

**New Insights Lecture on
“Why the Welfare State Looks Like a Free Lunch”**

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Like too many societies, Singapore’s social welfare model faces increasing pressure. With population ageing, widening income inequality, and rising public expectations, the government will be looked upon to shoulder greater and more varied responsibilities. Social spending patterns have already pointed towards a trend of increase, first during the Asian Financial Crisis, where assistance to the unemployed was expanded, to the current work income supplement programme, which applies to all low income workers.

Professor Peter Lindert, Distinguished Professor of Economics at the University of California, Davis, was at the Civil Service College to share his views on social spending and economic growth. Contrary to the common notion that extensive social outlays impair economic productivity, Professor Lindert explained that history does not corroborate this interpretation perfectly. His lecture centred on six key points.

1. The welfare state is not an endangered species. There is no race to the bottom.

The evidence suggests that the welfare state is not in retreat. Since the 1980s, social spending as a proportion of GDP has continued to rise steadily across OECD countries. The number of OECD welfare states (broadly defined as countries with social outlays of 20 percent or more of GDP) has been constant or rising. Ireland has dropped out, but Switzerland has joined the ranks. Newer entrants to the OECD, like the Czech Republic, Hungary, and Poland have become democratic welfare states.

2. High-budget welfare states are enjoying a “free lunch” of more equality, slightly longer life span, with no discernible loss of GDP.

The negative impact of high social spending on GDP cannot be supported by statistical evidence. There are good reasons why welfare states do not exhibit the problems so often attributed to them—real world welfare states seldom, if ever, commit the gross blunders which conservative economists so frequently assume. Taxes on corporations and capital are not higher in welfare states than they are in low-budget social spending states like the US. On the contrary, corporate and capital tax rates are lower in a number of welfare states than the US. In welfare states, social spending is primarily financed through higher valued added taxes (VAT), and taxation on labour across all incomes levels, which has been found to exhibit less sensitivity to taxation (compared to capital). Taken as a whole, welfare states feature a relatively pro-growth tax regime, better healthcare, education, and more investment in women’s careers.

3. Big government has outperformed small government in health insurance, healthcare, promotion of women’s careers, and the taxation of addictive goods with negative externalities.

Universal and progressive social transfers have worked better for these areas than decentralised free markets. America’s health insurance system is a notorious example of a

decentralised system without the purported efficiency gains. Instead, it suffers from more bureaucracy, higher administrative costs and, critically, saves fewer lives.

Welfare policies in contrast have produced better results in several areas—not only for outcomes in terms of wellbeing, but also in terms of productivity gains. Extensive support for women’s careers has proven to be an example of positive investment. Although policies to support for women’s careers—from parental leave to subsidised day-care—imposes an upfront cost to the state, it can also benefit GDP. The cost of easing women back to work is offset at least partly by not having to finance unemployment compensation. More critically, it reduces the disruption to women’s careers. This prevents women from having to leave the workforce for extended periods, which often results in lower wages and slower career progression when they return. The higher female wages in Sweden testify to the efficacy of such policies.

Welfare states have also done better in imposing some of the heaviest “sin taxes” on products with negative externalities, like alcohol and tobacco.

4. Western Europe has too many over-protective policies to the detriment of competitiveness.

This is a problem in the Mediterranean, France and Belgium. Although big government has performed better in certain areas as highlighted, much of the economy consists of markets that do not fail, and therefore the US does better than Western Europe in some aspects. In higher education, the US government refrains from over-subsidising higher education, unlike the predominantly public university system in Europe. This forces universities to compete with each other and private universities for research funding, students, and a reputable faculty, resulting in a vibrant and dynamic higher education sector.

European Employee Protection Laws (EPLs) is another major load that drags down the region’s competitiveness. Professor Lindert explained that EPLs have protected the jobs of senior male workers, with little impact to the overall unemployment rate, but at the (great) expense of employment opportunities and career development for younger adults and women. Over the long term, the delays in careers create a cumulative loss to the country’s productivity.

