https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

DOES THE WELFARE STATE HELP THE POOR?*

By Tyler Cowen

I. Introduction

Does the welfare state help the poor? This surprisingly simple question often generates more heat than light. By the welfare state, I mean transfer programs aimed at helping the poor through the direct redistribution of income. (This excludes general economic policy, antitrust, the volunteer military, and many other policies that affect the well-being of the poor.) Defenders of the welfare state often assume that the poor benefit from it, while critics suggest that the losses outweigh the gains. The most notable of such criticisms is Charles Murray's *Losing Ground*, which suggests that the welfare state has failed to achieve its stated ends.[1]

I attempt to revise both positions in this debate. I look first at how much the welfare state transfers to the poor, which turns out to be a surprisingly small sum, relative to the stock of wealth. This, of course, limits both the benefits and the costs of the welfare state. I then consider the empirical evidence for the traditional conservative argument that the welfare state is bad for the poor. In general, the evidence indicates that current recipients of welfare benefit from the transfers, contrary to what Murray and some other critics have suggested. Nonetheless, the welfare state appears to harm the interests of future generations and foreign citizens, and in this regard it does not help the poor more generally.

The debate over the welfare state thus should be recast. Common philosophical opinion suggests that impersonal consequentialism favors the welfare state by creating obligations to support others in need. If good consequences matter, and all persons are to count equally in the social-welfare function, it would seem that our obligations to the poor, through the welfare state, are very large. In contrast, I argue that impersonal consequentialism is more likely to militate *against* a welfare state, once the interests of all individuals are considered. The case for a welfare state

* The author wishes to thank Bryan Caplan, Robin Hanson, Rebecca Menes, Ellen Frankel Paul, David Schmidtz, and the contributors to this volume for useful comments and discussion.

[1] Charles Murray, *Losing Ground: American Social Policy 1950–1980*, 2d ed. (New York: Basic Books, 1994). The moral foundations of the welfare state have been criticized by Robert Nozick in his *Anarchy, State, and Utopia* (New York: Basic Books, 1974), and by David Schmidtz in David Schmidtz and Robert E. Goodin, *Social Welfare and Individual Responsibility* (Cambridge: Cambridge University Press, 1998). Schmidtz also questions whether the welfare state has in fact benefited the poor. On the other side of the philosophical debate, John Rawls, Michael Walzer, Robert E. Goodin, Ronald Dworkin, and Shelly Kagan number among the defenders of the welfare state.

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https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

rests upon assigning priority to the claims of one particular set of individuals—namely, currently living domestic citizens—over the claims of future generations and foreign citizens. Throughout the essay I focus on a U.S. context, although the central arguments can be generalized to any modern capitalist economy with a welfare state.

II. How Much Does the Welfare State Redistribute?

In the developed Western democracies, most government expenditures recycle tax dollars rather than create a net movement of tax dollars from rich individuals to poor individuals. These expenditures and their associated programs affect individual behavior at the margin, through taxes and subsidies, but many do not redistribute net wealth to the poor. Direct antipoverty programs account for only 8 percent of federal expenditures, rising to 14 percent if we count the federal contribution to Medicaid. Another estimate is that U.S. antipoverty expenditures comprised roughly 4 percent of gross domestic product (GDP) in 1992.[2]

The net effects of the U.S. Social Security system are complex, and I do not count them as part of the welfare state in this essay.[3] In any case, most of this redistribution is across generations rather than to the poor per se. Earlier generations (the current elderly) get the best deal, and subsequent generations receive increasingly inferior deals, given the pay-as-you-go feature of the system (i.e., the very first generation received benefits but did not pay a comparable tax burden). More generally, returns are tied to what individuals put into the system. Many aspects of Social Security are regressive, given that (1) the payroll tax stops at $76,200, and (2) the poor start working earlier (thus increasing their contribution) and tend to die sooner, thus lowering their payout.

Many of the largest and most expensive government programs benefit the rich or the middle class rather than the poor. Sociologist Christopher Jencks estimates that in 1980 only one-fifth of all social-welfare spending was explicitly aimed at the poor.[4] Subsidies to higher and lower education do most for the upper middle class. The real value of public goods is greater in wealthy communities, even relative to local tax expenditures. Many health care subsidies benefit the elderly, who tend to be wealthier

[2] For the 8 percent figure, see Rebecca Blank, *It Takes a Nation: A New Agenda for Fighting Poverty* (Princeton, NJ: Princeton University Press, 1997), 83. The 4 percent figure is from Sar A. Levitan, Garth L. Mangum, and Stephen L. Mangum, *Programs in Aid of the Poor* (Baltimore, MD: Johns Hopkins University Press, 1998), 41; this book also provides the best empirical survey of the American welfare state and its scope. These figures are the most widely accepted and best-informed estimates. Since the time of these estimates, there has not been a significant expansion in the size of the welfare state, and in some respects it has been curtailed.

[3] I do not count Medicare either, which subsidizes many well-off elderly people.

[4] Christopher Jencks, *Rethinking Social Policy: Race, Poverty, and the Underclass* (Cambridge, MA: Harvard University Press, 1997), 76.

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than the national average. Our tax system is only weakly progressive, all things considered, and many kinds of taxes, such as sales taxes, have a regressive impact. Milk price supports, most tariffs, and corporate welfare are but a few of the many regressive policies enacted by the American government.

The American welfare program that comes closest to representing a pure transfer payment is the program that, before the Clinton-era welfare reforms, was called AFDC, or Aid to Families with Dependent Children. AFDC, which originated in 1935, provided welfare supplements to families below a certain income level. AFDC now has become Temporary Assistance for Needy Families (TANF), which provides block grants to the states to help finance their welfare programs. Federal TANF expenditures have been capped yearly at $16.4 billion through 2002, or less than a fifth of 1 percent of 1999 GDP.[5] In-kind assistance adds to this total but does not significantly change the picture. The food stamps program, for instance, costs about $21 billion a year, just slightly more than TANF expenditures.

