

Welfare State and Public choice

Welfare state

- A solution to problem of incompatibility of democracy and capitalism
- Postwar bargain/embedded liberalism = free markets for capitalists and Keynesian welfare state for workers

Things to know

- Types of welfare states
 - Decommodification versus spending
 - Liberal, social democratic & conservative/corporatist welfare states
- Causes of welfare states
 - Logic of industrialism - wealth
 - Left power – socialists and unions
 - Institutions – veto points

Welfare regime	Degree of decommodification	Degree of stratification	Dominant welfare provider	Institutional design
Liberal	Low	High	Market	Means-tested social assistance, limited social insurance, and company-based welfare
Conservative-corporatist	Medium	Medium	Family	Bismarckian social insurance programs and NGO-based welfare services
Social democratic	High	Low	State	Universal social security and welfare programs

Source: Compiled by author based on Esping-Andersen (1990) and Aspalter (2011, table 2).

<i>Regimes</i>	<i>'Liberal'</i>	<i>'Conservative'</i>	<i>'Social-democratic'</i>
Prime examples:	USA, UK	Germany	Sweden
De-commodification	Low	Medium	High
Social rights	Need based	Employment-related	Universal
Welfare provision	Mixed services	Transfer payments	Public services
Benefits	Flat benefits	Contribution-related	Redistributive

Sources: Esping-Andersen (1990); cf. Kohl (1993).

Things to know

- Welfare retrenchment
 - Different dynamics of expansion and cuts
 - Policy feedback: interest groups, negativity bias
 - Blame avoidance as key to cuts

Public choice theory

- Politics without romance
- Government failures common
- Democracy not a panacea

Things to know

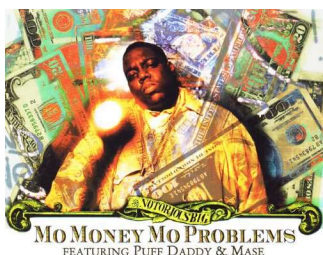
- Public choice theory
 - Political actors motivated by self-interest
- Collective action theory
 - Many groups don't form due to free-riding
 - Solutions: coercion, small #s, selective incentives
 - Concentrated/diffuse benefits/costs
 - Client politics, also interest group, majoritarian, entrepreneurial

Things to know

- Bureaucracies
 - Rent-seeking
 - Bureaucratic capture & iron triangles
- Voter irrationality
 - Rational ignorance
 - Systematic biases: anti-market, anti-foreign, make-work, pessimistic
- Solutions: limited government, veto points, conservative revolution

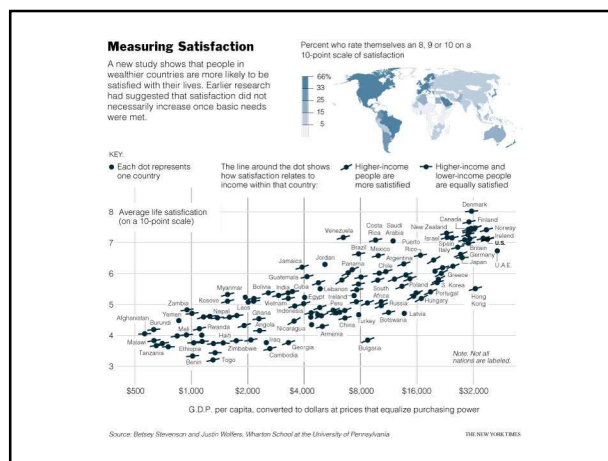
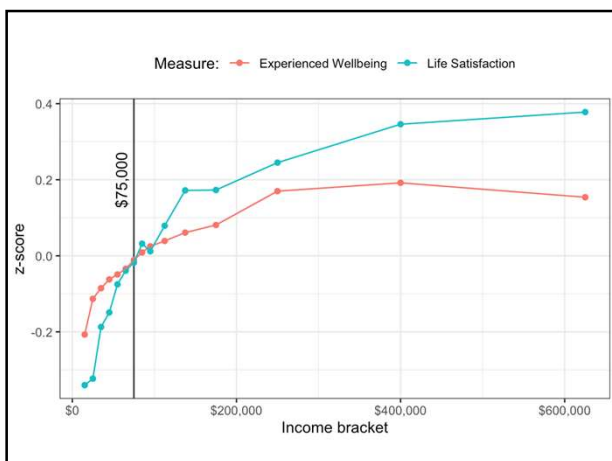
Debate: Money and happiness

- Does more money make people happier?



