UNIVERSITÁ DEGLI STUDI DI TERAMO

The Economics of the Welfare State (1)

Noemi Pace
Facoltá di Scienze Politiche
npace@unite.it

Outline

- **What the *welfare state* is and the rationale for it.**

- Poverty: measurements, consequences and relationship with development and economic growth (The Economics of the Welfare State – 1).

- Inequality: measurements, consequences and relationship with development and economic growth (The Economics of the Welfare State – 2).

- Development policies and programs (The Economics of the Welfare State – 3).

Welfare State

What does “welfare state” mean?

- During World War II, a British clergyman gave a speech in which he contrasted the «warfare state» of Nazi Germany, dedicated to conquest, with Britain’s «**welfare state**», **dedicated to serving the welfare of its people.**

- Since then, the term welfare state has come to refer to ***the collection of government programs that are designed to alleviate hardship.***

- A large share of the government spending of all wealthy countries consists of government transfers – payments by the government to individuals and families – that provide financial aid to the poor:

- assistance to unemployed workers, guaranteed income for the elderly, and assistance in paying medical bills for those with large health care expenses.

Welfare State

Three major economic rationales for the creation of welfare state:

1) Reducing poverty

2) Alleviating income inequality

3) Alleviating economic insecurity

Welfare State

1) Reducing poverty:

- This rationale involves the social benefits of poverty reduction and access to health care and education, especially when applied to children of poor households.

- Researchers have documented that poor children, on average, suffer lifelong disadvantage. Children from economically disadvantaged backgrounds are more likely to be underemployed or unemployed, engage in crime, and to suffer chronic health problems—all of which impose significant social costs.

- So, according to the evidence, programs that help to alleviate poverty and provide access to health care generate external benefits to society.

Welfare State

1) Reducing poverty:

- Some political philosophers argue that principles of social justice demand that society take care of the poor and unlucky.
- Others disagree, arguing that welfare state programs go beyond the proper role of government.
- In 1971 the philosopher John Rawls published *A Theory of Justice*, the most famous attempt to date to develop a theory of economic fairness.
- He asked readers to imagine deciding economic and social policies behind a “veil of ignorance” about their own identity.
- That is, suppose you knew you would be a human being but did not know whether you would be rich or poor, healthy or sick, and so on.
- Rawls argued that the policies that would emerge if people had to make decisions behind the veil of ignorance define what we mean by economic justice.
- Rawlsian theory is often used as an argument for a generous welfare state.

Welfare State

1) Reducing poverty:

- Three years after Rawls published his book, another philosopher, Robert Nozick, published *Anarchy, State, and Utopia*, which is often considered the libertarian response.

- Nozick argued that justice is a matter of rights, not results, and that the government has no right to force people with high incomes to support others with lower incomes.

- He argued for a minimal government that enforces the law and provides security and against the welfare state programs that account for so much government spending.

- Philosophers don’t run the world. But real-world political debate often contains arguments that are clearly based upon either a Rawls-type or a Nozick-type position.

Welfare State

2) Alleviating income inequality:

- Suppose that the Taylor family, which has an income of only $15,000 a year, were to receive a government check for $1,500.

- Also suppose that the Fisher family, which has an income of $300,000 a year, were to face an extra tax of $1,500.

- This hypothetical exchange illustrates the second rationale for the welfare state: alleviating income inequality.

- Because a marginal dollar is worth more to a poor person than a rich one, modest transfers from the rich to the poor will do the rich little harm but benefit the poor a lot.

- Programs that are designed to aid the poor are known as **poverty programs**.

Welfare State

3) Alleviating economic insecurity:

- Imagine ten families, each of which can expect an income next year of $50,000 if nothing goes wrong.

- But suppose the odds are that something *will* go wrong for one of the families, although nobody knows which one.

- Now suppose there's a government program that provides aid to families in distress, paying for that aid by taxing families that are having a good year.

- This program will make all the families better off, because even families that don't currently receive aid from the program might need it at some point in the future.

- Each family will therefore feel safer knowing that the government stands ready to help when disaster strikes.

- Programs designed to provide protection against unpredictable financial distress are known as **social insurance programs.**

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Sustainable Development Goals 2030

Poverty

- Objective n.1: eradicate poverty
- **What does poverty mean?**

From Britannica:

The state of one who lacks a usual or socially acceptable amount of money or material possessions.

Poverty is said to exist when people lack the means to satisfy their basic needs. In this context, the identification of poor people first requires a determination of what constitutes basic needs.

These may be defined as narrowly as “those necessary for survival” (*absolute poverty*) or as broadly as “those reflecting the prevailing standard of living in the community” (relative poverty).

The first criterion would cover only those people near the borderline of starvation or death from exposure; the second would extend to people whose nutrition, housing, and clothing are adequate to preserve life BUT do not measure up to those of the population as a whole.

Poverty

- According to the UN definition, poor are those who live on a daily income of less than $ 1.90 per day in PPP dollars.

