how to improve the design of the welfare state

Concluding Remarks

- **Objectives of economic and social policy: Increasing well being of citizens**
 - Too often, there has been a confusion of means with ends
 - Welfare state improves well being of *most* citizens
 - With many of the programs actually *investments* in people
 - Rewriting the rules: current system of rules is a distortion of the market economy, which serves a minority at the expense of the majority
- Evidence that a twenty-first century welfare state would actually increase overall economic performance
 - Not *just* a matter of social justice
 - The only sustainable growth is shared/inclusive growth