The Easterlin Paradox

- Economist Richard Easterlin finds that income doesn't increase happiness
 - Yes, the poor are unhappy
 - But richer countries not happier than poorer
 - Also, doesn't appear that people are getting happier over time as income rises
- Happiness depends on relative position?
 - You are happy if you are ahead of others
- But recent evidence different



What would policy look like if we tried to maximize happiness?

- Encourage people to get married?
- Encourage religiosity – subsidies to churches?
- Spend more on national sports teams (but zero-sum game)
- How to spend money to maximize happiness:
<https://twitter.com/emollick/status/1653061940795539456>

A better way: Global love rankings?

- Gallup survey: “Did you experience love for a lot of the day yesterday?”
- The Top: Philippines – 93%, Rwanda – 92%, Puerto Rico – 90%, Hungary – 89%
- The Bottom: Armenia – 29%, Uzbekistan – 32%, Mongolia – 32%
- Slovakia #110, Czech Republic #112, both at 58%
- We are a loving world: on average day 70% of world experiences love
- But how to increase love?

Discussion questions

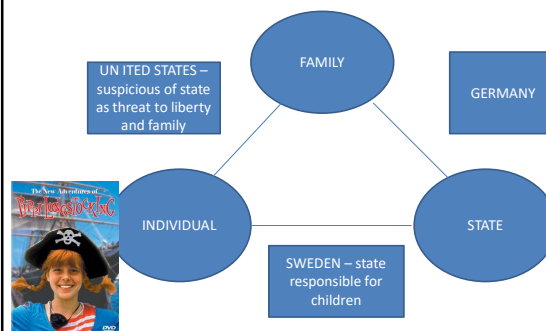
Conservative welfare state

- The conservative welfare state exemplified by Germany might seem strange at first glance, but could you make the case for some version of it in the future.
- On the one hand, it emphasizes high-skilled workers and provides differential benefits to support them.
- On the other, it focuses on families, which might be important given declining birthrates and the difficulties of raising a family.
- Is there something we can learn from the German model or are the inequalities disqualifying?

Individual, family, state

- I mentioned a speculative theory that would divide societies according to which of the triad of individual, family, and state they disfavor. Thus, in the US we would favor the individual & family and disfavor the state.
- Does this theory help us in understanding the welfare state and politics more generally?

A speculative theory



Future of welfare

- A number of political scientists have pointed to the resilience of the welfare state even when there is economic pressure or political opposition
- Does that mean that welfare state supporters don't really need to worry about it being cut back? Under what circumstances do you think the welfare state would be endangered?

Cashification of welfare

- In recent years, many people have been advocating for UBI (universal basic income) or cash-based benefits in place of welfare services.
- Why do you think there has been a turn from focusing on services for the poor – healthcare, housing – to just providing money? Is it an ideological shift? A failure of existing programs?
- Is it a good thing? Should we just replace the whole welfare state with a universal cash benefit?

Public choice theory

- How controversial are the public choice axioms about studying politics: rational choice and politics as exchange? Is this just common sense?
- Is politics something different for you? Have your PS classes taught you this or something else? Is it too cynical? What side of the political spectrum would be more “romantic” about politics?

Bureaucratic incentives

- Is there any real reason to trust government to do the right thing? Bureaucrats aren't particularly well-paid and the most talented people would tend to prefer higher prestige and better paid jobs. Coming up with better policies doesn't bring bureaucrats large rewards
- What are the arguments that we should expect something more from the bureaucracy than fulfillment of its basic duties? What are the relevant incentives for bureaucrats?