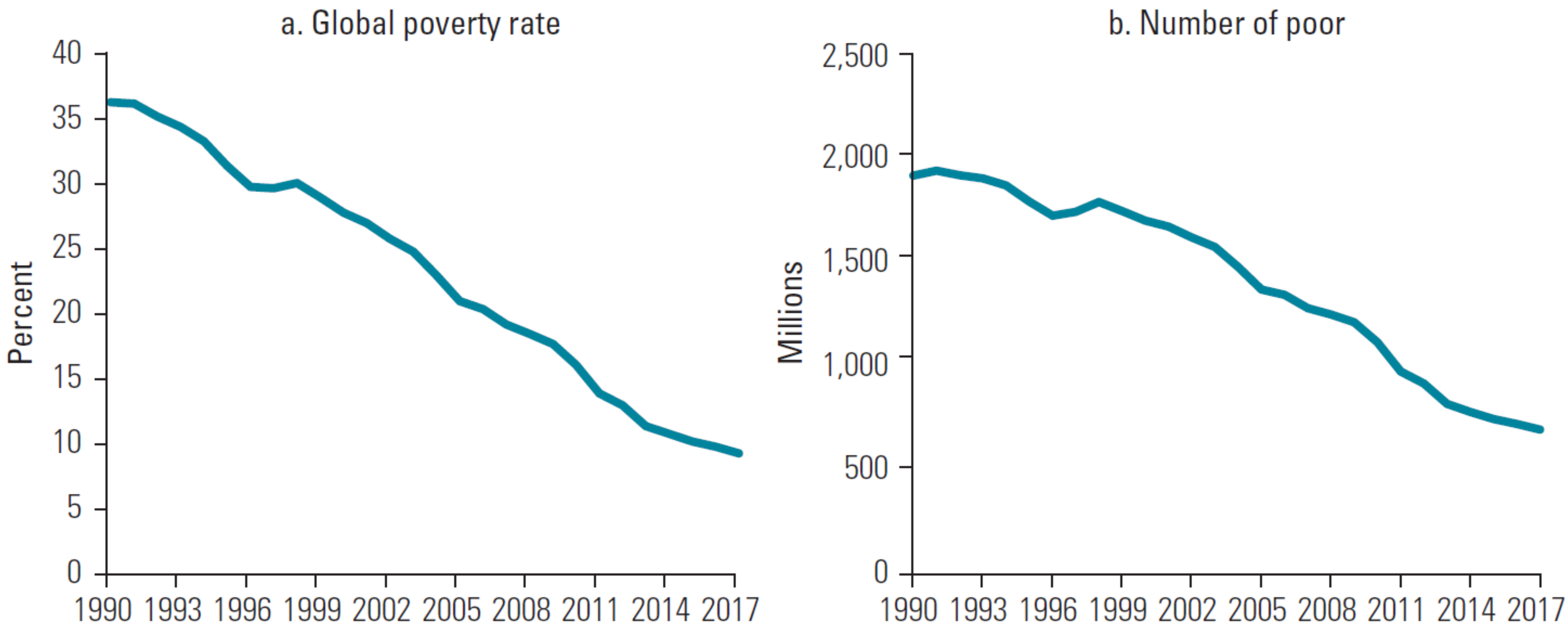
- Poverty is defined in absolute or relative terms.

- Absolute poverty means the situation of not being able to meet the essential sustenance of food, clothing and shelter.

- Relative poverty defines the poor of a society, or of a particular country, in relation to the economic status of the other members of the same society.

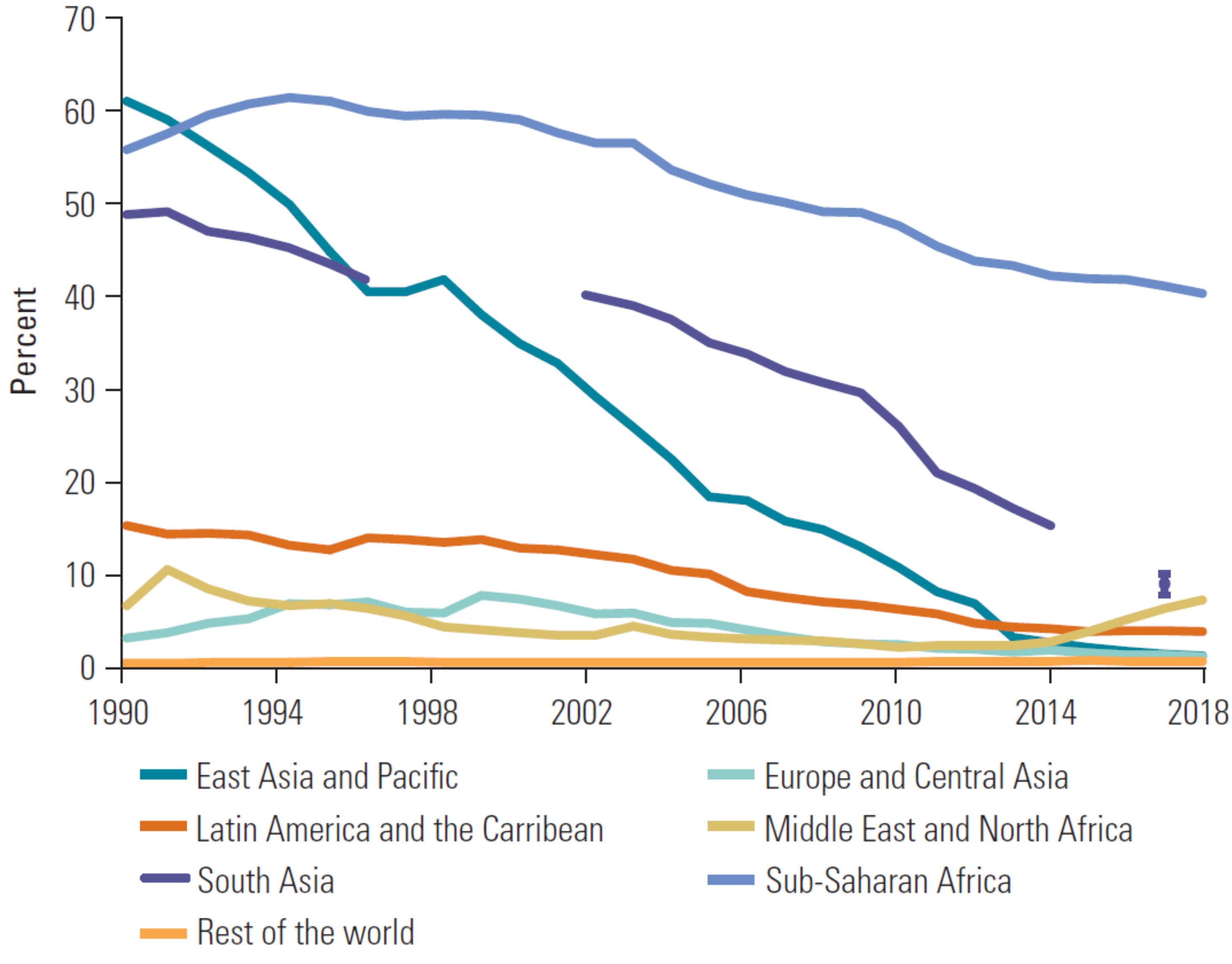
- This division takes into consideration only **the parameters of income and consumption** and does not consider the fact that income is not the only element that determines the possibility of accessing the goods and services necessary to live.

