THE WELFARE STATE REVISITED

EDITED BY

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PREFACE

For a third of a century, the welfare state has been under attack, even more so since the crisis of 2008. The idea that the state has a responsibility for social protection dates back at least to the nineteenth century. Bismarck is usually given credit for creating the first social security program.[1] There were both economic and political objectives: Bismarck believed that social insurance would increase productivity and that it would stave off more radical reforms.

Since then, critics of the welfare state have argued the opposite. They claimed that it attenuates incentives and encourages a dependency mentality. Somehow, as Europe and the world grows richer, the welfare state increasingly appears to be a luxury out of reach, given today's economic and budgetary constraints. European Central Bank head Mario Draghi, in some of his press interviews, seemed to go so far as to blame the welfare state for Europe's woes, declaring: "The European social model has already gone."[2]

The central thesis of the papers in this volume is that Draghi and those who argue similarly are wrong. Now, more than ever, there is a need for a welfare state. A stronger welfare state is part of the answer to Europe's problems, not the cause of them. Those countries in Europe with the strongest welfare states weathered the crisis better and have higher living standards. The development of welfare states is also essential for equitable development in middle- and low-income countries. Furthermore, it is critical to reverse the adverse domestic inequality trends that have been in place throughout the world since the last decades of the twentieth century.

But a twenty-first-century welfare state will have to be different from that of the nineteenth century, when it began under Bismarck, or the twentieth century, when it was extended, reaching new heights, for instance, in the United Kingdom with Clement Atlee implementing the Beveridge Report.

Thus, this book deals with two interrelated issues that are central challenges of the twenty-first century. The first is the welfare state. How to redesign it for the twenty-first century in a way that is consistent with a coherent vision of its role in the economic and social system. How to facilitate the spread of the welfare state throughout the whole world, especially in the developing countries that have not yet subscribed to its principles. How to strengthen it in developed countries where its advancement is incomplete (as in the United States) or where it has been weakened in response to ideological political shifts (in several countries since the Thatcher-Reagan era) and austerity policies put in place over the past decade (in some European countries). The redesign of the welfare state must respond to the demands generated in many parts of the world by demographic changes, the new features of labor markets, technological change, and the fiscal constraints created by tax competition in the globalized world. Moreover, research in recent decades has provided new insights into the roles that the welfare state has to perform and how to design a better, more efficient, and equitable system.

The second challenge is rising inequality, a fairly widespread trend of the world economy since the 1980s—with some exceptions, notably the improvements that took place in most Latin American countries in the early twenty-first century, which still left this region as one of the most unequal in the world. This challenge is, of course, related to the first, as the welfare state was historically the major institutional framework to manage the inequalities generated by the functioning of markets, inequalities that have been magnified by globalization.

These two challenges were central to the world's agenda put forth in the Sustainable Development Goals (SDGs) approved by the UN General Assembly in 2015. The commitment to reduce inequality is clearly stated in SDG-10: "Reduce inequality within and among countries." The objectives of the welfare state are captured in SDG-1: "End poverty in all its forms everywhere," and this goal includes a particular commitment to social protection: "Implement nationally appropriate social protection systems and measures for all." Social protection is also included in the objectives set out in SDG-3, to "ensure healthy lives and promote well-being for all at all ages"; in SDG-4, to "ensure inclusive and equitable quality education and promote lifelong learning opportunities for all;" in SDG-5, on the commitment to "end all forms of discrimination against all women and girls everywhere"; and through the particular emphasis placed on children, the elderly, and persons with disabilities in several goals.

The volume is organized in two parts. The first part analyzes the conceptual issues associated with the two challenges outlined above, while the second focuses on the experience of specific regions or countries. The two parts intersect throughout. For instance, there are specific analyses of the U.S. welfare system in chapters 1 and 2, and some chapters in the second part of the volume deal with the broader issues of the design of the welfare state.

