CHAPTER 1

The Welfare State in the Twenty-First Century

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Designing the twenty-first-century welfare state is part of a broader debate redefining the role of the market, the state, and "civil society"—non-state forms of collective action.

One of the tenets of the Reagan-Thatcher revolution was questioning the welfare state. Some worried that the financial burdens of the welfare state would drag down growth. Some worried about the effect of the welfare state on the sense of individual responsibility, others that the welfare state provides an opportunity for the lazy and profligate to take advantage of hardworking citizens. A sense of social solidarity had united citizens around the world during World War II. Some thirty years after that global conflict, that solidarity was eroding, and economic arguments quickened its disintegration. Even two decades after the doctrines of the Reagan-Thatcher revolution of the 1980s had taken root—and long after its shortcomings had become obvious—others argued that the welfare state had contributed to the euro crisis.[1]

This chapter argues that these arguments criticizing the welfare state are for the most part fallacious and that changes in the global economy have even increased the importance of the system. It then describes some of the key elements of a twenty-first-century welfare state.

1. BASIC PRECEPTS OF THE WELFARE STATE

To understand the principles and philosophy of the welfare state, it is useful to contrast it with the "neoliberal" or market-oriented state.[2]

The central economic doctrine of neoliberalism is that markets are efficient. (There are limited exceptions to this belief; for example, many

who believe that markets are normally efficient still believe that the government should intervene in certain cases, for example, to ensure macroeconomic stability or to prevent pollution.) Moreover, market advocates believe that every (Pareto-) efficient outcome can be supported by a free-market economy, with the appropriate (lump-sum) redistributions.[3] This implies that one can separate issues of efficiency and distribution, and that the task of economics is to maximize output (as reflected, say, in GDP), leaving the distribution to the political process. When the conditions required for these results to hold are not satisfied, the job of the economist is to advise governments on how to ensure that they are. For example, markets must be made competitive through effective enforcement of antitrust laws.

Of course, politicians who have argued against the welfare state typically do not frame their critique in the formal language of economics. Rather, they talk about how the provision of social insurance attenuates incentives, for example, through the taxes that are used to finance it. Many politicians go further, saying that the welfare state creates a culture of dependency, implicitly arguing that it changes the nature of the individual. This argument moves beyond standard welfare economics, which takes preferences as fixed and given. This is an important argument, to which I return shortly.

By contrast, the advocates of the welfare state believe that markets are not, in general, efficient; that market failures are pervasive and not easily correctable; and that as a result, government needs to take a more active role. Of course, government should do what it can to ensure that markets work well, more in accord with how they are described in standard textbooks—for example, making sure that there is strong competition and that firms do not exploit ordinary individuals through questionable practices.

Later in this chapter, I will briefly recount the theoretical research done over the past forty years that helped us understand that pervasive market failures indicate that markets are often not efficient and that there is an important role for government, including those roles typically associated with the welfare state. The political debate was framed differently: the demand for the welfare state was driven by hard-to-ignore imperfections in markets that sometimes had a devastating effect on people's lives and well-being. It was obvious that markets were not providing insurance against many of the important risks that individuals faced, such as unemployment and inadequately financed retirement. The annuities that were

available were expensive, and none had provisions against important risks, like the risk of inflation. The absence of these insurance markets had profound effects both on efficiency and individual well-being. Indeed, it can be shown that the provision of well-designed unemployment benefit programs can not only increase well-being but even increase GDP (Stiglitz and Yun 2017).

So too, many individuals had substandard housing, suffered from hunger, and had inadequate access to medicine. Access to these necessities was declared a basic human right under the UN's 1948 Universal Declaration of Human Rights. Whether one framed these deprivations in terms of basic economic human rights or in other ways, there was a call for *specific equalitarianism*, focusing not just on income but on specific goods (Tobin 1970). Economists might debate why individuals faced these specific deprivations—whether it was a result of market failures or individuals' poor decisions or the failure of the political process to make the necessary redistributions—but the fact of the matter is that the deprivations were deep and pervasive.

Of especial concern were those deprivations confronting children, which were in no way a result of their own choices or behavior. Here again it was clear that such deprivations represented a social injustice but also led to lower GDP—these individuals would not be able to live up to their potential.

Thus, the creation of the welfare state was motivated by observed failures in the economy and society, outcomes that seemed socially unacceptable. Developments in economic theory only helped explain why these failures should have been expected.

Twenty-first-century advocates of the welfare state begin with the premise that something is not working when large sections of society face such deprivations and that government can and should do something about these failures. Moreover, ordinary individuals are having difficulty coping with unanticipated financial stresses. In the United States, what was once viewed as a basic middle-class life is no longer attainable for large swaths of society. Matters are so bad that life expectancy across important parts of the population is actually in decline (see Case and Deaton 2015; 2017). The welfare state cannot remedy all of the ills facing our society, but the advocates of the welfare state believe it can make a difference. The traditional welfare state focuses on a particular set of "market failures" associated with the markets' ability to help individuals confront important risks that they face,[4] such as providing for social

protection, through, for instance, retirement insurance (annuities) and health insurance.[5] Markets have also failed to provide insurance against unemployment and disability, and again the welfare state stepped in.

In some ways, there is a parallel between the welfare state and the developmental state. In the latter, it was recognized that markets on their own often did not succeed in the structural transformations that were required if countries were to achieve their developmental ambitions. As in the case of the welfare state, the rationale for state intervention was partly pervasive market failures of both the static and dynamic varieties. The developmental state corrected these market failures and had a catalytic role in promoting structural transformation. It helped change mind-sets—to understand that change was possible and to understand the scientific and technological bases of change.

Advocates of the twenty-first-century welfare state argue that it should go beyond the traditional welfare state model in six critical ways:

1. *Risk and innovation*. They argue that imperfections of risk markets may dampen the ability and willingness of individuals to undertake risky investments, including in innovation. Thus, the welfare state leads not only to better outcomes within a conventional static framework but also to a more dynamic and innovative economy (Stiglitz 2015a).

2. *The country as a community: social solidarity*. Neoliberalism begins from very individualistic premises. The central theorem underlying reliance on the market is Adam Smith's invisible hand theorem, that individuals in the pursuit of their own self-interest are led, as if by an invisible hand, to the well-being of society. Greenwald and Stiglitz (1986) showed that the reason that the invisible hand often seemed invisible was because it wasn't there: with imperfect information and imperfect risk markets, markets are not Pareto efficient. But the welfare state is based not just on this critique; it begins from quite different premises. Think of a country as a community, as a large family. Family members take care of one another. That is one of the most important things they do. There is solidarity among the members of the family. Many advocates of the welfare state thought of society in much the same way: national solidarity implies that those who can do so take care of those who are less fortunate. At the very least, they provide some form of social protection.

Families (or corporations) operate on quite different principles than markets do. Even if there is some reciprocity, there is not the well-defined quid pro quo. We think of ethical norms as governing relationships, not just self-interest and markets. Interestingly, though, the market works best when those participating in it are ruled by strong norms, such as those that discourage cheating or that encourage fulfilling contracts. It becomes expensive to enforce contracts through the law, and markets break down in the presence of extensive cheating. The law is designed in part to reinforce norms, severely punishing those who stray too far from them.