Absolute poverty

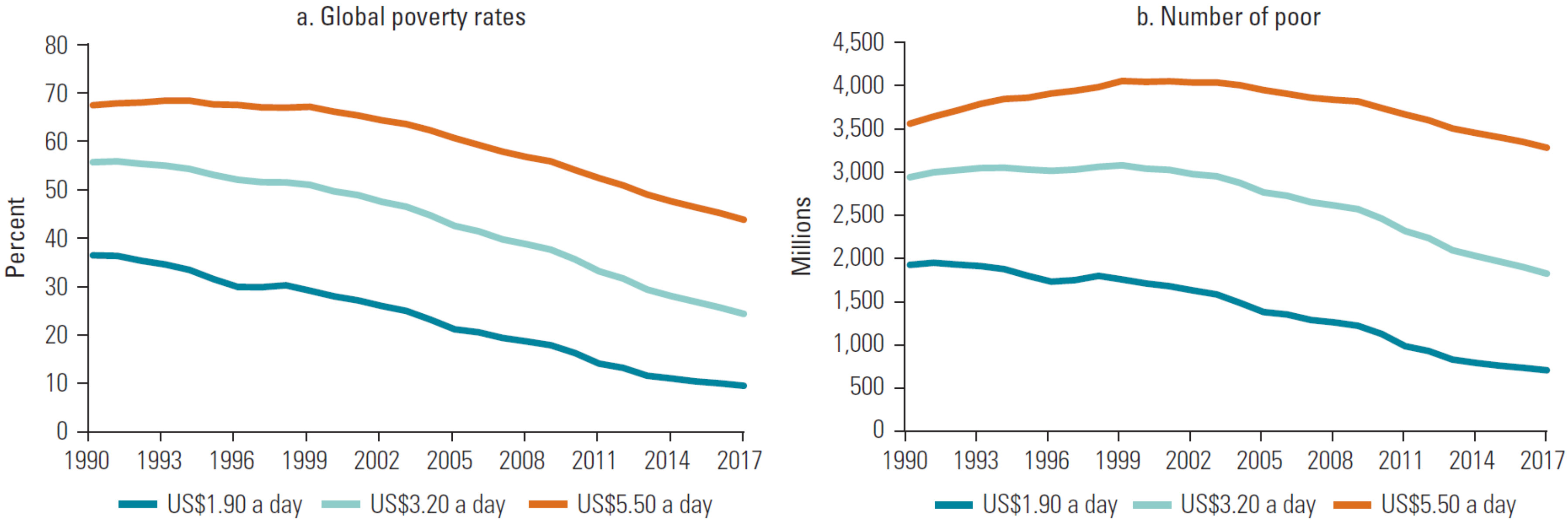


Source: World Bank

Absolute poverty by region

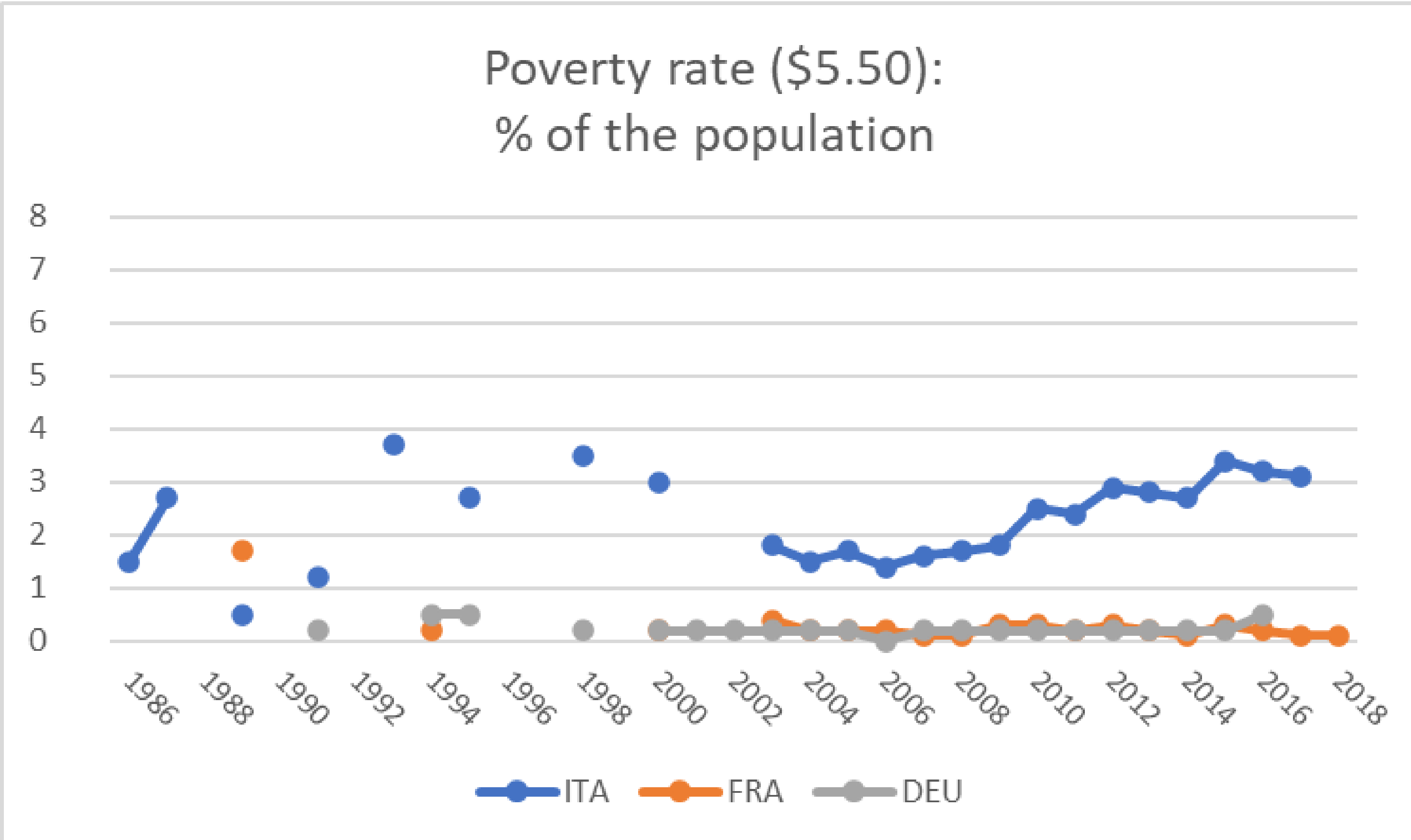


Absolute poverty: different lines of poverty ($1.90, $3.20, $5.50)