The conceptual framework of the project is laid out in chapter 1 by Joseph Stiglitz, as well as in the contributions by Sandra Polaski and Isabel Ortiz (from the International Labor Organization), in chapters 2 and 3, by Jody Heymann and Aleta Sprague in chapter 4, and more specifically by many other contributors to this volume. As Stiglitz argues, the welfare state's major defense is ethical: a desire for social justice, based on a sense of solidarity and social conscience that must be at the center of adequate social arrangements. Underlying the welfare state is the question of what kind of society do we want to belong to and create. Of particular concern are those that cannot care for themselves, children and others who, without the help of the state, might face severe deprivations.

Beyond this ethical argument, the authors of this volume argue that a well-designed welfare state also improves *economic* performance. Stiglitz underscores the pervasiveness of market failures—including their incapacity to provide insurance against major risks that people face, such as severe sickness, unemployment, and old age—and the inability of markets to mitigate, and rather, their tendency to increase, inherited inequalities. Imperfections in capital markets means that without the assistance of the government, talented individuals with poor parents would never be able to live up to their potential. One of the major market failures is, of course, the absence of any mechanism to guarantee cross-generational risk-sharing, which would have entailed contracts with unborn generations. A greater awareness of the breadth of these market failures has led to a broadening out of the meaning of the welfare state. It embraces not just that the state takes responsibility for social protection but also that it engages in a range of investments in arenas where, in the absence of the government, there would be underinvestment. So too, because of pervasive market failures, the welfare state may offer a more efficient way of providing a variety of needs that individuals confront at various stages of life, from education to children, to retirement income for the aged, to mortgages for homeowners. This theme—that a twenty-first-century welfare state is broader than just social protection—is a central one of this volume.

Correcting these market failures may not only enhance social justice, but also improve economic performance. In particular, the social insurance provided by the welfare states results in more innovative societies and economies where individuals are more willing to accept change and its associated risks. These features are key to faster productivity and economic growth. The absence of adequate systems of social protection may well have contributed to the growth of protectionist sentiments that have spread in many parts of the world in recent years. These positive results go against the view of critics of the welfare state, who argue that welfare attenuates market incentives and creates a culture of dependency that blocks change.

Stiglitz points out that the welfare state has proven itself robust, able to adapt to differences in circumstances. Thus, while this volume focuses on welfare states in Latin America and Europe, Stiglitz notes that there are successful cases in Africa (Namibia, Mauritius, and the Seychelles). The papers in this volume explore the variety of forms that the welfare state has taken around the world.

Stiglitz also argues that changes in the world necessitate changes in the structure of the welfare state. In particular, work-based welfarism of the mid-twentieth-century variety—where much of the burden of social protection was imposed on individual employers—will not work today. And changes in social structures imply that social institutions, like the family, may not be able to play the role that they did in the past.

Workers' increasing vulnerability is, of course, partly a result of their weaker bargaining power, so addressing the concerns of the welfare state entails addressing the broader issue of why that is so and what can be done about it—what changes in, say, labor market rules would enhance workers' bargaining power?[3]

Changes in the world and our understanding of how the economy functions[4] have also broadened the instruments and refined the design of the welfare state. Cash transfers and microcredit schemes[5] represent two important innovations within developing countries. Even more importantly, as the relevant chapters in the book show, several Latin American countries have been putting in place universal health, pension and child and maternity benefits, and India created the very novel National Rural Employment Guarantee.

Stiglitz emphasizes new understandings, too, of the areas in which the state may have a comparative advantage based, say, on lower transactions costs (taking advantage of economies of scale and scope, including those arising from its role in collecting taxes) and weaker incentives to engage in abusive practices.[6] The design of the welfare state also has to take into account changing views on the role of individual responsibility and choice, which look more askance at mandates and more favorably at programs that expand the range of choices that individuals face. But any move away from universal, mandatory programs confronts problems of adverse selection ("cream skimming"), which can at least partially be addressed through appropriate tax and regulatory policies.[7]

These ideas form the basis of some of his suggestions for a twenty-first-century welfare system for the United States, which includes a public option for supplementary coverage of Medicare (the U.S. program of health care for the aged) and basic coverage of those below retirement age, a public option for supplementary retirement insurance, going beyond the mandatory levels required of all individuals, income-contingent loans, not only for education but also for unemployment and other areas currently provided through grants and insurance,[8] and a public option for mortgages, including income-contingent mortgages.

