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Macroeconomics II

Lecture 18

Growth policies and social structures

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Theoretical Lecture 18

Part IV Growth policies

Chapter 14 Social infrastructures and the role of institutions

Forms and quality of work, potential growth and social distribution

Social security systems

Other social functions of the Welfare State

Readings:

Louçã e Ash (2017)**, Sombras, chap 11**

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income distribution: what are we talking about?

GDP: value of the output of an economy in a year

(economic value created = income generated)

income

income generated by whom? (production factors)

income due to whom? (owners of the production factors) / **property rights**

income distributed to whom? (economic and social rights) / **redistribution**

functional income distribution

(primary) distribution of income by production factors (Labor and Capital)

personal income distribution

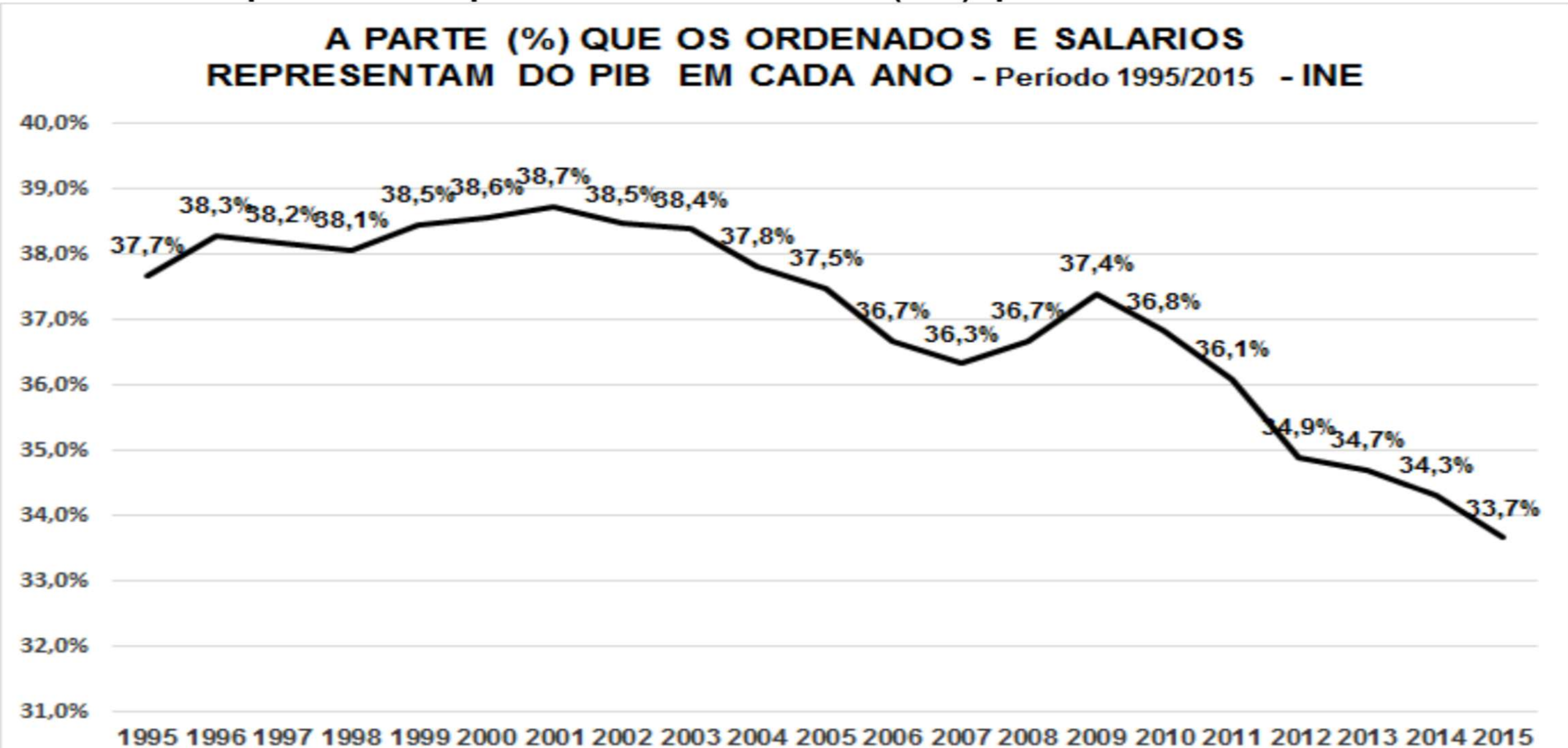
distribution of income among the owners of the production factors

