



Re-inventing the welfare state

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Introduction



- What is the European "welfare state"?
 - The set of institutions aiming at guaranteeing all members of society a minimum level of well-being and equal opportunities to realize their own goals in life
 - pensions, unemployment benefits, health care, education, employment policy.
- Generalizations are dangerous:
 - Different countries and different subsectors have experienced a different development (e.g. Sweden vs Belgium, unemployment benefits vs health care).
- My story is very speculative, without any scientific pretensions.

- *Sandmo, 1991, Economists and the welfare state* (Presidential address EEA):
 - in the first decades after WW II, most economists had a positive attitude towards the welfare state.
 - this situation changed since the seventies:
 - because of real-world developments: growing expenditures.
 - because of new theoretical developments (moral hazard, public choice and government failures).
- Recently the situation is changing again – the Piketty-case as an illustration.

Recent developments

- Some examples in the world of academic economics:
 - support for pay-as-you-go in pension systems.
 - relationship between economic growth, redistribution, human capital.
 - emphasis on social interactions (social capital).
 - behavioral economics, decision heuristics and imperfect information.
- Importance of redistribution and of welfare state institutions recognized by international institutions (such as the OECD and the EU).

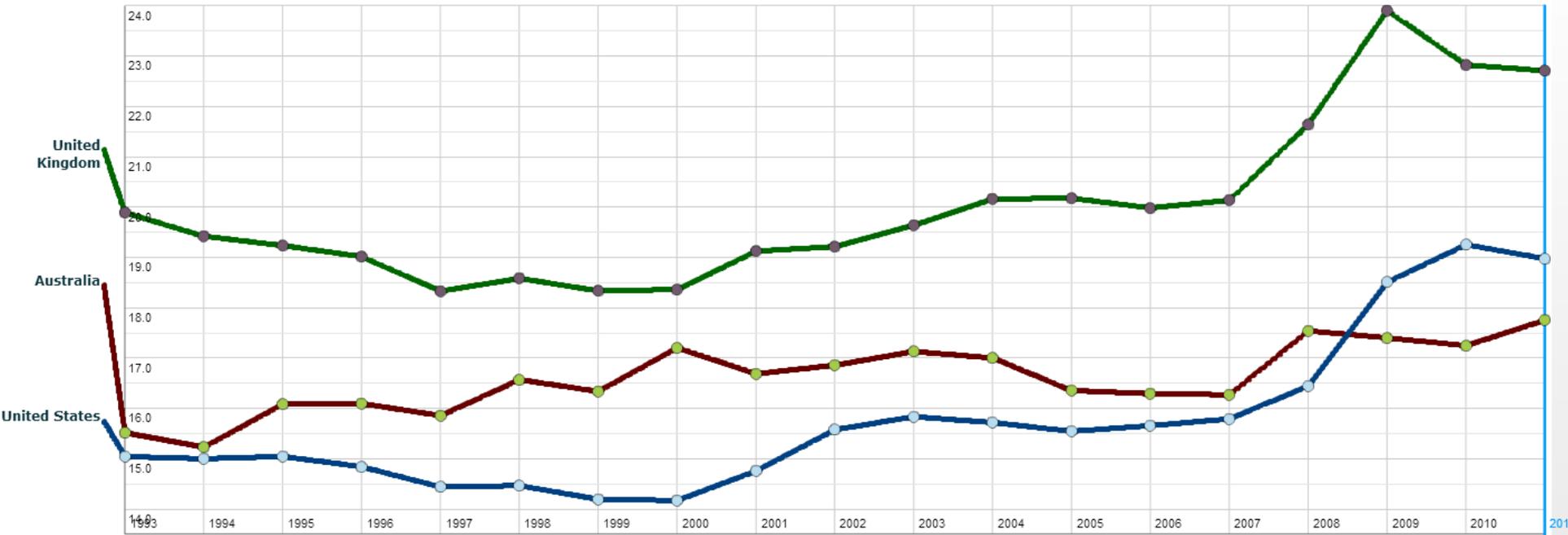
The resilience of welfare state institutions: facts



Some data

- The welfare state under pressure? Let us first look at some data:
 1. Total public social expenditures.
 2. Health care expenditures.
 3. Income (re)distribution.
 4. Poverty.

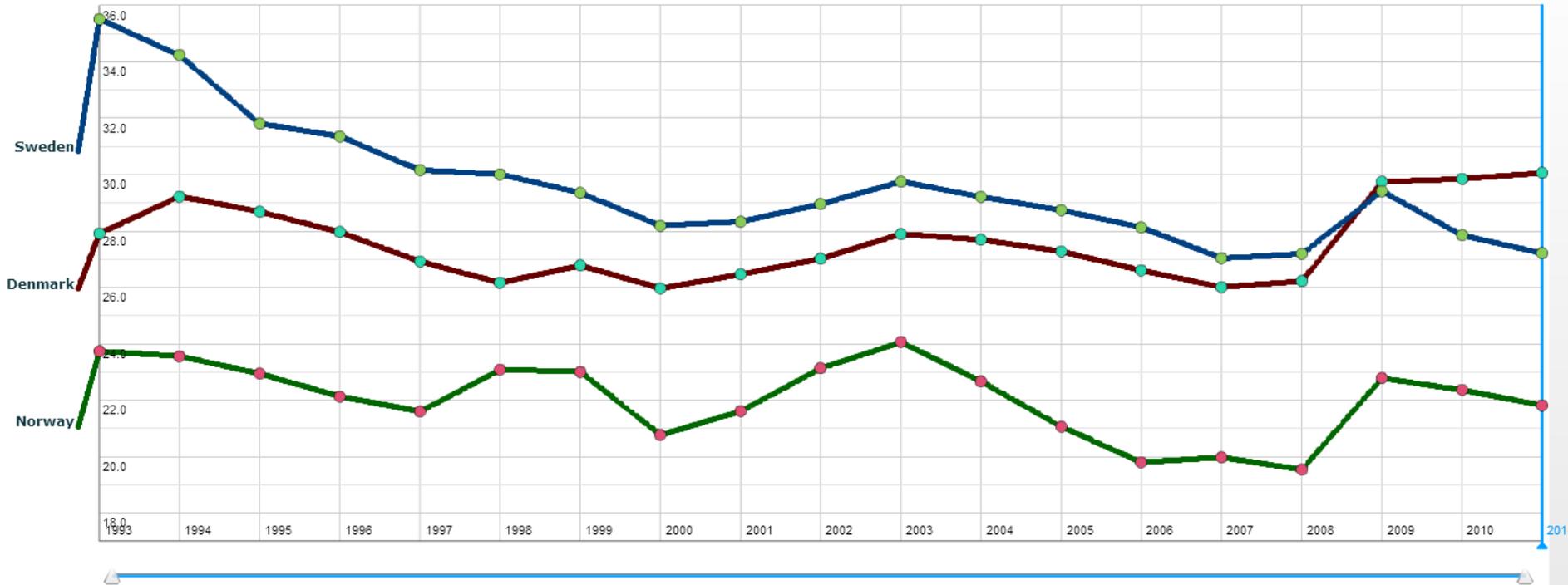
Public social expenditures as a share of GDP: Anglo-Saxon countries



