

“Private Welfare and the Welfare State”*

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I. Overview

A. The Issues

It is natural to wonder how well poverty and economic risk could be reduced by private means, such as charity, private insurance markets, and private capital markets. We know, of course, that the successfully growing countries trended away from relying on private insurance and poor relief solutions, c1880 - c1980. Yet over those hundred years, even private social assistance and social insurance rose in all rich countries.

This essay summarizes what is known about the causes and consequences of the rise in aid, and the prospects for reversing the shift toward public aid in the twenty-first century. These immediate questions must be faced:

- Why did the world do so little giving and insuring until the last hundred years, and why has its recent rise concentrated in the rich industrialized OECD countries? Is the rise likely to continue across the twenty-first century?
- Among sources of funding for giving and insuring, why did tax financing outrun private financing, and will taxation go on rising, as a share of such funding or as a share of GDP?
- Among uses of the funds, why have poverty and need been reduced so much more for the elderly than for the young, and will that continue?
- Are these developments efficient, in the sense of raising something like GDP per capita?¹ If efficient, why were these gains delayed until the last hundred years? If inefficient, why were these changes so widespread?

Arriving at answers to these basic long-run questions does not require a particularly long journey, in comparison with some other basic historical quests. It will turn out that plausible but unnoticed answers can be reached, at least in part, by applying common theories and common sense.

B. Definitions Broad and Narrow

An initial preparation for the journey, however, is to define the basic subject matter.

(1) *The broader activity: Social spending.* This essay will start with the broad concept that recent authors, including those managing the SOCEXP data sets for the Organization for Economic Cooperation and Development (OECD), have called “social expenditure” or “social welfare expenditure”. Convention has cast the definitional net very broadly, so broadly as to limit its usefulness. The available measures of social welfare expenditures by the OECD and by scholars include any expenditures that cushion people against low levels of – or short-term drops in – health, income, and general wellbeing.² Some measures include educational expenditures, yet others (e.g. the OECD’s SOCX series) do not. This essay sometimes includes education expenditures, especially public ones, and sometimes excludes them, depending on the issue at hand. Remarkably, the broad measures of social spending do not restrict who pays for these expenditures, or who receives them.³ The payers need not be richer than the recipients. The payers and recipients tend to be persons in different families, but even this tendency has exceptions, as in the “social” pension expenditures that you get from your own previous paycheck contributions.

(2) *The narrower activity: Helping the neediest.* This essay adopts the narrower, but still conventional, focus on expenditures insuring against, or alleviating, extreme need as defined either by living below the poverty line or by suffering incapacities that greatly reduce material wellbeing even above the poverty line.⁴ That is, we emphasize the kinds of social insurance and social assistance that have always generated more controversy because they involve more vertical redistribution of income.⁵

(3) *Defining success and efficiency.* In what follows, private and public institutions will be judged on the basis of their record in lowering poverty rates, lowering physical suffering, lowering income variance for the targeted populations, achieving a high internal rate of social return, and raising GDP.

C. A Preview of Findings

This essay offers the following tentative conclusions:

(1) Private giving seems to have been driven by relatively narrow sentiments. Donations are driven by the giver's own "warm glow" from being a giver, and people tend to give heavily to their own socio-economic group. Private giving rose slightly with rising incomes, though it has never been a large share of the economy.

(2) The rise of public welfare spending has not crowded out private giving, despite a common fear that it might do so. The two actually have a positive correlation over time.

(3) The modern rise of public social spending probably brought considerable gains in efficiency, GDP, and the larger concepts of human welfare quantified in the chapter in this volume by Leandro Prados de la Escosura.⁶ These investments in humans were blocked for millennia by weak and rapacious governments, and by a concentration of political power that rejected universal public schooling, family assistance, and public health insurance. Once the spread of voting power opened the doors to large universal social insurance, economies of scale and economies of universal coverage brought down the operating costs of tax collections and or social investments.

(4) Yet since about the 1960s, the expansion of public social programs has probably stopped reaping efficiency gains, due to what journalists would call "mission creep". Several countries, most notably Japan, the United States, Italy, and Greece, have drifted away from their original mission of investing in the young, while at the same time maintaining intergenerational transfers in favor of the elderly. This drift did not bring any obvious net loss of GDP in the late twentieth century, but further population aging in the twenty-first century will force reforms that hold support for the elderly within sustainable steady-state limits.

II. Linking Welfare Theory and History: Some Low-Hanging Fruit

Linking economic theory with the broad historical patterns of social insurance and giving is not difficult. Micro-economists have developed theoretical ideas that seem to have good predictive power, and some have even been tested on data since the 1960s. To deal with the broader sweep of history, one should concentrate on a common-sense procedure that can establish good prima facie explanations while we await more focused statistical tests. The procedure is a simple qualitative analogue to econometricians' differences in differences technique. Once the overall historical patterns of social insurance and social assistance have been established (in the next section), let us inspect the timing and the geography of differences in each popular explanatory variable, and see how well they correlate with differences in the level of insurance or assistance. We can further judge their likely unit impacts, or coefficients, with the help of other studies.

The popular explanatory variables are arranged schematically in Table 1. As one can see by comparing the two columns, the list of theoretical influences is nearly the same for social assistance (right-hand column) as for social insurance (left-hand column). The straightforward reason for this similarity is that the target group for social assistance consists of those who already suffer the poor condition(s) that social insurance was supposed to cover. What affects the one generally affects the other, albeit with different unit impact. Accordingly, the key players are introduced here by going from top to bottom in Table 1, discussing social insurance and social assistance at the same time.

The generosity of either insurance or assistance is shaped by familiar supply and demand forces, such as cost determinants on the supply side and the usual triad of income, prices, and tastes on the demand side.

A. Transactions costs and free riding⁷

To set up firms or agencies supplying insurance requires overcoming the transactions costs of getting organized, aligning private ventures with legal institutions, and overcoming opposition from vested interests. A related task is to overcome free riding from consumers and imitating suppliers. The greater the

numbers of potential participants, the higher are the hurdles. Economists are not completely pessimistic about the prospects for overcoming transactions costs and free riding. They note that in some cases, the solution can even be privately achieved, as in the textbook case of port dues to pay for a lighthouse. It is time to breathe more history into this issue: When, where, and how were private solutions achieved?

It can be even harder to solve the public good problems of private social assistance than it is for insurance. Many who benefit from having social assistance given to the needy can “free ride”, knowing that their contributions will probably not be crucial. In some cases, the problem can be solved by having the supply of potential charity concentrated into a few hands, so that free riding does not lead to under-provision. In other cases, donors will not free ride, but instead will give simply because they derive a “warm glow” of utility from the very act of giving. In still others, a large prospective donor may win over the otherwise free riders with a matching-grant approach, as long as their threat to hold back in the absence of matching is a credible one.⁸

Theorists and authors of public finance textbooks typically see a stronger case for having the public sector intervene to make assistance mandatory, the greater is the “free rider” problem that besets attempts to mobilize private demand for assistance as a public good. However, public approaches also face free ridership problems, especially in democracies. Election campaigns are weakened by voters’ realization that their individual votes are not likely to be crucial, so that they often fail to vote. Forming a pressure group in favor of a public solution faces the same difficulties as private efforts. In addition, even elected representatives may have free-riding incentives to avoid supporting a public solution they want implemented, in order to avoid the wrath of constituents who oppose it. We therefore need to explore how the hurdles of both private and public provision of social aid have been lowered or raised in history, and how well these changes correlate with changes in the observed level of provision.

B. Unit operating costs

Obviously, either insurance or assistance will expand if something lowers its unit operating costs, such as administrative costs or the tax deductibility of insurance and charity. The key questions about such costs are empirical and comparative, not theoretical or conceptual. The empirical record shows clear patterns of difference in the scale and (therefore) the unit operating costs of private and public insurance and giving, as we shall see.

C. Income effects

Are social insurance and social assistance luxury goods, so that they take a rising share of the economy as incomes advance? The theoretical answer is yes on the giving front. Incomes do not govern the supply of private insurance directly, the way that income shapes consumer demand behavior. Rather, the effect of rising incomes on private insurance supply works indirectly through the tendency of growth and development to cut the cost of capital to insurance firms. We should expect that private social insurance would spread in response to the declining cost of capital that is integral to the growth process.

The supply of private charity has a more direct (and positive) income effect than does the supply of insurance, since charity supply is equivalent to a consumer demand for providing relief, and any consumer demand responds to income.

Should income growth raise the public supply of insurance and assistance? Theory is less clear here than for private giving. Something called “Wagner’s Law” posits a rise in the share of all government spending in GDP in response to rising incomes, and it might seem natural to posit the same for the social part of government spending. Yet Wagner’s Law is just something imagined about the data, with little theoretical underpinning, rather like the Kuznets curve of inequality and development, or the Philips Curve of macroeconomics in the 1960s.⁹ While we shall explore the possible income elasticity of public support, we shall do so without having any clear theoretical presumption to test.

D. Taste factors (warm glow versus altruism, affinity versus diversity)

The prominent “warm glow” theory of private giving argues that people get direct utility from the act of their own giving. The same desire might be labeled giving for self-respect or, in a religious person, giving for spiritual salvation. As James Andreoni emphasizes, the warm-glow theory denies that the wellbeing of the recipient is a pure public good. If it were, then extra donations by others would reduce, or “crowd out”, one’s own donations. The warm glow theory is thus an alternative to an altruistic theory of private giving.¹⁰

Economists have also devoted considerable attention to positing and testing theories about private individuals’ choices of target populations. *To whom* do people choose to give privately – people like themselves, or people in hardship? Both the prevailing theories and recent evidence suggest a stronger willingness to give to one’s immediate social and economic peers, and not to distant groups. An immediate implication is that social diversity and economic inequality reduce private giving, for any given price structure.¹¹

For public social insurance and public assistance, there is a similar tendency of theory and, especially, empirics to emphasize the role of social affinity between paying groups and recipient groups. Both within and between countries, the evidence seems to show that ethnic and religious diversity has a negative effect on the willingness to allow public programs to target the poor. The more diverse the population, the more the middle and upper income groups seem to resent public transfers and entitlements as redistributions from “us” to “them” through government.¹² A corollary would seem to be that admitting more immigrants of different ethnicity and religion would cut the provision of public aid.