Beyond the significant impacts of social welfare systems on individual workers, households, and firms, these systems also generate short-term macroeconomic benefits, as argued by Polaski in chapter 2. Most obvious is the fact that systems of social protection act as automatic stabilizers. By contrast, as Ortiz argues in chapter 3, the weakening of social welfare systems as a result of short-term austerity programs, has contributed to the poor social and economic performance of those countries over the past decade.

These arguments are closely linked to the debates on inequality, where there is a growing body of theory and evidence showing that societies that are more equal have better economic performance. Several chapters in this volume confirm this relationship. Polaski notes that productivity and economic growth were much stronger during the earlier postwar period when labor and social protections were arguably at their peak. Torben Andersen argues in chapter 7 that human capital, and its more equitable distribution, enhances economic growth. Similarly, José Antonio Ocampo and Natalie Gómez-Arteaga (chapter 10) find that the spread of social protection had stronger effects on poverty reduction in Latin America in 2003–2013 than did economic growth.

In chapter 4, Heymann and Sprague propose four essential pillars of a welfare system: healthy development, economic opportunities, foundation for resilience, and nondiscrimination. The first includes policies for infants and paid leave for their mothers, as well as policies that support children's education. The second pillar states that access to a decent job is an essential pathway out of poverty and requires adequate wages and a work-life balance for workers. The third pillar entails basic support during illness, unemployment, and old age—a system of social protection. The last pillar overlaps with the former two, and should guarantee the equal social treatment of people of all genders, races, and persons with disabilities.

Polaski proposes in chapter 2 five major elements that are necessary for successful social protection reform for the United States. These elements can be applied in broad terms to other countries: (1) to preserve, defend, and improve the already established rights and social protection systems; (2) to close existing loopholes in labor laws; (3) to improve enforcement of labor laws; (4) to adapt and expand contributory social insurance systems; and (5) to fill the gaps in the social protection floor in comparison to other economies.

In turn, based on the current world debates on social protection, Ortiz argues in chapter 3 that reducing inequality in the twenty-first century will require strengthening welfare systems by (1) expanding social protection until universal coverage is achieved at adequate benefit levels; (2) reducing informality, incorporating youth and informal workers into the labor market, and regulating precarious forms of work (e.g., digital employment); (3) enhancing labor standards and social rights, strengthening collective bargaining and social dialogue; (4) re-reforming pensions to ensure pension adequacy and old-age income security; (5) investing in the care economy, creating millions of jobs in long-term care and childcare, which will additionally increase female labor force participation; and (6) supporting other redistributive policies outside social protection.

Some conceptual debates cut across the whole volume. One particularly important debate relates to the role of universalism versus targeting in the design of social policies—or, in the specific realm of protection between the design of social security and social protection systems versus more limited social safety nets. The views expressed in this volume are definitely inclined to the universal character that the welfare state must meet its broader societal goals, but also generate its full expected economic benefits.

A second conceptual debate relates to what Stiglitz calls "income fetishism": the belief that well-being is enhanced by cashing out benefits and allowing individuals to make choices of their own. Income fetishism is tied to the substitution of market instruments—in pensions, but also health or education—for public sector arrangements. As Ortiz argues, the introduction of individual accounts, pension privatization, and other reforms in a number of countries weakened the redistributive components of social security systems. In chapter 12, Uthoff forcefully argues how the pension privatization in Chile—a model that received significant attention in other countries, including in the United States, and was championed by the World Bank for several years—failed to guarantee both universal access and adequate pensions.

Several other issues with the welfare system are underscored in different chapters. These problems include particular policies for children and the challenges of aging societies—a major obstacle faced by several developed countries, but also by China and other developing countries. There is also a discussion of novel debates and policies, including the proposal to design a universal basic income (UBI), raised in chapter 3 by Ortiz, and more extensively in chapter 14 by Richard McGahey. In chapter 15, Amit Basole and Arjun Jayadev analyze India's National Rural Employment Guarantee.

The issue of financing and its redistributive effects are discussed in detail in chapter 5 by Nora Lustig. An essential point she makes is that, although social policies generally improve income distribution and reduce poverty, there are actually cases in which they leave the poor worse off in terms of actual consumption of private goods and services, and thus increase income poverty. Such cases occur when there are taxes on basic foods that are consumed by the poor, or when there are taxes on agriculture in poor countries.