Source: World Bank

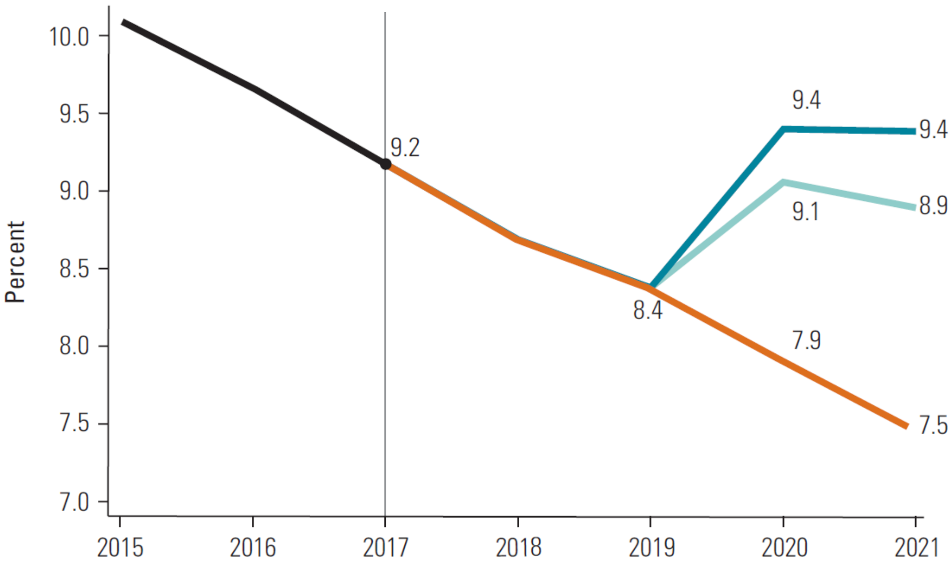
Absolute poverty in Italy, France and Germany



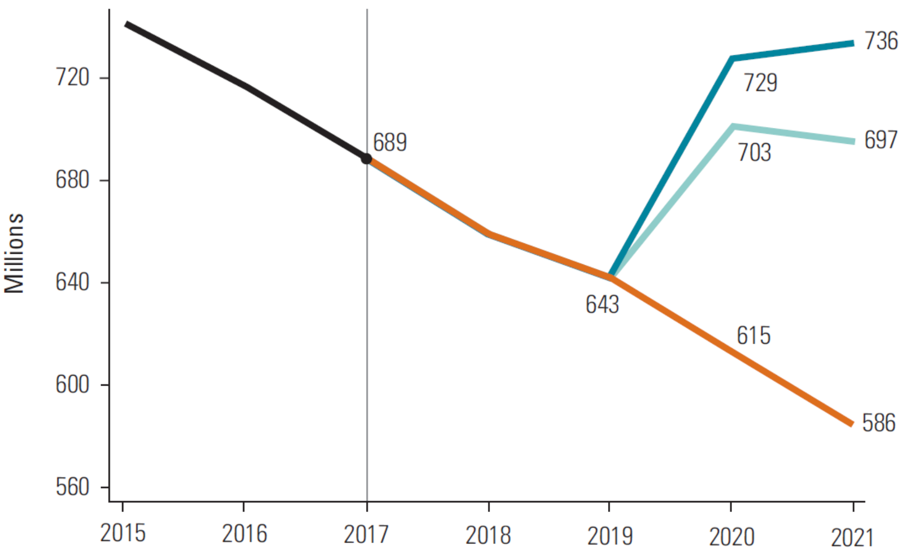
Source: Own elaboration of World Bank data

