The Meaning of the Welfare State in the Twenty-first Century

Joseph E. Stiglitz
Columbia University
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Question is part of a broader debate

• Redefining the role of the market, the state, and “civil society”

• Major changes in our economy
  • Urbanization
  • Moving to a knowledge economy
  • Change in the labor market—there are no longer lifetime jobs
    • Implying less incentive to invest in workers
    • Less loyalty between workers and firms
    • Workplace-based welfarism won’t work
Other major changes in the economy

• Growth in inequality
  • Including childhood poverty
  • Including across gender, race, ethnicity
  • Special problems of those with limited education

• Greater importance of rents
  • Competitive model provides a poor description of many (most) sectors of the economy
Major changes in our understanding of economics and the economy

• Greater understanding of the pervasiveness of market failures
  • Adam Smith’s presumption has been reversed
  • Absence of insurance markets
  • Imperfections of capital markets
  • Imperfect competition
  • With market power exercised by the rich (often through corporations)
  • Exploiting the disadvantaged, or even ordinary individuals
• And writing the rules of the game to enable them to do this legally
Inequality

• Greater understanding of the adverse effects of inequality
  • Political, social, and economic

• And 19th century justifications of inequality (“just deserts,” marginal productivity) are increasingly unpersuasive

• Greater understanding of the sources of inequality
  • Intergeneration transmission of advantages—not just wealth
  • Rules of the market economy have been *rewritten* to favor those at the top
  • Markets don’t exist in a vacuum; they have to be structured
The basic economic model has changed

- The **rational actor** model has been discredited
- Firms have ruthlessly exploited these irrationalities
  - Among those who are most vulnerable to such exploitation are the poorest
- But government has made less use of these insights
  - Including understandings about *endogeneity of preferences*
- Recognizing the important allocation of resources that occur within the household (which were given short shrift in earlier analyses)
Twenty-first century welfare state is about achieving a just society

• And **improving the well-being of ordinary citizens**
• Recognizing that markets, on their own, won’t necessarily do this
  • Corporate interests and national interests (interests of ordinary citizens) are often markedly different
  • Civil society (“charity”) is important, but there cannot be reliance on it
• 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
• And with ensuring that the basic pre-requisites of a middle class life (appropriate to the country’s GDP) are accessible for most citizens
More than...

- A safety net, providing a subsistence floor
- A system of social protection—making up for the failure of private risk markets
- A system of consumer, investor, and worker protection
  - Including a system trying to increase competitiveness and transparency of markets
- Ensuring equality of opportunity
  - One can’t have equality of opportunity within a society with large disparities in income and wealth

Although all of these are important elements
Multiple instruments and some new instruments

- Sometimes employing market mechanisms
  - Including those with strong incentives
    - Like EITC and Conditional Cash Transfers
- But rejects “income” fetishism—cashing out benefits
  - Both first and second fundamental theorems of economics have been shown to be true only under highly restrictive conditions
    - Not a matter of paternalism
- But sometimes wary of market mechanism, recognizing the magnitude and extent of exploitation, and the difficulties of regulation
• Recognizing asymmetries of bargaining 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
All of the instruments relevant to reducing inequality should be considered part of “welfare policies”

Changing the distribution of market income
  • By changing distribution of asset ownership
    • Helping savings of poor as well as rich
    • Taxes on intergenerational distribution of wealth
    • Public Education
  • Rewriting the rules 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
  • Corporate governance and bankruptcy laws
    • Changes in these over last thirty years in US have played important role in increase in poverty and extremes of inequality
Changing the distribution of “standards of living”

• Tax and transfer policies
• 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
Role of government

- More than finance
- Government-run programs, especially in finance (contingent loan programs)
  - Housing
  - Education
  - Government has marked advantages in information, transactions cost, risk pooling, avoidance of exploitation

- Government regulations
  - Strong government oversight in areas like insurance, education and health

- Recognizing not only “conventional” market failures, but opportunities for exploitation
Elements of 21st century system for US

- Programs aimed at elderly
  - Medicare
  - Social security
    - Some element of inter-generation and intra-generational distribution
- Public option for supplementary coverage
- Fiduciary regulations for private supplementary coverage
- Nursing home care
Programs for children

- Pre-natal
- Pre-school
- Nutrition and health
- Compensatory education systems
- Income support for low income parents (EITC)
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”

- Housing
  - **Public option for housing finance**
  - Open question about how best to provide housing for low income individuals
Higher education

• Access to higher education and life-long learning
  • Income contingent loans, 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

• Critical question: 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
  • Is a welfare state viable today? Need to reframe the discussion

• 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 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