Voter irrationality

- Is the public not just ignorant, but irrational or biased? In what ways?
- Do you suffer from any of the biases that Caplan identifies: anti-market bias, anti-foreign bias, make-work bias, pessimistic bias? Would you agree that they are biases?
- Are there other biases that he misses or that are more important?

Welfare State

Today

- Varieties of welfare states
- Causes of the welfare state
- Retrenchment and the future of the welfare state

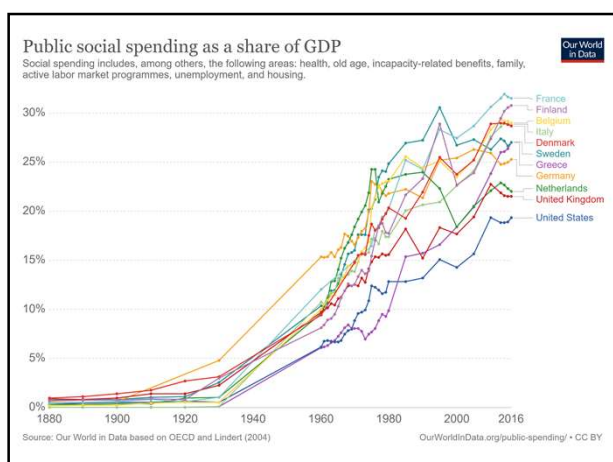
From last lecture

- Welfare state key part of postwar bargain
 - Free markets in exchange for welfare state
- Allows free market and open economy to be accepted by all classes

1. Varieties of welfare states

T. H. Marshall, Citizenship and Social Class

- Three major expansions of rights
- 18th c.: Civil rights (speech, assembly, press)
- 19th c.: Political rights (democracy, voting)
- 20th c.: Economic rights (welfare state)
- Assumption of natural progression



Is social spending the key?

- Do unions fight for a percentage of GDP?
 - Typically, they want certain benefits: pensions, unemployment insurance
- Details of programs are important: eligibility, generosity, duration

Decommodification

- Degree to which welfare state allows people to maintain their living standards independent of market forces
 - Recall Polanyi
- Can citizens without work maintain their income and general welfare?
 - Are benefits equal to normal wages
 - Do benefits depend on prior contributions?
 - How long do benefits last?

Liberal welfare state

- Little decommodification; market determines social status
 - Entitlement rules strict: means-tested
 - Benefits usually low even for universal programs
- Beneficiaries mostly poor and benefits associated with stigma
- Political logic: emphasis on efficiency & economic growth plus individualistic ideology
- Examples: US, Canada, Australia

Social democratic welfare state

- Highly decommodifying and universal
 - Benefits at middle class standard
 - Benefits open to all classes
- Dependent on high levels of employment to generate revenues, esp. women
- Political logic: benefits have to be attractive enough that middle classes use and support
- Examples: Scandinavia

Conservative/corporatist welfare state

- Partially decommodifying
 - Rights attached to social class
 - State role to preserve social status
- Family-focused: benefits encourage single earner for family
- Political logic: corresponds with traditional social values, maintains highly skilled workers
- Examples: Germany, Austria

Life in a conservative welfare state

NEUÖTTING, GERMANY — Manuela Maier was branded a bad mother. A **Rabemutter, or raven mother**, after the black bird that pushes chicks out of the nest. She was ostracized by other mothers, berated by neighbors and family, and screamed at in a local store.

She felt ostracized after signing up her 9-year-old for lunch and afternoon classes — and then returning to work. “I was told: ‘Why do you have children if you can’t take care of them?’” she said. **Her crime? Signing up her 9-year-old son when the local primary school first offered lunch and afternoon classes last autumn — and returning to work.** ... Ten years into the 21st century, most schools in Germany still end at lunchtime, a tradition that dates back nearly 250 years ... For several mothers, their great-grandmothers’ maxim, “Kinder, Küche, Kirche” — children, kitchen, church — holds true, even if, as Mr. Haugeneder says, “increasingly it is a way of life people can’t afford.”