In turn, the importance of intrahousehold distribution is analyzed in detail in chapter 6 by Ravi Kanbur. He underscores that intrahousehold distribution has a major effect on some traditional social policies, including, in particular, a minimum wage. Kanbur therefore argues that intrahousehold effects must be incorporated in the design of transfer programs to guarantee that they maximize social welfare.

The selection of regional and national experiences covered in the second part of the volume is not meant to be comprehensive, but the range of issues discussed reflects the challenges that welfare states face around the world. The experiences included are the European Union, Scandinavia, Latin America (the region of the developing world on which we focus, largely because of its significant advances in social protection in the early twenty-first century), the United States (also dealt with in chapters 1 and 2), and India's National Rural Employment Guarantee.

Chapter 8, by Elva Bova and Ernst Stetter deals with the EU welfare states. As the authors indicate, these welfare states have undergone major transformations in the past to respond to surges in unemployment, to adapt the systems to aging populations, to account for shifting gender roles within households, and more recently, to accommodate the austerity measures put in place after the 2008–2009 financial crisis. Changes in the welfare systems have also been accompanied by labor market reforms and a reduction in the power and role of labor unions and collective bargaining. While Bova and Stetter note the need for a reaffirmation of the European welfare state (the EU social model), in particular as a result of new emerging social risks due to the crisis (higher unemployment and dualism between insiders and outsiders of the labor market), international competition, as well as the expansion of new forms of unprotected (including digital) labor, are challenging the scope of the welfare state and providing less room to maneuver for nation-states.

Chapter 9, by Kalle Moene, analyzes the experiences of the Northern European countries (Scandinavia in particular), and how they are relevant to the developing world. The welfare state, he argues, raises the individual labor productivity of poor workers, empowers weak groups, and generates a continuous and politically sustained redistribution. The chapter starts with a broad-based discussion on how the welfare state raises the productivity of low-skilled workers and reduces poverty. The welfare state also enables weak groups to take more control over their lives, to be more resistant against shocks and deprivation, and to be better protected against abuse of power by employers and landowners. The chapter emphasizes the political popularity of welfare programs in these countries, which is key to their sustainability. Northern Europe's experience provides important guidance for other countries, though obviously benefit levels must be set in accordance with the local living conditions in each country. As Stiglitz also emphasizes, experiences within Scandinavia support the theory that the model is supportive of innovation.[9]

The next three chapters deal with experiences in Latin America. The first, by Ocampo and Gómez-Arteaga (chapter 10), shows the significant improvements in the social indicators that took place in the region over the 2003–2013 decade, including reductions in income inequality in most countries. Aside from favorable external conditions (high commodity prices and ample access to external financing), improvements can be attributed to the construction of new forms of social protection as part of the development of stronger and innovative welfare states. Broadening coverage to guarantee universal access has been the best guarantee for strong redistributive impacts of social spending. The authors point out that, despite much progress, many challenges remain: the limited social protection coverage of informal workers (particularly in pensions), and the low redistributive impact of fiscal policy. These challenges are becoming more important in the new era of slower economic growth that the region is facing.

In chapter 11, Ana Sojo argues that efforts of diverse nature and magnitude will be required in Latin America for continued expansion of social protection coverage, improvement of its quality, and an increase in the equitable features of its financing schemes. The strategy of universalization cannot be exclusively focused on increasing resources, but must rather target institutional changes to break the fragmentation and segmentation built into the very structures of the region's social protection systems. Coverage expansion requires continued improvements in formalizing employment and a mix of contributory and noncontributory pillars.

The experiences in Latin America are similar to those elsewhere: the presumed advantages that market systems allegedly offer to consumers have not materialized. This is forcefully argued by Uthoff in chapter 12, which presents a critical evaluation of Chile's 1981 reform, the earliest and best-known case of a reform that replaced the old social insurance with a system of compulsory individual pension accounts and health plans managed by the market. The system has shown poor results in terms of guaranteeing universal access, affordable risk coverage, and sufficient benefits for the poor and vulnerable. Overall, he argues, the system is inconsistent with the solidarity principles that should be at the center of well-designed social protection systems. He proposes a series of reforms to repair it. In health insurance, this would require regulation to access a single and open health plan, and risk-pooling to compensate across insurers by risk exposure. In the pension system, this implies providing a universal flat benefit for all; defined contributions financed in a tripartite way, with cross-subsidies topped to a level that guarantees an income similar to the minimum wage; and a self-funded benefit out of individual savings accounts.