3. *Endogenous preferences*. The construction of society—including the rules of the economic game—affects the nature of the individual—his or her beliefs, preferences, and behavior. Indeed, we noted that some critics of the welfare state emphasize that it may undermine its beneficiaries' sense of individual responsibility. Supporters make precisely the opposite argument: the welfare state encourages social solidarity, making the individual think more about the community of which he or she is a part and, in doing so, improving social behavior in a myriad of other ways.[6] Neoliberalism has encouraged selfishness and has led to pervasive moral depravities, evidenced so clearly by the bankers in the run-up to the Great Recession: a willingness to do almost anything that enhances profits, so long as one could get away with it. For the bankers who caused the financial crisis, this greed meant in some cases crossing the line of legality—massive fraud, multiple instances of insider trading and market manipulation, and racial and ethnic discrimination. More often, though, it meant skirting the law, with practices such as abusive credit card practices and predatory lending. The head of Goldman Sachs trumpeted the new set of norms: bankers used to pride themselves as being trustworthy; now, it was every man for himself—a new standard of caveat emptor.

4. *Social justice*. The welfare state is essential to achieving social justice, broadly understood. Rawls (1971) provides a convincing case for thinking about social justice as choosing rules for society behind a veil of ignorance, before one knows one's ability, or one's station in life. I would add: and before one knows the risks that one will confront. Clearly, if individuals are averse to risk, and if markets fail to provide adequate insurance, one would want society to provide social protection.[7]

5. *Life-cycle support*.[8] Earlier, we noted that there was a compelling argument for government support for children, and especially provision of health care and education. There is another set of arguments for government provision of annuities (retirement) insurance and health insurance. As individuals go through their lives, they face a variety of other basic needs—for instance, housing. Neoliberalism simply assumed that markets provided the most efficient way of providing for these life-cycle needs, at

least at a basic level. In some countries or circumstances that might be true. But it was also obviously not so in certain other circumstances. The largely private health sector in the United States is far less efficient than that of European countries with greater state involvement, and delivers poorer outcomes with greater expenditures. Australia's system of public income–contingent student loan programs is far more equitable and efficient than America's privately based student loan system. The American public social security annuity program is far more efficient than any private annuity—with a smaller fraction of resources going into overhead.

6. *Cross-generational risk sharing.* No matter how one views the trade-offs or complementarities between the welfare state and the market, there are some forms of risk sharing in which the market cannot engage but the state can. Cross-generational risk sharing is one. Individuals within a generation can pool their risks, but it is not possible for an individual to make a contract with someone in a generation yet to be born. Society as a whole can, however, make such social contracts, and it does so all of the time. Some of the costs of fighting World War I and World War II were borne by later generations. Of course, the societal expenditures occurred during the war. And aggregate consumption during that period was reduced. But later generations' effective transfer of goods to the working-age people of the 1940s—via social security and other society-wide expenditures—meant that the World War II–era generation's consumption was probably reduced by less than it would have been otherwise. Well-designed social security systems are in part structured to facilitate this intergenerational risk sharing.

GOVERNMENT AND MARKET FAILURE

There are some who acknowledge the pervasive market failures that we have described and the ability of government, *in principle*, to correct them. But they argue that government failures are so deep and pervasive that, in practice, government interventions are unlikely to correct the market failures.

There is, of course, ample evidence of both government and market failure, without highlighting one and underestimating the other. How far the government should go in correcting market failures and with what instruments may depend on the capacities and capabilities of the state. The best-performing societies (using almost any measure) have created a well-functioning state—these societies have shown that the welfare state *can* work. In other societies, there may not yet be comparable state institutions. But it should be noted that in those societies that have achieved the best-functioning welfare states, such as those of Scandinavia, markets also work better. This is probably no accident: a well-functioning welfare state may contribute to the functioning of the market.

A VARIETY OF PRACTICES

In the twenty-first-century welfare state, there is no ideological attachment as to the best way of addressing the failures with which the state is concerned. Whether the welfare state operates through government provision of services, government regulations, or interventions in markets is not important, so long as it is effective. In some circumstances, the evolution of the market—sometimes as a result of the catalytic effects of government—reduces the magnitude of the market failure and changes the nature of public-welfare-state intervention. Thus, some might say that annuity markets are better today than they were at the time retirement social insurance programs were created (in the 1930s for the United States). Though this is true, they still do not provide insurance against critical risks like inflation, and the private market still makes much of its profits from exploiting consumer ignorance or behavioral irrationalities–for example, systematically overestimating the probability of the occurrence of certain risks. There are still unacceptably high transactions costs.

When we look around the globe, we see a range of practices. Some countries have retained the welfare state, modifying it here, strengthening it there, as they identify problems and opportunities for improvement. The Scandinavian countries are all thought to have a welfare state, but remarkably, there are also a few developing countries, like Namibia, Mauritius, and the Seychelles, that can be said to have a form of the welfare state, adapted to their (much) lower standards of living. These countries think of the welfare state as advancing a broad range of societal objectives—including economic growth. They have done well (well above the average for Africa), and many in these countries attribute at least part of that success to their having a welfare state. At the other extreme, some countries, including the United States, have at most limited social protection. The safety net is just something to prevent citizens from starving, but is not designed to enable them to live a life with dignity or to give them the capabilities to be more self-supporting.

There are many institutions, laws, and programs that make up the welfare state, and many of these overlap with what occurs in governments that do not think of themselves as having a welfare state. For instance, in all governments, there is some investment in infrastructure, though in the welfare state—more sensitive to the social benefits, with a more comprehensive societal analysis of what those benefits are—they may be larger relative to GDP. I want to focus on those aspects of the role of government that are particularly associated with a twenty-first-century welfare state.

I begin with a discussion of the developments in ideas, especially in economic theory, that have influenced—or should have influenced—thinking about the welfare state. This is followed by a discussion of some of the changes in the world that also have had an effect on the evolution of the modern welfare state. Section 4 then analyzes the principles of a twenty-first-century welfare state. The chapter then turns to two particular issues, the welfare state and deprivations (section 5) and a twenty-first-century American welfare state (section 6).

2. CHANGES IN IDEAS AND THE EVOLUTION OF THE WELFARE STATE

There have been large changes in the world—and in our understanding of the world—that have affected views of the welfare state.

The welfare state came into its own in the aftermath of World War II and the social solidarity to which it gave rise. This was a period of rapid economic growth in both Europe and America, and it was a period of shared prosperity. Every group grew, but those at the bottom saw their incomes grow faster than those at the top.

A third of a century later, this sense of solidarity seemed to wane, and neoliberalism seemed to triumph. It is worth noting that neoliberalism did not come into fashion as a result of the failure of the welfare state. There were many problems that did smooth the way for neoliberalism's growing popularity. The United States, for instance, was beset by inflation, as it tried to fight a war in Vietnam without having anyone pay the price. This macro-mismanagement was then aggravated by the oil price shocks, which variously led to price increases, recessions, inflation, and stagflation. But these problems were not *caused* by the welfare state, and abandoning the welfare state was not the solution. Still, they provided an opportunity for the ever-present critics of the welfare state to push for another model, which promised faster growth—so much faster that all

would benefit. The pie would increase so much that even though those in the middle and bottom would be receiving a smaller proportion, the size of their piece would increase. But the supply-side reforms did not pan out: the economies grew more slowly, rather than faster; inequality was even greater than "promised," with the result that, in the United States, the incomes of the bottom 90 percent basically stagnated (Stiglitz et al. 2015). The welfare state, weakened but not gone, softened the consequences, especially in Europe, but did not reverse them: inequality grew in most countries around the world.