The point is simple. In any given year, the welfare state engages in net redistribution of only a *very* small portion of total wealth. This is true even in the more extensive European welfare states.

Let us look at some numbers more closely. Consider an economy where government expenditures account for 50 percent of GDP. As a very generous approximation, perhaps one-fifth of those expenditures represent net transfers of wealth to the poor. So 10 percent of GDP is redistributed, in net terms, in a given year. If we are considering the extent of egalitarianism, however, the relevant question is how much of the total stock of wealth is transferred. Given typical growth rates, a national stock of wealth might plausibly be twenty or thirty times greater than the output of a single year. For purposes of a very conservative estimate, let us say twenty times.

Given these numbers, each year only one-half of 1 percent of the national stock of marketable wealth is redistributed to the poor, on net. The real extent of redistribution, however, is arguably much lower, since the true stock of wealth includes more than just the marketable commodities represented in national income statistics. A variety of assets have little or no measurable market value, even though they contribute greatly to individual well-being. This includes human capital, the value of leisure time, the value of one's marriage and friends, and the general intellectual and cultural heritage of mankind, much of which has entered the public domain or is available very cheaply. For the most part, these "goods" are not redistributed by welfare policy. It is difficult to value these goods scientifically, relative to the stock of material wealth. But if we think they are equal in value to the stock of material wealth, the calculations suggest

[5] See Levitan, Mangum, and Mangum, *Programs in Aid of the Poor*, 80.

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that in a given year only one-quarter of 1 percent of the stock of total wealth is redistributed. And this is the figure for a relatively generous welfare state, one more generous than the United States is.

Of course, less conservative estimates could drive the figure down considerably. If the capital stock is worth thirty years of output (rather than twenty years), and if net redistribution is only 5 percent of GDP (rather than 10 percent), then only one-twelfth of 1 percent of the stock of total wealth would be redistributed each year.

Egalitarians may regard these numbers with disappointment, but I view the matter in a different light. They show that the welfare state represents a smaller philosophical difference between classical liberals and modern liberals than is usually believed. For better or worse, the welfare state is not a widespread engine for wealth redistribution, relative to the available total. Individuals who call themselves egalitarians usually are only very weakly egalitarian, once the larger picture is examined. In reality, few commentators wish to put all property rights on the table, regardless of their rhetoric. The available alternatives include very moderate redistribution, extremely moderate redistribution, and no redistribution at all. Complete or fully egalitarian redistribution is simply not on the agenda.

III. Costs to the poor?

Given these numbers, it is plausible that the welfare state yields only small benefits to the poor, in aggregate dollar terms. (Of course, to a single poor individual, a small dollar amount may still make a big difference.) Nonetheless, some critics wish to go further and argue that the welfare state makes the poor worse off. Most notably, Murray portrays in *Losing Ground* a world where rising welfare expenditures have led to increasing poverty and worsening social conditions.

This critique of the welfare state involves an analytic tension. In most matters, conservatives and libertarians argue from neoclassical and Chicago-school economic theories. In these approaches, a gift of cash always makes individuals better off, as evidenced by the classroom demonstration of how such gifts shift individuals onto higher "indifference curves." This is a basic lesson of any intermediate course in microeconomics, regardless of the political persuasion of the instructor. Furthermore, it does not matter whether strings or conditions are attached to the gift. After getting the gift, individuals have more options, and they can always turn down the money if the conditions are too onerous or unpleasant.

When it comes to welfare payments, critics often discard or neglect this argument. The cash payments are portrayed as breaking up families, destroying self-dignity, and creating a destructive culture of welfare dependency. The notion of freely choosing individuals who equate costs and

benefits at the margin is suddenly ignored or de-emphasized. Of course, if receiving welfare makes these individuals worse off, they could refuse to cash the check or give the money away. In fact, some programs, such as AFDC/TANF, find that as many as a third of the potential recipients do not apply for the benefits. Some may not apply for benefits out of simple ignorance, but others do not find it worthwhile to work through the welfare bureaucracy, given that they expect their lot to improve through other means. In other words, individuals who do not expect to benefit turn the money down.[6]

The available evidence supports the view that "transfer programs unambiguously make people less poor," to cite a literature survey by economist Rebecca Blank. Controlled experiments in this area are hard to come by, but the few we have suggest that welfare does benefit those who receive the money. In 1981, the Reagan administration changed AFDC rules to take 12 percent of the recipients off the rolls, essentially the least poor of the AFDC families. Several studies in the 1980s tracked these recipients, and found that subsequent private sector employment did not make up for the loss in income. A cross-national comparison of the United States and Canada shows that work behavior of single-parent families is roughly comparable, but that there is much less poverty amongst such families in Canada, primarily because the level of public assistance is higher. All of this evidence suggests that abolishing welfare would make its current recipients worse off, not better off.[7]

Nor do government welfare programs appear to displace an equivalent amount of private charity. Private giving does not vary inversely with the size of government programs, and there is little evidence of a "crowding-out" effect. Many private charities, in fact, rely on government funding to some extent. Private charitable giving to the poor, defined in narrow terms, runs in the range of $10 to $15 billion a year, and few observers believe that this sum is capable of significant augmentation in the short run, regardless of government policy.[8] Total philanthropy is of course much higher, and many of these donations benefit the poor as well.

