



Department
of Economics



Department of Economics and Centre For Macroeconomics public lecture

Are Welfare Programmes Just Keeping People Out of Work? An Economist's Take on Benefits Street

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Suggested hashtag for Twitter users: **#LSEecon**



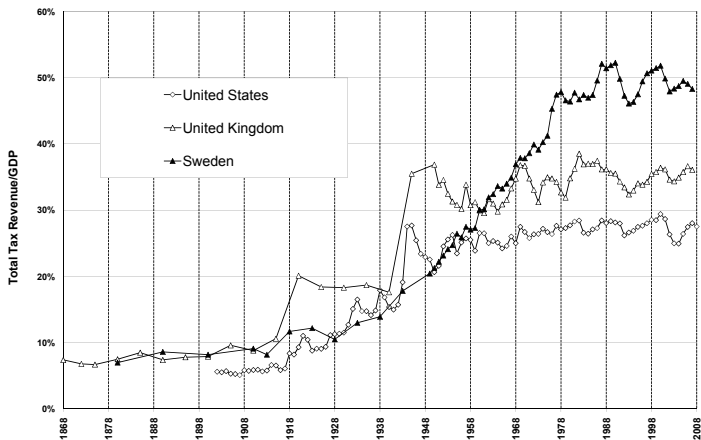
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An Economist's Take on Benefits Street

Camille Landais

February 17, 2015

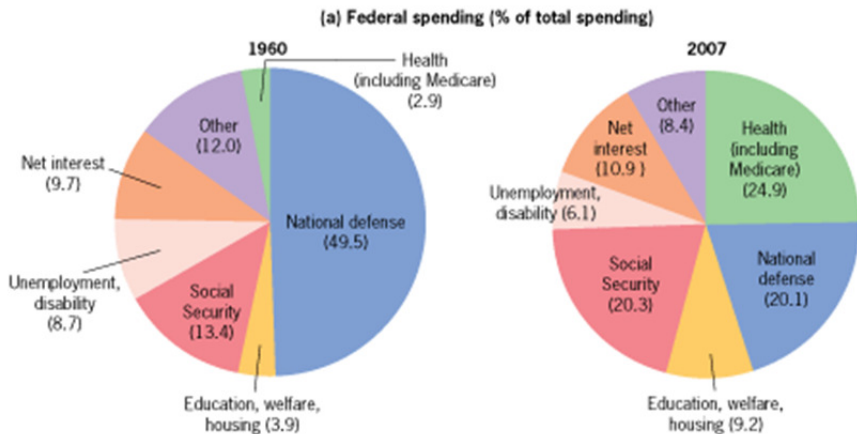
The rise of the welfare state

EVOLUTION OF TAX-TO-GDP RATIO IN THREE ADVANCED ECONOMIES



Source: Kleven, Kreiner, and Saez (2009)

The rise of the welfare state



Is it responsible for Benefits Street?



What is the case against Benefits Street?

The rise of the welfare state routinely accused of...

- Keeping individuals out of work
- Keeping recipients in poverty traps
- Inducing low investment in human capital
- Developing family welfare cultures
- Imposing tremendous costs on hard-working families to fund the out-of-work (“Us vs Them”)

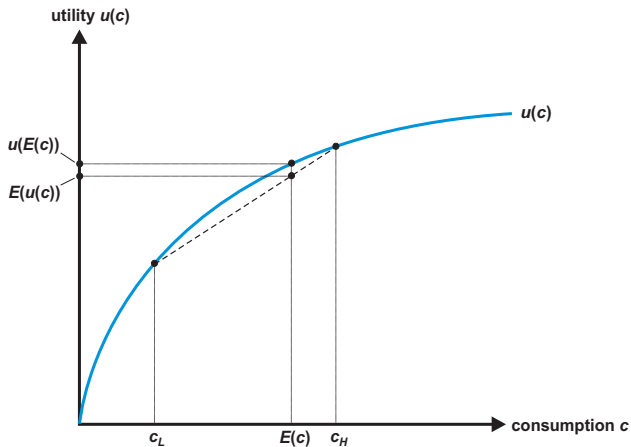
Welfare programs in practice

- Transfer money or resources:
 - ▶ Cash (WFTC)
 - ▶ In-Kind transfers (housing benefits, NHS)
- ...to population in need
 - ▶ Means-tested programs (assets, income)
 - ▶ Categorical programs (single mothers, elderly, etc.)