DEVELOPMENTS IN ECONOMICS

The irony was that this seeming faith in markets grew just as economists were beginning to understand the limits of markets and why market failures were so pervasive. Adam Smith's presumption—that markets would lead the economy, as if by an invisible hand, to societal well-being—was reversed. The first welfare theorem, that every competitive market economy was efficient, was turned on its head. Economists had always understood that markets are often not competitive; they understood, too, that when there are externalities, markets would not be efficient. Greenwald and Stiglitz (1986, 1988) showed that even competitive economies were almost always inefficient, so long as there were imperfections (asymmetries) of information and incomplete risk markets—that is, always.[9] These market failures were different from the kinds of market failures that economists had focused on following Arrow and Debreu's work, such as imperfections of competition and externalities, which presumably could be easily identified and corrected. Externalities, for instance, could be addressed through Pigouvian corrective taxes; anticompetitive behavior, through antitrust policies. The pervasive market failures identified by Arnott, Rothschild, Greenwald, Geanakoplos, Polemarchakis, and Stiglitz could not so easily be addressed.[10] This line of research has thus established that markets are efficient only under highly restrictive conditions, *which were essentially never satisfied*; hence the new presumption that markets are not efficient.

Arrow and Debreu provided sufficient conditions under which these results were true. For markets to be efficient in the management of risk, there has to be a full set of securities, called Arrow-Debreu securities. It is clear that such a full set does not in fact exist. Indeed, most individuals have a hard time buying insurance against some of the major risks that

they confront. Subsequent research (focusing on the economics of information) has explained why markets for insurance are incomplete.

There followed a quest to answer two questions: (1) Would the results be approximately true if these assumptions were, in some sense, approximately satisfied? (2) And were there weaker conditions under which the theorems were still valid? Market advocates hoped that so long as the imperfections of information were not too great, the standard model would provide a good description of the economy and the economy would be, if not fully efficient, at least approximately so. They also hoped that there were weaker conditions than those assumed by Arrow and Debreu under which the economy would be fully efficient.

Unfortunately for market advocates, both of these hopes were disappointed. Rothschild and Stiglitz (1976) and Diamond (1971) showed that even a little bit of imperfection of information could have very large consequences. Some had hoped, for instance, that one could obtain efficiency in the absence of a complete set of insurance markets (Diamond 1967), but that proved to be wrong (Stiglitz 1982).

The central concerns of traditional welfare economics—social protection—were thus at the heart of this growing recognition of the limits of the markets.

Imperfections of information also implied that one could not separate issues of distribution from issues of efficiency: the second welfare theorem was also true only under restrictive and unrealistic conditions. Distribution affected the magnitude of agency costs in a society.[11] Moreover, imperfections of information meant that lump-sum taxes targeted at correcting distributional inequities could not exist. Greater inequalities in market incomes put a greater burden on redistribution through the tax and transfer system, and such redistributions were not costless.[12]

Not only has there been greater understanding of the inefficiency of markets, but there has also been greater understanding of the origins and adverse effects of inequality. Nineteenth-century justifications of inequality ("just deserts," marginal productivity) are increasingly unpersuasive. Increasing inequality arises only partially as a result of changes in factor prices—for example, as a result of skill-biased technological change. There may be increased intergenerational transmission of advantages—not just wealth—because of changes in our education system and increases in economic segregation. Furthermore, our tax system may also have facilitated increased intergenerational transmission of advantages (see Stiglitz 2015b).

In addition, developments in game theory and markets with information imperfections provided understandings of why imperfections of competition were so pervasive, as well as understandings of the links among this market power, inequality, and the precariousness felt by so many ordinary citizens. Market power was often exercised by the rich (often through corporations) to exploit the disadvantaged, or even ordinary individuals. Because markets do not exist in a vacuum, they have to be structured: how they are structured affects efficiency and distributions. The rules of the game are set through political processes. But economic power too often gets translated into political power. The political power of the rich enabled them to write the rules of the game to enhance their market power and incomes—and to exploit workers and consumers. A vicious circle emerged (Stiglitz 2012).

One of the most profound implications of this new understanding of inequality was that it became clear that there was not necessarily a trade-off between economic performance (broadly understood as growth, efficiency, and stability) and equality. Older doctrines held that if one wanted more equality, one had to pay a price. I, along with an increasing number of other economists and institutions, including leading mainstream institutions like the IMF and the OECD, have argued that we pay a high price for inequality and that, especially once we take into account what gave rise to this inequality, we could get better economic performance if we reduced inequality from the extremes to which it is rising in the United States and many other Western countries.[13]

The research just described explained how it was that even with most of the standard assumptions of conventional economics—including fully rational individuals—market outcomes were inefficient and inequitable. But in recent decades not only have assumptions such as perfect information, perfect risk markets, and perfect competition that underlie the neoliberal model been questioned, the rational actor model itself has also been discredited thanks to the development of behavioral economics. Firms have ruthlessly exploited these irrationalities.[14] Among those who are most vulnerable to such exploitation are the poorest.

Government has made less use of these insights than it might, whether to combat this exploitation or to develop programs that better meet the needs of society. Government and economic theorists have paid too little attention to understanding *endogeneity of preferences* and the implications that this has for policy—though the private sector spends considerable efforts in shaping preferences.[15] Additionally, government and economists

have paid too little attention to the importance of the allocation of resources that occur within the household and firms, both of which occur without the mediation of prices and markets.

All of these increases in our understanding of the economy, the limitations of markets, the limitations of individual rationality, and the importance of equality should lead to a renewed focus on the welfare state—a reexamination of what it should do and how it should do it. Twenty-first-century welfare states should and will be different from those of the mid-twentieth century.

3. CHANGES IN THE WORLD

While changes in ideas provide a renewed interest in the welfare state and the role it can play in improving societal well-being, changes in the world have increased the imperative for reconstructing the welfare state.

For instance, there have been marked changes in the labor market—there are no longer lifetime jobs, implying less incentive for firms to invest in their workers and less loyalty between workers and firms. Workplace-based welfarism of the mid-twentieth-century variety won't work today.[16] Matters have been made even worse because of the "sharing economy" and "innovations" in worker-employer relations—converting workers into "independent contractors." Firms that have embraced these new models are motivated in part by the desire to avoid taxes and circumvent employer regulations.

At the same time, the enormous growth in inequality makes it clear that the market on its own, at least as it has been structured under neoliberalism, won't achieve anything approaching something that is socially acceptable, let alone any higher ambition, such as the just society. At the bottom, those in the United States confront the same real wages as they did sixty years ago. In the middle, the income of a full-time male worker—and it is increasingly difficult for those without a college education to get a full-time job—is comparable to what it was more than four decades ago.

