Social Policy and the New Economy

Comments to the Canadian Association of Food Banks

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Ladies and Gentlemen,

I have very little time, so let me move directly to the heart of the matter. Of course it is of great importance that we understand that social policy can and will have a profound impact on the competitiveness of the Canadian economy, that the New Economy places real constraints on the ability of governments to raise revenues, particularly through the taxation of mobile factors of production, and the importance of trade-offs in social policy.

But we must never never lose sight of the fact that social policy has a human face, that social policy is where the most vulnerable in our society will *either* find effective help in overcoming their challenges, *or* be failed by society and consigned to the margins of economic and social progress. ***I, for one, would be happy to trade quite a lot of economic prosperity and competitiveness for a society that was more effective in integrating its least successful and most vulnerable members into the mainstream of life.***

But while many people in the social policy debate wish to present the choices we have to make in terms of this kind of trade-off, I also believe that, on the whole, they are false choices, and that the right social choices are also the right economic choices; that the choices that promote the greatest social and economic development of those at the bottom of the income scale are also the ones that tend to promote the development of the society and the economy in the largest sense. But in the post war period we have actually made a series of mistaken policy choices that have trapped a whole sub-class of people in conditions of poor education, low-income and blighted life chances. The right social policy for the new economy also happens to be the right social policy to allow these people to reintegrate the mainstream of life, a mainstream from which they have been excluded by the very best of good intentions. And, the right social policy is in fact at least a partial return to what works, after several generations of policies that sounded good, but weren't.

So my presentation to you today will revolve, not around revolutionary social policy ideas, but rather the rehabilitation of some old social policy ideas whose value we have neglected, even denigrated, for decades, to our cost.

I am going to present you with four key ideas that, in my view, are indispensable in any redesign of our edifice of social programmes:

- The poor are not an undifferentiated mass, and poverty is not a single phenomenon
- Poverty is not merely—or even chiefly—an economic condition, but also in many cases a cultural condition
- Incentives Matter
- The state is not equipped to solve the problems that cause pathological poverty

1. The poor are not an undifferentiated mass, and poverty is not a single phenomenon

One of the curses of the way that we discuss poverty and social underdevelopment in Canada is that we have tended to homogenise the poor, again to lose the human face of poverty. We tend to think of poverty as a straightforward lack of income, and anyone who lacks this level of income is therefore poor. Nothing could be further from the truth.

Just as an illustration, there are two fundamental classes to remark among low-income Canadians (there are others, such as those unable to participate in the work force by reason of age, disability and so forth, but I'm going to focus on these two classes of those able to work). On the one hand, there are those for whom poverty, seen as lack of income, is real, but for whom it is also strictly temporary. In fact the StatsCan figures are pretty eloquent: *somewhere between a third and a half of the people in the bottom income quintile one year are not there the next*. Their place has been taken by someone else, while they have moved into a higher quintile. And the StatsCan numbers are also quite clear about what makes the difference between falling into poverty and escaping it: the best and most common route out is more family members working more hours. Hard work and a buoyant labour market do make the difference.

So for a large share of "the poor," *poverty is simply a temporary and strictly economic condition that can and will be escaped*. For this share of the population, social services, and particularly income support, in the form of welfare or UI, for example, functions exactly as it is intended to do, as a kind of social insurance. We as a society insure each member against the vicissitudes of life, against the possibility of temporarily being unable to fend for ourselves due to changes in circumstance. Job loss, illness, economic cycles and the rest take their toll on everyone at one time or another, but people in this group tend not to class themselves as "poor", but rather as middle class people fallen on hard times.

This idea of risk pooling is the central concept behind insurance. Such risk pooling is vital because, as we all know, the costs of many kinds of event can be catastrophic (illness, accident, Acts of God, economic catastrophe, etc.), and are concentrated fairly randomly on a few people each year. It is not just fair, but rational, for each of us to pool our risk of these events that can befall any of us across every member of society.

But every insurance system has its Achilles' heel: something known in the insurance industry as moral hazard. Being insured against a risk changes people's behaviour because now they can spread the cost of their personal decisions across all the other members of the insurance pool. People insured against fire may be less careful with their wood stove, and people with car insurance are statistically less careful drivers than those who know they will bear the full cost of a fender bender. People who wear seat belts statistically drive faster than those who do not, just as football players with heavy padding engage in riskier play than rugby players, who wear none.