+ redistribution of income (taxes, transfers) / **Welfare State**

= distribution of the disposable income among individuals/households

Income distribution in Portugal

Gráfico 1 – A parcela da riqueza criada anualmente (PIB) que cabe ao "Trabalho" diminuiu



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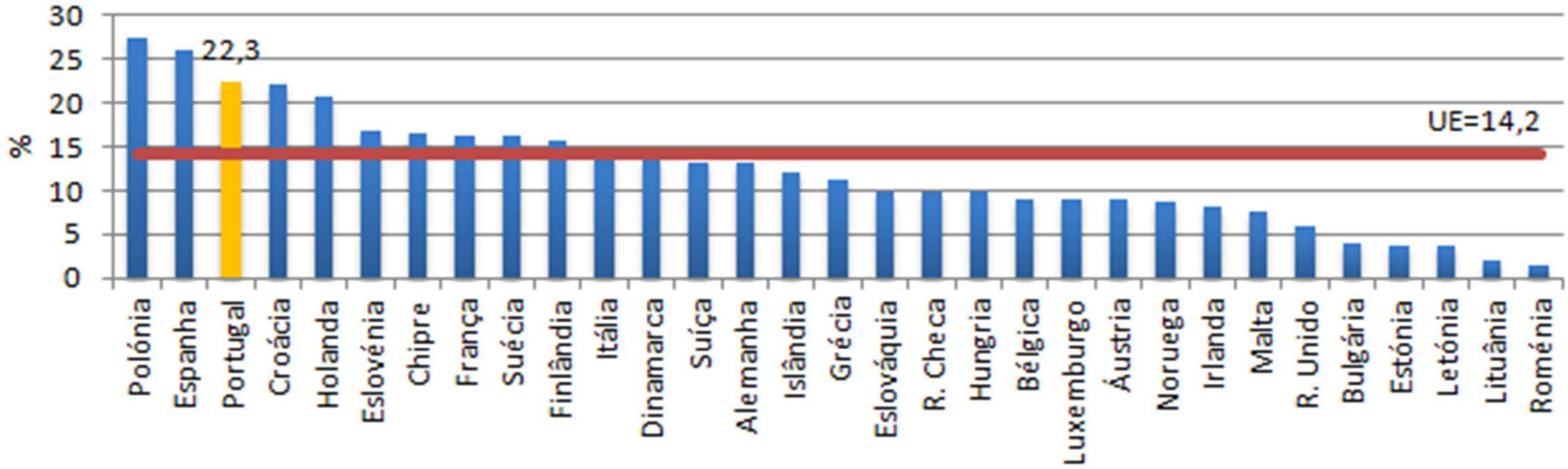
Four examples of social problems:

quality of work,
gender inequality,
ethnic differences
and social differences in education

Quality of work: a problem of growth and distribution

Figura 1. Trabalhadores com contratos temporários nos países europeus, pop. 15-64 anos (2016) (%)



Fonte: Employment and unemployment statistics, EU-Labour Force Survey (Eurostat). Dados acedidos em 19/10/2017.