Absolute poverty: impact of COVID-19

Global Poverty Rate
(2020/2021)



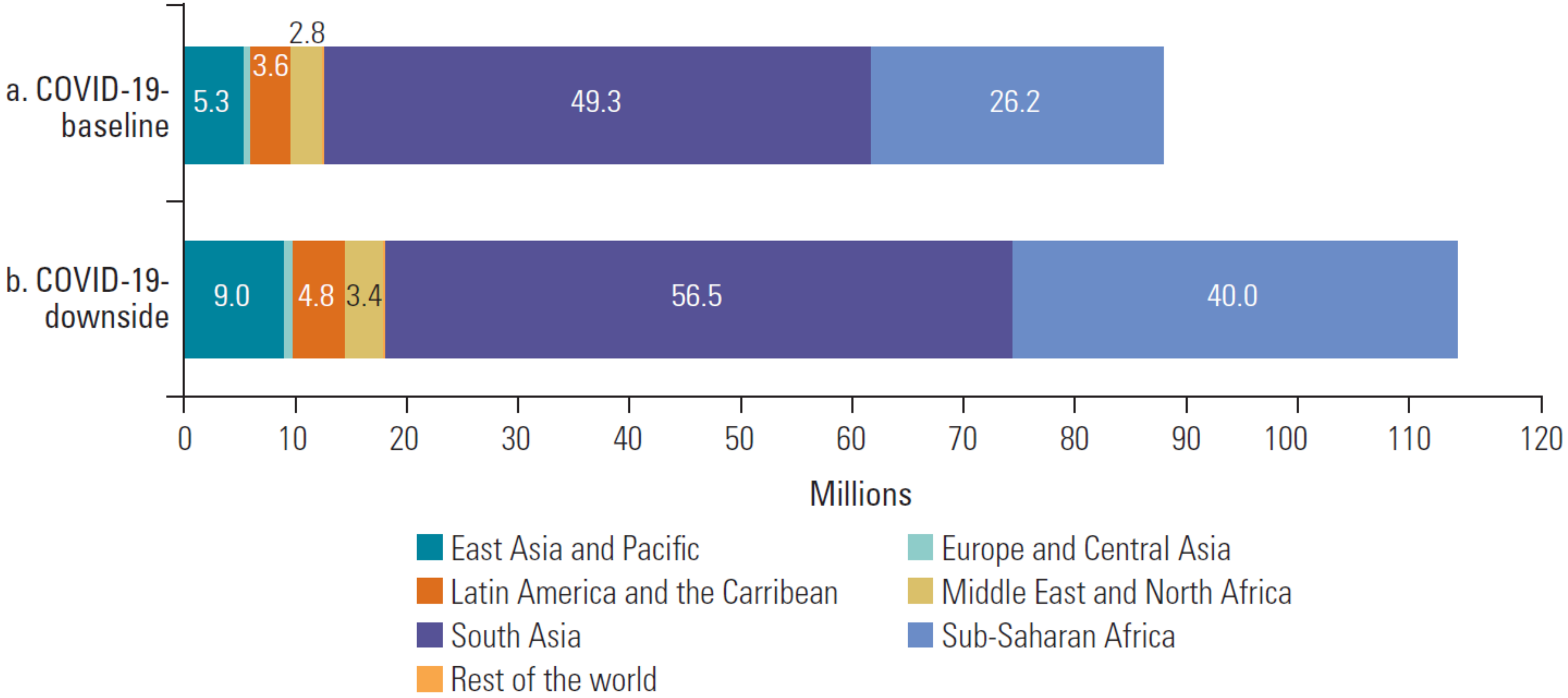
Number of poors
(2020/2021)



COVID-19-downside COVID-19-baseline Pre-COVID-19

Absolute poverty: impact of COVID-19 by region

New «poor» by region (2020/2021)