There is an especially strong consensus that something needs to be done about childhood poverty—with approximately one in five people in the United States growing up in families in poverty. While the United States committed itself to the elimination of discrimination, the large wage gaps in gender, race, and ethnicity are evidence that discrimination still abounds. (The financial crisis of 2008 provided further evidence of

racial and ethnic discrimination in lending.) Not only do the changes in the economy make it clear that the corporation cannot play the role in social protection that it once did, changes in the structure of our society limit the role of social institutions. Changes in demography mean that we have gone from the extended family to the nuclear family and, increasingly, to the non-family, as marriage becomes increasingly unpopular, especially among low-income individuals. As urbanization has progressed, social bonds have weakened, and with that the kind of social protection provided by communal solidarity (Putnam 2000, 2015).

Finally, there have been a number of changes that have weakened the bargaining power of workers—including poorly managed globalization—and increased the market power of firms. Some of these have led to weakened unionization, and weakened unionization has led in turn to workers' weakened bargaining power. Rents have taken on greater importance: the competitive model provides an increasingly poor description of many (or even most) sectors of the economy (Council of Economic Advisers 2016).

This means that without the protection of the state, there will be more individuals at the bottom, and the deprivations they suffer will only be addressed by state action, providing further impetus for a twenty-first-century welfare state.

4. PRINCIPLES AND PRACTICES OF A TWENTY-FIRST-CENTURY WELFARE STATE

The 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 and that corporate interests and national interests (interests of ordinary citizens) are often markedly different.

The modern welfare state focuses 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 to ensure that the basic prerequisites of a middle-class life (appropriate to the country's GDP) are accessible for most citizens.

Similarly, the modern welfare state does more than just provide a safety net, a subsistence floor. The focus of the traditional welfare state is on social protection—making up for the failure of private risk markets.

But the modern welfare state is more than that: it is also a system of consumer, investor, and worker protection, including a system trying to increase competitiveness and transparency of markets, in the belief that more competitive and transparent markets enhance the welfare of society.

A central tenet of a twenty-first-century welfare state is ensuring equality of opportunity, and that, of course, entails a particular focus on children and their health and education, fighting against the intergenerational transmission of advantages and disadvantages and against discrimination in all its forms. And there is increasing recognition that one can't have equality of opportunity in a society with large disparities in income and wealth.

MULTIPLE INSTRUMENTS

Earlier we observed that the twenty-first-century welfare state is focused on creating opportunities and improving outcomes but is not wedded to any particular mechanism for achieving these. It sometimes employs market mechanisms but rejects income fetishism—the idea that well-being is necessarily enhanced by cashing out benefits—and allows individuals to make choices of their own. This rejection is not a matter of paternalism, though it is partially motivated by a concern about children who are not allowed to make choices for themselves and may not be in good positions to make good decisions. Behavioral economics has shown that individuals may make short-run choices that are not in their long-run interests, and persistent irrationalities can and are exploited by profit-maximizing firms. But even absent these, market mechanisms may not be appropriate: pervasive market failures may make access to certain basic necessities difficult at best for those of modest income. Private sector firms can take advantage of those who are less informed and have shown the willingness and capacity to engage in broad and deep exploitation. This means, at a minimum, that relying on the private sector necessitates tight monitoring and regulation; but both monitoring and regulation can be difficult—and once a private sector has been established, a political economy process is set in play to weaken regulation and its enforcement.

Moreover, there can be social consequences from the way the private sector works, which in turn have important societal consequences. In education, for instance, it can result in segregation by income or ability.[17] Again, one can imagine regulation to prevent this, but the design

and implementation of such regulation is difficult. Further, education has shown itself to be one of the areas where exploitation is particularly easy: those from poor backgrounds may be in a weak position to judge what is being "sold," and in the United States, private for-profit colleges have proved particularly adept at taking advantage of this. The industry has also proved to be particularly adept at fighting off attempts to regulate it—even attempts to force disclosure of information (such as graduation rates, employment rates and average salaries for degree holders) that would facilitate good choices on the part of potential enrollees.

One can think, moreover, of there being social externalities, with the education of one child being affected by who else is in the classroom. But it is more than that: the provision of public education, with children from all backgrounds sharing similar experiences, helps shape society, providing an example of the endogeneity of preferences and attitudes discussed earlier in this chapter.[18]

While market power and asymmetries of bargaining power can arise in any market, the consequences can be particularly important in the provision of basic necessities. There can be, and typically is, more concern about the redistributive consequences. (By contrast, the social consequences of market power in diamonds are likely to be more limited.) Here, if the market is relied upon, a welfare-state government has to be particularly sensitive to the importance of the rules of the game; changing the rules of the game can change relative bargaining positions.

For instance, in a twenty-first-century welfare state, most jobs will be provided by the private sector, but there must be rules that facilitate workers engaging in collective bargaining. And the government will need to impose constraints on the market processes, setting minimum wages, maximum hours, minimum overtime pay, minimum family leave benefits, and so on.

All of the instruments relevant to reducing inequality might be considered part of "welfare policies," going well beyond the usual tax and transfer policies. Antitrust and consumer protection policies may be especially important in preventing exploitation. Changes in corporate governance and bankruptcy laws over the last thirty years in the United States have played an important role in the increase in extremes of inequality at the top and have even contributed to the increase in poverty. Creditor-friendly bankruptcy laws encouraged, for instance, predatory lending, with lenders knowing that it would be more difficult for individuals to discharge their debts.

GOVERNMENT AS PRODUCER AND REGULATOR (AND ENTREPRENEUR)

The neoliberal agenda attempted to discredit government in many of its roles, except perhaps in providing a safety net for corporations, as was evident in the aftermath of the 2008 crisis. The oft-noted irony is that an agenda focused on minimizing the role of the state had resulted in the largest intervention of the state ever. But while corporations were provided with social protection, much more limited social protection was provided to those losing their homes and jobs. In the United States, of the hundreds of billions of dollars that went to "saving the economy," a very small fraction went to helping homeowners. Many conservatives opposed providing bankruptcy relief or extending unemployment insurance, even as many reached even the extended time limits for support.

However, government-run programs can play an important role in the twenty-first-century welfare state. The next section will illustrate the role they can play through income-contingent loan programs; and our previous discussion has noted problems associated with the private provision of education.

Government has marked advantages in information, transactions cost, risk pooling, and the avoidance of exploitation. There at least needs to be strong government oversight in areas like insurance, education, and health, recognizing not only market failures but also the opportunities for exploitation.

As we noted earlier, in some areas government has proved to be an effective catalyst and entrepreneur, and not just in innovation.[19] Public social insurance for retirement has perhaps provided the spur leading to the development of the private annuity markets, though again, as we noted earlier, private annuities remain expensive, partly because of the large profits, sales costs, and other transactions costs.[20]

At the same time, a better understanding of economics has enabled an improvement in the design of the programs provided by the welfare state. Behavioral economics, for instance, has provided insights into how "nudges" can increase retirement security (see Sunstein and Thaler 2008). Combining income-contingent loan programs with standard unemployment insurance can lead to more efficient provision of insurance (Stiglitz and Yun 2014; 2017), as can the integration of various social insurance programs (Stiglitz and Yun 2005). Advances in the economics of information have also made it clear that the intertwining of adverse selection and moral hazard made reliance on private markets for health insurance at

best problematic,[21] and that care even had to be taken in allowing private supplementation of public provision.[22]

5. DEPRIVATIONS

The growth of the welfare state was associated with the recognition that there were large groups in society suffering from significant deprivations—even in wealthy countries. For simplicity, we can divide them into three groups: youth, the elderly, and the poor of working age.