[6] On nonapplicants, see Blank, *It Takes a Nation*, 155. That many do not apply for the benefits suggests that the gain to the recipients is less than the full value of the cash. This further supports the claim that the egalitarian effects of the welfare state are small.

[7] The quotation summarizing the evidence is from ibid., 135. On AFDC studies, see, for instance, Sheldon Danziger, "Budget Cuts as Welfare Reform," *American Economic Review* 73, no. 2 (1983): 65–70; Robert M. Hutchens, "The Effects of the Omnibus Budget Reconciliation Act of 1981 on AFDC Recipients," *Research in Labor Economics* 8 (1986): 351–87; and Robert A. Moffitt and Douglas A. Wolf, "The Effect of the 1981 Omnibus Budget Reconciliation on Welfare Recipients and Work Incentives," *Social Service Review* 62, no. 2 (1987): 247–60. On Canada, see Rebecca M. Blank and Maria J. Hanratty, "Responding to Need: A Comparison of Social Safety Nets in Canada and the United States," in David Card and Richard B. Freeman, eds., *Small Differences That Matter* (Chicago: University of Chicago Press, 1993), 191–232.

[8] Blank, *It Takes a Nation*, chap. 5.

https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

Cutting welfare benefits nonetheless would reduce the net size of the transfer to current recipients.

I sometimes hear the claim that the welfare state presents a prisoner's dilemma to poor communities. (I have not seen this argument in print in these terms, though I think it is implicit in the arguments one does find.) That is, perhaps each single individual is better off taking the cash, given that other individuals take the cash. But the collective effect is to make the entire community worse off, due to some increase in dependency or some destruction of values. We might imagine, for instance, that welfare dependency turns a formerly vibrant inner city community into a ghetto.

The first question is whether this argument is empirically true. Even if we accept the stated mechanism as analytically coherent, it may not apply to most of the poor. Just slightly more than 10 percent of the poor and 25 percent of all black poor live in urban ghettos. American poverty is more rural than is commonly recognized.[9]

Even as a matter of logic, the prisoner's dilemma argument is unlikely to lead to significant losses. The costs of a prisoner's dilemma are limited whenever individuals have the option of leaving the game, or in this case the option of leaving the community. The United States has many communities that are not wrecked by widespread acceptance of welfare, some of them quite poor and with low residential rents. Furthermore, the poor have proved to be extremely mobile throughout American history. Given the possibility of exit, well-being in a welfare-dependent community cannot fall below the level of well-being available in other communities.

The aggregate evidence provides little support for the view that cash transfers hurt those who receive them. If we examine *Losing Ground*, usually considered the seminal work in this regard, little empirical evidence is presented with direct bearing on this question, despite the ambitious claim embodied in the title of the book.

Murray does provide one central fact, which is presented as follows:

> The unadorned statistic gives pause. In 1968, as Lyndon Johnson left office, 13 percent of Americans were poor, using the official definition. Over the next twelve years, our expenditures on social welfare quadrupled. And in 1980, the percentage of poor Americans was—13 percent. Can it be that nothing has changed?[10]

This fact does not establish that welfare programs have had no impact. In most cases, income-transfer programs bring individuals closer to the poverty line, rather than pushing them over the poverty line. (If welfare pushed people over the poverty line, the incentive effects might be disastrous.) Even if a constant percentage of the population remains below

[9] Ibid., 27.
[10] Murray, *Losing Ground*, 8.

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the poverty line, they have higher real incomes because of welfare. Murray's statistic indicates that the welfare state will not "end poverty in our time," but it does not show that the expenditures fail to make people better off.[11]

Furthermore, the poverty line is a misleading measure of well-being, as it does not count in-kind transfers. Jencks attempts to adjust for this factor and estimates that the real "net" poverty rate was 29 percent in 1950, 18 percent in 1965, and 10 percent in 1980. This shows more improvement than Murray's statistic would indicate.[12]

A second set of corrections involves inflation. Many economists believe that the consumer price index (CPI) has been overestimated, typically in the range of 0.8 to 1.2 percentage points per year. If this is the case, real incomes are higher than measured and poverty has been declining at a higher rate than the statistics would indicate. Under one common way of adjusting for this measurement error, the poverty rate fell from 19 percent in 1965 to 13 percent in 1980. This adjustment, unfortunately, does not take in-kind transfers into account, and thus it differs from the numbers stated directly above; I have found no single comprehensive correction for all the potential biases in the poverty rate.[13]

Finally, the poverty rate may have been sluggish for non-welfare-related reasons. It is commonly recognized that relative wages for unskilled labor have been falling. Murray's comparison also starts in a boom year, 1968, and ends in a recession, 1980. Economic cyclicality has always been a significant determinant of the poverty rate. The 1965–80 period also saw slow increases in productivity growth, relative to the historical average (although part of this effect goes away if we adjust for CPI mismeasurements).

An alternative attempt to measure poverty looks at data on *consumption* rather than on formally reported income. For individuals living from savings, or engaged in black-market activity, their consumption level will provide a better measure of how poor they are than will their income. The measurement techniques used to support this approach are by no means uncontroversial, but consumption data provide further support for the view that the poverty rate has been falling. Economist Dale W. Jorgenson, for instance, uses consumption data to find a low and declining rate of

[11] For some exact numbers on how welfare programs lower the "poverty gap," the difference between the incomes of the poor and the poverty line, see Blank, *It Takes a Nation*, 139–40.

[12] See Jencks, *Rethinking Social Policy*, 72–74, on various ways of adjusting the poverty rate.