Source: OECD

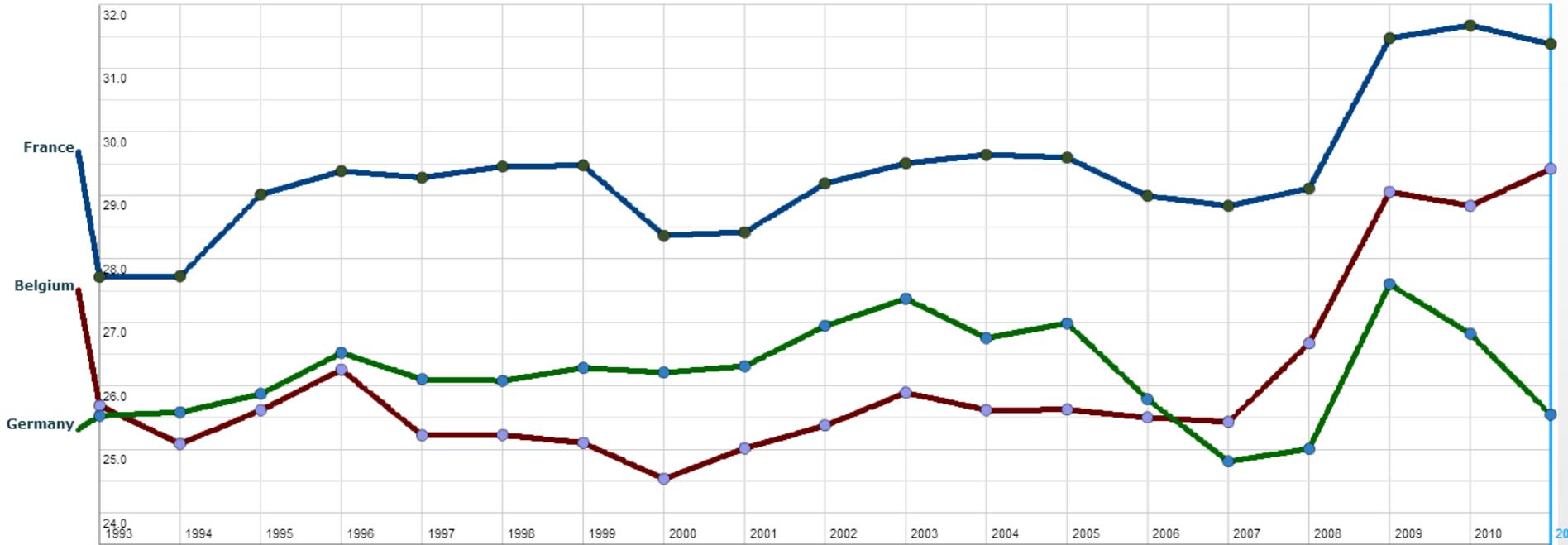
Public social expenditures as a share of GDP: Scandinavia

Public, Total, Total, Total, In percentage of Gross Domestic Product



Source: OECD

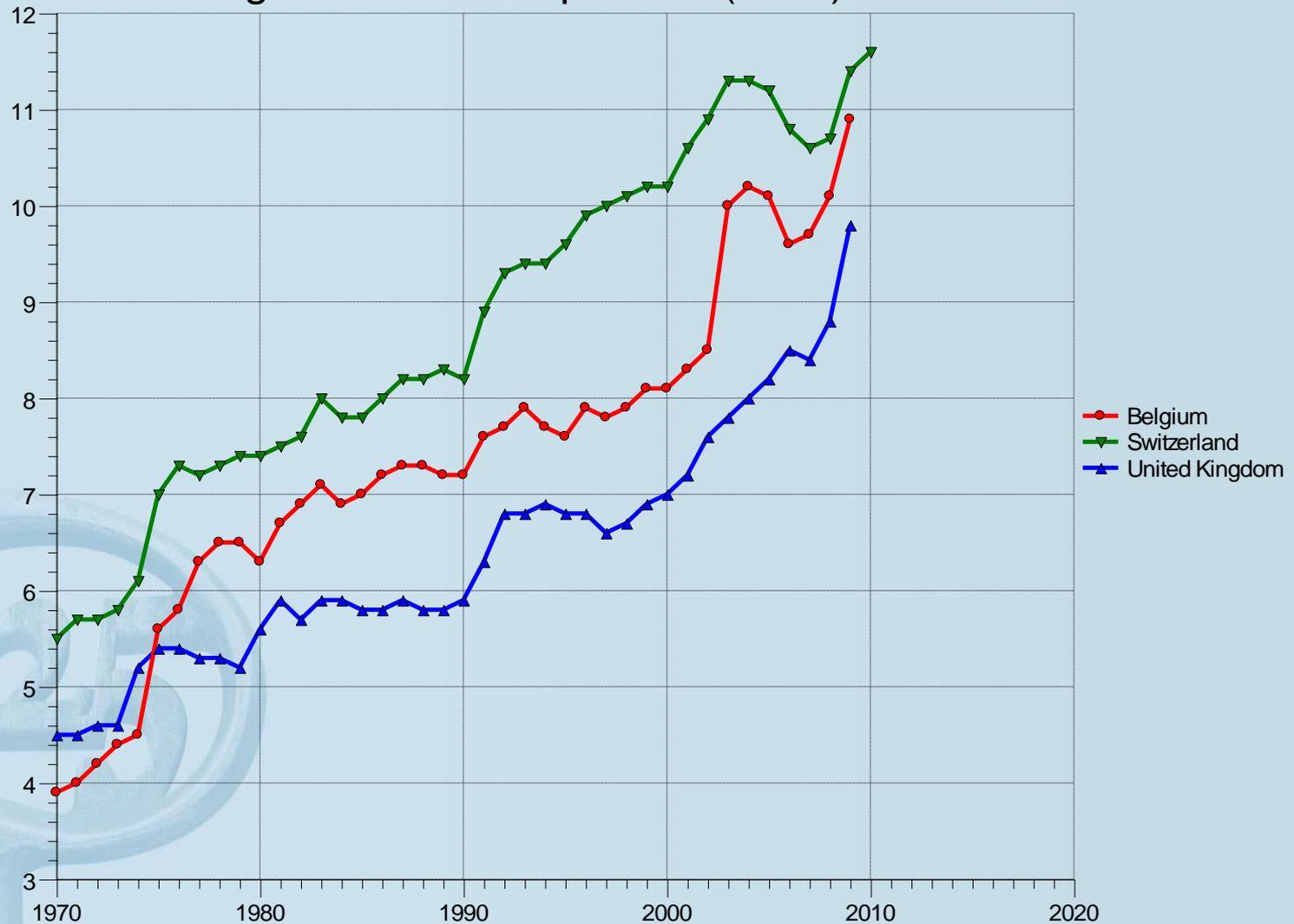
Public social expenditures as a share of GDP: Bismarck countries