OBSERVATÓRIO DAS DESIGUALDADES

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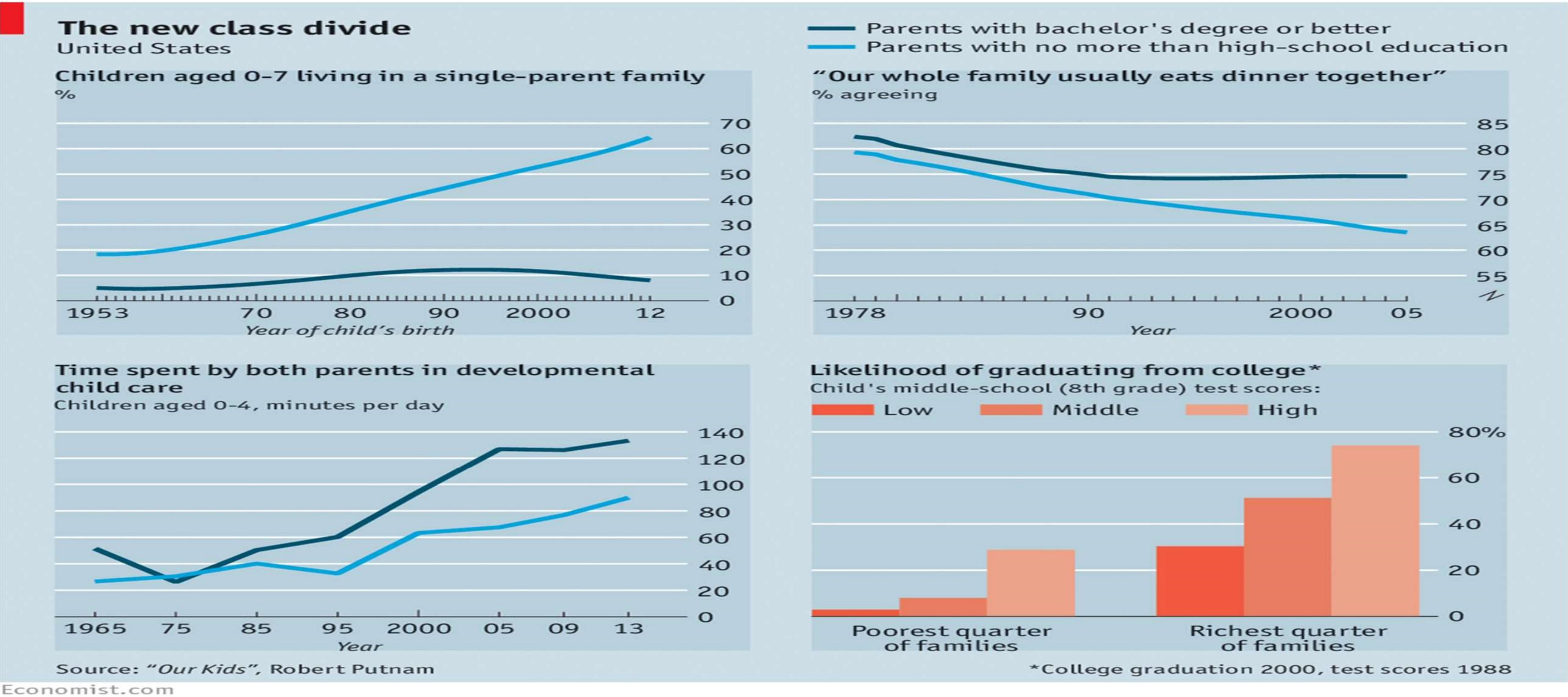
Gender inequality in the EU (2005-2015)