[13] On inflation, see Richard W. Stevenson, "Economists Readjust Estimate of Overstatement of Inflation," *New York Times*, March 1, 2000, C14. Murray himself admits that the poverty line does not count various benefits, although he correctly notes that even an improved measure of the poverty line does not show continual upward progress for the poor; Murray, *Losing Ground*, 63–64. For a comprehensive discussion of how poverty is measured, see Constance F. Citro and Robert T. Michael, eds., *Measuring Poverty: A New Approach* (Washington, DC: National Academy Press, 1995).

https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

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poverty; another economist, Daniel T. Slesnick, finds that the poverty rate in 1989 was only 2.2 percent.[14]

Since the publication of Murray's book, we also have more years of data on poverty. From 1994 to 1997, for instance, the (unadjusted) income-poverty rate declined to 10.3 percent.[15] This is more likely due to economic growth rather than the welfare state, but it does show that the welfare state does not *prevent* the poor from bettering their lot.

Beyond his single statistic—the 1968–80 comparison—Murray offers little or no evidence that the welfare state has made the poor worse off. He effectively catalogues and criticizes a variety of ineffective government programs in the areas of education, housing, and crime, among others, but he does not focus on how the welfare state has affected the overall well-being of the poor.

One commonly cited cost of the welfare state is more properly regarded as a benefit. Especially in the American context, critics frequently charge that the welfare state encourages single, poor women to have more babies than they otherwise would. Murray, for instance, writes that "[i]n 1984, at every college speaking engagement I had to defend the proposition that illegitimate births are a problem for children and for society. Now only the most militant feminists argue otherwise."[16] Yet under most plausible assumptions, illegitimate births should not be counted as a cost. The new life created is certainly a benefit to the individual who lives it. Furthermore, that individual is likely to pay taxes over the course of his or her life, thus making the birth subsidy self-financing. I am not arguing that we face a moral compulsion to increase the number of people to the highest possible level, but certainly such population increases should not be counted as a net cost, especially in an uncrowded country such as the United States.[17]

Illegitimate births prove costly only to the extent that these babies grow up to be violent criminals. But if the expected value of another individual is positive, any birth-inducing effects of welfare are unlikely to involve net social costs. Certainly in the European context, where violent crime rates are relatively low, the new babies are likely to prove to be net benefits. Even in the United States, with a much higher violent crime rate, welfare babies are not typically future drug pushers and murderers. As noted above, poverty is more likely a rural than an urban phenomenon.

Nor should we recoil at the fact that the welfare state might encourage births amongst *unwed* mothers, as those babies otherwise might not have

[14] See Dale W. Jorgenson, "Did We Lose the War on Poverty?" *Journal of Economic Perspectives* 12, no. 1 (1998): 79–96; and Daniel T. Slesnick, "Gaining Ground: Poverty in the Postwar United States," *Journal of Political Economy* 101, no. 1 (1993): 1–38.

[15] See Garth Mangum, Andrew Sum, and Neeta Fogg, "Poverty Ain't What It Used to Be," *Challenge* 43, no. 2 (2000): 97–130.

[16] Murray, *Losing Ground*, xvi.

[17] For a more detailed discussion of normative population theory, see Tyler Cowen, "What Do We Learn from the Repugnant Conclusion?" *Ethics* 106, no. 4 (1996): 754–75.

been conceived or carried to term. If a mother has a child "only because of welfare," then we know the system is producing at least one benefit, whatever other costs it may involve.[18]

For these reasons, I believe that the traditional conservative critique of the welfare state fails. Within the context of this debate, the welfare state does appear to bring net benefits to the poor. I will now consider two additional (and stronger) arguments that welfare may damage the interests of the poor, the "growth argument" and the "international argument."

IV. The Growth Argument against the Welfare State

Although I have argued that the welfare state helps the people who receive the cash, this does not imply that the welfare state benefits the poor more generally. The secondary consequences of having a welfare state may in fact be negative for a wide variety of individuals, including the future poor.

Many of the future poor, of course, will not be so poor by today's standards, due to continued economic growth. Nonetheless, they will still be poor by the standards of their time, and the poorest of them may be poor by the standards of any time. We do not cease worrying about today's poor simply because some of them enjoy comforts that Napoleon never dreamed of. In similar fashion, we should not assume that poverty will disappear as an issue in the future.

If the welfare state damages the prospects for economic growth, it is unclear whether it benefits the poor as a general class. As shown in the early part of this essay, redistribution has only a very limited ability to make the poor better off, given the small amount that is redistributed. As a matter of empirical fact, it is economic growth that lifts most people out of poverty, not transfer payments. If we consider the city-state of Hong Kong, we see that virtually all of its citizens were poor in 1950. By 1990 Hong Kong had per capita income comparable to other developed countries, even given that it absorbed a periodic influx of poor migrants from mainland China. This elimination of poverty was fueled almost completely by economic growth.

The economic growth of the West has been an effective antipoverty mechanism in similar fashion. By modern measures, most of the individuals in the 1920s were poor. Yet the 1920s, in their time, were thought of

[18] The elasticity of response, however, appears to be small. See Robert Moffitt, "Incentive Effects of the U.S. Welfare System: A Review," *Journal of Economic Literature* 30, no. 1 (1992): 1–61; and Blank, *It Takes a Nation*, 148–51 for a survey of the evidence. It also should be noted that a split family is not a cost per se to whatever extent the welfare state causes families to dissolve. The higher income, for instance, gives women who receive welfare the option to leave abusive men. Many of the costs of split families are internalized by family members, which suggests that increased freedom of decision-making in this regard brings net social benefits rather than net costs. See Jencks, *Rethinking Social Policy*, 84–85.

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as a highly prosperous decade. Similarly, about one-third of the American population was poor in the 1950s, by current measures, although, again, at the time the 1950s were regarded as wealthy without precedent. The difference, again, comes from continued economic growth.