E. Demand-side “need”

Common intuition and formal theorizing agree that social insurance should experience greater payouts, and social assistance should also be more forthcoming, in bad economic times and in poor places. The operative kind of need is *perception* of need, either in its altruistic variant (“they need our help”) or its self-projecting variant (“that could be me”) that has often given rise to fund-raising campaigns and new insurance programs. Historical data on poverty and the macro-economy make

it relatively easy to test the strength of this pull of need, since perceptions presumably follow the macroeconomic realities.

The other principal “need” variable is the general severity of capital constraints. Throughout human history, a large share of the population has been trapped by the inability to borrow for investing in its own future productivity, either for human investments such as schooling or non-human investments such as land improvement. And at any phase of development, social insurance and social assistance provide an efficient means of alleviating that constraint and promoting both growth and equality. This kind of efficient gain from social insurance and social assistance would presumably decline in importance as the economy advances.

F. Political voice

The theories introduced so far have yet to face the question “Who makes public decisions on social insurance and social assistance?” For that, we must turn to the field of political economy, for a literature recognizing that the political tug-of-war over redistribution depends on the distribution of political voice. As that literature emphasizes, greater lobbying power for wealthy potential taxpayers is a key negative influence on vertically redistributive public tax-transfer programs. On the other side of the same coin, extending voting rights to lower and lower income groups raises the expected value of tax-based social insurance and assistance. Clearly, if we are to make sense of the long global history of social spending, we must take into account the changes in the voting franchise and in the power of elites.

III. Social Spending since the Late 18th Century

To sort out which of these most popular theories help most, and which help least, in explaining the long history of private and public aid, this section begins by charting the global contours of that long history.

A. Little before the late 18th century

Before the late eighteenth century, there was relatively little in the way of social insurance and social help for the needy, despite all the books and articles written about the institutions of early aid. To be sure, some private institutions of mutual aid did insure their members, conforming to the tendency toward social affinity, the exchange of help with one's own social group. To judge from the few data we have, and to conjecture that absence of data tended to betray absence of generous aid, private insurance and mutual aid seemed to have reached their highest levels in the late eighteenth century in England and the Netherlands, as shown by a few estimates in Table 2. Marco van Leeuwen's important recent study of private Dutch insurance pools in the second half of that century shows significant benefits paid out for burial expenses, sickness benefit, medical costs, widowhood, and old age. For those receiving them, pension and old age benefits ranged from 20 to 50 percent of the typical wage. Yet those covered represented a small fringe of society, mainly middle-class members of large craft guilds in the main cities. Their restrictiveness and small size was one means of avoiding adverse selection.¹³

Much harder to find before about 1800 were significant levels of private insurance or assistance to the poor, even if we include aid from religious institutions and even if we confine our search to relatively prosperous Western Europe. Private and church charity was ubiquitous, elaborate – and negligible. Every country had tens of thousands of individual bequests. Wealthy individuals seeking salvation went beyond almsgiving and set up their own trusts, just as many do today. Most charities were not for the poor, but for supporting general worship, apprenticeships, and general hospitals.

As best we can gather from official inquiries and later historical studies, churches and other private charities gave little to the poor in the eighteenth and nineteenth centuries (again see Table 2). In relatively generous England, officially monitored charities gave less than 0.4 percent of national income to all recipients, only some of which were poor. Granted, these data miss some unrecorded individual gifts. Yet the amounts in the late eighteenth century, and presumably in previous centuries as well, were low by modern standards, even though the totals would have included donations for education. In the Catholic countries of Western

Europe, the church aid received by the needy was apparently even lower, presumably less than half a percent of national income.¹⁴

As of the late eighteenth century, the public sector's most frequent social prop was confined to its own employees, especially the military. Even the military's own pensions and survivor support was not reliable unless the state itself had permanence. The rise of a stable military state created secure pensions for surviving military personnel, both in the Roman Empire and in the early modern period. Often the pension was embodied in a gift of land.¹⁵

Public support for the poor, disabled, and dependent was extremely limited before the late eighteenth century. The literature on Western Europe sometimes dates the rise of poor relief too early by imagining that it became substantial upon the passage of some early law, such as the Elizabethan Poor Laws of 1597 and 1601. In fact, such laws were largely designed to restrict or at least regularize existing practice, without providing any funding for an expansion of aid. Much of the seventeenth- and eighteenth-century legislation was punitive, calling for increasingly harsh treatment of vagabonds. Poor relief did not exceed one percent of national income until after 1750, and then only in two countries, the Netherlands and in England-Wales, where it peaked at around 2.5 percent just before the Poor Law Reform of 1834 slashed assistance. Even tax-financed public education was notably absent around the world, as it had been for millennia, although some monarchs (e.g. Prussia's Frederick Wilhelm II in 1763 and Austria's Maria Theresa in 1775) passed unfunded mandates telling localities that they should educate their children.¹⁶

B. The gradual rise, 1800-1945

Even in the nineteenth and early twentieth centuries, support for social insurance and assistance rose only at a modest pace, relative to the ability to pay. The private insurance business continued to do little business with families. As of 1929 in the United States, for example, households paid only \$880 million, or less than one percent of GDP on life insurance, and a negligible amount (\$2 million) on health insurance. The postwar era brought an acceleration of private purchases of

personal insurance, rising by 1999 to a little over one percent of GDP for life insurance and personal pension plans and another 0.7 percent of GDP on individual purchases of health insurance, plus the much larger amount of postwar insurance contributions to employer-based plans.¹⁷

Private philanthropy continued to be modest, and only a small share of it was directed toward the poor and those in bad health. So we conclude from data for the United States, one of the few countries to quantify charitable giving, and perhaps also the country where the most was given privately. Table 3 illustrates with estimates of the shares of GDP contributed privately in 1927 and 1970. Even if all philanthropy had gone to “welfare” in 1927, that would have delivered only 1.52 percent of GDP, a lower share than England and Wales local governments gave to their poor a century earlier under the Old Poor Law. As Table 3 further reminds us, very little of American philanthropy went, or still goes, to the poor. In 1927, only a tenth of a percent of GDP went to “youth services, welfare, and race relations”. The parts of other categories received by the poor and needy were probably offset by the parts of this category they did not receive. The private contributions to “welfare” were much smaller than the amounts contributed to churches, to parochial schools, and to higher education (e.g. the Ivy League or Stanford).

Another striking pattern from the well-documented American record is revealed by the behavior of private giving after 1927, and after the arrival of huge needs in the great Depression. Figure 2 sketches this history, comparing two different measures of private giving for welfare-type recipients with the time path of public aid to the same target group. Private aid has gone on rising since the 1920s, even though it did not rise as fast as public aid, which jumped twice after having been a tiny share of the nation’s income until the Great Depression. During the nation’s first jump in public relief under the New Deal, private charity changed little, partly because it was small already and partly because the asset value losses of 1929-1933 must have made it more difficult to give to others. The second great rise in public relief spanned the entire postwar period, with temporary accelerations during recessions. Interestingly, private giving also continued its (slower) upward

march after the war, judging either from the narrower and more targeted spending on the needy or from a less narrow measure of private welfare services.

For other countries, as well as for the United States, the advance of public social spending accelerated across the twentieth century, as shown in Figure 3. Even as late as 1930, no country spent as much as 5 percent of GDP on public social programs, not even in the Nordic States, where it later hovered around 30 percent of GDP. We must return to the task of explaining some glaring historical facts that stand out in Figure 3: Why was there no significant social insurance or social assistance for most of human history, and why was the eventual rise so unequal among countries?

C. The Postwar Welfare State Revolution

The real rise of public social spending, and possibly private social spending to a lesser extent, came after World War II, as shown again in Figures 1 and 2. That is, of the major formative episodes highlighted in the introduction to this volume by Kevin O'Rourke and Jeffrey Williamson,¹⁸ the rise of social spending accompanied the postwar "spread and deepening" of global capitalism, not the earlier interwar retreat from it. While the trend has stopped after 1980 in the highest-spending welfare states, as illustrated for Denmark in Figure 3, social spending continues to rise as a share of GDP in many OECD countries. At the core of the dramatic postwar rise of public social insurance was the switch to universal entitlements, from "means-tested" support restricted to the poor (those of little "means"). For pensions in particular, support for the middle-income groups became greater than support for the poor in absolute purchasing power, since an individual's pension became greater, the more one had earned at work. Accordingly, the redistribution from rich to poor did not keep pace with the rise in public social spending.¹⁹

In this setting, and in so many historical settings, the rise of a phenomenon prompts governments to measure and publicize it. The welfare state revolution caused a diffusion of social expenditure data gathering, first among a couple dozen OECD countries and then around the globe. Taking advantage of this diffusion, we can examine intercontinental patterns more clearly, with the help of Table 4.

As of 2007, the OECD now has developed a fairly clear snapshot of both private and public social spending, broadly defined. Private social insurance can be mandated by law, as in Switzerland, or overwhelmingly voluntary, as in the United States, or both. The extent of the shift toward public social spending is underlined by contrasting the lowest share among these countries in 2007 – namely, Mexico’s 7.2 percent of GDP – with the fact that no country in the world spent such a large share on social services as late as 1930.²⁰ For twenty countries in Table 4, we can now explore the international correlation between public and private social expenditures. That negative correlation (-0.19) suggests that the issue of public programs’ “crowding out” private contributions has more potential in the contrast between countries than it does within countries over time.

The fact that lower-income countries still devote lower shares of their incomes to social spending raises the question: Will their social spending shares catch up when their incomes catch up, as Wagner’s Law would predict? The answer to the catching-up question, it turns out, varies by world region. Countries of the former Soviet Bloc, including those in Central Europe, definitely spend a greater share of GDP on social services than did Japan, Sweden or the United States with comparable income levels in the more distant past. On the other hand, Korea and Singapore and other East Asian countries spend less than income comparisons would have suggested. Among other regions, those from Latin America and the Middle East tended to have larger social budgets than their incomes would have suggested, rather like Chile or Turkey in Table 4. By contrast, countries from South Asia spent less. We seem to be glimpsing the emergence of a global geography of differences in social spending driven by differences in history. It remains to be seen whether any non-European and non-Communist country will develop a welfare state devoting more than, say, 20 percent of GDP to public social spending.²¹

IV. Explaining the Delayed Rise

A. Why no take-off in private social spending?

With the broad historical movements in view as fully as the data allow, we can ask whether any simple combination of the theoretically predicted influences can explain the directions and the timing of these movements, beginning with the absence of any known movement over the millennia leading up to the late eighteenth century.

The first question is why private individuals and organizations, including churches, delivered only negligible private aid or insurance, beyond the boundaries of the families and organizations themselves, especially before the nineteenth century. Did the basic variables in Table 1 behave differently up through the eighteenth century, or even the nineteenth, from their behavior in the twentieth century, when private giving rose very modestly?