5. The coming pension crisis does not spell the demise of the welfare state.

Pension systems must reform, because of population ageing—but this will apply to public and private pensions alike. Professor Lindert stressed that adjusting for longevity is not the exclusive need for pay-as-you-go (PAYGO) schemes. With Singapore being an exception, he said that funded systems were not necessarily more politically stable. History shows (US and Germany being prime examples) that PAYGO programmes easily replaces funded programmes. Professor Lindert felt that the reform process should not be a cause for concern either. Since the 1980s, several OECD countries have started to fine-tune their systems, adopting a model of lower support per elderly citizen, with no change in tax share (for example, the Swedish “notional” formula in 1998). He believed that was likely to be the direction of political consensus going forward.

Professor Lindert explained that the source of pension problems needs to be pinpointed accurately. Having a population which ages too rapidly is the first source of trouble (especially for Japan and Italy); countries also land themselves in difficulty with early retirement policies (which are prevalent in the Mediterranean, France, Belgium and

Germany); lastly, countries invite trouble when they chalk up overall government deficits. Japan and the US—both non-welfare states—have the highest deficits of the OECD cluster. To resolve the deep-seated challenges in pension systems, policymakers will have to grapple with these issues.

6. The “trade-off” between equality and efficiency is false.

The fact is that both America and Western Europe have passed up opportunities to better equality and efficiency. America can adopt a better health insurance system; Western Europe could abolish some of its employment protection laws. The dichotomy is therefore false. With political will, countries can improve both equality and efficiency.

Q&A

After Professor Lindert presented a broad overview of social spending, participants engaged him on the ideas he shared.

One asked if there were other mitigating factors that could explain why welfare states did not falter (for example, could some exogenous factor have fuelled consistent and widespread growth for all states—welfare and non-welfare states alike?). They wondered if other economists would read the same data but arrive at different conclusions. Another inquired if welfare states, while viable in economic upswings, could be sustainable in prolonged downturns, when opportunities are reduced, and more citizens necessarily become dependent on the state.

Professor Lindert acknowledged that it was responsible to be concerned for the sustainability of the welfare state, and indeed prudent. However, the evidence for its debilitating effects was simply absent. Welfare states enjoy a greater state of happiness, exhibit more economic dynamism, and have higher employment rates on average. He reiterated that welfare states do not employ the imprudent policies that conservatives assume. Benefits come with time limits, and their recipients are required to perform certain tasks to qualify (engaging in active job search or retraining for instance). Welfare states can minimise the supposed ills of welfarism through good policy design. Professor Lindert contended that if the woes of the welfare state were as true as conservatives alleged, Sweden would have become a failing state, and the statistics would surely reflect it, even if it was based on crude data.

Questions followed on whether (i) Singapore should change its Central Provident Fund (CPF) to a defined-benefit system and (ii) how—if it was desirable—for Singapore to move from the current tax structure (where government spending is minimal at 16% of GDP), to a tax-heavy setup of the welfare state. A participant also inquired if culture affects the level of acceptance and support for big government.

Professor Lindert clarified that he was not for overhauling any system rashly, or suggesting that every country should become a welfare state overnight. He said that where the CPF has worked for Singapore, there wasn't a need to create a system afresh. Each country works within its history, constraints, and context. Policies are necessarily path-dependent. Policy changes should therefore be gradual. If Singapore wanted to increase the tax base, benefits ought to also rise in tandem, which would make for an acceptable social compact.

He agreed that cultural norms were important. Americans viewed immigrant workers as generally diligent people who contributed to the economy but took little from the state. Consequently, America accepts a fairly large proportion of immigrant workers; the minimum wage is relatively low. The opposite is true of Denmark. There are fewer immigrant workers but a higher minimum wages. Immigrant workers are perceived to be less industrious, less trust-worthy, and more prone to free-ride on the welfare state.

For Singapore, Professor Lindert saw the demand for social spending increasing. He observed that although Singapore did not have the most highly skilled labour force in the past, it managed to thrive, in part, because the region was less developed and competitive. China's and India's entry into the global market, with their mass supply of workers, has introduced stiffer competition, and generated more economic dislocation for Singaporeans. As Singapore endeavours to move up the value chain, cushioning these shocks, and providing more resources for retraining, will be an issue of political and economic necessity.