THE ELDERLY

The distinction between neoliberalism and the welfare state is perhaps clearest in the context of the treatment of the elderly. If the elderly have insufficient income to live a decent life, the neoliberal response is: they should have saved for their retirement. Those that did not save enough are getting the just deserts of their profligacy, of their failure to save and manage risk appropriately. The nanny state undermines incentives for individuals to take care of themselves, according to the neoliberal view, and almost inevitably results in those who are responsible subsidizing those who are not. Since it was realized that individuals might not save enough, and that our humane society was too soft not to bail out an elderly person who hadn't saved adequately, there needed to be a *minimal* compulsory savings program with minimal or no discretion over the management of funds.[23] And because some individuals had so low an income during their lifetimes that there was no way their savings could finance a retirement with a minimum of human decency, there was a need for supplementing what these workers would receive on an actuarial fair basis.

Yet this twentieth-century perspective ignored multiple failures in the market for annuities and retirement products: (1) Before social security, the market did not provide adequate annuities; and indeed, the market for annuities has been very slow to develop. (2) Even as it developed, premiums were high, partly because of high administrative costs compared with the government, which could take advantage of certain economies of scale and scope, including lower transactions costs in collecting and dispersing funds. (3) Even today, those who manage retirement accounts are often not required to obey fiduciary standards, resulting in large transfers of wealth from retirees to those managing the funds. (4) Today, markets do not provide adequate insurance against some of the important risks,

which are sometimes hard to anticipate. Private annuities do not provide insurance against inflation. Those buying safe government bonds can't buy insurance against the risk that the government will push interest rates down to zero for an extended period of time.

Modern theory has explained why, with adverse selection, important insurance markets (like the market for annuities) may not exist. Government can force pooling and risk sharing in ways that the private sector cannot.

Ironically, much of the interest in privatization of social security arose from the desire of the financial sector to increase its profits: they wanted to increase transactions costs, and they knew that there were huge opportunities for them to "phish for phools"[24]—to find individuals who were relatively financially unsophisticated and could be exploited.[25]

Thus, today, many elderly in the United States who prudently put their savings into government bonds are bereft of income. They acted responsibly: who could have anticipated a decade of zero interest rates? Neoliberalism simply accepts that they were unlucky. The welfare state says that societal well-being can be improved by providing social protection—social insurance—against the vagaries of markets.

CHILDREN

We have argued that the neoliberal philosophy of putting the onus for deprivation among the elderly on the individual is questionable; but even most of those who believe that there should, in general, be reliance on markets agree that the same approach cannot be adopted for children. One cannot claim that they should have done a better job at picking their parents.

Admittedly, there are real concerns with state paternalism. What happens, for instance, if parental views about education differ from those of the government? But such issues arise with or without the welfare state. The welfare state is concerned about access to resources—including educational resources—not who directs how those resources are used.

Even with children, there are moral hazard/incentive issues: parents may not work as hard knowing that the state will provide some support. The magnitude of these effects is almost surely not large; but in any case, advocates of the welfare state put primacy on the well-being of the child and the long-run consequences of the child facing deprivations. Though this is an ethical stance, from a long-run efficiency view, the economic

benefits of ensuring that each child lives up to his or her potential almost surely outweigh any adverse incentive effect, if one exists.

There is one more philosophical issue: many parents may believe that they have a fundamental right to advantage their children over others. This conflicts with a principle of equality of opportunity. In some societies, such inequities would be viewed as intolerable. In others, circumscribing them would be viewed as intolerable. The welfare state begins with the premise that *at a minimum* every child should have the opportunity to live up to his or her potential. This entails access to good preschool education and to affordable higher education, either through low tuition (subsidized by the state) or income-contingent loans (as in Australia).[26] And most of those subscribing to welfare-state principles, while not proscribing individuals from attempting to give some advantage to their children—how could one even imagine doing that—want to tilt the scale at least slightly toward equality. Thus, there is free public education, and parents wishing to send their children to private school forgo this benefit. But the charter school movement is in part an attempt at circumvention of this attempt at creating a more egalitarian educational system, unless strict regulations are imposed on the socioeconomic and racial mix of students. Local education in the United States suffers from a similar problem: with increasing economic segregation, rich parents move to rich suburbs to get their children a "private-school quality" education. If one is committed to maintaining a modicum of equality of opportunity, one has to ensure more economic integration and less dispersion in spending.

THE WORKING-AGE POPULATION

Neoliberalism and the welfare state have the greatest conflict when it comes to the working-age population. The young cannot be held accountable for their state. The elderly can be, but it's too late to lecture them that they should have saved more. But what about those who are able to work but do not. Should one let them suffer?

Here, the advocates of the welfare state again emphasize the presence of market failures. With high levels of unemployment, it may be hard to get jobs. India has made the most important contribution to the welfare state agenda: the rural guaranteed-employment scheme, which guarantees a job for everyone willing to work in a public works project, at a wage at or slightly below the minimum wage.

Even a full-time worker may be in poverty, if market wages are too low. Neoliberals and welfare state advocates often agree that if someone works full time, he or she should not be in poverty; there needs to be an earned income tax credit to ensure that all full-time workers deserve to live above the poverty level. (Some advocates of a welfare state believe that there are other tools the government should use—namely, a minimum wage.)

Welfare state advocates are typically concerned not just with income but with access to certain basic goods, like food, medical care, and shelter. Presumably, if everyone had an income large enough to guarantee adequate access to these basic goods, then there would not be such a concern about these goods. But no country has achieved that ideal, and in its absence, welfare state advocates argue that some attention must be paid to ensuring that individuals have access to adequate amounts of these basic necessities. But there is another reason for their focus on these markets: the belief that they often do not work well, in ways that lead to large numbers of the poor and middle class facing deprivation. Direct intervention is needed. Today, as our understanding of market failures has improved, there is a better grasp of why the markets for these goods often fail, and this knowledge can be used either to design ways of correcting the market failure and/or to create better systems of public provision. Neoliberal economists, by contrast, tend to ignore or minimize these market failures; and even when they recognize them, they suggest that government actions are not likely to improve matters. In some cases, they believe that the market failures have been exacerbated by the government.

The growing concern about labor-saving technological progress—the notion that robots may replace humans, and that jobs for all but the highly skilled will be scarce—has led to growing support for a universal basic income (UBI), a grant given to everyone. This proposal also has the support of many who believe that targeted welfare programs (aimed at the "needy") are sufficiently cumbersome and inefficient that they often do not reach those in need, and when they do, they do so in ways that undermine human dignity. While recognizing the merits of these arguments, I still believe that work is an essential part of human dignity and a meaningful life, and that our economic system must be designed to provide work that pays a livable income to any who are able and willing to engage in it. Besides, we are far from the point, even in our richest countries, where there is a public willingness to tax at a level that would ensure that the UBI benefit would be sufficient to sustain a decent life.

