CHAPTER 2

Findings and Lessons

So what do we now know about the role of social spending in the economy and society? This chapter summarizes ten main findings supported by global experience and fresh research in the early twenty-first century. Documenting these findings yields three clear policy lessons, and an international scorecard on the far-sightedness or myopia of different countries’ approaches to social spending.

TEN MAIN FINDINGS

**Finding #1.** A country’s government social spending takes off only after the country has both the fiscal capacity and the political will to build safety nets. This is why the world had only negligible social spending before 1800, and why it emerged first in Northwest Europe after that.

The main reasons why social spending has spread all over the world is the mirror image of what prevented social spending outside of Europe before the last century: Having the government spend on the poor, the sick, the elderly, and school children requires fiscal capacity plus political pressure from below (Chapters 3 and 4).

Within the last sixty years, government social spending has grown to absorb more than a quarter of GDP in over a dozen countries, mainly in Europe. The demand for such tax-based programs was raised by...
a diversity of forces: the shocks of world wars, revolutions, hyperinflations, and the Great Depression; the continuing rise of political voice for middle- and lower-income groups; rising trust in government; improvements in medicine; and population aging (Chapters 5 and 6).

**Finding #2.** A major barrier to growth and equality has been the refusal of those with power to devote taxes to universal education. Government funding for mass education has always been the main driver of adults’ years of schooling, building human skills and productivity. The leading countries passed up chances to capture these gains in the eighteenth century and part of the nineteenth. Once tax-based schooling took off, it became more equal. The Americans were leaders in the quantity of primary and secondary schooling, but never leaders in its quality.

No country has ever delivered primary and secondary education to the majority of its children without financing it mainly through taxes.

In the eighteenth century and part of the nineteenth, the leading countries passed up chances to capture the gains from public schooling of the masses. In Britain and the Netherlands, the payoffs from basic schooling already promised high rates of return, privately and socially, partly by interacting with the rise of commerce. Yet these two leaders delayed for at least a century and a half, partly because of church-school issues and more fundamentally because those with political voice resisted paying taxes for educating the children of others.

Once the political will was mustered to launch universal primary education, adults’ years of school not only grew, but became more equal. So say the data on years of school worldwide since 1870. This growth and leveling of schooling was, again, dominated by the rise of tax-based public schools (Chapter 5).

Starting around 1850, the Americans were leaders in the quantity of education, as measured by years of enrollment and of adults’ accumulated education. Yet as best one can tell from indirect and circumstantial
evidence, the United States never led the world in the quality of primary and secondary schooling (Chapter 5).

**Finding #3.** Since around 1910, there has been a long mission shift in social spending, toward support for the powerful and elderly, at the expense of assisting the young and the poor. This mission shift in social targeting has offset part of the pro-growth and pro-equity effects of the overall expansion of safety-net spending.

Over the last hundred years, many countries’ social spending shifted missions, toward public pensions for the non-poor and away from progressive policies like mass schooling and aid to the poor. This mission shift has not been reversed since. It probably compromised both income equality and income growth. The global mission shift toward public pensions may have been due in large part to improvements in life expectancy, which allowed longer life past work and contributed to political “gray power.” The inference about gray power springs from the fact that public pension spending rose even *per elderly person*, and not just at the rate of population aging. Its per person generosity rose faster than the rise in educational spending per child of school age.

The rising demand for government pensions was probably also linked, in addition, to a quiet global change in the role of intra-family transfers. Career and family developments may have raised public pressure for more tax-based support of the elderly (Chapter 6).

**Finding #4.** Larger social-spending budgets have not produced any net loss of GDP, or in skills, or in work. Without any such costs, Europe’s welfare states have produced greater equality, cleaner government, and even longer life. There are good economic explanations for this “free lunch puzzle.”

So says the international evidence for any decade or combination of decades back to 1880, before which there was little social spending at all.
None of these decades, or any longer periods, showed any significantly negative correlation between the share of GDP channeled into social spending and the level (or growth) of GDP itself. The lack of any significant negative correlation is all the more remarkable because shocks to GDP should have biased the results in favor of seeing a negative relationship (Chapter 8).