Casual observers frequently underestimate the effects of compounded economic growth on real income. If the annual growth rate of American GDP had been one percentage point lower between 1870 and 1990, America today would be no richer than Mexico. Similarly, if a country grows at a rate of 5 percent per annum, it takes just over 80 years for it to go from a per capita income of $500 to a per capita income of $25,000. At a growth rate of 1 percent, that same improvement takes 393 years.[19]

It remains an open question how much the welfare state limits growth, but some negative effect appears to be present. First, the empirical literature on economic growth suggests that noninfrastructure government spending lowers the growth rate, although systematic data on welfare-state spending per se have not been available.[20]

Second, a welfare state will cause some people to substitute welfare dependency for private work, thus lowering the number of individuals in the active workforce or causing them to work less hard. Welfare payments are typically withdrawn from individuals as they earn more income, and thus serve as a high marginal tax rate on the economic efforts of the poor. The poor could be engaging in more productive exchange with other individuals in the economy, but to some extent they desist for fear of losing welfare benefits.[21]

Third, the taxes used to support the welfare state discourage taxpayers from working or otherwise creating economic value. Measures of the "excess burden" of taxation vary, but most public-finance economists regard as reasonable a figure of twenty cents on each dollar raised in the United States, and more in countries with higher marginal tax rates, such as several Western European nations and Canada. In other words, for each dollar raised by taxation, the resulting distortions bring twenty cents' worth of cost.

[19] Schmidtz discusses some of these numbers at Schmidtz and Goodin, *Social Welfare and Individual Responsibility*, 61; I have calculated others myself.

[20] Robert J. Barro, "Economic Growth in a Cross Section of Countries," *Quarterly Journal of Economics* 106, no. 2 (1991): 407–43, is the classic study here.

[21] One obvious (but incorrect) measure of welfare's real economic burden is to look at the quantity of money spent on welfare programs. This is the measure most frequently cited by critics of the welfare state (though they do not wish to restrict the costs to this magnitude). We have already seen that the redistributive component here is quite small. More importantly, counting these expenditures as direct costs neglects the difference between monetary transfers and actual consumption of real resources. The transfer of money from one person to another does not itself occasion economic costs, net of the administrative costs of transfer. One individual has more money, and another individual has less money, but no real resources are destroyed. The correct measure of the costs of the welfare state will involve the economic distortions it creates.

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The extensive welfare states of Western Europe typically are bundled with labor-market protections and interventions. It is not politically or economically feasible to give the nonworking significantly more risk protection than the working. Western European welfare states therefore tend to create a privileged class of working "insiders" with high real wages, high benefits, and near-guaranteed positions of employment. This practice, of course, lowers the number of new jobs that are created, limits labor-market mobility, and raises unemployment (which also creates a built-in constituency for the welfare programs). Even politicians on the left, such as German prime minister Gerhard Schroeder, are looking for ways to cut welfare-state expenditures given these costs. To these considerations we may also add the administrative costs of the welfare state and the expenditures of real resources on lobbying the state for welfare privileges.

A. Growth rates vs. once-and-for-all changes

Once we postulate the costs of the welfare state, the question still remains whether the economy bears the costs up front in a once-and-for-all fashion, or whether there is a systematic decline in the growth *rate* over time. This somewhat arcane distinction is in fact of great importance for evaluating the welfare state.

Economists sometimes use growth models, such as the model of Robert Solow, to argue that a decrease in wealth lowers the base on which growth occurs, but has no necessary implications for the succeeding rate of growth. To use a biological metaphor, the Solow growth model portrays the economy as akin to a lobster. If an arm is lopped off, another arm grows rapidly to replace it, and in the long run the economy looks virtually the same and is only slightly worse off. In economic terms the mechanism runs as follows: A decline in the capital stock raises the rate of return on capital, which induces more savings, which tends to restore a higher capital stock. In the long run, an increase in the savings rate makes up for "destroyed" resources. The very rapid recovery of some economies after wars or major natural disasters would appear to represent this mechanism in operation.

But the Solow model, properly understood, still allows the welfare state to lower the rate of economic growth. In the Solow model, a distortion lowers the growth rate when it causes the economy to develop new technologies and new ideas at a slower rate. In this case, there is no mechanism of replaceability to restore the initial state of affairs and the initial rate of growth.

A welfare state will plausibly have a negative effect on innovation. If individual labor is withdrawn from the productive sector of the economy, the rate of discovery is likely to fall. Both the poor and the taxpaying nonpoor will work less when a welfare state is in place. If we think of

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research and development, broadly construed, as one kind of work, we can expect the rate of growth to decline. Even if the poor do not participate in ideas-production directly, they do so indirectly. To provide a simple example, to the extent it is harder or more costly to hire good janitors, and other forms of cheap labor, fewer research laboratories will be opened. Note that these costs are not "replaced" by an increase of labor supply or investment elsewhere in the economy. The welfare state permanently discourages various individuals from contributing to technological development and thus lowers the rate of economic growth in lasting fashion.[22]

In the Solow model, the induced lowering of the growth rate might be small. First, the poor might not create much economic value in any case (they are, after all, poor and thus relatively unproductive, in economic terms). Second, to some extent welfare recipients will move into the underground economy, where they can keep their welfare benefits without reporting their income. Third, a decline in labor supply may lead parents to spend more time caring for their children, which may have some offsetting positive effects on long-run growth.[23]

Even if the induced decline in the growth rate is small, however, the difference in terms of national income will compound over time. Over a long enough temporal horizon, real income in a world with a large welfare state will be *much* lower than it would be in a world with no welfare state or a smaller welfare state.