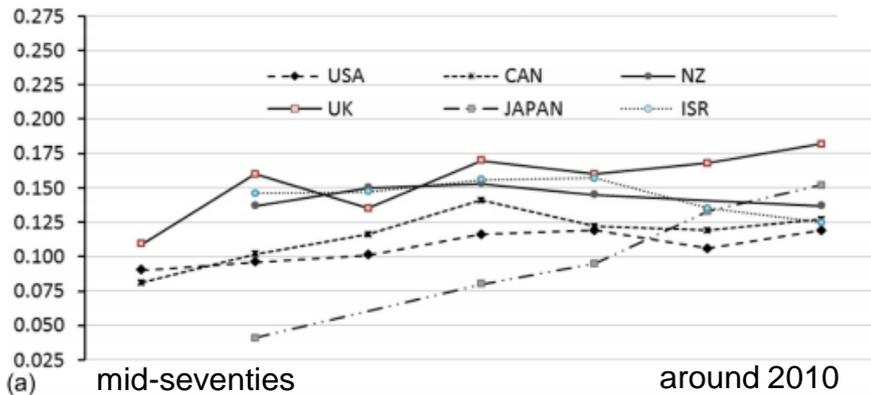
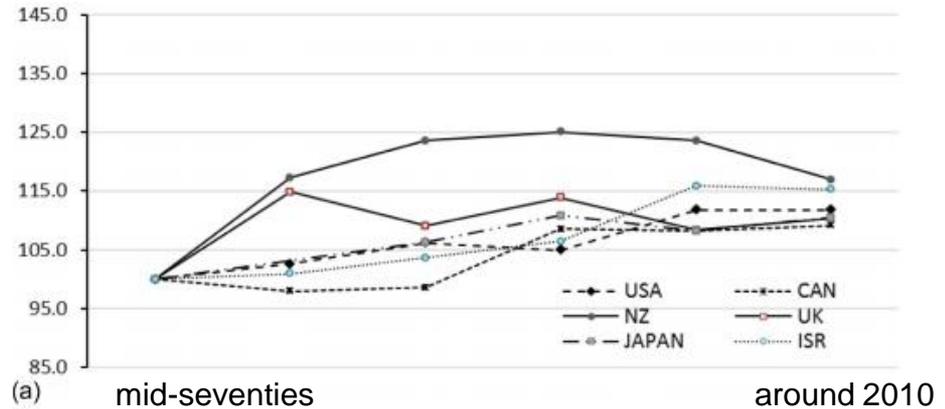
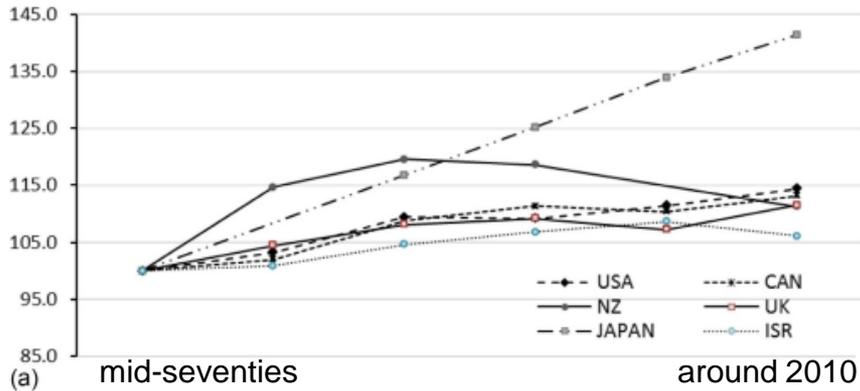
Source: OECD

Development of health care expenditures

Total health expenditure as % of gross domestic product (GDP)

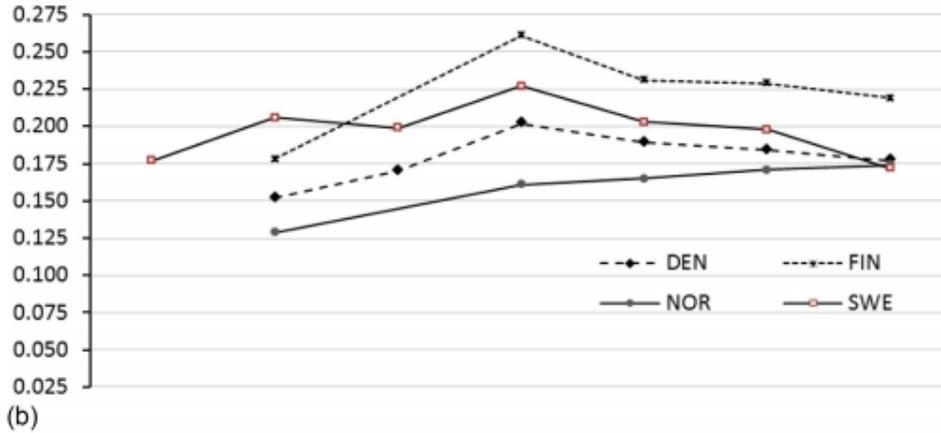


Income (re)distribution: Anglo-Saxon countries

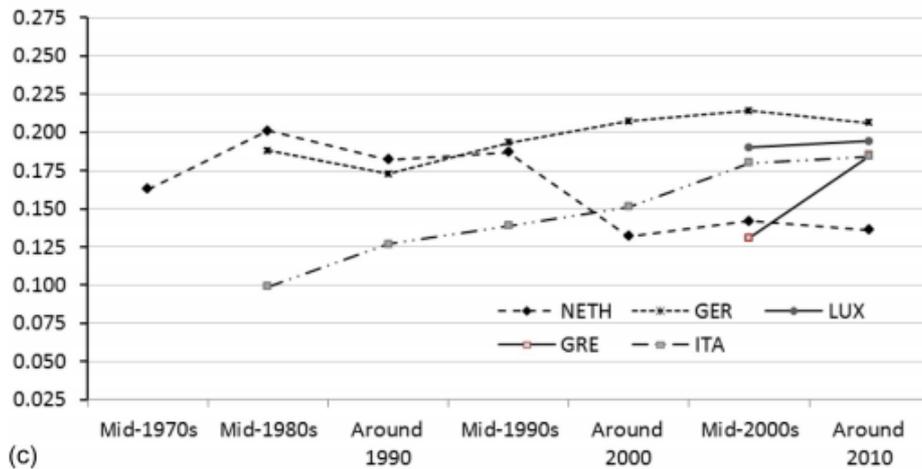


Source: Morelli et al.,
2015, LIS-data

Income redistribution



Nordic countries



European continent

Source: Morelli et al., 2015, LIS-data

Poverty

		Poverty rates			Percentage point change from initial year	
		Initial year	End year			
Years		Relative	Relative	Anchored	Relative	Anchored
Czech Republic	1996–2004	5.1	5.8	3.4	0.7	–1.7
Germany	1994–2007	7.7	8.4	7.3	0.7	–0.4
France	1994–2005	8.0	8.5	7.2	0.5	–0.8
Netherlands	1993–2004	8.1	6.3	4.4	–1.8	–3.7
Hungary	1994–2005	9.9	7.4	4.8	–2.5	–5.1
United Kingdom	1994–2010	10.8	15.4	7.2	4.6	–3.6
Canada	1994–2007	11.3	11.9	7.6	0.6	–3.7
Australia	1995–2003	11.4	12.2	7.8	0.8	–3.6
Italy	1995–2010	14.1	12.5	9.5	–1.6	–4.6
Greece	1995–2010	15.4	13.6	6.4	–1.8	–9.0
United States	1994–2010	17.6	17.9	14.5	0.3	–3.1
Mexico	1994–2004	20.8	18.3	16.5	–2.5	–4.3
Average		11.7	11.5	8.0	–0.2	–3.6

Data are based on the authors' calculations from LIS microdata files, <http://www.lisdatacenter.org/>.

Note: Poverty is measured by the percentage of people living in households with income (adjusted for family size) below half of the median national income.

Source: Morelli et al., 2015, LIS-data

Perception, ideology, facts

- Facts: welfare state has in general been rather resilient. Simple general stories do not work.
- YET: perception and ideology have changed. Post WW II-consensus has disappeared.
 - My hypothesis: the consensus was the exception. Since the 70's we are back in what is the normal situation.
- Note: among nationalist and populist movements, wide variety of opinions concerning the welfare state.