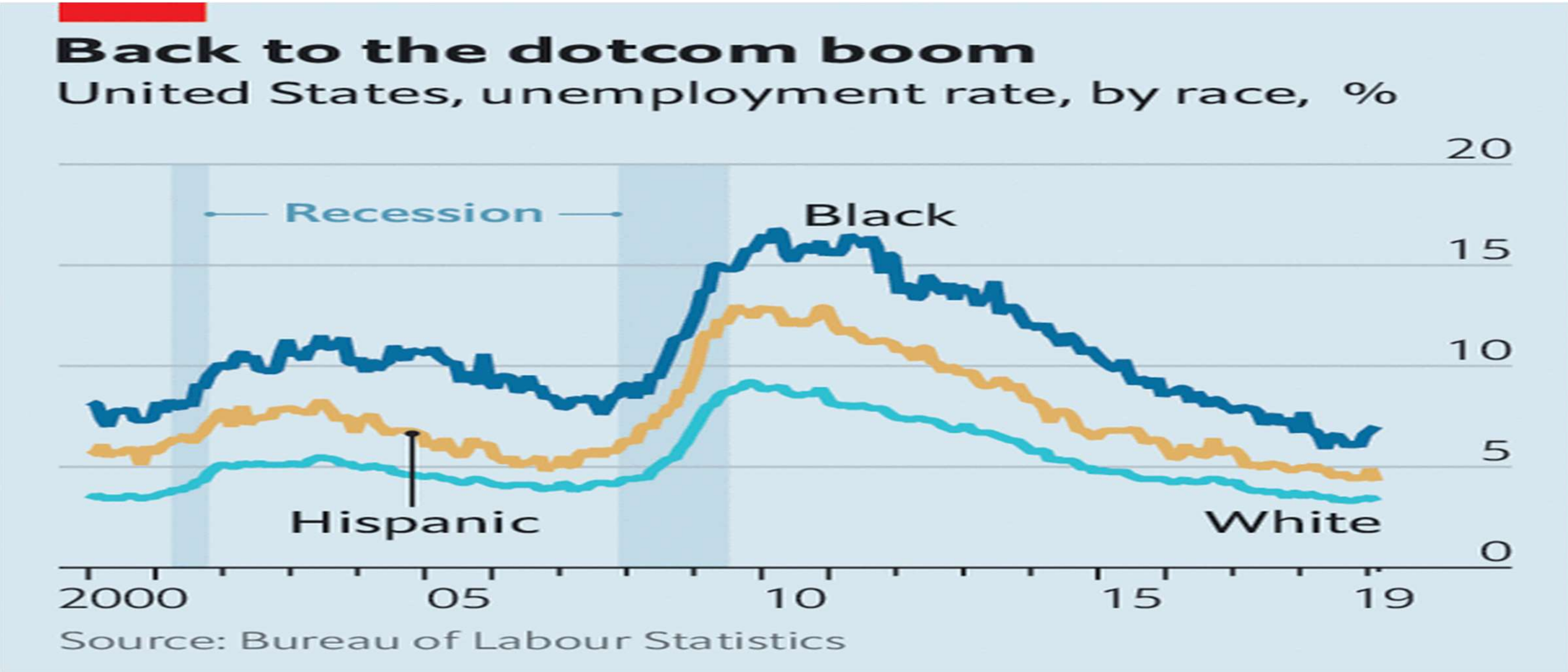
Figura 1. Índice de Igualdade de Género nos países da UE28 em 2015 e evolução entre 2005 e 2015

Fonte: Gender Equality Index 2017 – Measuring gender equality in the European Union 2005-2015 (EIGE, 2017: 8).

Social inequality and education (USA)



Social differences by ethnic origin



The Economist

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is functional income distribution constant? or, instead, does it change?

<u>functional income</u> distribution is a crucial concept of income distribution to be related to economic growth (growth of production factors account for growth of GDP, as all theoretical models);

which factors have impact on the trends of functional income distribution (that is, the share of wages on GDP)? It depends on the quantity of the production factors (K and L) and on their prices (r and w) (under the assumptions previously discussed in different models)

$Y = w.L + r.K$

remind: in the theoretical models of growth, $Y = K^{\alpha} L^{1-\alpha}$ (Cobb-Douglas) and, assuming that the price of the production factor = marginal productivity of the factor, it comes:

$\alpha = r.K/Ye$ 1-**$\alpha = w.L/Y$**

α (= income distribution) is a parameter: is it an acceptable assumption (remind Kaldor facts)?

