

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

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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