Behind this statistical outcome lie some sound reasons suggested by recent history. One can find at least four positive features of the real-world welfare-state bundle of policies, features that have cancelled any anti-growth effects. One consists of those economies of scale in delivering social insurance: the more universal the coverage, the smaller the administrative, or bureaucratic, costs of raising tax revenues and allocating transfers. A second is that the large welfare states raise their tax revenues through broad consumption taxes and sin taxes, the type of taxation that conventional theory predicts will favor growth the most. Third, the welfare-state policies of parental leave and pre-school child development foster better human productivity for both the child and the career-interrupting parent, usually the mother. Fourth, single-payer public health insurance is more cost-efficient than voluntary private insurance (Chapters 9 and 14).

The claim that greater social spending must somehow shrink the size of the economic pie is in deep trouble, and has already retreated in the slump of 2020.

Finding #5. Governments around the world have shifted toward equalizing incomes since 1910. This tide has not been reversed, not even by the conservative movements since 1980. The usual measures of fiscal redistribution understate the rise of progressivity, by missing the delayed equalizing effects of public education expenditures.

Over the last hundred years, government redistribution of income has become more “progressive,” shifting income from richer households to poorer ones in the Robin Hood tradition. Retreats toward the opposite
“regressive” redistribution have been rare and limited. For all that has been written about a shift of political sentiments and government policy away from progressivity since the late 1970s, no such trend is clear yet in how overall taxes or social spending are distributed. Among democratic welfare states, the closest thing to a demonstrable reversal against Robin Hood is the slight retreat in Sweden since the 1990s. Globally, the most dramatic swing since the late 1970s has been Chile’s record-setting return toward progressivity after the regressivity of Pinochet.

Finding that redistribution has continued to march slowly toward progressivity carries a strong implication for our interpretation of the rise in income inequality since the 1970s, so firmly established by the World Top Incomes Project and by Thomas Piketty (2014). That rise may owe nothing to a net shift in government redistribution toward the rich, despite the lowering of top tax rates. If so, it is all the more important to explore what non-fiscal forces have widened gaps in market incomes around the world (Chapter 10).

Finding #6. A short-run threat to the future of social spending looms from waves of refugees and the nationalist reactions to these waves. Of four policy options facing rich destination countries, politics will probably favor the option that protects national goals, including social programs, at the expense of international growth and equality. The likely favorite policy, Chapter 11’s “Option 4,” will add more cherry-picking restrictions favoring skilled immigrants.

An open humanitarian acceptance of refugees (“Option 1”) would serve global growth and global equality. It could also serve domestic growth, and is fiscally sustainable. Yet it is politically unsustainable, because it threatens domestic equality, domestic political harmony, and social programs. The backlash against this option will be around for a while. The opposite option, “Option 2,” would slam the immigration door shut, catering to nativist reaction, but at a cost in terms of economic growth. The recently discussed option of “welfare chauvinism” (“Option
admitting all sorts of immigrants but denying them access to social assistance and social insurance is unsustainable. The cherry-picking Option 4 seems to win by default (Chapter 11).

Finding #7. The most durable threat to the future of social spending and the welfare state is posed by the upward march of senior life spans. Something has to give, for financial sustainability. Five countries are clearly keeping their total public pension costs under control, while protecting their basic anti-poverty pensions, but at least seven others are not.

The aging of human populations will continue, at least until 2050. By then, the number of persons over 65 for each person of prime working age (18–64) will have doubled. In the face of this aging, balancing pension budgets requires that benefits per year must grow more slowly than wages and salaries per member of the working-age population. Something has to give. Indeed, the same adjustment to longevity would be called for even if individuals self-financed all of their old age privately. If the share of your adult life spent earning income drops, with each generation living more of adulthood beyond work than did its ancestors, then your lifelong annual consumption must drop relative to your annual earnings. The problem faces us all, with or without government pensions (Chapter 12).

Finding #8. To be sustainable, average public pension spending per elderly person should not, and need not, rise as a share of peak GDP. The annual public support per elderly person can rise with average income growth, but should fall behind income growth as the population ages.