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which factors originate the change of the functional income distribution? (that is, the share of wages in GDP)

share of wages (Sw) = w.L/Y = (w, nominal wage; wL total wage pay in the economy)

= w.L/Yc.P = (Yc, GDP constant price; P, price index)

= (w/P)/(Yc/L) = (w/P, real wage; Yc/L, labour productivity, y)

= wr/y (wr, real wage/labour productivity, constant price)

r (Sw) = r (wr) – r (y)

The share of wages is **constant** during a period if and only if the average growth rate of the **real wage** is **equal** to the average growt rate of **labour productivity;**

if the average growth rate of real wage is **larger** (*less*) than the growth rate of labour productivity, the share of wages in GDP **increa** (*reduces*);

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Welfare State and economic growth

Welfare State is a social construction that assures **social citizenship rights** and constitutes **space of bargaining and negotiation** of different (and divergent) interests and tension and potential and conflict among them, within a framework of plural political representation of such distinctive interests.

what are the **economic effects** of the *Welfare State*? and, namely, which are its effects on economic growth? will it be a constraint to economic growth?

Is the *Welfare State* **economically sustainable**? due to the redistributive mechanisms that supports its working (intergenerational transfers), the demographic trends may constrain its sustainability? what is **the role of economic growth** to guarantee its sustainability?

Social Policy

The whole set of **public policies** aiming at to promote and to assure **social** **welfare**, through the guarantee of **social rights** and the provision of the conditions required to their fullfilment in the society.

management of social risks (to protect the citizens from the negative effects of unforeseen events that may occur with negative effects on social rights: ex: unemployment benefits);

redistribution of resources, either for reasons of efficiency / horizontal equity (ex: free health care of the NHS/SNS), for reasons of vertical equity (monetary benefits to the poor), for intergenerational equity (transfers from the active young to the retired old);

to promote social inclusion (to prevent situations and processes of social exclusion, by promoting integration in the society either in its monetary or non-monetary dimensions)

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social protection by social transfers: old age pensions

with the objective of obtaining a regular flow if income during the lifecycle;

it protects this regular flow against the risk of unintended events which may cause breaks in such regular flow during life (unemployment, sickness, old age, etc);

great share in total social public expenditures;

old age pensions are ruled by quite diverse principles in the EU, but all have the same objective: to transfer resources from a early stage of life (when income is earned from economic activity) to a later stage of life (where there are no earnings from economic activity);

The origins of the Welfare State

dates of the creation of national social programs

Alemanha	1884	1883	1889	1927	1954	1880
Reino Unido	1887 (1) 1906 (2)	1911	1908	1911	1945	1948
Suécia	1901	1910	1913	1934	1947	1962
Canadá	1930	1971	1927	1940	1944	1972
EUA	1930	-----	1935	1935	-----	-----
França	1898 1946 (**)	1930	1905 (1) 1910 (2)	1905 (1)	1932	1945
Itália	1898	1928 (1) 1943 (2)	1919	1919	1936	1945

Fonte: KUDRLE & MARMOR (1984:83)
(1) Following Hugh Heclo; (2) following Peter Flora
(**) Required as forceful