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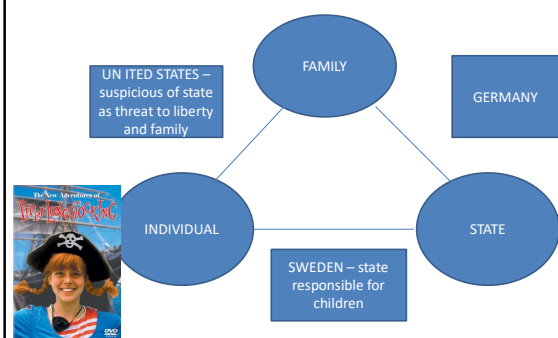
Problems

- Few states are pure types
 - Eg, UK seems liberal, but universal national health service
- Many states don't fit: How many worlds?
 - Mediterranean type: family networks, lower spending, limited access, mostly pensions
- Changes over time

Which works the best?

- Social democratic model best at protecting from poverty and unemployment
 - But Sweden has to reform in 1990s
- Is it a fair comparison?
 - Small, homogeneous, educated states (SWE) versus large, heterogeneous states (US)
 - What about other values: growth, innovation, and efficiency

A speculative theory



Welfare State

Today

- Varieties of welfare states
- Causes of the welfare state
- Retrenchment and the future of the welfare state

2. Causes of the welfare state

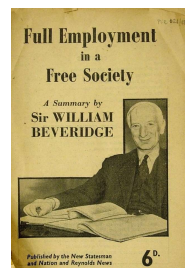
Paradoxical birth of welfare state

- First large-scale national welfare programs initiated by right-wing authoritarian government in Germany
 - Insurance elements based on workplace
- Attempt to buy off working class so that they don't support socialists and communists



Beveridge in UK

- Wartime report by William Beveridge recommends creating national insurance for sick, unemployed, and retired
- Churchill loses first postwar election and Labour government implements National Health Service and other basics of welfare state

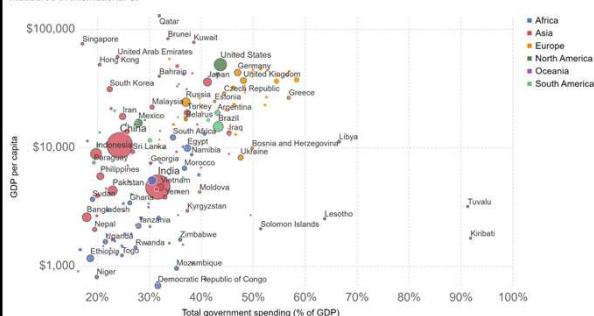


Logic of industrialism

- As countries grow richer, they develop a larger welfare state – Wagner's Law
 - Citizens like welfare state, but need to wait until state can afford it
- Seems to apply at broad level: Western Europe versus Third World
- But can it explain differences within rich countries? Over time? Mechanisms?

Government spending vs GDP per capita, 2011

Total government expenditure includes interest payments on debt. To allow comparisons between countries and over time, GDP per capita is adjusted for price differences between countries and adjusted for inflation – it is measured in international-\$.

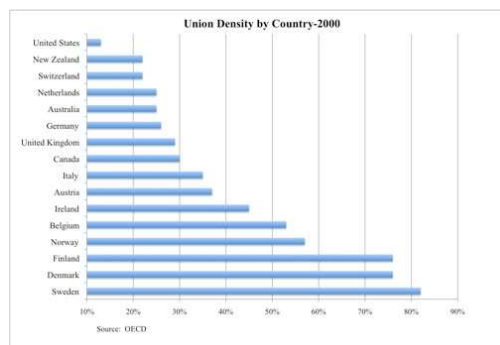


Source: IMF Fiscal Affairs Departmental Data, based on Mauro et al. (2015), World Bank, Population by country, 1800 to 2100 (Gapminder & UN). OurWorldInData.org/public-spending/ • CC BY

Left power

- Size and de-commodification of welfare state correlated with strength of social democratic party and labor unions
 - Main forces which fight for welfare state
- Seems to fit basic patterns: Social Democrats in Sweden versus Republicans in US
- But business sometimes pushes for welfare state. Why?