The welfare state under pressure? A traditional story



The welfare state under pressure: external forces

1. Ageing of the population.
2. Growing primary income inequality as a result of "skill-biased" technical progress and international competition (recall the data).
3. Declining power of the nation-states and international tax competition (much less impressive evidence).

Motivations for the welfare state

1. INSURANCE AND EX POST SOLIDARITY

- Human beings want to insure against risks:
 - unemployment, income loss when ill or retired, health care expenditures.
- Spontaneous (but very imperfect) insurance mechanisms within families or close social networks have been gradually institutionalized. Synergy between public and private insurance institutions.

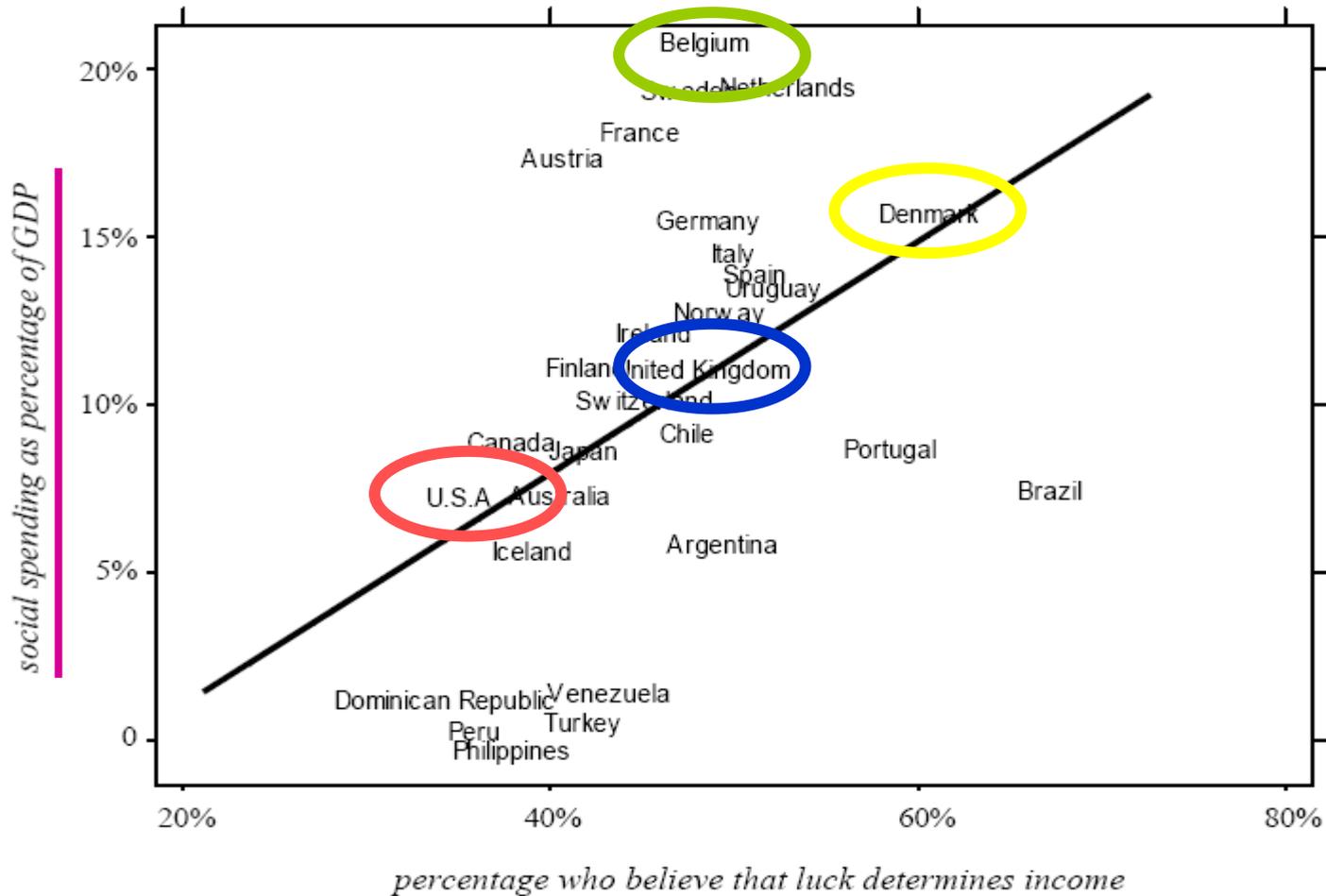
2. EX ANTE SOLIDARITY AND ALTRUISM

- Examples: unemployment compensation and health insurance.
- Post WW II-consensus.
- Ex post and ex ante-solidarity closely linked in a long run-perspective (children and grandchildren).

3. JUSTICE AND RECIPROCITY

- In larger anonymous groups (and definitely with state intervention), feelings of "justice" become crucial.
- "Common sense" opinions dominated by two concerns:
 - importance of a guaranteed minimum (altruism);
 - personal responsibility should not be neglected (reciprocity).
- Reciprocity is important in micro-relations, but also "*a basic human motive that in modern market economies is expressed in the form recognized as the principle of equity*" (Bowles, Gintis).