If car insurance paid for an annual paint job and oil changes, and house insurance paid for a weekly cleaning service and to have the lawn mowed, insurance would be hugely expensive and very inefficient, with people trying to get other premium payers to absorb the cost of minor things that each person should expect to pay for themselves. To avoid these problems and control costs, the insurance industry has evolved a series of devices such as deductibles and co-payments to diminish the ability of the insured to pass too many costs along to others.

So any kind of insurance, and social insurance should be no exception, is the intersection between the highly desirable outcome of risk sharing or risk pooling, and the problem that outcome creates, namely moral hazard. In the case of social insurance, in the form of various kinds of income and other social supports financed by taxpayers, then, there is a whole second class of people who are not merely availing themselves of a social safety net in times of temporary distress, but *who are actually pursuing a life premised on the constant and reliable availability of welfare benefits in various forms, and who have become stuck in dependence on those benefits.* In other words, they are the living proof of the problem of moral hazard when you pool risk in a way that doesn't take sufficient account of how that changes behaviour.

The first class of low-income people are not especially problematic for social policy, but note why: they have ingrained in them a set of behaviours and expectations, including discipline and a sense of the value of work, which allows them to move relatively easily out of low income and back into a way of life more in keeping with their expectations. The turnover in this class of the poor is just one sign of the robustness of the particular individuals that find themselves there at any particular moment.

The real social policy problem *for those able to work*, then, is not the total number of people on low income at any one time, but rather that second class of the poor, which leads me to my second point.

2. Poverty is not merely an economic condition but also in many cases a cultural condition

Contrary to much political rhetoric and the claims of the welfare rights movement, poverty is not merely — or even primarily — an economic condition. It is also in many cases a cultural condition – it involves values. That means that *poverty can never be overcome by mere income support or the passive writing of cheques, but only by challenging and changing behaviour*. Poverty really is a question of character to a surprising extent.

A key book here that many have forgotten, to the great cost of people trapped in our social service system, was Edward Banfield's *Unheavenly City*. In that book, on the problems of inner city America, Banfield piled up a convincing array of evidence to show that the key difference between the poor and the non-poor was not income, but cultural values, and in particular attitudes towards time. To put it in his words, the poor were totally present-oriented, whereas everyone else was future-oriented.

Consider that many of the assumptions we make about how people need to behave in order to succeed in the world — including in the New Economy — are predicated on the idea that it makes sense to forgo present gratification for future benefits. Saving to buy a house or for retirement, getting married and starting a family, getting an education or training, acquiring job skills in a low-paying job in order to move up the career ladder later, sexual abstinence or use of contraceptives, protecting yourself against sexually-transmitted diseases, buying insurance against many forms of risk, controlling your diet and intake of alcohol and drugs, taking adequate exercise, etc., etc. All of these things presuppose a set of cultural values that see individuals as powerful agents acting through time. But what if you inhabit a world in which the connection between your actions today and consequences that may follow tomorrow, let alone one, five or ten years down the road is a murky or even totally obscure one, a world in which you do not believe that what you do today affects your future, because you are radically in the present.

The idea of personal efficacy through time is not innate in humanity, but seems to be to a large extent a learned value. And for a lot of people the learning may be weak or non-existent — this certainly tends to be a trait of the young, for example, who frequently have a very attenuated sense of the long-term consequences of their action. Society traditionally compensated by a set of institutions – parents, schools, employers, churches, community groups, legal and social pressures to form stable families and avoid pregnancy outside marriage — that rewarded people for behaving in ways that benefited themselves and society. Work was rewarded, and not just because it was the only way to pay one's way in the world. Work also conferred *status*, a sense of being a valued member of the community, and not working was stigmatised.

The socio-economic mobility which I noted earlier was the route out of poverty in fact depends on the willingness of the poor to make investments whose pay-off is in the future — investments of time, energy, psychic commitment, and money. As Charles Murray pointed out in his seminal book *Losing Ground*, because these investments are made by people with very little to spare in the first place, investing means that an already difficult experience must be made even more difficult. The investments inevitably mean that something else has to be given up, whether free time or money.