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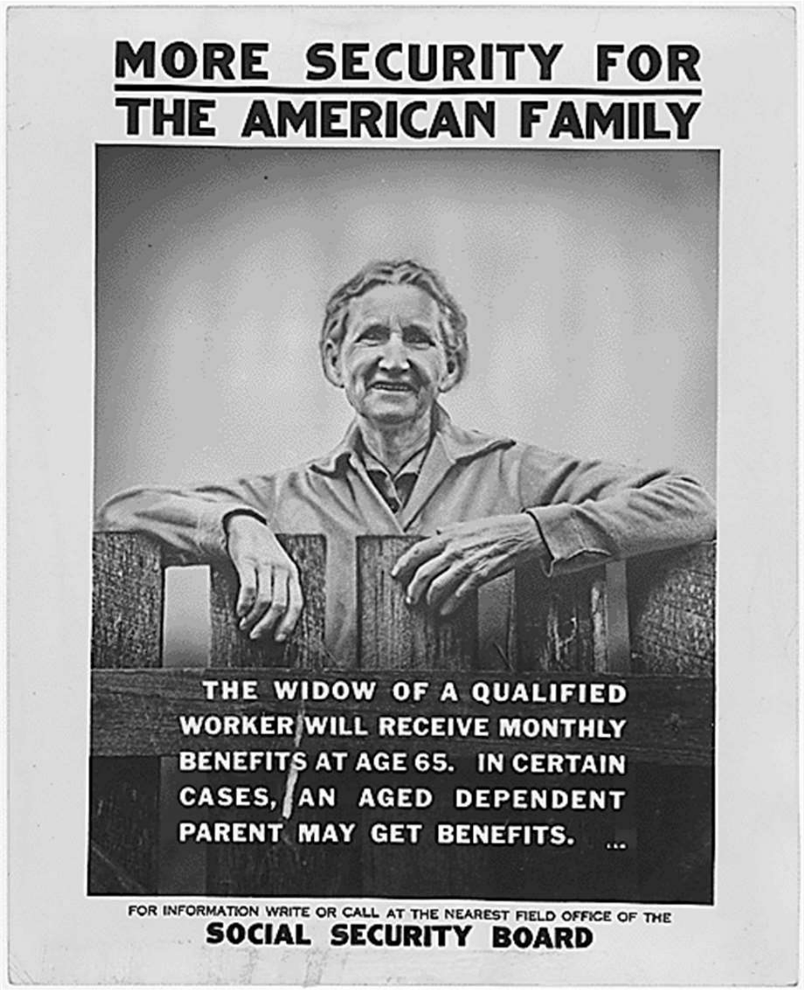
Propaganda for the Social Security Act (Roosevelt, New Deal, USA)



The debate about the pensions system

Three alternatives:

1. Public system

2. Private system (Chile)

3. Public systems and private partnership

(including different combinations, such as the contemporary Portuguese system, or the alternative Swedish model)

1. A public system

- There are only contributions to a national public fund
- The fund is responsible for the payment of pensions
- It may use its reserves buying public debt (national or of other countries) or some other assets (property, stock, bonds)

2. Private system (Chile)

The privatization of the pension system in Chile was an essential decision of the military dictatorship (1973-1990), favoring some large financial groups, following a model that came to be known as the "Washington Consensus"

The Chilean system was designed in 1981 by Jose Piñera, Minister of Labor, one of the “Chicago Boys”. It was even presented by the IMF as model for developing countries

It is based on the creation of private entities to manage the pension funds (today some 75% of the GDP).

Functioning:

Individual accounts, for which the workers deduce a forced saving of **10% a month**, creating the personal account, to be managed by private financial firms. The pension will be paid at age 65 for men and 60 for women. Firms do not contribute to the system. If they live more than 83 (men) and 88 (women), they should look for an extra insurance to pay for the pension.

Problems of the Chilean system:

- the average pension is US$ 250, or 10% less than the minimum wage
- the replacement rate is on average 30-35%.
- Firms do not contribute.
- The cost of management is higher than in other countries
- It requires a large financial corresponsibility of the State, that uses some 30% of public spending in order to pay for the old system pensions and to contribute to a "Solidarity pillar" in order to complement those pensions that are inferior to the minimum wage.

3. A public plus private system (1/2)

Different cases:

A) Portugal

Two main public funds: the general social security system + the public servants system (now closed)

Financed by workers (11% of the wage) and firms (23,75% of paid wages) plus the budget through a part of IVA and other contributions

The pension is attributed according to age and contributions, following a standard rule

Plus some other important private funds (e.g. banking employees)

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3. A public plus private system (2/2)

B) **Sweden**

- Legal rights plus a private account for each citizen
- The payment of ongoing pensions partially depends on the rate of growth of GDP and other macro variables
- The contribution is 16% of the wage to the public fund
- Plus a compulsory contribution of 2,5% to pension funds, managed by private firms