Labor unionization



Institutions

- Veto points may prevent countries from instituting a welfare state
 - Actor whose assent required for bill to be enacted
- More veto points => smaller welfare state
- Consider healthcare
 - Switzerland, US: universal healthcare blocked by referenda or Senate or federalism
 - Sweden, UK: single party with no veto points leads to National Health Service
- But doesn't explain forces pushing for expansion

Why welfare state weaker in US?

- Politics
 - Courts block changes in direction of welfare state
 - Two party system more conservative – no socialist party in US
 - Stable political system – no upheavals: consider what happens after war
- Behavior
 - Racial prejudice and beliefs about deserving poor
 - Beliefs about laziness versus misfortune

Public opinion in US & Europe

- | | | |
|---------------------------------------|--------------------|--------------------|
| • Are poor people trapped in poverty? | • 29% of Americans | • 60% of Europeans |
| • Does luck determine income? | • 30% of Americans | • 54% of Europeans |
| • Are poor people are lazy? | • 60% of Americans | • 24% of Europeans |

3. Welfare state retrenchment

Welfare state as victim of its own success

- End of postwar boom
 - Slowing growth and productivity
- Rising cost of welfare state: aging societies
- Reduced incentives to work & hire
- Globalization/EU and race to bottom
 - Multinational firms relocate to low-wage

Has the welfare state been cut?

- Image of Reagan and Thatcher as great cutters of welfare state
- But largely unsuccessful
 - Reagan focuses on tax cuts; social spending constant, only success is small public housing cuts
 - Thatcher more successful at beating unions; in social policy only housing & pensions



Is retrenchment the inverse of expansion?

- Cutting programs is not the opposite of expansion
- Different dynamics once programs are established
 - Entitlements to benefits enshrined in law
 - Interest groups in favor of benefits
- Welfare state harder to cut than expand

Policy feedback

- Welfare state policies generate support
 - Interest groups who benefit can mobilize around programs
 - Harder for opposition to mobilize: dispersed, smaller gains
 - Negativity bias: losing a benefit is more painful than gaining an equivalent benefit

How to cut the welfare state

- Obfuscation: make unpopular cuts invisible
 - eg, complicated changes in benefit formulas
- Timing: unpopular cuts at the beginning of an electoral term
- Divide and conquer: remove particular groups from beneficiaries
- Compensation: create new programs to divert attention from old

The Future?

- Social programs typically largest part of budget – often >40%
 - Pensions, healthcare, housing, social assistance
- Cost rising as populations age
- Also rising healthcare costs
- Declining fulltime employment
- But welfare state still very popular
 - Even in US!

Extra slides

Cashification of welfare

- Previously unions & parties pushed to remove areas of social life from market: education, health, housing
- But now focus on cash transfers: universal basic income (UBI)
- Economists' view that individuals should decide what to consume + new precariat & weak union
- Is poverty = lack of money or lack of access to services?

Welfare state and skills

- Using welfare to encourage and preserve skill formation
 - Businesses don't want to invest in skills of workers because another firm might take them
 - Workers hesitant to invest because skills might not be in demand
- State can help by supporting skills and giving jobs to skills not in demand

What do theories predict?

- Logic of industrialism: slowing growth since golden years => some retrenchment
- Left power: labor unions in decline, left wing parties embrace third way (Blair) => retrenchment
- Institutions: should see more retrenchment where few veto points (UK, Sweden)
 - Harder to cut back where many points to block

Blame avoidance

- Politicians want to claim credit for good things and avoid blame for bad things
 - “Never be seen to do harm”
- How to avoid blame?
 - Make negative effects hard to see
 - Make it hard to link negative effects to policies
 - Make it hard to link policies to politicians
 - Automaticity, time lags

Public choice theory

Today

- **Public choice theory**
- Collective action theory
- Bureaucracy
- Voter irrationality
- Solutions?

Recall: Markets often suboptimal

- Public goods like infrastructure & public health are underproduced
- Negative externalities like pollution are overproduced
- Markets create inequality and poverty

Does this mean state is solution?