Chapter 13, by Teresa Ghilarducci, complements the analysis of the deficiencies of the U.S. welfare system by Stiglitz and Polaski in the first two chapters of the volume. She underscores that, for the first time in two generations, the risk of elderly people being poor or nearly poor will increase because the American pension system has failed. She attributes the failure to the ideological emphasis on individual asset building. Extending large tax breaks and encouraging more voluntary participation in individual accounts may have boosted participation, but the costs of the system were very high, and its distributional aspects were ineffective, and in fact enhanced inequality. In her view, a pension system should do three basic things to smooth life-course consumption: accumulate sufficient assets over the life course, invest those assets well, and distribute them as a lifelong stream of income. These objectives are most successfully attained through a guaranteed retirement account plan, in which sufficient accumulation is achieved through mandatory participation, with other rules that ensure both that contributions are not dissipated in transaction costs and in that the investment risks are managed so that the risks facing the retiree are at most limited.

The last chapters of the volume analyze two interesting innovations. Chapter 14, by McGahey, analyzes the proposal to introduce a UBI as a complement to existing welfare state policies, or in some cases, as a replacement for the welfare state as currently constructed, with its myriad of programs directed at particular needs. His chapter highlights the economics of different versions of this idea, discusses the social welfare policy issues associated with a UBI (with special reference to the United States), and outlines an agenda for future research on how it would function in relation to existing welfare state policies. In McGahey's view, much of the current interest in UBI stems from a belief that robots and technology will rapidly eliminate jobs, but the evidence in this regard is still uncertain. The author argues, therefore, that the UBI debate might be better linked to the analysis of changing economic and power relations between business and labor and the growth of the "precariat"—the large number of individuals who view their station in life as highly precarious. He believes that focusing on the continuing decline of job quality, labor standards, and dependable income returns us to the core arguments about the design and efficacy of the welfare state.

The final chapter, by Basole and Jayadev, analyzes an innovation that has actually been implemented: India's employer of last resort program, the

(Mahatma Gandhi) National Rural Employment Guarantee Act (NREGA). NREGA guarantees 100 days of wage employment in a year to every rural household whose adult members volunteer to do unskilled manual work. Work is undertaken to produce durable assets that will contribute to environmental conservation, irrigation, and infrastructure. In terms of its coverage, it is perhaps one of the largest social programs in the world. Equally interesting, while relief through employment under public works programs have been part of poverty alleviation in many pre-industrial contexts, the idea of a programmatic employment program such as this one is a great novelty. The authors argue that India's peculiar structural transition has created significant employment challenges. In this regard, the NREGA has been a step toward providing the country's workers some security and dignity. Such an intervention also has the advantage over an unconditional income transfer in that it can simultaneously create meaningful work, develop skills, and provide economic goods.

Finally, we want to thank all of the organizations that supported Columbia University's Initiative for Policy Dialogue on this project: the International Labor Organization, the Roosevelt Institute, the University of Oslo, the Foundation of European Progressive Studies, and the Ford Foundation. This project was part of a broader agenda on inequality of the Ford Foundation and represented the international complement to the Roosevelt Institute's work on inequality. Their work has centered on how the rules of the market economy have been rewritten over the past third of a century—beginning in the Reagan-Thatcher era, in ways that have led to poorer economic performance and more inequality. One aspect of this "rewriting the rules" has been stripping away the protections of the welfare state, at the same time that changes in the economy, and in the rules themselves, exposed individuals to more risks, and seemingly inhibited the ability of the state to perform the social functions that it has in the past. The central theme of the Roosevelt Project is that rewriting the rules once again can increase societal well-being, promote equality, and strengthen economic performance. One important aspect is rethinking the welfare state. We hope that this project and volume serve as significant contributions to some of the most important debates of our time.