The most obvious difference is that potential donors were poorer in the past. Yet history constrains the likely importance of this income effect. As we have seen, private giving was still less than one percent of income in Western Europe by 1800, when incomes of the wealthier classes had already risen considerably, and was similarly low in the much richer United States as late as 1927. The fact that affluent families and organizations were poorer in 1800 than today could not have made a great difference, given that we know of no exogenous rise in the after-tax price of giving or any global shift of tastes away from giving, which could hypothetically have hidden a strongly positive income effect. The income elasticity could not have been very high over the long run.²²

History similarly constrains the idea that the after-tax price of private social insurance or giving was higher back before 1800. Granted, the private insurance industry was hobbled by weaker financial and property-rights institutions in the past. Its ability to supply affordable insurance may have improved greatly with subsequent financial developments. Yet, as we have seen, the American experience suggests that private health insurance did not exceed one percent of GDP until the postwar era. As for the long-run price history of private charitable giving, it too cannot have changed much, in the general absence of income taxation or of charity-based deductions from it.

If private giving rates and the prices of giving moved little, while incomes rose significantly across the nineteenth and twentieth centuries, we are left with three explanations of the lateness and gradualness of long-run change in private giving as a share of income. Either

(1) the income effects were in fact large, but their stimulus to giving was largely cancelled by exogenous shifts in tastes away from charity; or

(2) the income effects were in fact large, but the rise of the welfare state crowded out what would have been a large rise in private giving by altruists caring about the total amounts that the needy received (induced shift in tastes); or

(3) the income elasticities were in fact small and the affluent never felt inclined to give much.

Seeing no historical reason why tastes should have shifted away from charity at the same time that incomes accelerated across the nineteenth and twentieth centuries, I tentatively doubt the first explanation. The second option – large income effects were offset by crowding out from the welfare state – would have worked if there had been historical evidence of a rise in private giving during a long period when incomes were growing and there was no welfare state. Yet American experience finds a large rise in per capita income from, say, 1800, to 1927 with no appreciable private giving either at the start or at the end of that period.

Accepting the third explanation fits with that “warm glow” model favored by the present-day microeconomic literature. Over the centuries, people have given privately because they gain utility from the act of giving, and the amounts they gave did not respond much to competing supplies of aid to the targeted group (i.e. no crowding out of altruists). To the “warm glow” theory, this simple reading of history suggests a friendly amendment: The warm glow is achieved by very low levels of giving. Perhaps over the centuries, donors have gained satisfaction by giving at least something, and felt no need to “give until it hurts”. That would help to explain why there have always been so many charities, with so little closure of poverty gaps.

B. Why the delayed arrival of the welfare state

The next interpretive task is to ask why the rise in public social insurance and assistance arrived so late in history, only after World War II, and why it then grew so large in several European democracies. A follow-up set of questions relates to the efficiency of the observed history: Would it have been efficient, in the sense of achieving high rates of return and raised GDP, if the welfare state had arrived earlier; or was the change only efficient under postwar conditions; or was it never efficient? Partial answers are forthcoming, using qualitative contrasts that imitate the econometricians' "differences in differences" approach.

Would today's higher shares of social spending have been efficient anytime before World War II? One's answer must imply, of course, a judgment of what it was that prevented the earlier arrival. The quickest road to an overall tentative answer starts with tax-based public primary education, one of the earliest forms of tax-based social spending. The reason to start with public education is that it is a case with a famously high and positive rate of return, especially in less developed settings, even without reckoning the value of its "externality" benefits. As far as we can tell, there never was a time in the last six or more centuries in which the returns to primary education were low, waiting to be raised by some onset of modernization. Literacy and numeracy paid off, especially for males. Even if access to some occupations, such as government officialdom, was artificially restricted, a young man could apply his literacy and numeracy to unregulated commercial and craft occupations that had a use for them. History's constraint on primary education has always been the inability to solve the capital constraint. Since private capital markets have never solved the problem of universal investments in children's education, to be repaid by their future earnings, primary schooling always needed tax-based support, even in the eyes of Adam Smith, Thomas Jefferson, and Milton Friedman.²³

The first historical step toward efficient public investment in primary education was to build state fiscal capacity, so that the government could administer public investments with a minimum of mistakes and corruption, while borrowing at a low interest rate reflecting the government's own credibility. As demonstrated by Mark Dincecco, state fiscal capacity arrived at different times in different countries,

as soon as each country's political history cleared the way for limited yet centralized government, as in Britain after the Glorious Revolution of 1688. Dincecco and Gabriel Katz have further shown that the arrival of state fiscal capacity led not just to more military might, but also to investments in education and infrastructure, with a statistically significant and sizeable stimulus to the growth of GDP.²⁴

Even after this fiscal barrier had been removed, most governments failed for some additional decades to deliver tax support for universal primary schooling, at an economic cost to the economy as a whole and in some cases a cost even to the government's own budget. As I have quantified elsewhere for two settings, Victorian England and Venezuela from the 1950s to the 1980s, the social rate of return to tax-based investments that were not made in primary education was so high that the government itself could have reaped a competitive rate of return based on the extra tax revenues from adults who had received the tax-based schooling. In the case of England, what we know about interest rates and skilled-wage premia suggests that government and society passed up high rates of return all the way from about 1717 to the implementation of the Fees Act of 1891. Further studies should continue to turn up other historical cases in which *prima facie* evidence suggests that high returns to public schooling were passed up.

For what other kinds of social investments could the return have been high, and why were the investments not made earlier?

Poor relief was a second kind of social spending that could have yielded a high rate of return in terms of life expectancy, labor supply, and national product. Roderick Floud, Robert Fogel, Bernard Harris, and Sok Chul Hong offer extensive evidence that extra nutrition for the bottom decile or two of English and French society in the eighteenth and early nineteenth centuries would have raised labor supply and productivity. If one further assumes that poor relief brought the extra nutrition it was meant to bring, then the relative generosity of English poor relief before 1834 deserves high marks for feeding the poor and raising their labor supply. Outweighing the famous conservative argument that the poor relief would reduce labor supply, by encouraging laziness and insolence, is the likelihood that labor supply would have been raised overall given the magnitude of the positive survival effects estimated by Floud, Fogel, Harris,

and Hong. Unfortunately, England and Wales cut poor relief in 1834 and again in 1870, delaying some of the nutrition gains until very late in the nineteenth century.²⁵ Here too, efficiency seems to have been sacrificed by holding back on social spending.

A third missed opportunity might have been the delay in public health investments, such as urban sanitation. Jeffrey Williamson has argued that Britain's investments in urban sanitation lagged a couple of decades behind the knowledge that cholera and other diseases were waterborne.²⁶ This third case of temporary underinvestment seems less glaring than the case of primary schooling, since sanitation infrastructure did not lag as long behind the discovery of potential benefits as was true of the long-known gains from schooling.

Why should it be so easy to document historical cases in which high-return social investments failed to receive tax support even though governments had the capacity to finance them? Comparing governments and time periods suggests a clear answer. The key second barrier that had to be removed was the concentration of political power into the hands of elites opposed to taxation for growth-enhancing public investment.²⁷ The concentration could only be broken up by shifting power toward potential beneficiary groups. Across the nineteenth century and the early twentieth, voting rights finally became more widespread, and the ballot became secret, in one country after another in Europe and North America. Since the earlier restrictions on voting rights favored the wealthy, one impact of spreading the vote was to place fiscal issues more and more into the hands of middle and lower income groups. This spread of voice played a clear role in raising public investments in schooling, family assistance, and public health.²⁸

While these two explanatory forces -- the rise of state fiscal capacity and the spread of political voice -- deserve to be featured as prime movers in the gradual rise of social spending up to about 1930, they must share the spotlight with several other forces when our historical explanations are to encompass the further acceleration of public spending up to about 1980.

A long-run force tipping in favor of high-budget government social programs has been their efficiency in delivering lower unit operating costs on both the tax side and the expenditure side. Prosperity and democracy have allowed countries to

economize on administrative costs by shifting from narrow and expensive taxes and transfers to broad taxes and broad entitlements. On the tax side, history shows steep declines in the administrative cost shares of indirect tax collection across the nineteenth century and the early twentieth, both in Britain and in the United States, as shown in Figure 4. In both countries, the cost of collections dropped from over 4.5 percent of the amounts collected in the mid-nineteenth century or earlier to two percent or less since the middle of the twentieth century. Economies of scale have cut the costs of bureaucracy, so that the US Internal Revenue Service, for example, costs only half a percent of the amounts collected. To the extent that the same happened in other countries, a part of the history of the rise of public social spending conforms to Mark Dincecco's story of increasing efficiency in government.²⁹

On the public social expenditure side, our time series on administrative cost shares do not antedate the 1930s, but we can add comparisons of public and private delivery systems today. These comparisons suggest that shifting from narrow and heavily policed social assistance to broad public entitlements programs have cut costs, through economies of scale and the reduction in monitoring. Back before 1880 Europe's main kind of program was classic poor relief. Societies intent on forcing all the able-bodied to work tried to emphasize "indoor relief" in which one was kept in a poorhouse or workhouse. They never succeeded in getting such "indoor" relief to account for half of their budget, or for half of the recipients covered. Still, to the extent that relief was given indoors, its administrative costs were a high share, often 25 percent, of the total amount spent. The reason was simply that the poor had to be policed and completely provided for. By contrast, once democracy and prosperity and other changes made society more willing to give aid to people in their own homes, with minimal supervision, the administrative costs fell as a share of the amount spent. Stricter regimes are more bureaucratic and more costly.

By the postwar era, program-operating costs have fallen to almost-negligible levels in the high-income OECD countries. So say not only data on programs for the poor, but especially the data on pension programs. International data on pension

support programs show that administrative costs are less than 3 percent of the pension-program budget in all high-income countries, and often below 1 percent. As if to re-wind history in a global cross section, the cost burdens are much higher for the public pension systems of developing countries, partly because they are not universal, but are rather narrow not-so-contributory programs redistributing in favor of the public sector itself.³⁰

In the health sector, there is a similar cost contrast, though it shows up as a contrast between two mixed systems, rather than a contrast between purely public and pure private. The best-documented contrast is that the somewhat-more-private health care system of the United States has administrative and overhead (i.e. bureaucratic) costs that are far above those in the universal insurance countries of Canada and Germany, on a per capita basis.³¹

The same relative efficiency of public over private social programs is suggested by today's rough administrative cost shares for private charities, which tend to be higher than the 3 percent for public pensions and broad public assistance programs. For example, in 2010 the administrative cost burden took about 8 percent of current outlays for the American Red Cross, and some large part of the 13.7 percent taken by "Program and administrative expenses" at the Bill and Melinda Gates Foundation. A higher bureaucratic burden seems evident for United Way, given that "general, administrative, and fundraising" support services took 10.0 percent, and expenses for "Brand Leadership and Campaign and Public Relations" took another 17.2 percent in 2010. Some of these accounting categories might mix some true grant aid in with the administrative burden, but the latter's share would probably still be well above the public programs' cost burden.³² The most likely reasons for these cost differences are that the more private institutions must invest more in screening applicants, and must operate on a smaller scale because of limitations on donor generosity.