- Should state then provide public goods and welfare and regulate industry?
- Market failures don't mean that government will do a better job
 - Possibility of government failure
 - Government can always make things worse
 - May have to live with some market failures

An example: Sugar subsidies in US

- Department of Agriculture sets minimum prices for sugar + import restrictions
 - Benefits small group of sugar producers in US
 - Very large political contributors
- But large side effects
 - Costs US consumers \$2 billion/year
 - Hurts manufacturers of candy and ice cream
 - Smuggling – supersweet iced tea from Canada

Public choice theory

- Apply rational choice economic theory to the government
- Key assumption: Both voters and government officials pursue their self-interest
- Key result: Government failure as common as market failure



Politics without romance

- Democracy may produce results that are individually rational, but collectively irrational
- Often policies widely regarded as wasteful and unjust persist despite existence of better alternatives
- Need to compare real-world imperfect markets with real-world imperfect democracy
 - Not ideal democracy versus imperfect markets

Important theories

- Collective action theory – inequalities in group formation & persistence
- Bureaucracies – rent-seeking and iron triangles
- Voter irrationality – voters may support policies that don't benefit them

Public choice theory

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Groups are central to politics

- Individual action rarely successful
- Assumption that group formation is easy
 - If some citizens want environmental policies, then they will form a group to advocate for them
- But is it true?

Why do some groups form and others don't?

- Participating in a group has benefits and costs
- Benefits if group achieves its aims
- Costs of participating in group
 - time, money, energy, risk of getting arrested
- When deciding whether to join you weigh the costs and benefits

Problem of collective action

- My contribution alone doesn't determine success of group
- If group succeeds everyone gets benefit, not just joiners (cf., public good)
- Thus, I may decide to 'free ride' on the efforts of others
 - Not contribute but reap benefits
- Enough people may not join that group doesn't form

Groups in U.S.

Group	Adults	Organizations
Management	7%	71%
Education	4%	4%
Workers	41%	4%
At home	19%	2%
Unemployed	4%	<1%

How to solve collective action problem?

- Coercion: state provision of public goods
- Size: small groups are easier to form. Why?
- Selective incentives: rewards given only to contributing members

What does the theory explain?

- Absence of groups representing many interests
 - Where are groups for poor, unemployed, consumers, etc.?
- Power of small numbers
 - Why factory owners stronger than workers

Consider sugar quotas

- Small group can organize to take advantage of most citizens
 - 60,000 employees of sugar industry can organize
 - 300 million sugar consumers cannot defend themselves
- “Exploitation of the great by the small”
- Why doesn’t everybody do this?
 - Sugar is a hard business to enter
 - Doesn’t work for authors or real estate agents

Types of politics

	Concentrated costs	Diffuse costs
Concentrated benefits	Interest group politics: eg, labor v. capital	Client politics: subsidies, group benefits
Diffuse Benefits	Entrepreneurial politics: pollution, guns	Majoritarian politics: eg, Social Security, war

Characteristics of each type

- Majoritarian: public opinion, ideological debate, political parties
- Interest group: changing cleavages in society, political parties, continuing struggle
- **Client politics: low visibility, little role for parties**
- Entrepreneurial politics: key role of policy entrepreneurs & media, compelling symbols

Business lobbying

- Lobby against new technologies and techniques that threaten position
 - Cable TV forbidden for decades in US in order to protect local TV stations
- Create barriers to entry
 - Medical licensing requirements
 - Licenses for hairdressers, interior decorators, etc
 - Regulations often a way to keep competitors out

But collective action theory may be too pessimistic

- Some people enjoy participating
 - like being part of group
 - like supporting a good cause
- Probably more important for non-economic than economic issues

Public choice theory

Today

- Public choice theory
- Collective action theory
- **Bureaucracy**
- Voter irrationality
- Solutions?

Rent seeking

- Investment of resources into counterproductive activities
- Lobbying of government in order to get privileges
 - Monopolies, trade restrictions, barriers to entry, regulations
- Losses both from bad policy and from energy and resources spent on lobbying

Consider incentives of bureaucracies

Serve public

But public...