Support for redistribution



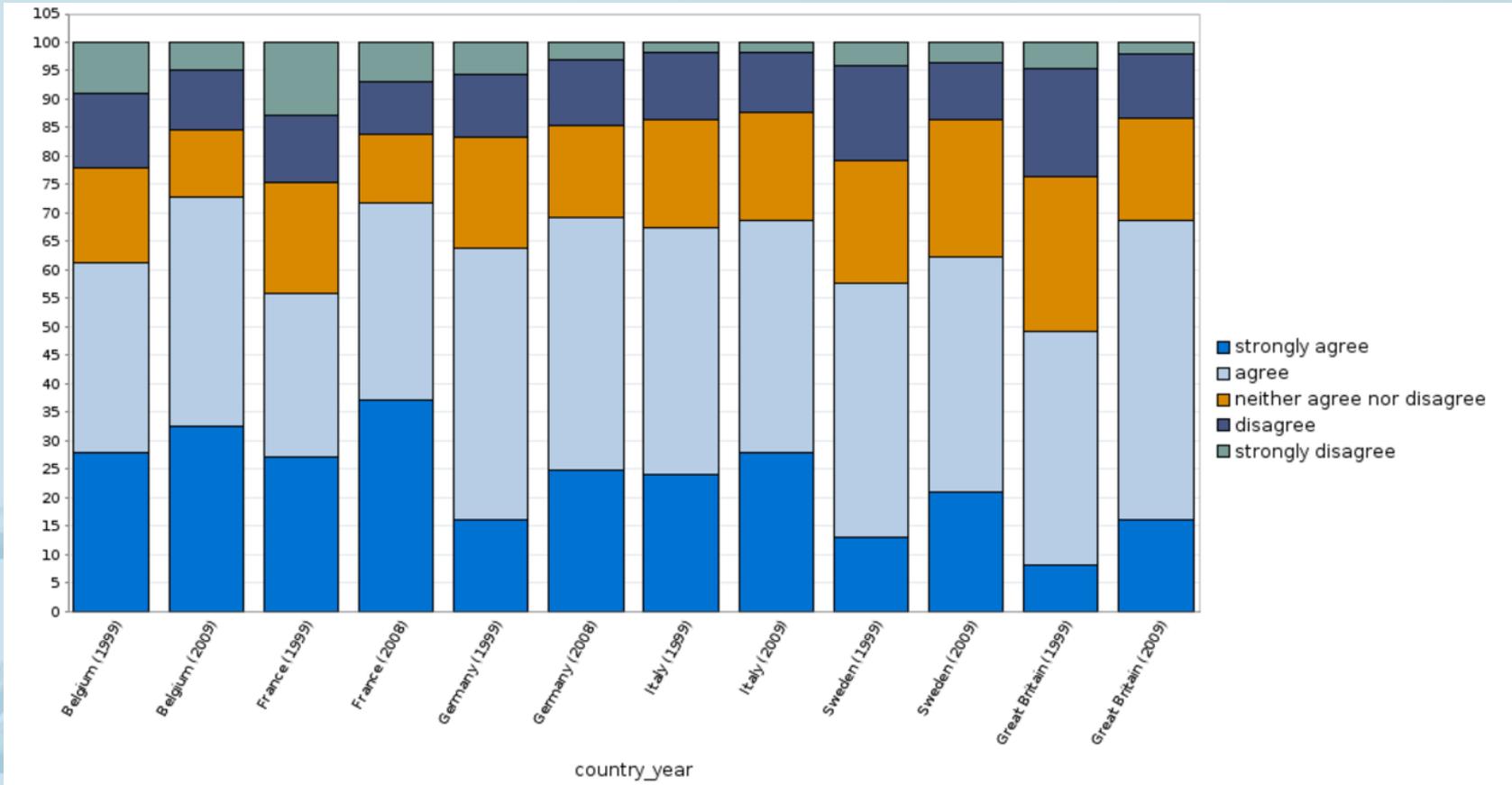
Source: Alesina, Angeletos, 2006

The welfare state under pressure: internal forces

- EROSION OF INSURANCE PRINCIPLE
 - Link between contributions and benefits has been weakened, even in the Bismarckian countries.
 - Social risks have become better predictable (position of the low skilled, predictability of illness in health insurance).
 - Increased focus on responsibility.
 - Example: genetic information and personalized medicine. (Since you knew that you were a worse risk, why did you not adapt your behaviour?).

- **DECLINE OF SOLIDARITY** (increase in social distance, fragmentation of society, increasing diversity).
- **RESPONSIBILITY.** Although the concern about large income inequalities remains, there is a shift in the social norms with stronger emphasis on personal responsibility.

“Work is a duty towards society”



Source: European Values Study

Civil society

- The pressure on the welfare state institutions has been accompanied by a decline in the traditional civil society organisations.
- A strong civil society is absolutely needed if we want to revitalize the welfare state.