The logic governing how public pension budgets must behave in the long run produces this necessary rule for sustainability. Some countries have already built something like it into official policy rules. The notional
defined contribution (NDC) system fixes the share of GDP (or earnings) to be paid out in yearly pension benefits. The simple rule stated in Finding #8 indexes pensions not to the latest GDP or earnings, but to the real value of peak GDP or earnings. Pension institutions need to retain this safeguard, to avoid having yearly pensions sink as fast as GDP in a short-run recession or depression like the one triggered by the coronavirus pandemic of 2020 (Chapters 12–14).¹

Finding #9. The “second pillar” of government social insurance, the job-based kind that intervenes in the workplace, has shown various flaws. In many countries, it has redistributed in favor of top occupations. The famous second-pillar compulsory paycheck-deduction systems of Chile since 1980 and Singapore since 1965, while promoting financial stability, do not function as their proponents claim. Far from being “privatized,” they have become slightly regressive instruments of state taxation and control. Universal first-pillar provision better protects transparency and equity.

The practice of linking social security to one’s job or occupation should be cut back (Chapters 12 and 13).

Why should social security have anything to do with one’s workplace? The two are mismatched, aside from the narrow cases of workplace accidents and experience-related unemployment compensation, where the job itself is the focus. If the benefits of social insurance (e.g. pensions, health) are shared by society as a whole and the covered individuals, the usual principles of public goods say that the insurance costs should be shared between the same two parties, i.e. society as a whole and the covered individuals, job or no job.

A further violation of economic principles arises as soon as linking the insurance to one’s current job imposes a net cost on the employment relationship, a cost shared by employers and employees. Why should the employment of labor bear such a cost, when employing capital bears no such insurance cost?
Worse, many countries have had top-heavy pension practices, in which the general population bears a net fiscal burden of providing generous pensions to those in the well-paid formal-sector occupational groups, including civil servants, the military, and the courts. This book spotlights such regressive practices in a global South, here meaning Latin America, Africa, the Middle East, and South Asia (Chapters 7 and 12).

Chapter 13 reinterprets two mandatory-payroll-deduction pension systems, those of Chile since 1980 and Singapore since 1965. Both became famous as “privatized” pension systems, yet both are systems of central government taxation. Thinking of them as tax systems fits both common intuition and the official Organization for Economic Cooperation and Development (OECD) practice of defining mandatory payroll deductions as taxes.

Finding #10. The younger the person, the greater the long-run social return on society’s investments in them, both on the average and at the still-unexploited margin. For any given total public social spending, investing in child development, not least pre-school children, is more pro-growth and pro-equality than spending the same amount on public pensions for the well-off (or on transfers favoring the rich). Generations of powerful groups in many countries have selfishly failed to heed this lesson from history.

An invest-early consensus that has emerged among micro-economists in this century can now be backed up by international and historical comparisons. The new finding gained momentum in two stages. First, in the late twentieth century, empirical studies came to an earlier-pays-more conclusion for the traditional levels of schooling: the average social rate of return on education was respectable for higher education, but greater for secondary schooling, and still greater for primary schooling, as previewed in Finding #2. Then early in this century, numerous studies based on a variety of micro-level interventions, mostly in the United States, concluded that the payoff to inputs into children before age 6 probably paid even higher returns. Those returns could come from greater
parenting time and/or from expenditures on pre-primary education programs. The earlier the expenditure, the better.

Policymakers have been moving toward the same earlier-is-better conclusion. First the communist countries took the lead in government-run child care and parental leave on a modest scale. Among democracies, substantial support arose in the late 1960s and 1970s in response to the rise in women’s labor-force participation, with Sweden leading the way. A pro-natal wave of supports has arrived since the 1990s, in response to concerns about low fertility rates (Chapter 9).