6. ELEMENTS OF A TWENTY-FIRST-CENTURY SYSTEM FOR THE UNITED STATES

Any welfare state program has to be tailored to the country and its history, institutions, and problems. In advanced countries like the United States, the scope for tax evasion is limited, and most transactions now occur digitally. Indeed, it would be easy to move to a completely digital system (see Stiglitz 2016a, 2016c, 2017). By contrast, in Latin America, where there is a strong welfare state tradition, many people still fall within the informal sector—those small-scale economic activities that the government often does not fully monitor or tax and that typically provide few of the fringe benefits and job security associated with the formal sector. Much of the social protection is directed at those in the formal sector—who are typically better off than those in the informal sector—and the worry is that, if there is a fiscal deficit in these programs to be made up for by support from general revenues, the beneficiaries of such state support are those who are better off on average. The response is to make more of the schemes universal and less contingent on income (because income is not accurately observable for large portions of the population). But moves in that direction result in the programs providing less social insurance—evening out income across good and bad "events." Income-contingent public loan programs (described in greater detail later) may be one way of squaring the circle.

In many quarters, there has been resistance to the notion of the welfare state, with even Democratic presidents justifying the strength of our corporate welfare system (but not the weakness of our system of social protection for the rest of society) by saying that we're different from Scandinavia.[27] That puts a special onus on those proposing public programs. Yet, while there is widespread skepticism of public programs, there is very strong support for both Social Security and Medicare. Indeed, in a famous incident at a 2009 town hall meeting with a congressman from South Carolina, an audience member shouted for the representative to "keep your government hands off my Medicare": evidently, because the program was so successful, it was presumed it must be a private program.

In the following sections, I briefly describe elements of a twenty-first-century welfare state for the United States.

PROGRAMS AIMED AT THE ELDERLY

Medicare and Social Security should continue to be at the center of programs for the elderly. These programs have elements of both intergenerational and intragenerational distribution. It is not clear that the design of these programs takes into account differences in life expectancy and retirement ages across income classes to the extent it should. These differences may be becoming even more important.[28] Changing the structure of retirement income with retirement age can rectify existing inequities, at least on average.

But there are at least three important extensions that should be considered:

1. PUBLIC OPTION FOR SUPPLEMENTARY COVERAGE FOR MEDICARE, STRONGER FIDUCIARY REGULATIONS FOR PRIVATE SUPPLEMENTARY COVERAGE, AND TAXES ON CERTAIN TYPES OF SUPPLEMENTAL COVERAGE

The provision of supplemental insurance interacts with the public provision of base coverage. Again there is an irony: neoliberals consistently worry about the moral hazard effect, the effect of coverage on the likelihood of the insured-against event occurring. They worry that people will not take as good care of themselves if they have health insurance or that they will overuse medical care. Yet when it comes to advocating for private supplemental coverage, these concerns are suddenly forgotten. If such coverage were provided by a competitive, nonexploitative market, there would be excessive coverage, because the private sector firms would ignore the additional costs their coverage imposes on the public sector. But the sector is often far from perfectly competitive, and there is ample opportunity to exploit the elderly, especially given the complexities of the coverage, that is, describing what is and is not covered.

That is why it may be desirable to have a public option, one that enables consumers to feel they are not being exploited. The public option would likely be less expensive (more value per dollar premium), simply because it can take advantage of economies of scale and scope—the government is already providing Medicare coverage to everyone. Moreover, because so much of private insurance companies' costs are associated with marketing, cream skimming (efforts to ensure that one is insuring only good risks), and collecting insurance premium and other charges, overall "transaction costs"—dollars that go to running the insurance system rather than to providing health care benefits—would be lower with the public option than under the current regime.

The pervasive incentive of private providers to engage in cream skimming, the attempt to recruit as customers only the most healthy—imposing a kind of externality on others—provides a rationale for forbidding private coverage, regulating it to ensure that it does not engage in cream skimming, or taxing it in a way that reduces the incentives for cream skimming.

2. RETIREMENT INSURANCE

The United States has created a multitiered system—an efficient, universal basic coverage provided by government; corporate pensions for those lucky enough to work for a corporation providing these tax-preferenced benefits; and a supplemental retirement program that, up to a point, also receives tax preferences. In these programs, individuals are left to invest in the market, with the individual drawing down his or her savings post-retirement or purchasing annuities. Corporate programs have switched from defined benefits to defined contributions, and thus both corporate and individual supplementary programs leave huge risks on the shoulders of ordinary citizens; and as we have noted, market annuities leave much to be desired. Criticism of the basic universal coverage is not based on its lack of efficiency but on the fact that, in some central forecasting models of the evolution of the economy over the next seventy-five years, its expenditures will exceed its revenues. Critics argue, moreover, that political economy considerations make it difficult to bring the public program back into balance.

The fact of the matter is that the deficit is relatively small, sufficiently small that reasonable alternative estimates of, say, migration would bring it back into balance. Alternatively, small adjustments either to taxes to finance it or to the design of the program itself would bring it back into balance. Part of the reluctance to make large changes now in the anticipation that fiscal gaps would appear later is that the models on which the projections of fiscal deficits depend are highly sensitive to the assumptions.

Prior to the 2008 financial crisis, there was a big push, especially by those in the private financial sector, to at least partially privatize social security. The argument was that the private sector was more efficient; the reality was just the opposite. It was simply an attempt by the private sector to grab more rents for itself; the incomes of those selling the annuities

increase as transaction costs increase—all at the expense of retirees. Results from the partial privatization of social security in the United Kingdom suggested that retirement benefits might be reduced by as much as 40 percent (Orszag and Stiglitz 2001).

A further critique of private programs is that, here again, there is an incentive to "phish for phools" (Akerlof and Shiller 2015)—profits can be increased more readily by developing better ways of exploiting the unwary than by lowering transactions costs or "beating the market" in one's investments, both extremely difficult. Indeed, the resistance the financial sector put up against fiduciary standards to prevent conflicts of interest was remarkable. They seemed to argue that they could not function if they were not allowed to continue with practices rife with conflicts of interest.

Again, a public option provides effective competition to the private sector and security against exploitation: the government would simply allow individuals to make contributions to social security, treating such contributions as if they were received as a result of employment. That is, what a retiree receives is based on contributions made into his or her account over the many years before retirement, both by the worker and by the employer on the worker's behalf. Those with greater contributions receive more back in their social security benefits. Now, there is a cap, because contributions are limited; in 2017, individuals and their employers only made contributions on incomes up to $127,200. The "public option" would allow individuals to choose to make contributions beyond that—and to put aside, in their social security account, more of their income than the 6.2 percent they currently contribute.

3. NURSING HOME CARE

The facts that individuals are living longer, families are getting smaller, and the cost of housing is high in the urban areas where an increasingly large proportion of families live mean that increasingly large numbers of the elderly are left to themselves in their old age. They have to turn to nursing homes, which they cannot afford. Through Medicare, the government is picking up a large fraction of these costs. Over the years, there have been discussions of adding nursing home care to the Social Security program. Private insurance again has proven very costly. Such insurance could be provided by a modest increase in the Medicare or Social Security contributions.