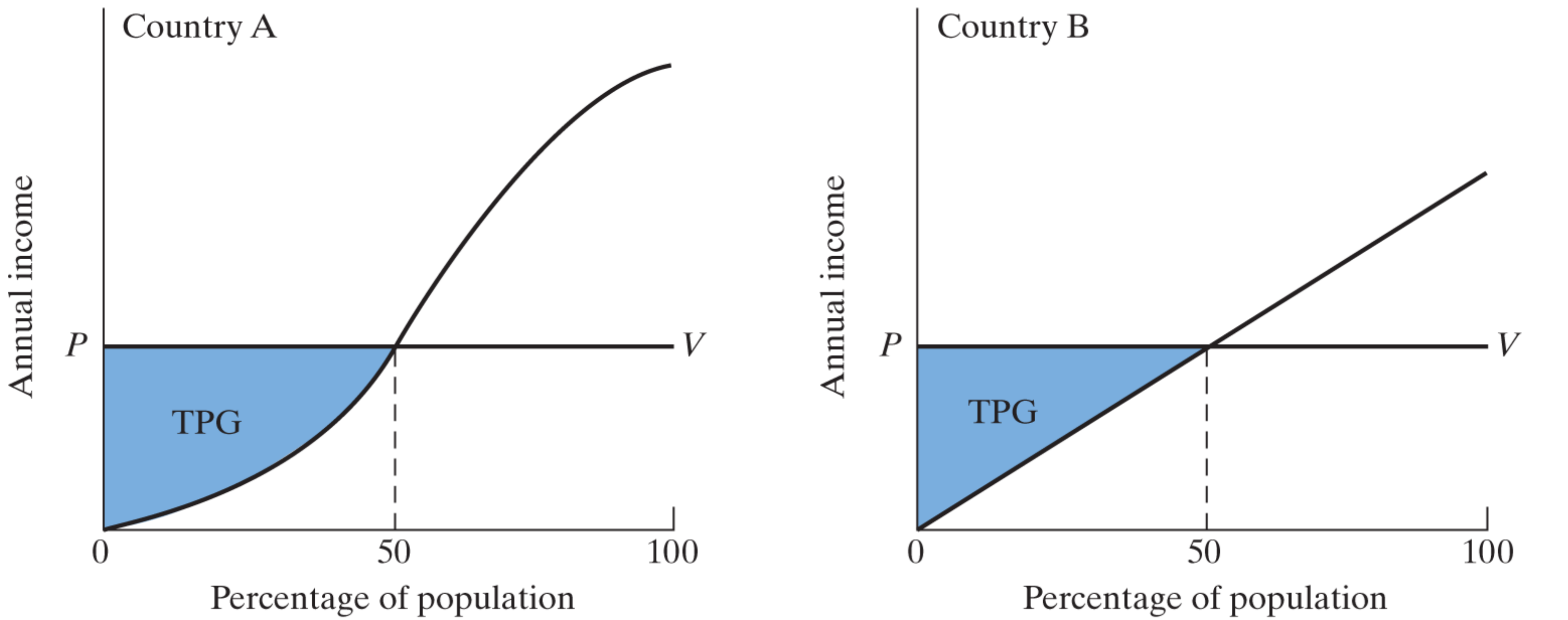


Total Poverty Gap

Total poverty gap:

- Where Y_p is the absolute poverty line; and Y_i the income of the i_{th} poor person

$$\text{TPG} = \sum_{i=1}^{H} (Y_p - Y_i)$$



(a) A relatively large poverty gap

(b) A relatively small poverty gap

Average Poverty Gap

Average poverty gap (APG):

$$\mathrm{APG} = \frac{\mathrm{TPG}}{N}$$

- Where N is number of persons in the economy
- TPG is total poverty gap
- Note: normalized poverty gap, NPG = APG/Y_p

Average Poverty Gap

Average income shortfall (AIS):

$$\mathrm{AIS} = \frac{\mathrm{TPG}}{H}$$

- Where H is number of poor persons
- TPG is total poverty gap
- Note: Normalized income shortfall, NIS = AIS/Y_p

Multidimensional Poverty

- Poverty is a complex and multidimensional phenomenon.

- The quantitative and qualitative studies carried out on poverty show how poverty is perceived on dimensions that go beyond income: health, education and material well-being are essential factors to take into consideration.

- The Multidimensional Poverty Index (MPI) was introduced in 2010 by the UNDP (United Nations Development Program).

- The MPI captures the complexities of the concept of poverty and measures deprivation directly rather than indirectly through income.

Multidimensional Poverty

Domains	Indicators
Health (1/3)	- Child mortality (1/6) - Nutrition (1/6)
Education (1/3)	- Years of schooling (1/6) - School attendance (1/6)
Living Standards (1/3)	- Cooking Fuel (1/18) - Sanitation (1/18) - Drinking Water (1/18) - Electricity (1/18) - Housing (1/18) - Assets (1/18)

https://ophi.org.uk/multidimensional-poverty-index/

- An individual is considered poor if it reaches 33% of the weighted indicators

Multidimensional Poverty

- The Multidimensional Poverty Index (MPI) is calculated as:

MPI=H x A
H: Percentage of population MPI-poor (incidence of poverty in % terms)
A: Average of multidimensional poverty within the population defined as poor (in % terms)