THREE POLICY LESSONS FROM WORLD HISTORY

Findings #8–#10 imply three global lessons for government social-spending policies, namely

• Index annual pension benefits, both negatively to changing senior life expectancy and positively to peak GDP per adult. That will prevent any positive trend in the share of GDP that taxpayers spend on public pension benefits without any absolute pension cuts.
• As much as possible, uncouple the funding of social insurance from the workplace, reducing reliance on the second pillar of social insurance. Shift toward funding universal safety-net pensions and universal health care, with voluntary supplements.
• Invest more in the young, with a “cradle to career” strategy.

The final chapter returns to these three lessons, illustrating how a country can apply them, guided by its own history and by worldwide experience (Chapter 14).

THE MOST FAR-SIGHTED AND THE MOST MYOPIC

Which countries and which generations have shown far-sighted investment in the young, as opposed to the more myopic transfers to the current elderly? The historical listing should start with the selfish refusal of the whole world’s politically empowered adults to pay taxes for universal primary schooling before the mid-nineteenth century. The generational sin was clearest in the eighteenth and early nineteenth centuries, when

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investing in basic education in the richest countries could have repaid the older generations almost immediately, as previewed in Finding #2 above.

Among the currently living generations, which countries have overcome, and which have failed to overcome, the anti-growth selfishness with the right mix of social spending? Several advanced countries have got it right, with a greater educational support per child relative to support per elderly person (Chapter 7, especially Figure 7.3). The worst performers – among countries for which we have usable data – have been India, Turkey, Greece, Latin America, and the global South more generally. These countries’ underinvestment in the young shows up in their lower international test scores, lower GDP per person, and higher inequality.

To enrich this world geography with some history, we should ask which recent generations have been successfully selfish in their political influence? The generational timing of each country’s redistributions is unique, of course. Yet, in most cases, it has been only certain powerful groups that have reaped the inter-generational harvest. Here is a quick alphabetical roll call of some cases in which a particular generation has recently benefited at the expense of others.

• In Brazil, overly generous pensions have been enjoyed by every generation of pensioners between the passage of the stakeholder-defending Constitution of 1988 and the modest pension reform of 2019. Within these generations of pensioners, the gains have been disproportionately captured by the high-income civil servants, judges, and the military. Even without the coronavirus pandemic of 2020, the pension system was projected to run far beyond its reserves by 2022.

• In Chile, those who held formal-sector jobs in the period 1960–1973 extracted considerable social security transfers from the rest of society. Their unearned gains were both sanctioned by, and capped by, the military government’s pension reform of 1980–1981 (Chapter 13).

• In mainland China since the reforms launched by Deng Xiaoping, the inter-generational favoritism has been the reverse of what has happened in most other countries. In the super-growth since the 1980s, the government short-changed those who were born before 1925, who
suffered through their working life before 1990, while heaping health and education benefits on the generations born since 1970 in the east-coast provinces.

- **In Greece** between 1982 and 2014, pensioners in the public and formal private sectors received unsustainable gains paid for largely by others, contributing to the country’s debt crisis.

- **In Japan**, despite a tradition of saying that the elderly should be able to count on their adult children for support, the elderly population has instead been supported by the taxpayers of their children’s generation, ever since a jump in taxpayer support from 1974 to 1983. The support is only moderate per year of an elderly person’s retirement, but becomes a huge aggregate burden on younger workers in such an aged population (Chapters 12 and 14).

- **In Singapore**, the main beneficiaries will be the first future generation to benefit from a shift in government policy away from capital accumulation toward public social spending (Chapter 13).

- **Turkey**’s pensioners have captured increasingly unsustainable benefits at the expense of the rest of society, at least for the period 1980–2017. The beneficiaries are again those near the top of society, as in Greece and several Latin American countries (Chapters 7 and 12).

- **In the United States**, the generation becoming 65 years old between 1967 and 2002 (born 1902–1937) benefited at the expense of other generations from the arrival of age-restricted Medicare and the shift toward more generous non-contributory Social Security benefits. Also since 1967, the United States has lost its lead in public education, and has been particularly remiss about having the nation’s taxpayers provide paid work-leave for the parents of newborns (Chapters 9, 12, and 14).

In the long run, while all public safety nets have helped to stabilize people’s purchasing powers, the strongest safety net has been the one woven by investing more in the young.