- Has little contact with bureaucracy
- Provides few benefits to bureaucrats
- Provides few arguments

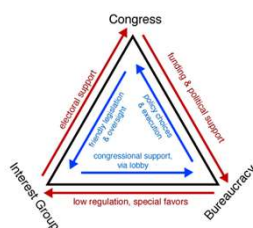
Serve industry

While industry...

- Has frequent contact with bureaucracy
- Can provide favors: dinners, fact-finding trips
- Hires experts and lawyers to make their case

Iron triangle or bureaucratic capture

- Close relationship between bureaucracy, parliamentary committees and interest groups
- Committees and bureaucracy serve interest groups
- In exchange receive support from lobbyists



Bureaucratic biases

- Food and Drug Administration approves new drugs and medical devices
- Very concerned about drugs that cause harm
 - Therefore, long testing and difficult approval
- But what about people who are harmed by these delays?
 - Consider incurable diseases
 - Consider organ transplants: illegal to pay compensation for an organ

Bureaucratic successes

- Quality of government not a constant
- Some countries create efficient, honest, and effective bureaucracies
 - Eg, Japan, Germany
- Others not so much
- Question is how you get to this sort of bureaucracy

Public choice theory

Today

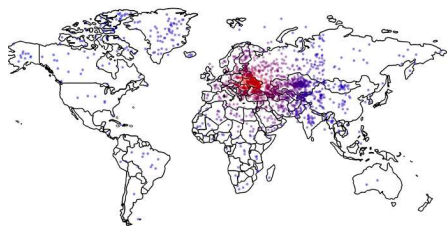
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Rational ignorance

- Becoming well-informed has large costs
 - Reading newspaper, studying economics, etc.
- Benefits of being informed and voting correctly are small
 - Consequences of elections shared by all
 - Thus most citizens will know little about politics

Where is Ukraine?

- Only 16% of Americans correctly pinpoint
- Those who don't know more likely to support war



Research on knowledge in US

- Average American is poorly informed but not uninformed
- Levels of political knowledge relatively stable over last 50 years
- Americans slightly less informed about politics than citizens of other nations
- Average levels of knowledge mask important differences between groups
- Knowledge is tied to many aspects of good citizenship
 - Tolerance, participation

Systematic biases

- Anti-market bias: people underestimate benefits of market
 - Profits perceived as gifts rather than incentives
- Anti-foreign bias: people underestimate benefits of interactions with foreigners
 - Trade seen as zero-sum rather than positive-sum

Systematic biases

- Make-work bias: people underestimate benefits of conserving labor
 - Worries about downsizing and technology; but they increase productivity
- Pessimistic bias: people overestimate problems and underestimate future

Consider other policies

- Occupation licensing
 - Appears to give us higher quality service, but also more expensive and limits jobs/supply
- Pollution permits
 - A price to pollute, but most efficient way to reduce pollution
- Minimum wage
 - Provides workers with better wage, but potentially fewer people get hired

Public choice theory

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- Bureaucracy
- Voter irrationality
- **Solutions?**

Public choice diagnosis

- Politicians motivated by self-interest
- Group politics skewed towards certain interests
- Bureaucracies likely to be captured
- Voters uninformed & maybe misinformed

Public choice proposals

- Limit size of government
 - But theory implies that government will expand
- Constitutional restrictions on spending, government activity; strong property rights
- Political institutions which make government expansion difficult
 - Veto points, federalism, supermajority rules
- Persuasion? Education?

Economic history in 70s and 80s

- OPEC raises oil prices => supply shock to economies
 - Stagflation: high inflation and slow growth
- Crisis of ungovernability
 - Strikes, public malaise, governments incapable of solving problems



Conservative revolution

- Reagan, Thatcher and supply side economics
- Deregulation of industries
 - Trucking, airlines
- Defeat of labor unions
 - Reagan against air traffic controllers
 - Thatcher against coal miners
- Lower taxes to create better incentives
- Left-wing parties adapt – Third Way