PROGRAMS FOR CHILDREN

There is an increasing recognition of the inequities faced by children from poor families and that investing in these children can pay large social dividends. There is a need for stronger prenatal and preschool programs. Earlier programs aimed at ensuring nutrition and health for all children have proven their worth.

Reducing inequities at birth requires not just equal access to education but compensatory education systems.

Children live in families, and income support for low-income parents redounds to the benefit of children. That, of course, is part of the philosophy of the earned income tax credit. That program has to be extended and strengthened.

Children from poor families get off to an unfair start even when compensations are attempted, but when it comes to tertiary education, they are again placed at a disadvantage. America used to be the leader in the fraction of the population that goes on to college; it no longer is, because it is more difficult for a young American of modest means to go to college or get access to a quality education to live up to his or her potential than is the case in other developed countries. President Obama recognized this, but he only offered to have universal access to community colleges. While these institutions have played an important role in extending access, the quality is typically not the same as in the country's best schools. Some critics say that we cannot afford even this much. But somehow, at the end of World War II, as we emerged with an enormous debt—130 percent of GDP—the country said that it could afford to provide education to all who had fought in the war, essentially every young man and many women, for as many years at as good a school as the person was qualified to attend. The country is much richer now; anyone who says the country can't afford this is making a statement about *choices* and *preferences*—that he or she thinks there are better ways of spending that money, such as leaving it in the pockets of the very wealthy or the banks or the corporations and letting them determine how it is spent. By contrast, anyone committed to a twenty-first-century welfare state would argue that one must ensure affordable access to college for *all*.

Around the world, there are two approaches: low tuition (financed by government subsidies) or income-contingent loans. The latter have proven particularly effective in Australia. With the government providing the loans, the transaction costs will be low. Repayment can be done

through the tax system, and the cost of capital for the government is far lower than for the private sector.

This is another area where more regulation is required—both on those providing finance and those providing higher education.

PROGRAMS TO GUARANTEE FULL ACCESS TO THE LABOR MARKET

There is also increasing recognition that the poor, and many middle-class Americans, do not have equal access to labor markets. Discrimination is pervasive. America has done less to make it easy for women to participate in the labor market and get ahead—which is why female labor force participation rates in the United States trail those of the best performing countries. Public transportation systems are weak, and when they exist, they often do not provide connections between the locations where low- and middle-income Americans live and where the jobs are situated.

Furthermore, an excessive focus on inflation and an unwillingness to engage in sufficiently large and effective fiscal policies has meant that the economy is often at less than full employment. Unemployment puts downward pressure on wages, especially when combined with provisions that have weakened workers' bargaining position.

The remedies for these problems are clear: stronger antidiscrimination laws more effectively enforced; active labor market policies to help those who lose a job get the skills needed for the new jobs being created; childcare and family leave policies; public transportation policies focused on connecting people and jobs; and a renewed commitment to full-employment policies.

BASIC ELEMENTS OF A MIDDLE-CLASS LIFE

The basic elements of a middle-class life seem increasingly out of reach for many Americans. Among those requisites are health care, housing, education for one's children, and a modicum of security, including retirement security and social protection in case one loses a job. I have already discussed several aspects of these. Here, I identify programs that might address other deficiencies in current arrangements.

1. HEALTH

The Affordable Care Act (ACA) made great strides in increasing access to health care, but twenty-six states refused to extend Medicaid so that more of the previously uninsured were covered. This extension was a

central part of the "design" of ACA, so there are still large gaps in coverage, though the numbers without insurance are, at the same time, markedly lower than before ACA. (This fact was brought home forcefully in 2017, as Republicans attempted to "repeal and replace" ACA. They simply could not come up with a new program that didn't leave some twenty million Americans who now have health insurance coverage without coverage. While many Americans still did not fully recognize access to medical care as a basic human right, the vast majority believed that millions *more* should not be left uninsured.) Beyond ensuring that *everyone* has health insurance, there are three further reforms needed. First is to recognize that health and access to health care are basic rights, as other countries have done.

Second is to improve competition in health care provision. There has been disappointment in the level of competition in many of the so-called exchanges that the ACA mandated, which are supposed to be marketplaces where consumers can compare plans. In some cases, there may be scope for stronger antitrust enforcement. In many cases, though, it may not be easy to prove collusion, and thus competition laws will not suffice.

What is required for competition is a public option, which can simply be provided by extending access to Medicare to everyone. (This had been originally proposed as part of the ACA, but got scuttled as the law was debated.) The presence of the public option will lead to more competitive pricing by private firms.

Third and finally, there must be policies aimed at behavioral changes and ensuring the availability of good nutrition. An increasing proportion of health problems are associated with social diseases, like obesity. The market has left large parts of the country as "food deserts," places, for instance, where it is hard to access fresh fruits and vegetables. In New York, former mayor Michael Bloomberg showed how public policy could remedy such shortcomings.

Many of these social diseases are in part the result of corporate avarice—corporations that enrich themselves by selling unhealthy foods, including to children, or, as in the case of cigarettes, making their products more addictive. What is required are strong regulations curbing these purveyors of disease and death.

2. HOUSING

Many Americans face inadequate housing and obtain housing finance only at excessively high costs. The private sector model of providing housing finance proved its inadequacies in the 2008 crisis, in which the

housing bubble played such a large role. But as the practices of the private sector came under scrutiny, it became clear that they were more focused on exploitation—exploiting both consumers and investors—than on risk management. Remarkably, nine years after the crisis, the private sector model is still broken; the government provides more than 90 percent of all housing finance.

While there is an open question about how best to provide housing for low-income individuals, there is a simple solution for providing housing finance, which I call the public option for housing finance. There are two pieces of information that are critical in determining an individual's eligibility for a mortgage—the value of the house and the individual's income—and both of these pieces of information exist in public records. Transferring this information from the public sector to the private sector is costly. This would become unnecessary under the public option. Moreover, the cost of collection would be greatly reduced; there are economies of scope in using the tax-collection system. Repayment could even be made on an income-contingent basis. Thus, a better product could be provided at a lower cost. The loan could be provided at just a little more than the rate at which the government borrows.

3. SOCIAL PROTECTION SYSTEMS

Individuals are averse to risk; they care about the risks they face, and security has a value. The market overcharges—or simply doesn't provide the security that individuals want and, as has been suggested, government could provide. Much of what we have already discussed is part of society's social protection system. Here, I want to make two observations.

Most individuals are unemployed for periods that represent a small fraction of their working lives. Unemployment, especially for the young or average wage earners, has a high cost, because they cannot engage in intertemporal smoothing. Providing unemployment loans (possibly income-contingent) would enable individuals to smooth their incomes without the adverse incentive effects sometimes associated with unemployment insurance. It would allow them to continue to search for jobs appropriate to their skills and preferences, thus increasing GDP (Stiglitz and Yun 2005).