The investment is made in hopes of long-term gains. But the ultimate payoff is remote. To sustain the effort over what may be a protracted period, the system must also offer incentives and rewards before the prize is attained. The two most important factors here are cultural values or rewards, not income. There has to be a belief that investments do pay off, and there have to be ongoing rewards while investments are made in the future.

Instead, our philosophy of social welfare has done a very great deal to undermine these cultural values, through its insistence that poverty is something that just "happens" to people, who are its powerless victims, not something from which hard work allows people to escape. Because if it is true that some people work hard and escape poverty, then many of those left behind could also have escaped, but did not — not necessarily because they are lazy, but rather because they may lack the set of cultural values which make success possible, the values that connect action today with your condition tomorrow.

So we have created a new set of cultural values in which work at the bottom end of the social scale is undervalued, and indeed denigrated, whether through creating conditions in which it pays better not to work than it does to work, or through the notion that there are many kinds of low-paying work that are beneath people's dignity, and that it is preferable to remain on welfare than to take these jobs –even though they represent exactly the kind of investment in the future that I am sketching out.

In fact, we have created the conditions in which low-income people who actually work, who make sacrifices, who save, who believe in the dignity of work, are chumps. As you know, the interaction of the tax system and the total edifice of social welfare programmes in Canada is such that the highest marginal tax rates in the country are paid by people earning roughly $13,000 to $20,000 a year – precisely the people trying to move from low-income to better economic opportunities.

Or, take the examples given by Malcolm Hamilton, the pension analyst, in the National Post some months ago. He looks at three hypothetical Ontario women:

Betty never works a day in her life and so never contributes to the Canada Pension Plan. Mary earns $30,000 a year from age 18 to 65, pays into CPP but doesn't save in an RRSP. Jane makes the same income as Mary over the same period but scrimps enough to save $75,000 in her RRSP.

The result? Betty, the woman who never worked collects $13,400 a year after tax from government programs; Mary, the hard-worker who never saves a dime, nets $15,800 a year after clawbacks of benefits and income taxes; and the big-saver, Jane, nets $18,100. The latter's reward for 47 years of working and saving and forgoing immediate consumption on a significant scale is to have $4,700 more in retirement income than a woman who never worked a day. That is a pretty meagre reward for a form of social behaviour, a cultural value, that tries to get people to focus on the importance of forgoing present consumption in favour of long-term benefits.

3. Incentives Matter

So we come to my next point, which is that, in this struggle to inculcate the right cultural values that equip the poor to succeed, incentives matter hugely. We will only get the kind of behaviour we want by rewarding it and reinforcing it. And this is doubly true in the era of the New Economy, an economy characterised by an abundance of capital and knowledge, but a shortage of labour.

You see, in Ontario and Alberta, but predominantly in the US, the technological revolution was accompanied by a huge social transformation: the end of welfare as we have known it, as President Clinton liked to say. Just as huge economic opportunities were opening up, governments throughout the United States began pushing people out of the welfare trap and into labour markets. They began to demand that people get training and get into the labour market instead of merely being warehoused as "unemployable" in the welfare system.

The result has not been impoverishment and misery, but rather a jump in the participation rate of the labour force, the application of new technologies to the problem of how to make people with little education productive, and the growth in both employment and incomes of the bulk of people who had previously been virtually totally excluded from the labour market, who had been unemployed for generations.

The application of the new technologies I mentioned is particularly apt in the context of the New Economy. As the labour supply began to dry up, it became more and more necessary to find ways to put people previously thought unemployable to work, and to do so quickly. Thus, for example, McDonald's invested a great deal of money in designing a cash register that could be worked by people who are illiterate. And since working provides tangible and immediate rewards (in terms of paycheques, self-esteem, a sense of achievement), whereas going to school requires precisely that faith in long term rewards that I am arguing is absent in many cases, putting people to work is often a more realistic strategy than trying to force them to go to school.