NOTES

1. According to the U.S. Social Security Administration, "The idea was first put forward, at Bismarck's behest, in 1881 by Germany's Emperor, William the First, in a ground-breaking letter to the German Parliament. William wrote: '. . . *those who are disabled from work by age and invalidity have a well-grounded claim to care from the state.*'" www.ssa.gov/history/ottob.html.

2. *Wall Street Journal*, February 24, 2017.

3. This is one of the central themes of several Roosevelt Institute reports, including J. E. Stiglitz, *Rewriting the Rules of the American Economy*, with Nell Abernathy, Adam Hersh, Susan Holmberg, and Mike Konczal (A Roosevelt Institute Book; New York: Norton, 2015), available at www.rewritetherules.org.

4. Including the development of behavioral economics, which recognizes that individuals do not necessarily act in the rational way hypothesized in standard economics and that an individual's beliefs and preferences are endogenous.

5. The role of microcredit schemes and their design has been a subject of immense debate, especially after the infamous collapse of the largest such scheme in India. See A. Haldar and J. E. Stiglitz, "Group Lending, Joint Liability, and Social Capital: Insights from the Indian Microfinance Crisis," *Politics & Society* 44, no. 4 (2016):459–497.

6. Recent work by Akerlof and Shiller have emphasized the pervasiveness of this kind of exploitation. See G. A. Akerlof and R. J. Shiller, *Phishing for Phools: The Economics of Manipulation and Deception* (Princeton, N.J.: Princeton University Press, 2015).

7. Standard economic theory has addressed the problems of moral hazard and adverse selection separately. There is very limited literature addressing the interaction of the two, which often plays an important role in policy, and especially in the design of the welfare state. See J. E. Stiglitz and Jungyoll Yun, "Optimality and Equilibrium in a Competitive Insurance Market Under Adverse Selection and Moral Hazard" (NBER Working Paper 19317, National Bureau of Economic Research, Cambridge, Mass., August 2013). See also Richard Arnott and J. E. Stiglitz, "Moral Hazard and Optimal Commodity Taxation," *Journal of Public Economics*, 29(1986):1–24; and "The Welfare Economics of Moral Hazard," in *Risk, Information and Insurance: Essays in the Memory of Karl H. Borch*, ed. H. Louberge (Norwell, Mass.: Kluwer Academic, 1990), 91–122.

8. Bruce Chapman has championed income-contingent loans. Higher education is now financed through such loans in Australia. See B. Chapman, T. Higgins, and J. E. Stiglitz eds., *Income Contingent Loans: Theory, Practice and Prospects* (Houndmills, U.K. Palgrave Macmillan, 2014); J. E. Stiglitz "Income Contingent Loans for the Unemployed: A Prelude to a General Theory of the Efficient *Provision* of Social Insurance," in Stiglitz, Chapman, and Higgins, *Income Contingent Loans*,180–204; and J. E. Stiglitz and J. Yun, "Income Contingent Loan as an Unemployment Benefit" (Columbia University Working Paper, Columbia University, New York, 2017). Stiglitz and Yun argue that there are distinct advantages of integration of different social protection schemes. See J. E. Stiglitz and J. Yun, "The Integration of Unemployment Insurance with Retirement Insurance," *Journal of Public Economics* 89(2005):2037–67. All of these are reforms which, at any level of risk mitigation, reduce the adverse incentive effects.

9. See also K. O. Moene, “Scandinavian Equality: A Prime Example of Protection Without Protectionism,” in *The Quest for Security: Protection Without Protectionism and the Challenge of Global Governance*, ed. M. Kaldor and J. E. Stiglitz (New York: Columbia University Press, 2013), 48–74; and the special issue of the *Journal of Public Economics* (2015) on Scandinavia edited by K. Moene and S. Blomquist, including J. E. Stiglitz, “Leaders and Followers: Perspectives on the Nordic Model and the Economics of Innovation,” *Journal of Public Economics* 127(July 2015):3–16; and E. Barth, K. O. Moene, and F. Willumsen, “The Scandinavian Model—An Interpretation,” *Journal of Public Economics* 127(July 2015):60–72.