But there are some individuals who face repeated and/or extended bouts of unemployment; thus "interstate insurance"—insurance against this risk—is important. But the risk of future unemployment decreases

the unattractiveness of a conventional loan (even if one could get one) to tide one over a short bout of unemployment, since it lowers consumption in some states where the marginal utility of income is very high. There is an easy solution: income-contingent unemployment loans. The optimal unemployment benefit program thus consists of a combination of income-contingent unemployment loans and unemployment insurance. The optimal design looks markedly different from that of the U.S. unemployment system (Stiglitz and Yun 2014, 2017).

More broadly, the design of optimal systems of social protection entails maximizing risk mitigation while minimizing market distortions (adverse incentive effects), and this can be done by pooling risks, that is, having a single individual lifetime account addressing a variety of risks, along the lines of Singapore or Malaysia's provident fund. It provides for a high level of individual responsibility—because of the risk pooling, individuals can themselves take care of most of the risks they face—while allowing social insurance against large cumulative calamities.

7. CONCLUDING REMARKS

Many critics of the welfare state believed it would bring down the economy, as the weight of social obligations and the security provided by social insurance both eroded incentives. It turned out that none of the major crises have been related to the welfare state but were instead brought on by the excesses of the financial sector (the sector that employs many of the welfare state's critics). Even after the crisis, some in the financial sector (including the European Central Bank) found it difficult not to seize the opportunity to warn against the dangers of the welfare state, even though countries with the strongest welfare states were among those with the strongest recoveries.

The question is sometimes posed: Is a welfare state viable today? 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, because of tax competition.[29]

There are two responses. The first is that we must reform globalization, limit the scope for tax competition, and design effective systems of taxation of multinational corporations. In Europe, this is an especially important issue, because of the ease with which goods, money, and people can move. On the Continent, there is a need for a progressive Europe-wide income tax, the revenues from which could in part be used to provide some basic social protection.

The second is to note that a well-designed welfare state would actually *increase* overall economic performance. As we noted, there is now a large body of theory and a wealth of evidence that societies that are more equal perform better, having both higher growth and more stability. We noted earlier, for instance, that equity can lead to more innovative societies, because individuals are more willing to take risks. [30] Karl Ove Moene and his co-authors (Moene 2013; Barth, Moene, and Willumsen 2015) have also noted the benefits in creating a politics that supports openness: with a modicum of social protection, individuals are more willing to accept change and openness. The evident growth in protectionist sentiments among Americans and Europeans who have been left behind bears testimony to this insight.

Thus, the welfare state is not *only* a matter of social justice. Still, I believe the most compelling case for the welfare state goes beyond these narrow economic arguments. It even goes beyond standard arguments for social justice. We must ask ourselves: What kind of society do we wish to live in, and what kind of individuals do we wish to be? For those who support the welfare state, its central role is in creating compassionate individuals with a social conscience and a sense of solidarity with their fellow citizens.

NOTES

1. Interview of Mario Draghi in the *Wall Street Journal* (Blackstone, Karnitschnig, and Thomson 2012).

2. As in any set of doctrines, there are large differences in views among the adherents of these market-based philosophies. I ignore those subtleties here and refer to doctrines that argue against the welfare state and for the reliance on markets as "neoliberalism."

3. These are referred to as the first and second fundamental theorems of welfare economics. For further elaboration on these issues, see Stiglitz (1994).

4. The welfare state can thus be contrasted with the *developmental state*, which focused on the role of government in promoting development (especially in East Asia—see, for example, Chang 1999), and the *entrepreneurial state* (Mazzucato 2015), which focused on the role of government in promoting innovation.

5. In the United States, for example, Medicare provides health insurance for the elderly. In the United Kingdom, the National Health Service provides such insurance more broadly.

6. Hoff and Stiglitz (2016) emphasize the endogeneity of preferences and the role that society plays in structuring beliefs. See, in particular, their citations to evidence concerning the effects of banking on greed and dishonesty.

7. The discussion of endogenous preferences above poses difficulties for this framework of social justice.

8. Section II elaborates on these issues, with a particular focus on the implications for social justice.

9. In particular, they showed that the economy was not *constrained* Pareto efficient, that is, there exist interventions within the given market structure that would make some individuals better off without making anyone else worse off. See also Arnott, Greenwald, and Stiglitz (1994); and Geanakoplos and Polemarchakis (1986).

10. Rothschild and Stiglitz (1976) showed that even a slight amount of information imperfections (asymmetries) had very large effects on equilibrium outcomes—or even the existence of equilibrium. In short, the standard theory was not robust.

11. See Shapiro and Stiglitz (1984); and Stiglitz (1993b, 1994).

12. See Stiglitz (1998, 2016b).

13. This was the central point of Stiglitz (2012). There have been a rash of empirical studies from the IMF (Ostry, Berg, and Tsangarides 2014; Dabla-Norris et al. 2015), the OECD (Cingano 2014), and elsewhere corroborating this perspective.

14. Evidenced so strongly in the Great Recession. See chapter 10 in Stiglitz (2010). See also Akerlof and Shiller (2015).

15. See Hoff and Stiglitz (2016); World Bank (2015); Sunstein (2016); and the references cited therein.

16. Just as earlier, the decline in the extended family and urbanization, with the weakening of the sense of community and the decreased role of religion, placed increasing burdens on the state for social protection.

17. For instance, if the rich prefer having their children go to school with the rich, profit-maximizing schools for the rich will be economically segregated.

18. Given the centrality of education to our society, it is not surprising that there is a large literature on these subjects—the effects of choice on the quality of education and on educational segregation; the consequences of particular market and market-like mechanisms, such as vouchers and charter schools; the political economy of private education; and market failures in education, particularly once one sees education not just as part of the formation of human capital but as at the center of how society screens individuals, differentiating among those with different abilities. Stiglitz (1973) discussed social externalities and the efficient provision of education; Stiglitz (1974) discussed the interactions between private and public educational systems, with a majoritarian political economy model; Stiglitz (1977) analyzed more broadly the inefficiencies associated with the provision of public goods by local authorities; Stiglitz (1975) discussed the inefficiencies of the market provision of education, when there is screening; and Stiglitz (1988) analyzed how market inefficiencies even extended to the market provision of textbooks.

19. See Mazzucato's book, *The Entrepreneurial State* (2015), describing the central role that government has played in the big innovations in recent decades.

20. And, like all insurance markets, they face problems of adverse selection.

21. See Stiglitz and Yun (2013)

22. There are important externalities that can be addressed, at least in part, by appropriate taxation. See Arnott and Stiglitz (1986, 1990).

23. See Stiglitz (1993a).

24. In the words of Akerlof and Shiller (2015).

25. The financial sector has engaged in extensive and well-documented fraud, but what we are talking about here is more subtle—selling products to individuals with higher fees that cannot be justified by performance.

26. See Chapman, Higgins, and Stiglitz (2014).

27. This was Obama's defense for his bank bailout, when it was pointed out that there were far better ways of dealing with banks in trouble—ways that are more consistent with the "rules" of capitalism. See Stiglitz (2010).

28. See Case and Deaton (2015, 2017).

29. This is a theme I analyzed in Stiglitz (2013). See also the other papers in that volume, in particular Moene (2013).

30. See Stiglitz (2015a).

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