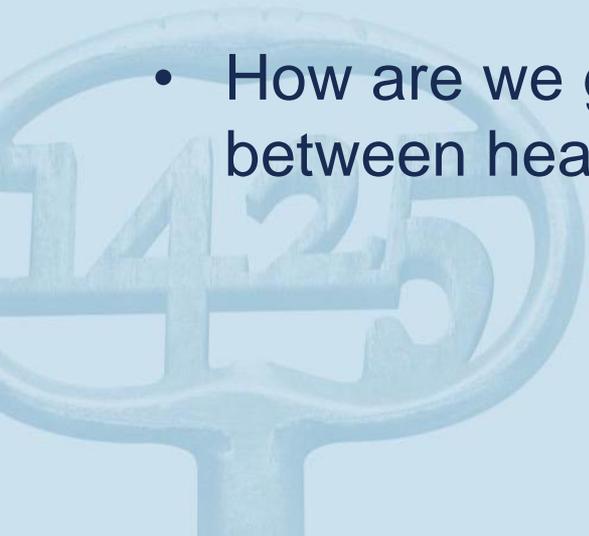


The new societal challenges

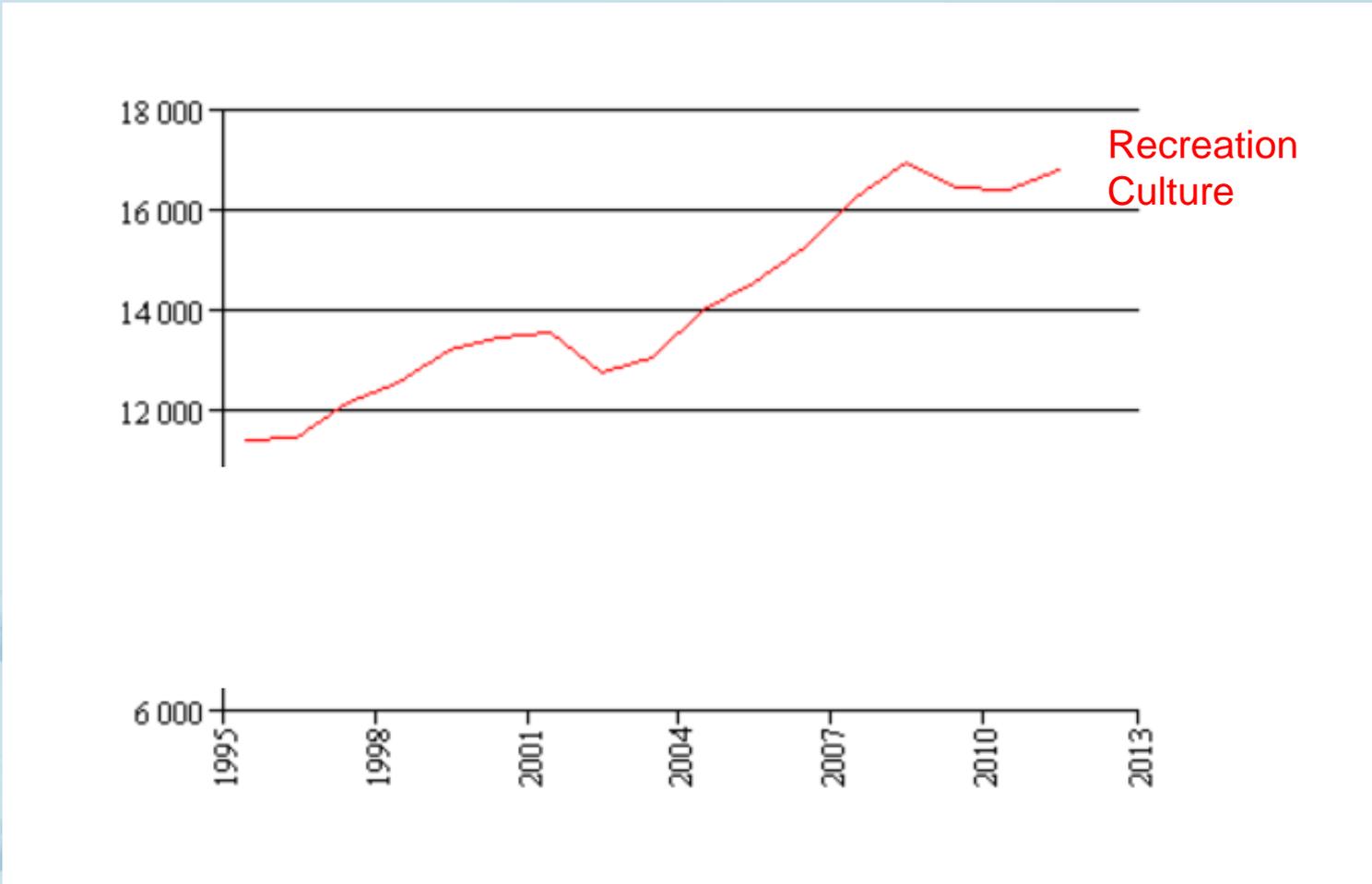


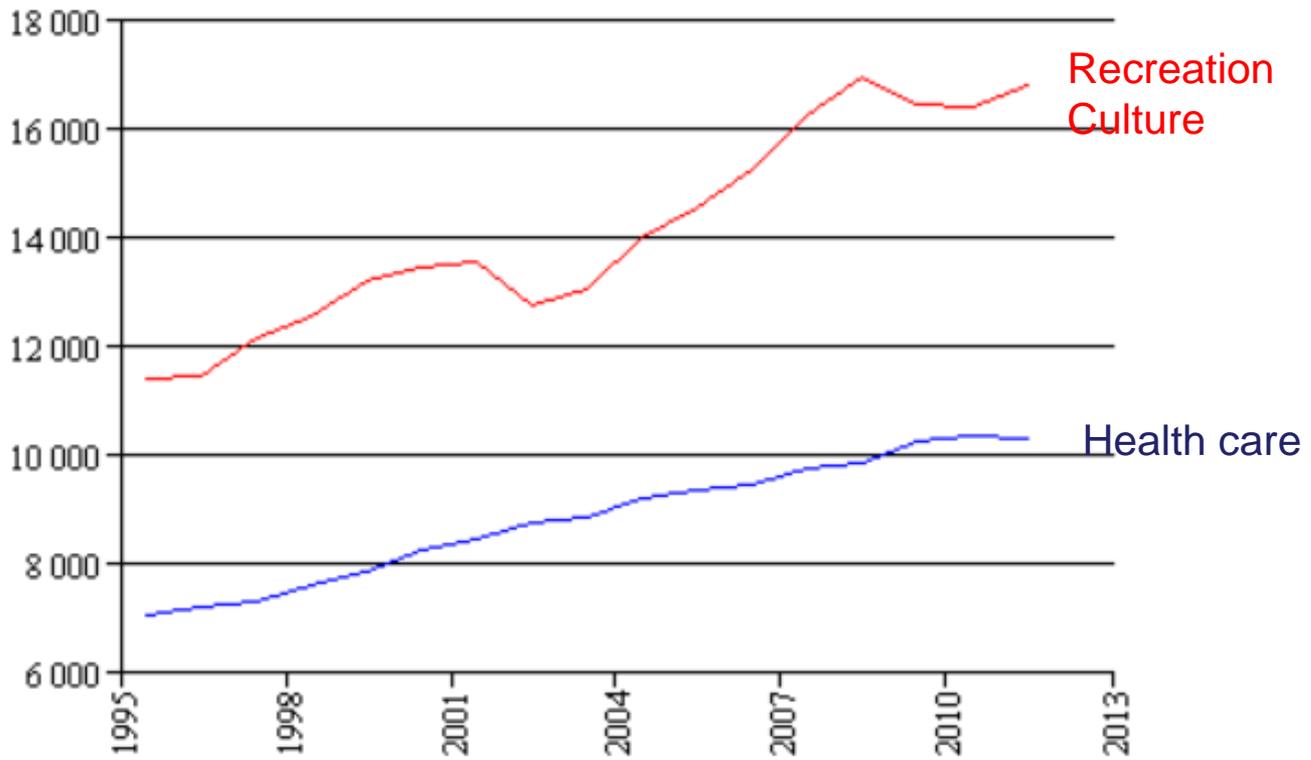
a. Health and innovation

- The increase in health expenditures is mainly driven by scientific and technical innovations in health care.
- Many of these innovations are welfare improving:
 - "as we get older and richer, which is more valuable: a third car, yet another television, more clothing – or an extra year of life?" (Hall and Jones, Quarterly Journal of Economics, 2007).
- How are we going to decide about the trade-off between health (care) and consumption?



Yet,... (data for Belgium)

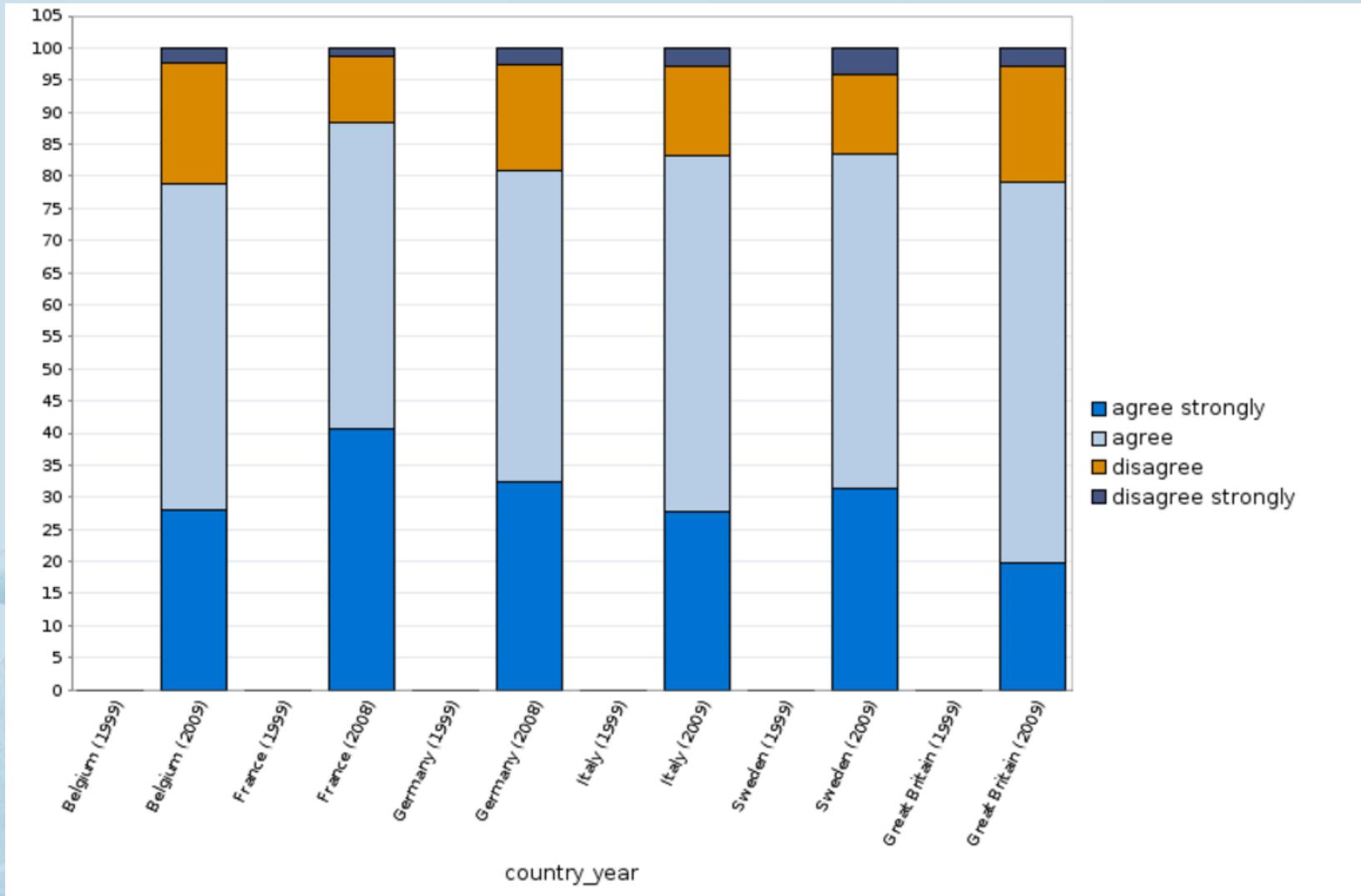




b. Climate change

- Tackling climate change is an evident requirement of intergenerational justice.
- Policies (e.g. CO₂-tax) will require drastic changes in our consumption pattern and in our production structure.
- Concerns about climate change are strong among the young people in Europe.