While operating costs were gradually being reduced by the expansion of public social programs, discrete shocks in the twentieth century shifted tastes toward universal social insurance and social assistance. Above all, the two World Wars and the Great Depression of the 1930s heightened the public sense of shared downward risk, and promoted new bonds of social affinity. For the United States and for Sweden, the

history of the “welfare state” was launched in the peacetime context of the 1930s. Yet for most of Western Europe, the two World Wars seemed to have played a bigger role in ushering in the modern welfare state. World War II also brought a revolution in the social thinking of the Roman Catholic Church. Before the war the Church had been a bulwark of conservatism, opposing state intervention into social insurance. After the war, it began to champion welfare state provision to those in need.³³

While state fiscal capacity, the spread of political voice, the rising efficiency of broad-based social programs, and the shocks of World Wars and Depression dominate our explanations of *when* public social spending accelerated, other forces must be introduced to explain *where* it accelerated. A frequently noted influence is racial, ethnic, and religious fractionalization. As noted earlier, it makes theoretical sense that whatever erodes social affinity can block the use of the public sector as a means to alleviate hardship. The degree of fractionalization shows statistical power as a negative determinant of public social and infrastructure programs, e.g. among African states, or among states of the United States, or in the contrasts among core OECD countries, once one has controlled for income levels and other variables.³⁴ Still, its power in explaining differences between countries is not so robust. Consider the contrast between two countries that fail to conform to the usual negative association of ethnic fractionalization with public social spending. Korea has an ethnically homogenous population, yet makes very little use of the public sector to lift up the poor. Belgium is the opposite kind of outlier, having a bitter and nearly even split between Flemish- and French-speaking populations, yet with a generous welfare state.³⁵ Such outliers are common enough that history refuses to offer a simple negative correlation between ethnic fractionalization and public social spending. Only when income and other variables are held constant does the negative relationship show up. It is possible that a rise in ethnic divisions caused by rising immigration will erode some countries’ political support for universal entitlements.³⁶

V. Gray Power, Mission Shift, and Efficiency Stagnation

Thus far, the rise of tax-based social insurance and assistance seems like a success story, capturing large gains in GDP as well as greater income security. That success featured different kinds of social spending in different countries. Some, particularly the United States, achieved the growth effects mainly through public education, while European welfare states achieved relatively greater gains through improved public health and safety nets for the poor.

Since about the 1960s, however, the further expansion of government social budgets changed focus, drifting away from the human investments with the greatest GDP gains and toward support for the elderly and the middle classes, with effects on GDP that are more neutral so far. This section charts the mission shift, first viewing the locus of its success, then examining its fingerprints in terms of social expenditure behavior, and finally conjecturing about its efficiency consequences and implications for the future.

Since the 1960s, poverty rates have been reduced much more for the elderly than for children or persons of working age. Figure 5 shows this for the United States, and Table 5 shows the same for averages over groups of OECD countries. In the United States since the 1960s, poverty declined dramatically for those over 65 but not for children. In larger groupings of OECD countries, we see a clear divide around age 50. All age groups up to 50 years of age experienced an increased poverty share relative to the population as a whole, while those above 50 shifted out of poverty faster than the whole population.

The drift toward lowering poverty rates more for the elderly than for children and those in working age is clearly tied to a bias in expenditure policy, particularly in certain countries. To show this, one needs to avoid just examining social expenditures as shares of GDP, which can be driven by the age group shares of total population. A more telling kind of expenditure measure is a relative support ratio, dividing (social expenditures on the elderly *per elderly person*) by (social expenditures on the young *per young person*). Such a ratio should be above unity, of course, since the average dependency ratio is higher for those over 65 than for younger age groups. We can compare the same ratio across countries to detect

outliers. Calculating such ratios takes some work, but fortunately much of the work has been done for us already. Figure 6 shows some of Julia Lynch's calculations of such an inter-age-group support ratio, graphed against the overall social spending share.³⁷ The bulk of countries in Figure 6 have similar inter-age-group ratios, whether they are high-budget welfare states like France and Sweden, or lower-budget states like Australia, Ireland, or Canada. There are four outliers, however, all of them having social expenditures that tilt heavily toward the elderly: Japan, the United States, Italy, and Greece. For the United States one immediately thinks of the fact that Social Security and Medicare, both concentrating on Americans over 65 years in age, are more generous than public support for the poor of working age. Yet the outliers are not extreme in the generosity of their support for the elderly themselves, as defined by (social expenditures on the elderly per elderly person) / (GDP per capita). Rather they stand out because they give so little to those of working age and to children.

To reinforce the connection between the social expenditure bias measures and degrees of success in curing poverty, let us consider a different data set including additional countries omitted from the Lynch study. Figure 7 draws on an OECD study comparing poverty among those of working age with the social expenditures that are specific to working age. Our four outliers from Figure 6 – Japan, the United States, Italy, and Greece – again occupy one end of the spectrum, now joined by Mexico, Korea, Turkey, and Canada. This group of countries has the lowest willingness to invest a share of GDP in people of working age, with the result that they have some of the highest poverty rates for that 18-64 age group. Again, their distinguishing fingerprint is their low willingness to invest tax money in the young and the middle-aged, not their treatment of the elderly. A related OECD diagram showing the poverty and spending rates for the elderly shows no revealing differences.³⁸

Is the relative underinvestment in those under the age of 65 something costly in terms of GDP? The answer depends on the social-budget counterfactual one chooses to pose. Here are the leading candidates:

Counterfactual A: Take some of the government money spent on the elderly, and shift it toward the leading kinds of social programs for children and those of working age (education, preventive out-patient health care for the children, worker retraining, etc.).

Counterfactual B: Privatize pensions, reducing taxes and mandating individual savings accounts for old age.

Thus far the text has implied that we are comparing actual practice with Counterfactual A, and for this comparison the answer is clearly yes, the bias in favor of the elderly is clearly costly in terms of GDP. That is evident from the simple fact that investing in human development brings a higher return, the earlier the stage of cognitive and career development. The importance of this point has recently been underlined in the writings of Pedro Carneiro and James Heckman, among others, finding that even among children, the rate of return is higher, the earlier the child age at which parents and society intervene.³⁹

By contrast, comparison of actual practice with Counterfactual B suggests no clear difference in GDP. For all we can tell from twentieth-century data, individual saving and tax-financed saving can yield the same GDP result with appropriate adjustments of parameters in programs targeting the elderly. One might note that universal programs like Social Security in the United States are administered with lower bureaucratic costs and lower default risk than private pension plans or individual investments. On the other hand, there is reason to fear that the political process would underfund public pensions. Twentieth-century panel data have not allowed us to deny that there is a zero net effect on GDP from choosing public pensions over mandated private individual pensions. Thus the historic drift toward funneling tax money to the elderly either has cost GDP or not, depending on whether one wants to consider Counterfactual A or Counterfactual B.

If there is no clear gain in GDP from shifting social insurance and assistance toward the elderly, why have so many societies done it? The answer seems to be gray power. In the postwar democracies, an ever-greater population share consists of the elderly plus those approaching old age, and the elderly have a relatively high

participation rate in politics. They have succeeded in gaining intergenerational transfers, with or without a net effect on GDP.

Yet something has to give in the twenty-first century, as many have long warned. Those over the age of 65 will go on rising as a share of the adult population, just as they have done over recent centuries. The ratios of the elderly to those of working age are rising most ominously in East Asia and Italy, but no country is exempt. The main reason is simply the upward march of senior life expectancy. The natural solution of having people work to later ages, to hold fixed the share of their adult lives spent at work, has been undermined by a decline in the average age of male retirement, though this has historically contributed less to the lengthening of retirement than has the improvement in life expectancy.⁴⁰ As some have argued, countries need to devise ways to prevent a rise in taxation on behalf of pensions (and elderly health care) by indexing each cohort's annual pension benefits to its senior life expectancy. Sweden's "notional defined contribution" pension system has that desirable feature, though Sweden – like other OECD countries – is still groping for solutions on the elderly health care front.⁴¹

VI. Summary

While the history of private and public behavior toward social insurance and social assistance has only begun to be written on the global level, this essay found it easy to pick some low-hanging fruit, in the form of links between economic theory and an economic history featuring North Atlantic experience. An obvious next task is to break out of the confines of European and North American experience, plunging into the history of non-family social insurance and social assistance in other continents.

Private insurance and charity appear to have advanced slowly to modest levels, helped by the rule of law and income growth. Private giving has not been

crowded out by the rise of public aid, because it has always fit the “warm glow” model better than the altruism model of caring about the aggregate conquest of need.

This essay suggests some tentative summary judgments on the history of efficiency in the provision of social insurance and social assistance. Throughout history, and still today, many opportunities for growth-enhancing provision have been sacrificed by both sectors. Those opportunities are revealed by high rates of marginal return on several fronts, particularly investments in human capital formation. The private sector faces daunting problems of free-riding problem in assistance, asymmetric information in some voluntary insurance markets, and above all the inability to enforce long-term lending contracts that would repay private lenders for investments in human capital. The public sector faces daunting problems of organization, free riding, and the concentration of voice into special interest groups whose objectives conflict with maximizing social efficiency.

The rise of public social insurance and assistance was held back for millennia until the arrival of state fiscal capacity plus the spread of mass political voice. Together these opened the door to lower-cost, more efficient, less bureaucratic public provision. The rise of universal tax-based education and health has brought great gains in GDP, and early poor relief may have done so too. Yet from the 1960s on, the further expansion of social spending has wandered away from its pro-growth egalitarian social targets toward relative under-emphasis on aid to the young and over-emphasis on aid to the elderly. Something has to give in the rapidly aging societies of the twenty-first century.