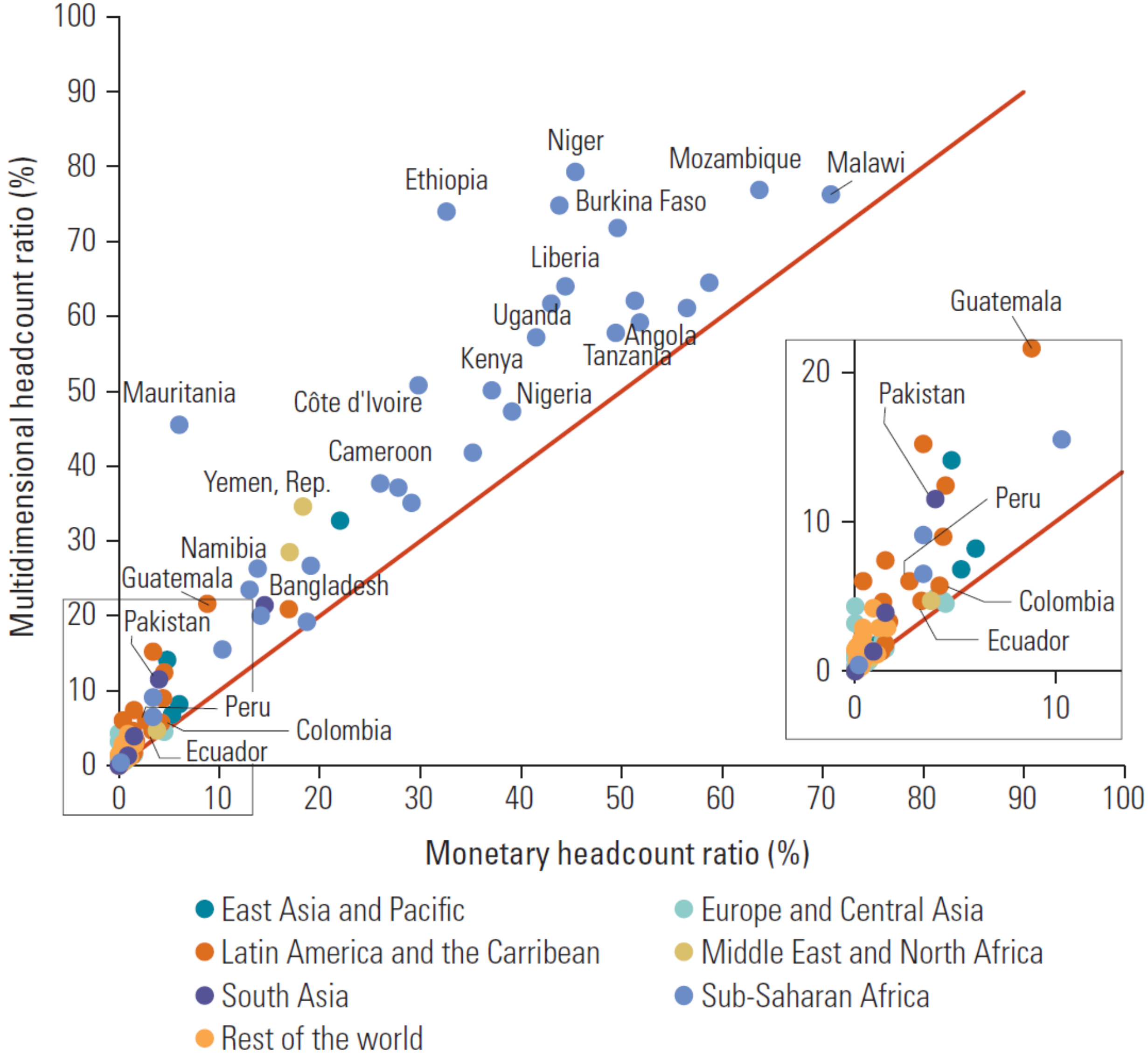
- Example for Afghanistan:

H=55%, A=48.6%, MPI=0.272

http://hdr.undp.org/en/2020-MPI

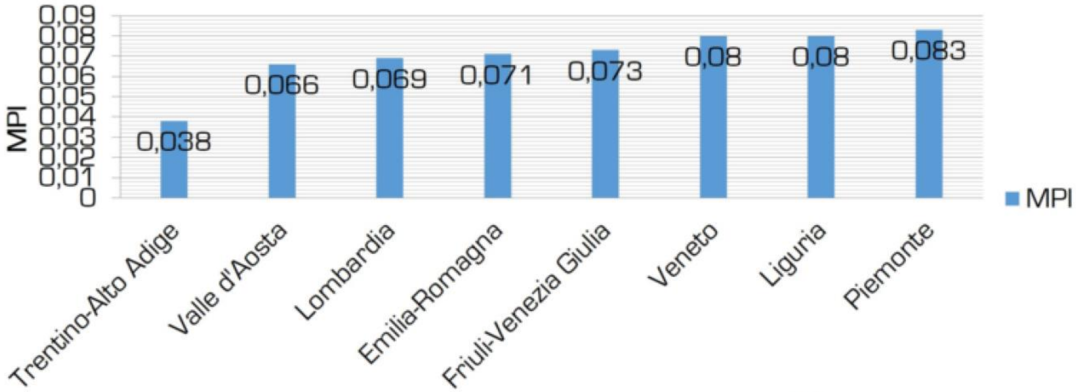
Multidimensional Poverty

Correlation between monetary poverty and multidimensional poverty (2017)

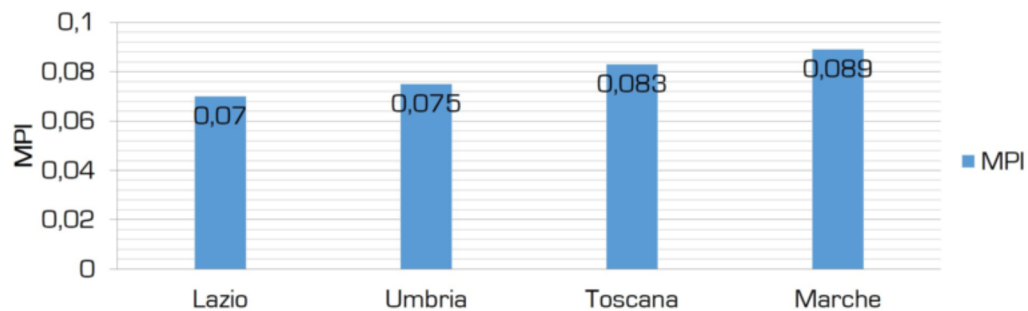


Multidimensional Poverty in Italy (2018)