“If things continue on their present course, we will soon experience a major ecological catastrophe”



Source: EVS

c. Migration pressure

- Nobody really believes that migration pressure on the European welfare states will stop in a miraculous way.
- Long run economic consequences are likely to be positive. In the short run: severe adaptation problems.
- (Only alternative: move of production activities towards the now developing countries. Will lead to similar economic adaptation problems.)



Re-inventing the good life



A. Structural adaptation and flexibility

- Transition towards another economy will require drastic shifts in our patterns of economic activity.
- These shifts will only be possible if our economic system can react in a flexible way.
- Flexibility makes victims in the short run.
- The risks are larger for the weaker groups in society.
- A strong welfare state (with a focus on insurance) will be a necessary element to make the transition in a socially acceptable way.

- It seems obvious that the insurance principle has to be strengthened again.
- If the collective (welfare state) institutions do not offer sufficient insurance, private market players will take over:
 - Pensions as an example: a pay-as-you-go system is only sustainable if there is a strong social contract between the generations, which reassures the young that they will receive an adequate pension when they retire. Yet the young are concerned about climate change and migration!
- Important: a lot of evidence supporting the hypothesis that the effect of social contributions on the wage cost is mitigated when the insurance component is stronger.

B. Choices with consequences

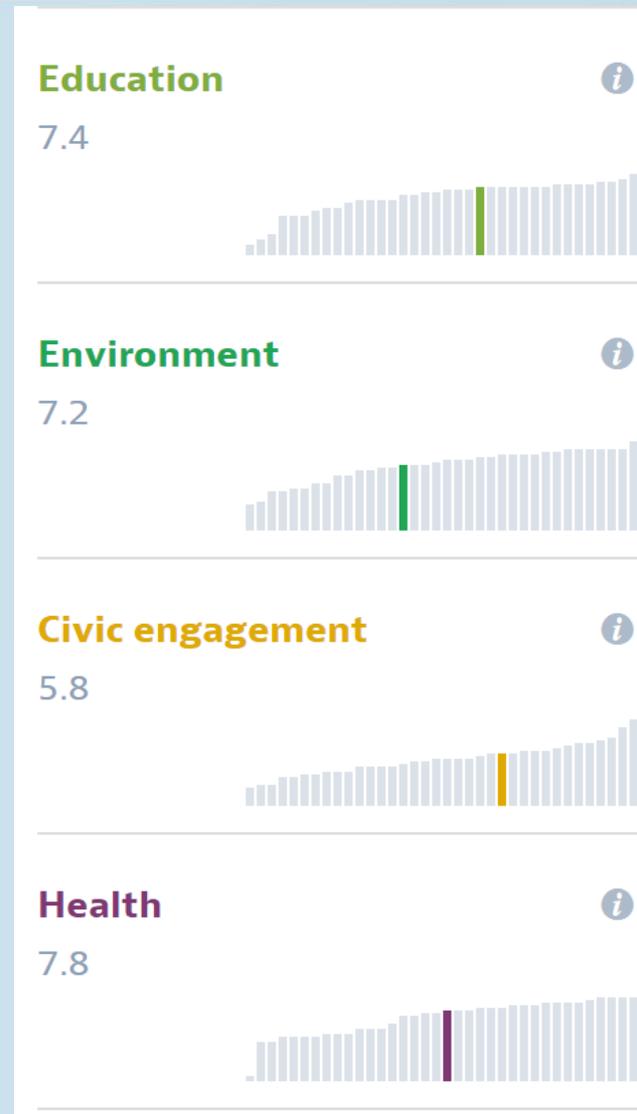
- The welfare state of the future (income transfers, health care system, educational system) must cope with these new realities:
 - increase in the social contributions for health care.
 - increase in the price of energy and (likely) decrease in material consumption.
 - changes in our actual patterns of eating and travelling.
- These changes will only be acceptable for society if we adopt a broader (less materialistic) concept of well-being and of social progress.

- Relatively easy to reach consensus about a list of relevant life dimensions (cf. OECD and EU).
- Necessary to collect information on a regular basis.

- Political debate on the relative weights to be attached to these different dimensions.



OECD: Belgium on the dimensions



OECD Better Life: equal weighting



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Create Your Better Life Index

Rate the topics according to their importance to you:

	Housing	<input type="range"/>
	Income	<input type="range"/>
	Jobs	<input type="range"/>
	Community	<input type="range"/>
	Education	<input type="range"/>
	Environment	<input type="range"/>
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	Health	<input type="range"/>
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⊗ Reset ⓘ Help

Gender differences
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 Share your index

How's life?

Let us know what matters most to you: submit your index!

- Why not a yearly debate (in the Parliament) on the question: did/do we make social progress?
- Such a debate would open a broader perspective on the welfare state.



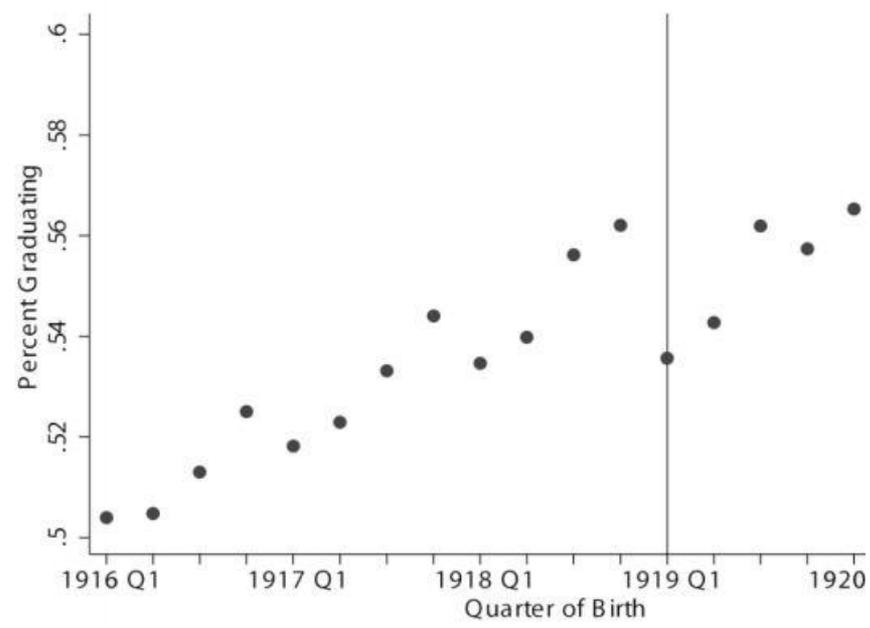
C. Solidarity and responsibility

- The welfare state has to take the issue of responsibility seriously, if it wants to keep the support of the population.
- Two “interpretations” of responsibility:
 - framing in terms of blame and guilt - society will sanction you if you do not behave “in the right way”.
 - framing in terms of freedom - the welfare state offers a menu of choices. Responsibility is then the other side of the coin.
 - example: flexible retirement age.