The basic trade-off of welfare programs

- We value welfare programs because they bring redistribution and/or insurance benefits
 - ▶ These gains stem from decreasing marginal utility
 - ▶ The more consumption I already have the smaller the gain of one extra unit of consumption
 - ▶ Other potential gains: higher trust level, social cohesiveness, mobility, etc
- But they come at the cost of distorting incentives and therefore behaviors:
 - ▶ **Moral hazard costs**
 - ▶ Stem from asymmetric information: individual actions / types unobservable for gvt

Decreasing marginal utility



Moral hazard costs

- Examples of moral hazard issues:
 - ▶ More generous UI increases unemployment duration
 - ▶ Labor force participation of individuals at the bottom of the income distribution reacts strongly to tax incentives
 - ▶ More generous health insurance increases health care utilization
 - ▶ Etc.
- Implied behavioral elasticities are rarely $\geq .5$
- Behavioral responses to welfare programs are not only driven by moral hazard, but also by wealth / liquidity effects

Culture of welfare across generations

- Does welfare promote a culture of dependency?
- Correlation in welfare use across generations is obviously not necessarily causal
- Dahl, Kostol, Mogstad (2013) analyze causal effect of parental use of Disability Insurance (DI) on children use of DI in Norway
- Identification uses random assignment of judges to denied DI applicants who appeal [some judges are severe, some lenient]
- Find evidence of causality: parents on DI increases odds of kids on DI over next 5 years by 6 percentage points
- Mechanism seems to be learning about DI availability rather than reduced stigma

Long-term effects: the Kibbutz

- Abramitzky '13: Perfect sharing in Kibbutz has negative effects on high school students performance
- High school students study harder once their kibbutz shifts away from equal sharing
 - ▶ Students are 3% points more likely to graduate
 - ▶ Students are 6% points more likely to achieve a matriculation certificate that meets university entrance requirements
 - ▶ Students get an average of 3.6 more points in their exams
- Effect is overall small in magnitude but driven by students whose parents have low schooling

Reducing moral hazard costs

Can moral hazard costs be reduced / mitigated?

- Better information / harsher monitoring to reduce information asymmetry
- Tagging
 - ▶ Make benefits depend on characteristics that cannot be altered, are observable, and correlated with being in need
 - ▶ Limits: lower efficiency costs but lower redistributive ability
- Ordeal mechanisms

The limits of ordeal mechanisms



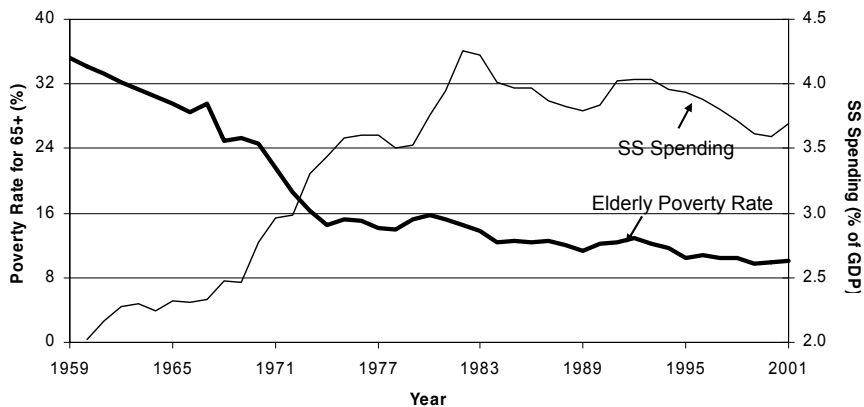
The limits of ordeal mechanisms

- Ordeal mechanisms impose costs to welfare recipients to induce self-revelation
 - ▶ Waiting time, queues, complex forms to fill in, stigma
- Reduce take up but efficiency gains highly debatable
- Depends on correlation between actual need for the program and utility cost of ordeal