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Table 1. Theoretical Influences on Social Insurance and Social Assistance

Social insurance (outside the family)

Supply of private insurance services
 Transactions costs (-)
 Unit operating cost net of taxes (-),
 reflecting input prices and information
 Private after-tax incomes, net worth (+)

Supply of public tax-financed insurance services
 Transactions costs, free riding (-)
 Operating cost net of taxes (-), reflecting
 input prices, technology, state fiscal capacity
 Private after-tax incomes, net worth (+)

Groups' demand, or "need" for insurance
 Efficient need (e.g. capital constraints (-))
 Rising perceptions of risk, due to macro
 shocks (+) Moene-Wallerstein (2001)

Groups' political "voice" demanding insurance
 Changes in franchise, lobbying institutions
 Social affinity (+) Benabou (2000)

Social assistance (grants, tax breaks) for need

Supply of private philanthropy
 Transactions costs, free riding (-)
 Unit operating cost net of taxes (-),
 reflecting input prices and information
 Private after-tax incomes, net worth (+)
 Tastes (warm glow, altruism, social affinity)

Supply of public tax-financed assistance
 Transactions costs, free riding (-)
 Operating cost net of taxes (-), reflecting
 input prices, technology, fiscal capacity
 Private after-tax incomes, net worth (+)

Groups' demand, or "need" for assistance
 Efficient need (e.g. capital constraints (-))
 Rising perceptions of risk (+), due to macro
 shocks (+), income of poorest groups (-)

Groups' political "voice" demanding assistance
 Changes in franchise, lobbying institutions
 Social affinity (+)

Table 2. Church and Private Charity for the Poor, as Shares of National Product in the 18th and 19th Centuries

(1) Netherlands 1790, estimated private and church aid	= 0.67-1.49% of GNP
(2) Churches in France, 1790	≤ 0.17 % of GNP
(3) England and Wales charities 1819-1837	≤ 0.40% of GNP
(4) England and Wales charities 1861-1876	≤ 0.10% of GNP
(5) Charities in Italy 1868	≤ 0.50% of GNP
(6) Church and private charity in France 1880	≤ 0.50% of GNP

For sources and notes to the tables and figures, see Appendix A.

Table 3. Recipients' Philanthropy Revenues, United States 1927 and 1970

	(Percentages of GDP)	
	<u>1927</u>	<u>1970</u>
Total	1.52	1.74
Religious organizations	0.81	0.66
Parochial schools	0.16	0.14
Higher education	0.22	0.24
Youth services, welfare, race relations	0.10	0.20
Hospitals and health	0.06	0.23
Other	0.06	0.27

Table 4. Private and Public Social Expenditures as Shares of GDP, 2007

	Private social expenditures		Public social expenditures				
	<u>Mandatory</u>	<u>Voluntary</u>	<u>Total public</u>	<u>Pensions</u>	Working-age	Health	<u>Other</u>
					<u>income support</u>	<u>services</u>	
Australia	0.5	3.3	16.0	3.4	4.0	5.7	2.9
Austria	0.8	1.0	26.4	12.3	5.3	6.8	2.1
Belgium	0.0	4.7	26.3	8.9	7.2	7.3	3.0
Canada	..	5.3	16.9	4.2	2.5	7.0	3.2
Chile	1.2	..	10.6	5.2	0.9	3.7	0.9
Czech Rep.	0.2	0.2	18.8	7.4	4.4	5.8	1.2
Denmark	0.2	2.3	26.0	5.5	7.0	6.5	7.0
Estonia	..	0.0	13.0	5.2	3.1	4.0	0.7
Finland	..	1.1	24.9	8.3	6.0	6.1	4.6
France	0.3	2.6	28.4	12.5	4.6	7.5	3.8
Germany	1.1	1.8	25.2	10.7	4.0	7.8	2.7
Greece	..	1.5	21.3	11.9	2.0	5.9	1.6
Hungary	..	0.2	22.9	9.1	5.3	5.2	3.2
Iceland	1.6	3.6	14.6	1.9	3.7	5.7	3.2
Ireland	..	1.5	16.3	3.6	5.3	5.8	1.6
Israel	..	0.5	15.5	4.8	4.0	4.3	2.3
Italy	1.6	0.6	24.9	14.1	2.8	6.6	1.4
Japan	0.6	3.1	18.7	..	..	..	..
Korea	0.6	2.0	7.6	1.7	0.8	3.5	1.5
Luxem	0.3	0.7	20.6	6.5	5.7	6.4	2.1
Mexico	..	0.2	7.2	1.4	0.9	2.6	2.3
Netherlands	0.6	6.3	20.1	4.7	5.3	6.0	4.1
NZ	..	0.4	18.4	4.3	5.1	7.1	1.9
Norway	1.2	0.8	18.4	4.3	5.1	7.1	1.9
Poland	..	0.0	19.8	10.6	3.5	4.6	1.1
Portugal	0.4	1.5	22.5	10.8	4.0	6.6	1.1
Slovak Rep.	0.1	0.8	15.7	5.8	3.5	5.2	1.1
Slovenia	..	1.0	20.3	9.6	3.9	5.6	1.1
Spain	..	0.5	21.6	8.0	5.1	6.1	2.4
Sweden	0.4	2.5	27.3	7.2	5.6	6.6	8.0
Switz	7.2	1.1	18.5	6.4	4.3	5.6	2.2
Turkey	..	..	10.5	..	..	..	..
UK	0.8	5.0	20.5	5.4	4.5	6.8	3.8
USA	0.3	10.2	16.2	6.0	2.0	7.2	1.0
OECD	0.6	1.9	19.3	6.9	4.0	5.8	2.5

Table 5. Relative Risks of Poverty, by Age of Individuals in the OECD, mid-1970s to mid-2000s

Poverty rate of the entire population in each year = 100

		Below 18	18-25	26-40	41-50	51-65	66-75	Above 75
OECD-23	Mid-1980s	110	95	78	70	93	134	190
	Mid-1990s	116	112	83	69	83	115	169
	Mid-2000s	119	127	85	77	80	99	144
OECD-7	Mid-1970s	84	113	61	66	119	180	214
	Mid-1980s	115	120	78	64	87	120	178
	Mid-1990s	116	143	81	61	82	99	149
	Mid-2000s	112	147	86	72	78	95	150

Figure 1. Poor-Relief Expenditures as a Share of National Product, Europe and USA, 1750 - 1880

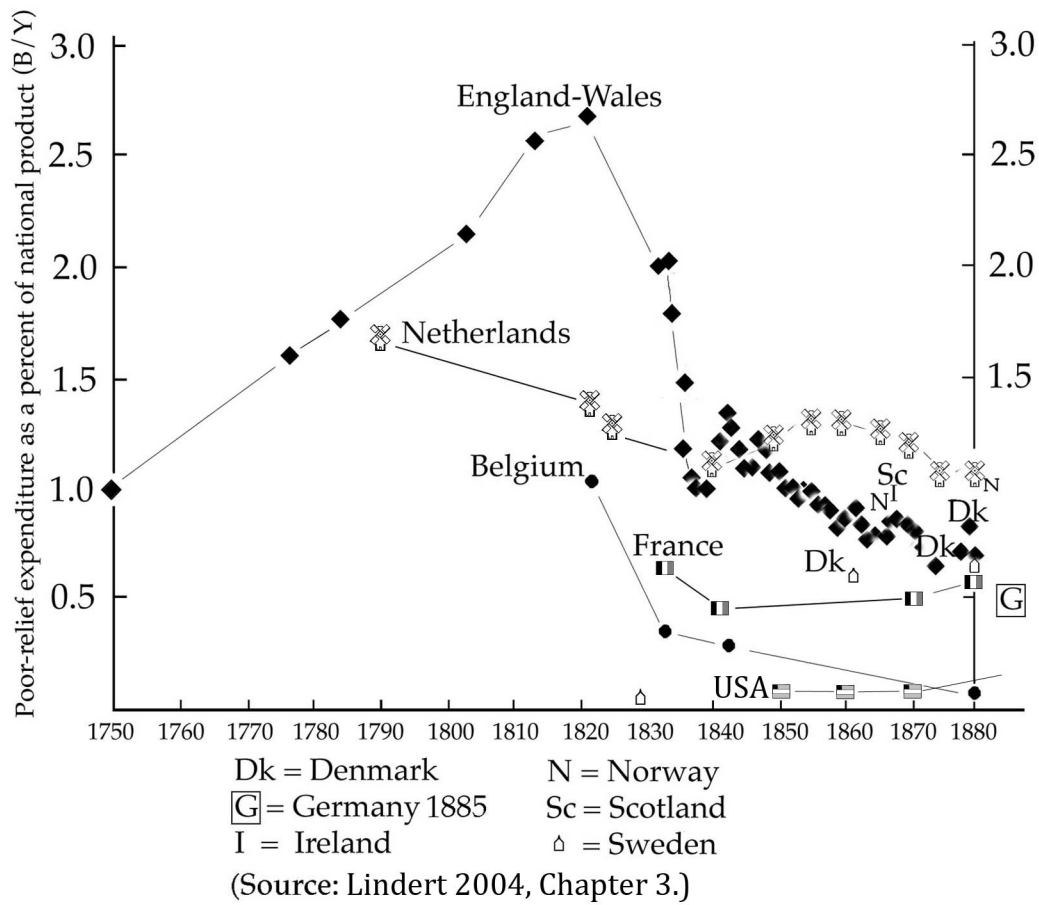


Figure 2. Public and Private Assistance to the Needy in the United States, 1850 - 2009