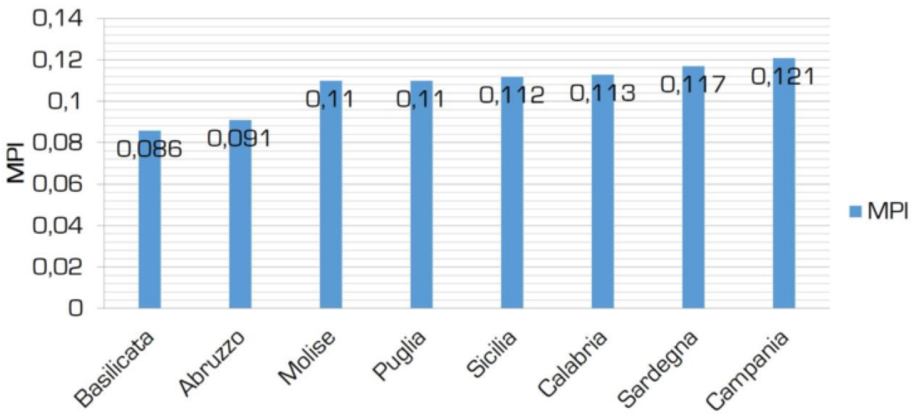
North



Center



South



Source: Billi and Scotti, 2018

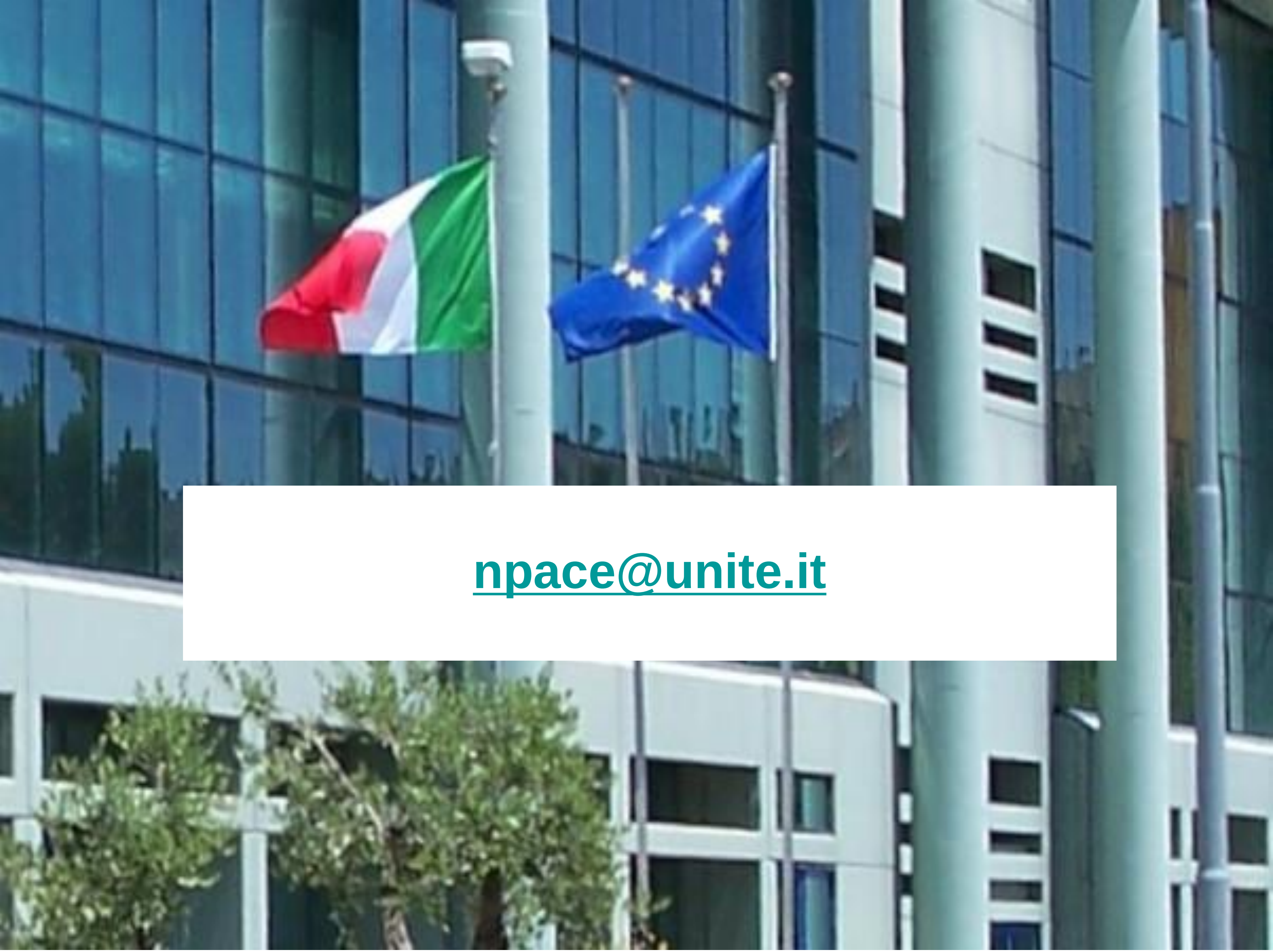
Multidimensional Poverty in Italy (2018)

Other measurements of poverty:
Multidimensional Child Poverty (Unicef, Innocenti Research Center)

https://www.youtube.com/watch?v=uhI3O7bJ3AE

Relationship between poverty and development

- Inclusive economic growth can lead to poverty reduction.
- At the same time, poverty reduction can lead to growth and development, while the inability to reduce poverty can limit development prospects.
- Poor health, poor nutrition and low education reduce the economic productivity of people in poverty, leading directly and indirectly to slower growth.
- Often the poor do not have access to the credit market, which limits growth: loss of opportunities for entrepreneurship, inability to finance the education of their children, reducing the skilled workforce necessary for development.
- Social exclusion/injustice, associated with poverty, can also cause long-term economic stagnation.



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