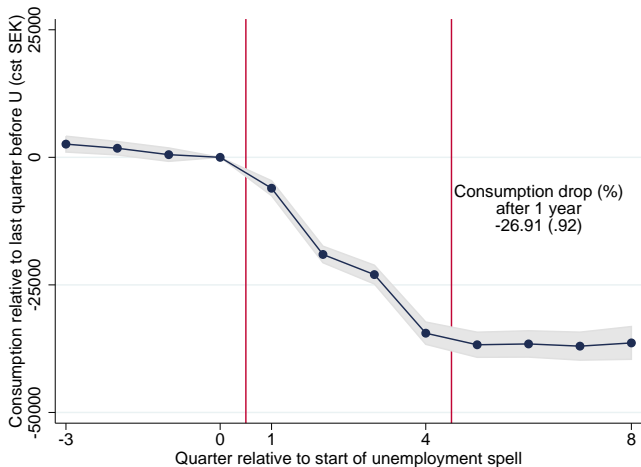
Redistribution and insurance value

- We know (almost) everything about costs of welfare programs
- But surprisingly little on the benefit side!
- Main reason: critical lack of good data on consumption
- Yet, redistributive and insurance value of welfare programs should not be minimized

Social security and poverty in the US



Unemployment and consumption



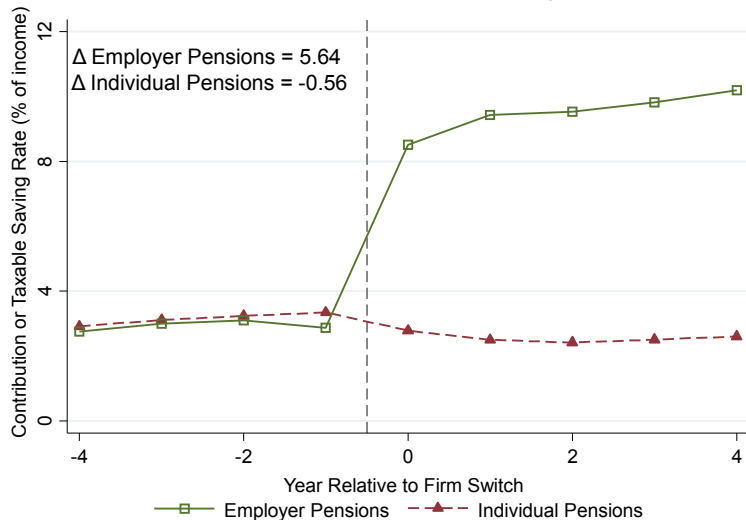
Source: Kolsrud & al. 2015

Is welfare crowding out self-insurance?

- Welfare programs may simply crowd out individuals' own means of insurance, limiting insurance value of these programs
- Example: do mandated contributions to retirement accounts affect individuals' total saving?
- Chetty et al. 2012. Idea: compare impacts of sharp increases or decreases in employer pension contributions at the time of job change
- Empirical analysis using Danish data suggests the presence of very large fraction (85%) of passive savers
- Mandates increase total savings of passive savers, with no crowding out

Chetty et al. 2012

Event Study around Switches to Firm with >3% Increase in Employer Pension Rate Individuals with Positive Pension Contributions or Savings Prior to Switch



Is welfare crowding out private charity?

- Big Society Speech: reduce welfare state and private charity will take over
- Pervasive argument: US has low welfare state and biggest charitable sector in the world...
- Debunking the crowding out argument:
 - ▶ Difference in size of charitable sector btw US & Scandinavia = 2% of GDP
 - ▶ Difference in welfare state size = 10 to 15% of GDP
 - ▶ Overall, crowding out estimates are relatively low $\leq .1$ (Gruber & Hungerman 2005)

Long term benefits of the welfare state?

- If anything positive correlation between size of the welfare state and income and social status mobility...
- Positive correlation between redistribution and trust
- Redistribution and welfare programs are costly, but benefits may be substantial as well, along dimensions that we still know very little about...



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