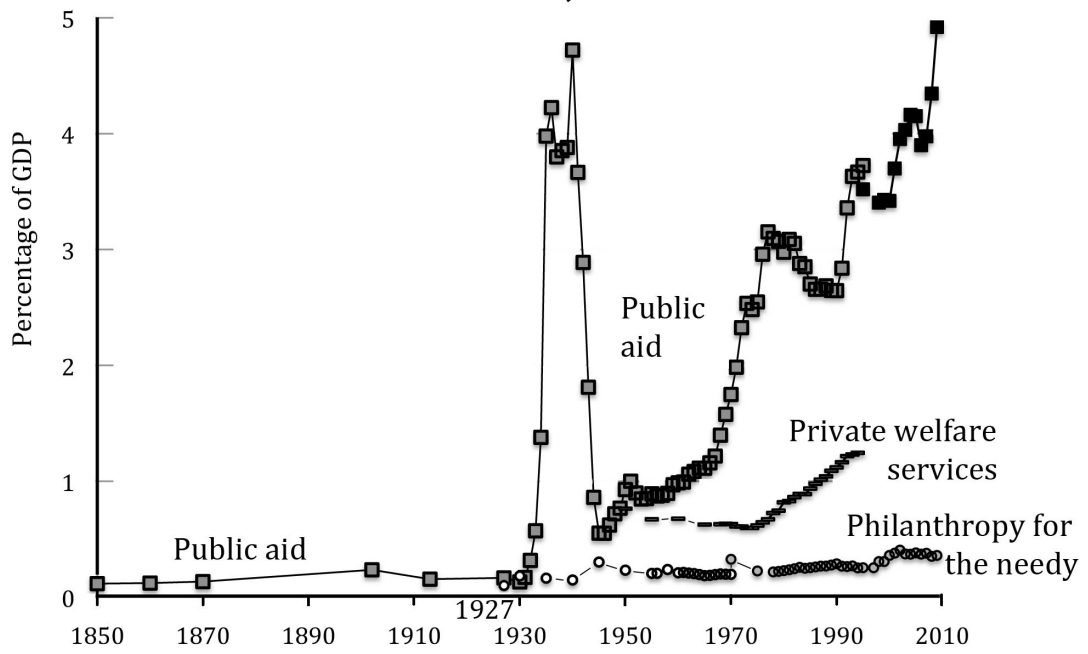


Figure 3. Public Social Spending as a Share of GDP, OECD Countries 1880 - 2011

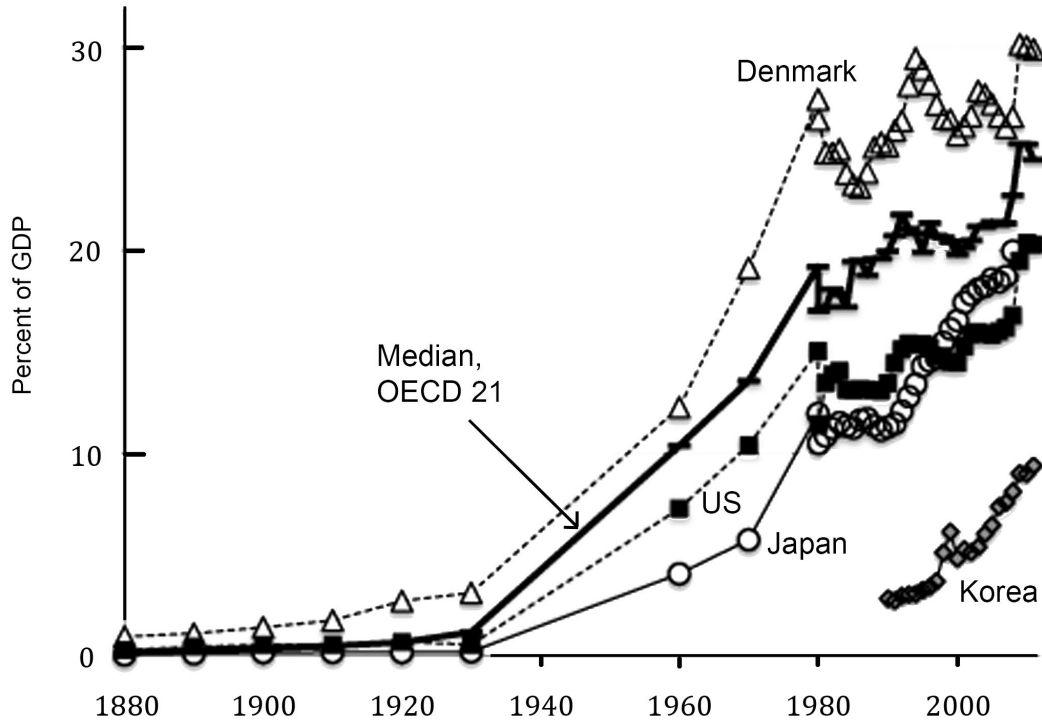


Figure 4. Tax Collection Costs as a Percentage of The Amounts Collected by Central Government, US and UK, 1787/96 - 2011