A cautionary note

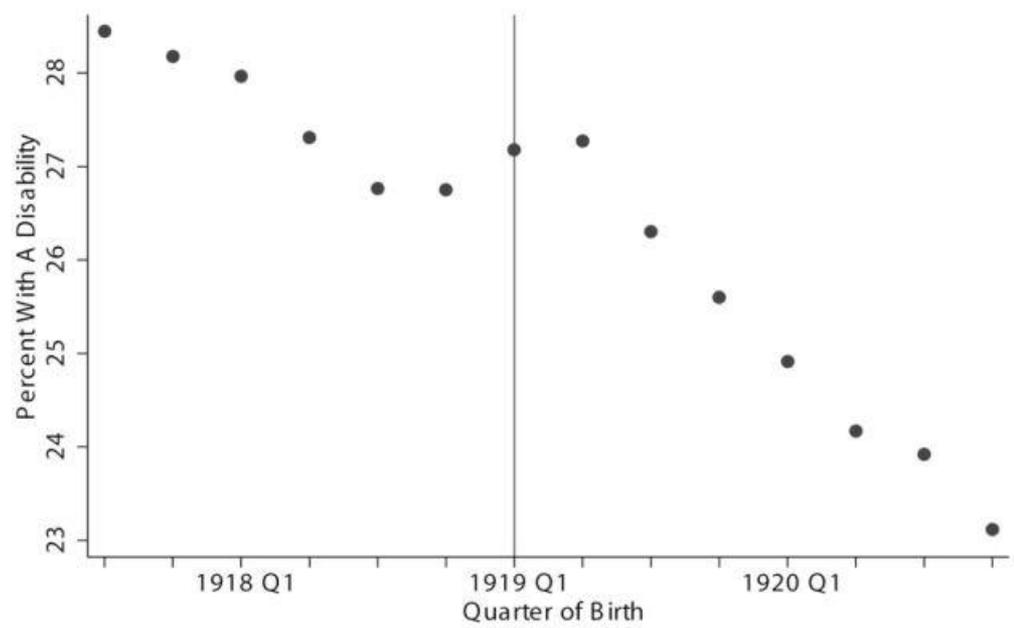
1. “Forgiveness” is essential. Individuals should be helped to take up their responsibility.
2. “Children” cannot be held responsible. Focus on equal opportunities for children puts limitations on ascribing responsibility to parents. Difficult ethical choices, because influence already starts before birth.
 - Recent empirical evidence is very convincing. Puts the debate on equal opportunities into perspective.

Effects of the influenza pandemic of 1918



Percentage with high-school degree

Percentage disabled in 1970



Source: Almond, JPE, 2006

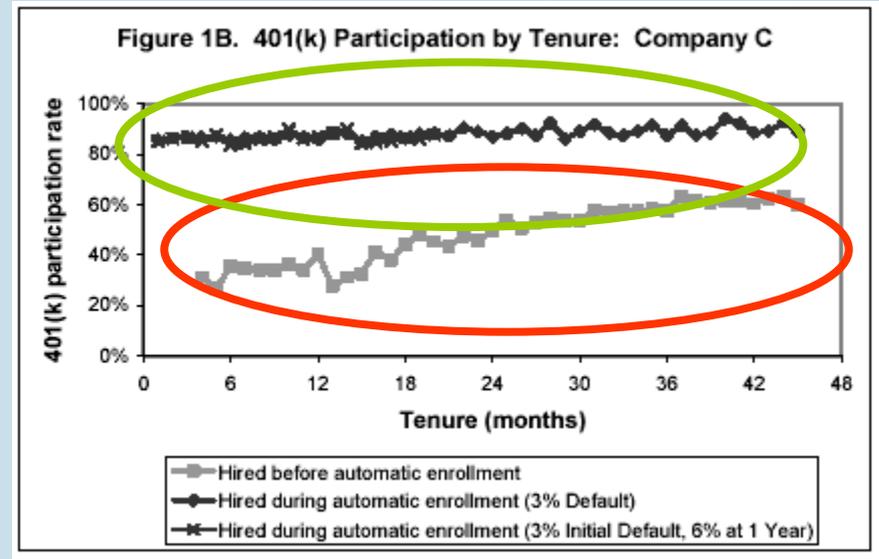
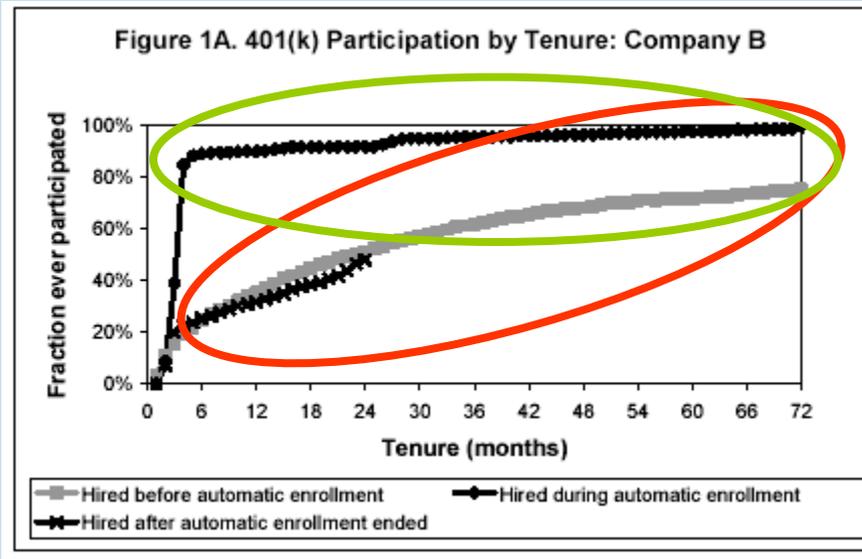
D. Re-inventing the civil society

- Civil society not as an alternative for or as a complement to the welfare state, but as its necessary breeding ground.
- Values and beliefs are formed through social interactions. Structure of civil society has historically played an important role in “equilibrium selection” (cf. Europe versus US).
- Important: bridging (not bonding) organizations.
- Important: civil society should give an answer to the new challenges.

Helping people to make choices

- Tendency to increase “individual choice” and, hence, responsibility (e.g. pension plans, health insurance).
- Many individuals, however, are not making the choices that are “best” for them.
- Historically, social organisations have played an important role in “helping members to make choices”. This role is becoming more relevant again if we introduce more individual responsibility.
- Minimal possibility: negotiate the status-quo options.
 - Example: participation in US employer-sponsored defined contribution savings plans (401(k) plans).

The default option (automatic enrollment)



effects are largest for younger employees,
lower-paid employees, Blacks and
Hispanics

Source: Choi et al., NBER, 2004⁴⁵

Conclusion



Conclusion

- Re-inventing the welfare state requires:
 - to re-invent the importance of social **insurance**.
 - to re-interpret the notion of **responsibility**.
 - to re-invent **civil society**.
- In the long-run, the most important challenges are financing health care and coping with climate change and with migration. This requires:
 - re-opening the debate about what is a **good life**.
- Repeated warning: avoid sweeping generalizations. Each and every specific policy option can only be evaluated within its own specific context.