[22] In Robert E. Goodin et al., *The Real Worlds of Welfare Capitalism* (Cambridge: Cambridge University Press, 1999), the authors argue that a democratic social-welfare state does not lower the rate of economic growth, but they use only two data points, the Netherlands and the United States. Their conclusion is contradicted by the findings of more general studies, such as that of Barro, "Economic Growth in a Cross Section of Countries."

[23] When individuals receive welfare, they cut back their labor supply for two reasons: an "income effect" and a "substitution effect." The income effect arises because the individual has more cash and feels less need to work, just as Hugh Hefner might choose to consume leisure at the expense of more income. This is simply an optimal reallocation of the individual's portfolio and occasions no real economic cost. The substitution effect arises because individuals find that additional work, at the margin, brings in less than otherwise, given that welfare is not awarded to high earners. Unlike the income effect, the substitution effect represents foregone gains from trade and thus involves a real economic loss. Ironically, many critics of the welfare state offer an account under which the income effect is relatively large, implying that the real economic costs of welfare are small. Popular criticisms frequently allege that welfare recipients are lazy or otherwise disinclined to work; sometimes a "culture of dependency" is postulated. To the extent these charges are true, the gains from trade from having the poor work are relatively small. The poor would produce little, but they would hate work intensely, meaning it would be hard to profitably employ them. They would shirk work at the first chance they got, if they could manage to live by any alternative means at all. In other words, this account postulates that the income effect is the primary reason why the poor do not work once they receive welfare. In this case, however, the economic costs of welfare are correspondingly small. It does not save the critics to charge that welfare "makes" these individuals lazy. That is precisely the income effect we are talking about. If individuals stop working once they have a little cash, they prefer not to work given that distribution of wealth. Again, this does not count as a real economic cost of the welfare state. For empirical evidence on the incentive effects of the welfare state, see Moffitt, "Incentive Effects of the U.S. Welfare System."

https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

Under alternative growth scenarios, such as "increasing-returns models," the negative effects of a welfare state can be even more serious. In an increasing-returns model, the welfare state lowers the rate of growth directly by shrinking the private sector. Intuitively, we can think of the increasing-returns concept as suggesting that resources multiply themselves. The larger the economy, the faster it will grow. To continue with the biological metaphor, cutting the arm off in this case does not lead to the regeneration of a new arm (as in the Solow model), but rather causes other parts of the body to decay as well, perhaps through the spread of gangrene. Increasing-returns models imply that policy mistakes, even small ones, have disastrous long-run consequences; in other words, there are no small mistakes.

Whether the Solow model or the increasing-returns model better describes reality has been the subject of ongoing debate.[24] It is impossible to resolve or even survey this debate in an essay of this length. Nonetheless, the welfare state will lower the rate of economic growth to some extent in either model, although the effect is greater if there are increasing returns to scale. The welfare state thus provides benefits for the current poor at the (great) expense of the future poor. Whether the Solow model or increasing-returns model is correct simply determines how far into the future we must look to find big losers.

B. Discounting the future?

There is no commonly accepted framework for evaluating whether a current benefit to the poor, as provided by welfare, outweighs the larger losses to be suffered by the poor in the future. Many economists typically apply a positive rate of discount to make current and future magnitudes commensurable. They make a future benefit worth less than a current benefit by some magnitude roughly comparable to the market rate of interest. This procedure, however, fails to yield clear answers in this context. Economic cost-benefit analysis applies only to the extent that the relevant benefits and costs are small for all relevant individuals, relative to their stock of wealth. More precisely, the benefits and costs should keep the marginal utility of money roughly constant for all individuals involved; otherwise we do not have a constant measuring rod for comparing the two states of affairs. But if a policy imposes very large costs on temporally distant individuals by lowering the growth rate, we are no longer dealing with small changes in wealth for the individuals concerned. Cost-benefit analysis then will not apply in traditional form, and

[24] See the symposium on this topic in the Winter 1994 issue of the *Journal of Economic Perspectives*.

https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

there will be no unambiguously correct rate of discount within an economic framework.[25]

The use of a positive discount rate may be subject to more fundamental objections as well. Many philosophers and some economists are skeptical of placing a positive discount rate on the well-being of future individuals simply because those individuals are more distant in time. If we use a discount rate of zero, the lower growth rate will mean that the future costs outweigh the present benefit. This would incline us to reject a welfare state, given its very large negative impact on future generations.[26]

I find that the zero-discounting argument is frequently accepted by individuals with left-wing political views, and usually dismissed by those on the right. But in reality, the political implications of zero discounting, when consistently pursued, may push us toward conclusions that the right may welcome more than the left. Zero discounting implies a rather ruthless commitment to maximizing the rate of economic growth, more typically a right-wing position than a left-wing position. This does not necessarily imply no welfare state at all, since some amount of welfare spending may create political stability and thus increase the rate of economic growth. Nonetheless, welfare spending would be justified on consequentialist grounds only insofar as it contributed to economic growth in some fashion or another.

This essay will not attempt to survey and resolve the issues surrounding the discount rate controversy, which are beyond the scope of this investigation. We are nonetheless left with the following, regardless of the appropriate rate of discount: If we institute a welfare state today, at some point in the sufficiently distant future many people, including the future poor, will be much, much poorer. It cannot be said that the welfare state makes the poor better off in general terms, once we consider the future.

V. The International Argument

A. The welfare state and immigration

Just as the welfare state hurts future generations, so does it hurt individuals in other countries. Most directly, the higher the level of welfare

[25] For a standard defense of discounting, see John Broome, "Discounting and Welfare," *Philosophy and Public Affairs* 23, no. 2 (1994): 128–56, although Broome too is wary of using discounting for very large policy changes. The point can be put another way as well. The market rate of interest represents the willingness of market participants to trade off the marginal dollar. When a given policy causes significant changes in wealth, it is no longer just the marginal dollar we are evaluating, and to that extent the market interest rate does not express the relevant resource trade-offs.