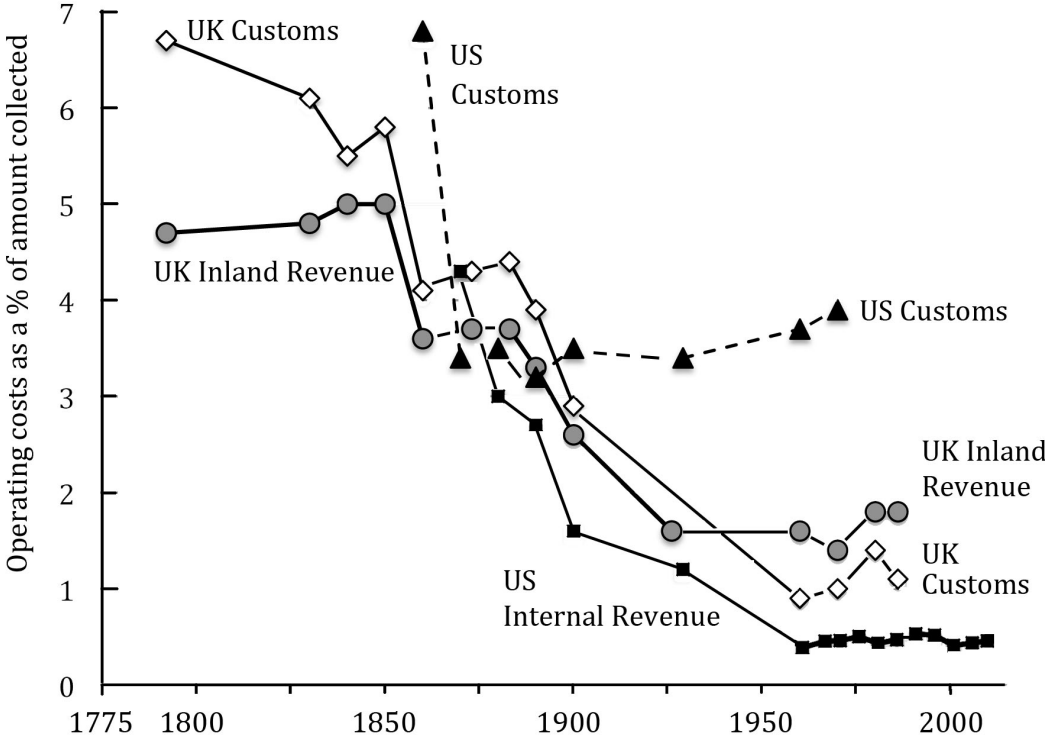


Figure 5. Poverty Shares among the Old and the Young, U.S. 1959 - 2010

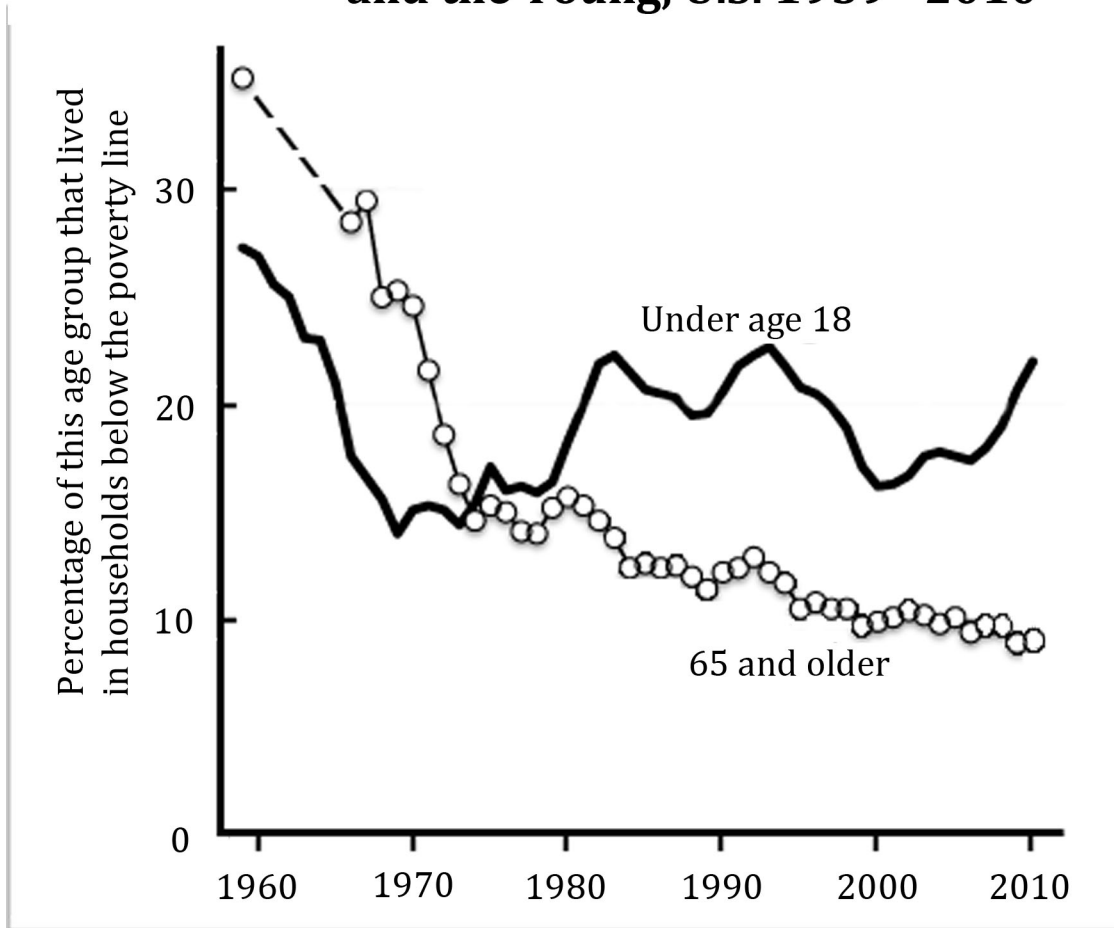


Figure 6. Bias toward the Elderly in Public Social Spending, 1985 - 2000

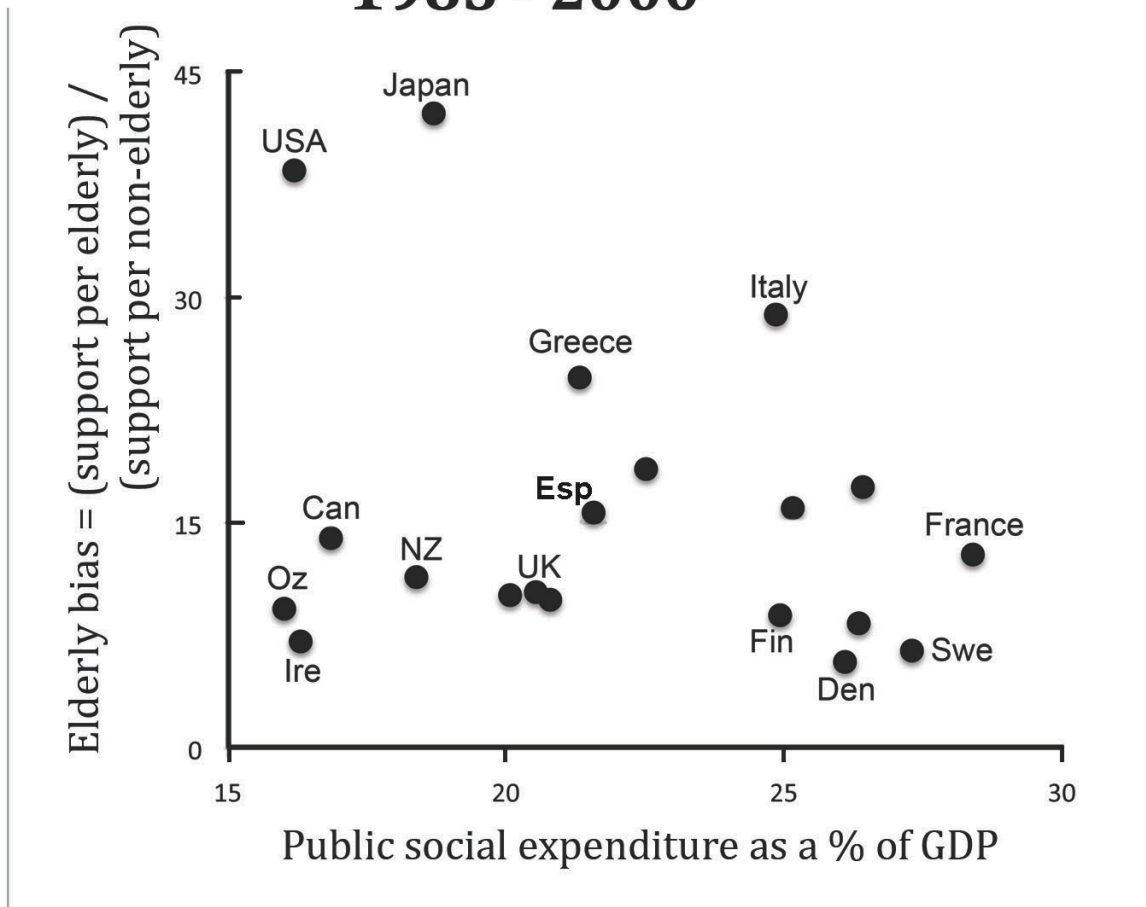
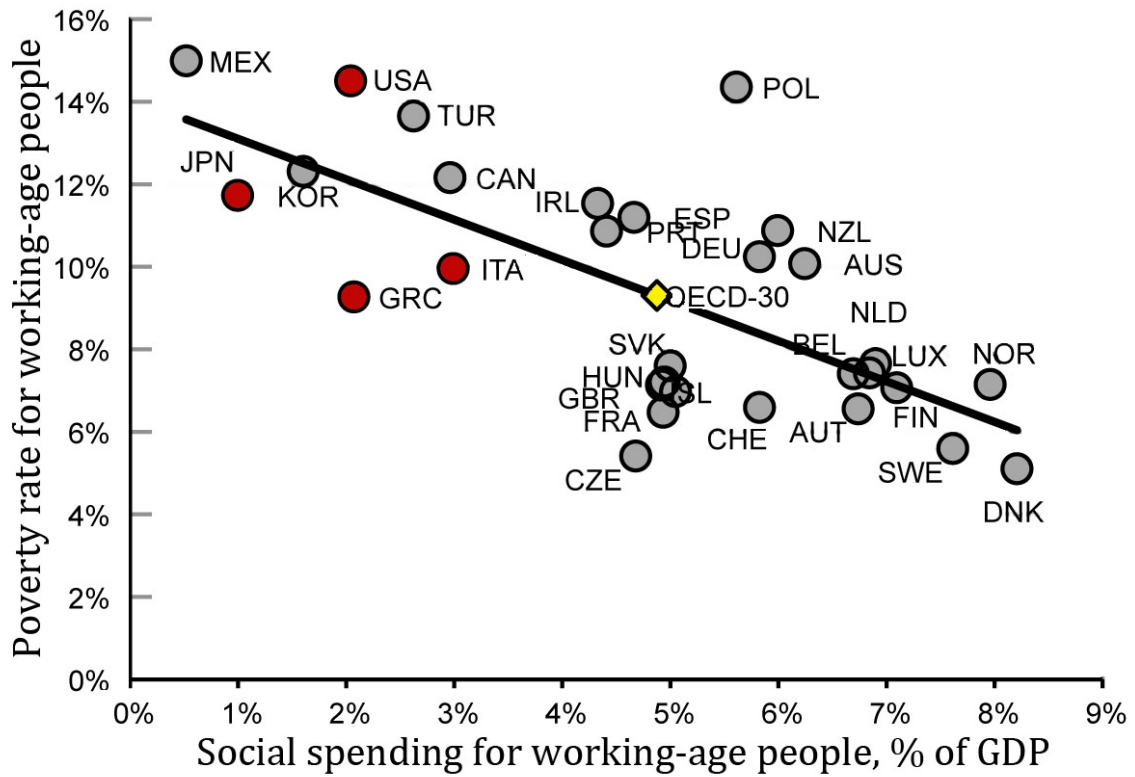


Figure 7. Social Spending vs. Poverty Rate, People of Working Age, c2005



APPENDIX A. Notes to Tables and Figures

Sources to Table 2: Lindert (1998, pp. 103-108) and the sources cited there.

Sources and notes to Table 3:

Source = Professor Ralph L. Nelson's contribution to U.S. Census Bureau, *Historical Statistics of the United States, Bicentennial Edition* (1976), series H398-H411. For slightly different estimates, see Census Bureau, *Statistical Abstract of the United States* (1973 edition, Table 510).

Sources and notes to Table 4:

Source = Adema, Willem, Pauline Fron, and Maxime Ladaïque. 2011, pp. 21, 24.
Note that this OECD definition excludes expenditures on education.
20-country correlation of total private spending shares with total public = -0.19.

Sources and notes to Table 5:

Source = OECD, *Growing Unequal* (2008, chapter 5, Figure 5.5), updated 12 September 2008.
OECD-23 is the average of poverty rates across all OECD countries except Australia, Belgium, Iceland, Korea, Poland, the Slovak Republic and Switzerland.
OECD-7 is the average for Canada, Finland, Greece, the Netherlands, Sweden, the United Kingdom and the United States. Data for mid-1980s refer to around 1990 for the Czech Republic, Hungary and Portugal; those for the mid-2000s refer to 2000 for Austria, Belgium, the Czech Republic, Ireland, Portugal and Spain (where 2005 data are not comparable with those for earlier years). Data based on cash income.

Source for Figure 1:

Lindert (2004, volume 1, Chapter 3).

Sources and notes to Figure 2:

"Public aid" = Poor relief, 1850-1870: US Superintendent of the Census, *Compendium of the Ninth Census* (1872), pp. 530-537. These figures probably include some public subsidies to private charities.

All public expenditures (federal, state, and local), 1902-1970: *Bicentennial Hist. Stats.*, Series Y533-Y566.

GNP in current prices: Carter *et al.* (2006), Series Ca10, collated by Richard Sutch.

For alternative estimates of public welfare, health-sanitation, and education for 1890, 1902, 1913, and later dates, see Musgrave and Culbertson (1953, pp. 114). The Musgrave-Culbertson estimates were used in Lindert (1994).

Further footnote on public aid 1995-2009 =

The Census Bureau's own footnote explains:

"Consists of federal benefits (food stamp benefits, Supplemental Security Income, direct relief, earned income credit, payments to nonprofit institutions, aid to students, and payment for medical services for retired military personnel and their dependents at nonmilitary facilities) and state benefits (Medicare care, Aid to

Families with Dependent Children, Supplemental Security Income, general assistance, energy assistance, emergency assistance, and medical insurance premium payments on behalf of indigents). Financed from state and federal general revenues.”

Private philanthropy for the needy, alternative series =

(a.) For 1930-1970, featuring “Youth services, welfare, race relations” expenditures: Bicentennial HSUS, Series H405-H411.

For 1955, 1960-2009, the Giving USA series, with these changing series:

(b.) “welfare” for 1955, 1960-1962, but not usable for 1963-1967 because it lost health expenditures for the “welfare” population;

(c.) “human resources (welfare)” for 1964-1975, now excluding donations to welfare agencies for health spending;

(d.) “social welfare” for 1960, 1965, 1970, 1973-1981;

(e.) “Human service” and “public/social benefit” for 1970, 1975-2009.

Private welfare services =

Private social expenditure, welfare services (*Historical Statistics of the United States*, 2006). Not specifically targeted at those below the poverty line, or those with disabilities.

Sources and notes to Figure 3:

Sources = Lindert (1994), OECD (1985), OECD Social Expenditure Database.

The series excludes expenditures for public education.

The OECD made a series change at 1980, resulting in a drop in the median expenditure share by 2.2% of GDP.

Sources and notes to Figure 4:

United States, two main revenue agencies: The cost percentages up through 1960 are five-year averages calculated from the annual reports of the U.S. Secretary of the Treasury. Those for 1966-2011 are annual figures published in the *IRS Data Book's* online archive at <http://www.irs.gov/taxstats>. I am indebted to Joel Slemrod of the University of Michigan for pointing out this continuation of the IRS series.

United Kingdom, main revenue services: Figures for years before World War I divide the official estimates of collection costs by gross receipts, while those after World War I divide it by what are called “net receipts.” The change in official convention matters little, since adding the collection costs themselves to the denominator would change the ratio by only about one percent of itself.