So what looked like tough social policies in fact turned out to be hugely empowering for hundreds of thousands of people. And the fact that the US labour market has been able to draw so many new people into its labour pool was a big factor in its economic boom throughout the 1990s, the longest in post war history. The best social programme is still a labour shortage, where people have reasons to take advantage of the opportunities that a labour shortage creates and where there are immediate rewards and reinforcement for the cultural values that allow people to succeed.

Note too that this has been a hugely successful *left-wing policy*. In Sweden under the social democrats, the UK under Labour, the US under Clinton's Democrats and increasingly in Germany under their Social Democrats, social policy is designed to push people capable of work aggressively back into the labour market, into training and into work. This is in part motivated by a realisation of the problem of moral hazard for social policy, but also by a realisation that every dollar spent on someone capable of working and therefore of looking after themselves, is a dollar not available to be spent on someone who is incapable of working, for whatever reason, or at least incapable of producing enough economic value to support themselves, and who therefore does not present the kind of moral hazard challenges that these other members of society do.

Now contrast that, for example, with how Atlantic Canada has been encouraged to respond to the emergence of new economic opportunities. We have trapped at least 2 generations in dead end part time seasonal work, and encouraged them not to get an education, most notably because of unemployment insurance. These people have effectively been withdrawn from the labour market and have little incentive to work or to get training. Employers trying to hire the unemployed are actually in competition with a benefit system that pays people a quite decent income in return for a few weeks' work each year, and provides beneficiaries with substantial leisure time as well as the income. This has made labour in our region expensive, rather than cheap, relative to our productivity.

4. The state is not equipped to solve the problems that cause pathological poverty

The final piece of what I want to say flows from the preceding points. Escape from poverty for those who will not do so under the impulse of their own cultural values can only come from changes in their behaviour. Some of that can and must be accomplished through improved incentives, but there are limits to our ability to improve "positive incentives". Increasing the flow of benefits to low-income people, or attacking income inequality by levelling incomes down will not merely fail, it will actively undermine the most promising route out of poverty.

So what is needed is not more money, but rather an improved ability for social welfare to discriminate between those using the social insurance function of welfare to tide them over a life crisis, on the one hand, and those whose values and consequent behaviour condemn them to poverty. And we then need to put in place policies that make it progressively more difficult for the latter to remain on benefits in the long term.

But the state is ill-equipped to undertake these social welfare roles. The state is quite good at issuing cheques based on abstract and objective criteria, such as low-income, unemployment, old age. It is very poor at discriminating between people whose values and behaviour will lead them to escape poverty and those who are liable to remain trapped by it.

Moreover, in the liberal-democratic state, it is not at all obvious that we want the state dictating behaviour, or that the courts will even let them do so. I am more and more convinced that our rights-based culture will consistently undermine attempts to impose behavioural conditions on receipt of social welfare benefits, on the grounds that such discrimination is, well, discriminatory.

It is precisely for this reason, in my view, that we have seen in both the US and the UK, a growing use of the private sector, including the not-for-profit and so-called faith-based charities, for the delivery of social services. The main attraction is not that this necessarily saves money — I actually believe that real welfare reform doesn't save money, and that's not the objective —, but rather that such private agencies may be more demanding of their clientele, and expect more in the way of improvements in behaviour. An officer in the Salvation Army is likely to be more personally committed to the success of those he is responsible for, as well as less lenient than a government welfare administrator.

In addition, the existence of a wide variety of such private agencies allows a wide variety of strategies to be employed in the effort to move people off benefits and into self-sufficiency. Because the needs and capacities of people trapped on welfare vary enormously, so too do the programmes that might help inculcate in them the values that they need to succeed. I predict, then, that Canada will begin to experiment much more extensively with contracted-out provision of welfare services, with payment to agencies being based, not on how many people are passively maintained on income support, but rather how many people are successfully moved off benefits and into employment over some sustained period of time.

Of course one of the ironies is that moving such agencies within the embrace of the state will likely change their behaviour as well. They are presently able to be innovative and demanding in part because they are not state agencies. But almost invariably, state money comes with requirements that the recipients behave more like governments. I also predict, therefore, that this will be a change that may give us 20 years worth or so of innovative social policy, but which will run out of steam by the end of that period. But maybe 15 or 20 years of good progress against welfare dependency is all that we can hope for from any policy innovation.

Thank you.