[26] This conclusion, of course, does not follow *a priori*. It might be the case, for instance, that we think the world will end soon, or stop growing, with or without a welfare state. For a skeptical view on discounting, see Tyler Cowen and Derek Parfit, "Against the Social Discount Rate," in Peter Laslett and James Fishkin, eds., *Justice between Age Groups and Generations* (New Haven, CT: Yale University Press, 1992), 144–61.

https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

payments, the more difficult it is for a country to absorb large numbers of immigrants.

The dilemma is simple. If welfare in a given country promises a certain dollar sum a year, this will stand above the real income in most poor countries. People will immigrate simply to receive the welfare benefits, putting a strain on the system. Continuation of the system therefore requires limits on immigration. Most treatments of the welfare state neglect this cost or ignore it altogether.

One alternative is for a country to take in many migrants, but not offer them full or any welfare privileges. Germany, for instance, has pursued such a policy with its *Gastarbeiter* (guest worker) system, most notably for the immigrant Turks. The United States also has moved to limit certain welfare benefits to citizens rather than permanent residents. Even these nations, however, must limit the number of entrants. If the number of immigrants becomes sufficiently high, it will prove difficult to deny them full political rights. The Israelis have experienced a comparable problem with the Palestinians, to cite one example, which is one reason why they allowed the creation of a separate Palestinian state.

It is difficult to estimate how far differential treatment of foreign residents can extend. We do, however, find some clues from the German context. Currently there is a strong, but not overwhelming, movement to give full legal status to the *Gastarbeiter* Turks in Germany. These individuals currently comprise 2.4 percent of the population in Germany. German critics of freer immigration frequently point out that if many more Turks were let in, it would be hard to deny them the same rights as German citizens. As a very rough estimate, then, we might believe that a doubling or tripling of the number of Turks would lead to an end to differential treatment. In the case of Germany, the relevant threshold is a relatively low one. Differential treatment can be extended to a small percentage of the population, but probably not to 10 or 15 percent. Differential treatment thus has severe political limits, however much economic sense it might make.

If our only goal is to make people less poor, the most effective antipoverty program might be to abolish or shrink the welfare state and allow in more immigrants. We can think of nineteenth-century and early twentieth-century America as providing an example here. During this period, there was essentially free immigration and not much of a welfare state. Many people suffered greatly under their poverty, but many others rose to riches or at least to a middle-class existence. Even if some poor Americans experienced lower wages because of the new workers, the immigrants gained far more in wages and wealth than the poor Americans lost.[27]

[27] Of course, many would-be migrants might not improve their lot by switching countries. They might be suffering from malnutrition, be illiterate, be elderly, and so on, and thus be unable to exploit their new environment. The point remains that looser immigration standards would attract more people who would benefit from the change in venue.

https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

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It therefore misses the point to argue that welfare payments benefit those individuals who receive them. The relevant comparison also must include those individuals who, as a result of welfare, have a smaller chance of being able to enter the richer country. And unlike welfare states, most forms of labor immigration raise the rate of economic growth rather than lower it. Lowering welfare payments and raising immigration rates would benefit future generations, at least provided that immigration did not rise to the point of extreme crowding.

We do not know that freer immigration would do more to alleviate poverty than current welfare states do, but the possibility cannot be dismissed. Poor immigrants to richer countries enjoy significantly higher real incomes as a result of their migration, and immigration arguably is the most effective antipoverty program that has been devised. Immigration not only enriches the new arrivee, but also supports remittances back home. Many nations already receive a significant percentage of their national income from remittances; it is common for remittances to account for 20 percent of national income or more in a poor country.[28] Freer immigration would further support this kind of transfer.

There is less evidence on how much a welfare state requires limits on migration, but a Western welfare-state existence provides a higher standard of material living than most of the individuals in the Third World currently enjoy. If migrants had free access to those benefits, we would expect the rate of migration to be very high, probably unsustainably high. The ability of migrants to receive welfare benefits is already a significant political issue throughout Western Europe. In the United States the welfare privileges of noncitizens were restricted in 1996, when health care and food stamp benefits were cut for legal immigrants.

B. Patriotic egalitarianism

The welfare state damages citizens of foreign countries in yet another sense. The money spent on domestic welfare payments could have been sent abroad to people who are much poorer. Economists correctly insist that the appropriate measure of the cost of a policy is its "opportunity cost," or in other words, the options that are forgone when a choice is made.

Economist Gordon Tullock frequently refers to the dilemma of "patriotic egalitarianism." Tullock notes that most advocates of redistribution are inconsistent, favoring redistribution only within national boundaries. If we are to take antipoverty motivations seriously, however, we should also redistribute resources from the United States, or other rich countries,

[28] See various country studies put together by the Library of Congress's Federal Research Division; several can be found at www.loc.gov/harvest/query-lc by searching under "remittances."

to the very poor countries in the world. In fact, almost all of the so-called "poor" in the United States are wealthy by global standards. A significant percentage of today's American poor have automobiles, televisions, and telephones, to name a few items that are uncommon in, say, Haiti.[29]

A consistent welfare policy, if based on egalitarian or antipoverty reasoning, would produce few disbursements within this country, if any. Given that practical considerations limit the size of the U.S. welfare state, domestic recipients will never be the neediest individuals at the margin or even close to it, given the vast scope of global poverty.