For 1787-1796: The figures are calculated from *The Fourth Report* of Great Britain, Select Committee on Finance, 19 July 1797. The collection costs are described only as the “charges of management” on the “collection of revenues,” and are compared to gross receipts. For 1830-1860: The main source is a special return in House of Commons, *Sessional Papers*, 1862, vol. xxx, 601. Each figure from this source refers to the single fiscal year starting in the year listed. However, the customs percentages for 1840, 1850 and 1860 are five-year averages centered on that same fiscal year. For 1873-1900: Annual Reports of the Commissioners of

Customs and Inland Revenue. The figures for Inland Revenue are again single-year figures for fiscal years starting 1 April, and those for the Customs service are five-year averages centered on that year. The customs figures for years between 1855/6 and 1876/7 had to be adjusted upward, to correct for the temporary exclusion of the Coast Guard costs. For 1926-1986: Single-year figures are calculated from the Annual Reports of the Customs Commissioner and the Commissioner of Inland Revenue.

Figure 4 graphs a Customs series and an Inland Revenue series for the United Kingdom as if they were consistently defined throughout. That is, the figure ignores the fact that excises were shifted from the Inland Revenue series to the Customs (and Excise) series between the 1900 data point and the 1926 data point.

Source for Figure 5 = <http://www.census.gov/hhes/www/poverty/data/historical/people.html>, accessed 31 December 2011.

Source for Figure 6 = Lynch (2006). For similar figures covering 1980, 1985, and 1993, see Lynch (2001).

Sources and notes to Figure 7:

Source: OECD, *Growing Unequal* (2008, p. 143), using computations from OECD income distribution questionnaire and OECD Social Expenditure database (SOCX). Note: Poverty rates based on a threshold set at half of median household disposable income. Social spending includes both public and mandatory private spending in cash (i.e. excluding in-kind services). Social spending for people of working age is defined as the sum of outlays for incapacity, family, unemployment, housing and other (i.e. social assistance) programs; social spending for people of retirement age is the sum of outlays for old-age and survivors benefits. Social spending is expressed in percentage of GDP at factor costs. Data on poverty rates refer to the mid-2000s for all countries; data for social spending refer to 2003 for all countries except Turkey (1999).

From its age-group analysis, the OECD report infers (2008, p. 143-144) that “While this pattern reflects the earnings-related nature of old-age pensions in most OECD countries, it also suggests that larger inroads into reducing poverty could be achieved by redirecting spending from pension programmes towards programmes targeted to people of working age and their children at the bottom of the income scale.”

ENDNOTES

¹ Among the many ways that economists modify GDP to make it a better measure of wellbeing, one in particular must be borne in mind throughout this essay. Private individual giving, as distinct from employer-based or tax-based transfers and insurance, is a form of consumption that delivers utility directly to the individual giver. Its monetary component could be counted as part of consumption, though national income accounting considers it a transfer payment rather than a payment for productive services. Donations of volunteer time could also be valued as consumption on the part of the volunteer, though this too is omitted in conventional accounting.

² The official OECD definition of social expenditures is as follows: “The provision by public and private institutions of benefits to, and financial contributions targeted at, households and individuals in order to provide support during circumstances which adversely affect their welfare, provided that the provision of the benefits and financial contributions constitutes neither a direct payment for a particular good or service nor an individual contract or transfer.” Adema, Fron, and Ladaïque (2011, p. 90).

³ See the broad inclusive measures offered by Adema (1997); Fishback (2010); Garfinkel, Rainwater, and Smeeding (2010); and Adema, Fron, and Ladaïque (2011).

⁴ Again, as with the broader social spending concept, the narrower and more targeted concept will either include or exclude expenditures on education, depending on the context.

⁵ In this essay we focus on expenditures of money and commodities, and not the donor’s time spent. This again allows us to focus on those resource transfers that are more controversial. For global data on the less controversial giving of volunteers’ time, see Charity Aid Foundation (2010) and Giving USA (2010).

⁶ Prados, “Capitalism and Human Welfare”, chapter 17 in this volume (Figures 8-9) notes the strong, though declining, international correlation between his broad welfare measure and the share of social transfers in GDP. The historical parallels between social spending and conventional measures of wellbeing are developed more fully in his background paper (Prados 2013).

⁷ On transactions costs and institutional barriers to setting up private businesses and government institutions more broadly, see North (1981, 1990). On the free rider problem and its possible solutions, see Olson (1965), and the textbook summaries in Musgrave and Musgrave (1989), Stiglitz (2000), and especially Gruber (2005, Part II).

⁸ Karlan and List (2007, 2012) offer experimental evidence of the power of matching grant offers by large donors. They theorize that part of the power might come from small donors’ feeling assured that large donors can monitor the charity’s behavior more effectively.

⁹ See Bird (1971). The original reference is Adolph Wagner’s *Grundlegung der Politischen Ökonomie* (1863).

¹⁰ See Andreoni (1988, 1990, 2006) and Andreoni and Payne (2011).

¹¹ Rotemberg (2011), Andreoni *et al.* (2011). Of course, the effect of income inequality on private giving can be sensitive to the tax structure. If tax deduction

rates for charitable contributions rise steeply enough with income, then greater inequality of pre-tax income could raise charitable giving.

¹² For a theory of political pressures emphasizing social affinity as the basis for redistribution, see Kristov *et al.* (1992). For empirical verification of the negative effects of ethnic fractionalization on public social and infrastructure spending, see Easterly and Levine (1997), Alesina *et al.* (1999), Alesina and Glaeser (2004), Dahlberg *et al.* (2012).

¹³ Van Leeuwen (2000, 2012). The larger guilds also combated the potential problems of adverse selection by compelling members to pay fees that helped finance the insurance pool.

¹⁴ Lindert (2004, volume 1, pages 40-45). Of course, the amounts given would be higher shares of donor incomes than of national incomes. The national income denominator is used here because it is more available, and because shares of national income suggest the limited extent of overall redistribution and of poverty reduction.

¹⁵ Clark *et al.* (2003 Chapters 2-3).

¹⁶ See Lindert (1998 and 2004, volume 1, chapters 1, 3, and 5).

¹⁷ See Carter *et al.*, (2006, Series Cd44, Cd48, Cd206, and Cd214).

¹⁸ Williamson and O'Rourke, Chapter 1 of this volume.

¹⁹ Reynolds and Smolensky (1977), Baldwin (1990).

²⁰ The one possible exception is the Soviet Union up to 1930, on which we lack sufficient data on social expenditures.

²¹ The text says "non-European and non-Communist" to allow for the exceptional case of Cuba.

²² This argument must remain rough and tentative, of course. The income and price elasticities of private charitable giving are exceedingly hard to identify statistically. Even for the United States today, where we have a rich database, it is hard to extract exogenous measures of income or after-tax price, in part because the income tax deduction for charitable giving is a price effect directly tied to income itself. For a thorough discussion of the difficulty of measuring income and price elasticities of giving see Andreoni (2006, pp. 1233-1258).

²³ This section's treatment of the history of public primary education draws on Go and Lindert (2010) and Lindert (2010).

²⁴ Dincecco (2011), Dincecco and Katz (forthcoming).

²⁵ For the evidence linking nutrition with health and labor supply for the poor of England and France, see Floud *et al.* (2011, pp. 125-225). We should add a further pair of links, from poor relief to fertility, and from fertility to labor supply. Boyer (1989) has shown statistically that England's poor relief facilitated fertility, thus further increasing the labor supply in the long run.

²⁶ Williamson (1990, pp. 276-298).

²⁷ The developments sketched here parallel those described as the arrival of "new alternatives to liberal capitalism" in the chapter in this volume by Jeffrey Frieden and Ronald Rogowski.

That elites with entrenched power, free from political competition, will block innovations and investments enhancing economic growth has long been suspected.

For a current theoretical model formalizing this point see Acemoglu and Robinson (2006).

²⁸ For the chronology of the spread of voting rights and voter turnout, see Flora *et al.* (1983) and Mackie and Rose (1991, 1997). For the issues of public social spending and the taxes to pay for it, the extent of the franchise seems a more useful measure than the oft-used Polity indices of constraints on the executive and interparty competition.

On the role of electoral voice in schooling, poor relief, and public health before 1930, see Lindert (2004, Chapters 4, 7, 15, and 16), Go and Lindert (2010), and Williamson (1990, pp. 294-298). **The same influence of voting power is documented globally for education spending in the postwar era by Ansell (2010).**

²⁹ Lindert (2004, volume 1, Figure 12.1 and the accompanying text), and again Dincecco (2011).

³⁰ The administrative costs for the US Social Security Administration were 1.6 percent of benefit payments in fiscal year 2012, and are projected as 1.4 percent for fiscal 2013. See www.ssa.gov/budget/2012KeyTables.pdf, and similar for 2013. For the late twentieth century, see Estrin (1988). For the slightly higher cost shares of less universal assistance programs in the early twentieth century, see Gordon (1940).

For the higher administrative cost ratios in developing countries of Latin America, see K. Lindert *et al.* (2006, pp. 76-78).

³¹ Woolhandler (2003, especially p. 771), Reinhardt (2000).

³² For the American Red Cross expenses in 2010, see <http://www.redcross.org/flash/AnnualReport/2010/AnnualReport.html>. For the Bill and Melinda Gates Foundation, see <http://www.gatesfoundation.org/annualreport/2010/Pages/overview.aspx>; and for United Way, see <http://www.unitedway.org/pages/2010-annual-report>; all last accessed 27 April 2012.

³³ Lindert (2004, chapters 7, 16, and 17). In Spain, however, this transition began only in the 1960s, in the second phase of the Franco dictatorship. Up to that time the Church was still Franco's ally against large social programs, with a similar alliance to Salazar in Portugal. Still, in countries threatening to vote for Communists, as in Italy and France, the Church showed more support for social safety nets.

³⁴ Again see Easterly and Levine (1997), Alesina *et al.* (1999), and Alesina and Glaeser (2004).

³⁵ For an explanation of how Belgium forged a social compact in the early twentieth century, providing for social aid despite its divisions, See Huberman (2008, 2012, and this volume).

³⁶ Again see Dalhberg *et al.* (2012), showing that the parts of Sweden more exposed to immigrants now express more doubts about the welfare state.

³⁷ See Lynch (2001, 2006).

³⁸ OECD, *Growing Unequal* (2008).

³⁹ Carneiro and Heckman (2006), and the sources cited there.

⁴⁰ For historical retirement trends from the United States see, for example, Costa (1998) and Lee (1998, 2001). One should also note that the trend toward earlier male retirement has reversed itself in many OECD countries since 2000.

⁴¹ On the need for a tax-rate-capping formula linking pension benefits to survival and elderly labor force participation, and on the Swedish 1998 reform, see Lindert (2004, volume 1, Chapters 9 and 11).