Foreign aid, of course, is a relatively small percentage of the budget, well under 1 percent in the United States, and it is also unpopular with voters. But there is no reason why domestic welfare spending could not be reallocated to foreign citizens, especially if foreign aid were made a humanitarian program rather than a tool of American foreign policy. If we wished, we could disburse the funds quite efficiently. Rather than using helicopters to spray for drugs in Latin America, we could fly those same helicopters over Haiti and have them drop packages of dollar bills. In this manner we could be sure that the foreign aid would bypass the corrupt Haitian government.

Under most accounts of human rights, borders are morally arbitrary. If there is an argument for redistribution from X to Y, it is not clear why it should matter whether Y lives on the same side of the border or not. Why, for instance, is the U.S. government obliged to pay welfare to poor Mexicans in San Diego but not to poor Mexicans fifteen minutes away in Tijuana? The primary difference between the groups is their location relative to a line drawn when the Mexican-American War ended, over 150 years ago.

It might be argued that communitarian considerations limit the scope of our welfare obligations to a single country, or that we have stronger duties to individuals with whom we share a common national history. Whether these arguments succeed is irrelevant for the purposes at hand. Even if they did, it would remain the case that the welfare state damages the interests of the truly poor, relative to the available alternatives.

Most individuals do not accept this perspective. They are convinced that the domestic welfare state is a good idea, and they do not waver in their support when they see that it violates some egalitarian principles. They hold the dual intuitions that doing something domestically is better than doing nothing, and that it is uncertain how far foreign commitments should extend. These intuitions, however, do not address why the marginal dollar should be spent at home rather than abroad. Quite simply, current welfare states represent a decision to give resources to the relatively wealthy rather than to the truly poor. The consistent egalitarian

[29] Tullock is well known for making these points in conversation, although by his own account he has not written up a systematic treatment of them.

https://doi.org/10.1017/S0265052502191035 Published online by Cambridge University Press

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should always favor the rerouting of this expenditure, and thus the elimination of the domestic welfare state.

One rejoinder formulates a two-step argument in response to the dilemma. This two-step argument first tries to establish that the national state (rather than world government) is the appropriate unit for supplying public goods, and then tries to argue that the welfare state is a public good. If both steps of the argument were to succeed, we would have a case for a domestic welfare state rather than foreign aid. This two-step argument, however, begs the question and still does not explain why the marginal welfare dollar should be spent at home rather than being spent abroad. Even if most public goods are produced on a local or regional basis, cash transfers are relatively easy to effect at an international level. If the helicopter-drop model does not work, the U.S. Treasury could simply wire funds to various small accounts in foreign banks. It would not be difficult to ensure that most of the money ended up in the hands of the poor, especially if the effort concentrated on countries filled almost entirely with poor people.

The two-step argument has another problem, namely, that the boundaries of the nation-state can vary. We can imagine richer countries promising to adopt poorer ones and to support them. Some of the current French colonial arrangements can be interpreted along these lines; French transfers account for almost half of the GDP of some of their island colonies, such as Martinique, for instance. The citizens of Martinique do not seem greatly upset by this arrangement, relative to their alternatives. The United States has adopted an intermediate arrangement with Puerto Rico, which receives food stamps and other forms of welfare, but would cease doing so if it declared its full independence. (Puerto Rican voters have rejected independence in referenda.) If we were true egalitarians, and yet still believed that national boundaries mattered for some reason, presumably we should feel compelled to set up more arrangements of this kind. But in reality, governments are moving in the opposite direction. The relatively poor Faeroe islands have recently stated their intent to secede from Denmark, and the Danes have responded by threatening to cut off all aid and subsidies within a few years of secession.[30]

These global comparisons further support suspicions that the case for the welfare state is not based in egalitarian reasoning. More likely, a citizenry spends welfare money at home, rather than abroad, to make their country the best possible country by some moral standard it holds, and to bring the country to the highest possible peak. This is achieved, to some extent, *at the expense* of starving people abroad. We help the relatively rich—the American lower class—rather than the truly poor, such as the Haitian lower class. The domestic welfare state, in this account, is

[30] On the Faeroes, see "Danes Take Hard Line on Islands' Secession," *New York Times*, March 18, 2000, A6.

based on a philosophy closer to perfectionism rather than egalitarianism or theories of positive rights to material goods. Once again we see that impersonal consequentialism would militate against a domestic welfare state, although not necessarily against foreign aid.[31]

VI. Concluding Remarks

Welfare-state defenders are correct to believe that the traditional conservative and libertarian critiques, as exemplified by Charles Murray, do not succeed. Yet this does not imply that all is well with the welfare state. The welfare state does not benefit the poor and the disadvantaged when we consider those categories broadly, to include future generations and foreign citizens. It is thus difficult to defend the welfare state in impersonal consequentialist terms.

If we are utilitarians, the costs of the welfare state are likely to exceed its benefits, at least if we give substantial weight to future generations. If we are consistent egalitarians, the current poor in North America and Western Europe are not close to being the most deserving recipients of resources. For these reasons, the "macro" normative arguments for welfare, usually based in some account of distributive justice, are peripheral or irrelevant to the actual practices and effects of welfare states. A defense of the U.S. welfare state, beyond the level needed to insure political stability and continued economic growth, thus requires that the current American needy be given a moral priority over future generations and over the needy in other countries.

In the current U.S. political context, a "person who cares" is assumed to identify with the interests of the current domestic poor. I have tried to show that this presumption is unwarranted. A person who cares ought to consider limiting the welfare state in the interests of the greater good of other, less visible poor persons.

Economics, George Mason University

[31] Of course, the empirical point remains that even the poorest countries in the world might be better off, in a suitably long run, if the United States and Western Europe retain their current status as rich, prosperous nations rather than shipping all of their surplus off to the very poor. The resolution of this question might then turn upon the rate of time discount we use when evaluating such decisions.

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