UNITED NATIONS RESEARCH INSTITUTE FOR SOCIAL DEVELOPMENT

DP 68

WHEN MARKETS FAIL: SOCIAL WELFARE IN CANADA AND THE UNITED STATES

by John Myles

June 1995

The United Nations Research Institute for Social Development (UNRISD) is an autonomous agency that engages in multi-disciplinary research on the social dimensions of contemporary problems affecting development. Its work is guided by the conviction that, for effective development policies to be formulated, an understanding of the social and political context is crucial. The Institute attempts to provide governments, development agencies, grassroots organizations and scholars with a better understanding of how development policies and processes of economic, social and environmental change affect different social groups. Working through an extensive network of national research centres, UNRISD aims to promote original research and strengthen research capacity in developing countries.

Current research themes include: Crisis, Adjustment and Social Change; Socio-Economic and Political Consequences of the International Trade in Illicit Drugs; Environment, Sustainable Development and Social Change; Integrating Gender into Development Policy; Participation and Changes in Property Relations in Communist and Post-Communist Societies; and Political Violence and Social Movements. UNRISD research projects focused on the 1995 World Summit for Social Development included Rethinking Social Development in the 1990s; Economic Restructuring and Social Policy; Ethnic Diversity and Public Policies; Social Integration at the Grassroots: The Urban Dimension; and The Challenge of Rebuilding War-torn Societies.

A list of the Institute's free and priced publications can be obtained from the Reference Centre.

United Nations Research Institute
for Social Development
Palais des Nations
1211 Geneva 10
Switzerland

☎ (41.22) 798.84.00/798.58.50
Fax (41.22) 740.07.91
Telex 41.29.62 UNO CH

ISSN 1012-6511

◆ Preface

As part of its programme of work for the Social Summit, UNRISD sponsored an international dialogue on **The Future of the Welfare State**. Under the direction of Gøsta Esping-Andersen, experts on social policy in seven regions of the world were asked to trace the response of different welfare régimes to the challenge of global economic restructuring. Their conclusions were presented in Copenhagen on 8 March 1995, at a conference hosted by the Danish Ministry of Foreign Affairs, and co-sponsored by UNRISD and the Danish National Institute of Social Research.

This is one of the conference papers, dealing specifically with the North American experience. As the author notes at the outset, the model of social policy adopted in Canada and the United States stands at the "liberal" extreme on the continuum of welfare régimes in industrialized market economies. The Scandinavian countries can be considered to lie at the opposite, "social democratic" extreme.

To deal with the challenges of slow growth and increasing international competition during the 1980s and 1990s, Canada and the United States have relied on a low-wage strategy which has been remarkably successful in creating new jobs. At the same time, in the field of social welfare, both countries have followed a policy which John Myles characterizes as "retrenchment": the level of support for disadvantaged groups has declined in real terms, and a number of programmes have been either cut back or phased out over the past few decades.

There are, however, significant differences in the impact of these strategies on the livelihood of low-income families in the two countries. As the author of this study points out, the process of retrenchment began at very different levels of social provision in Canada and the United States. Although labour market inequality increased markedly in both cases (as low wages created larger numbers of the "working poor"), Canadian households were able to offset low earned income through access to a generous system of support, including National Health Insurance. Americans, in contrast, could fall back on only a very modest, largely means-tested, social safety net.

The significant differences in welfare policy which characterize the two countries have grown out of distinct political experiences. In Canada, nation building has required both a centralization of responsibility for income security and development of a common set of national standards in key areas of social provision. There have been important interregional transfers from richer to poorer regions. In the United States, however, the federal system has left decision-making power over eligibility and benefit levels in crucial areas of social policy in the hands of the states. The result has been what Myles calls "fiscal competition among jurisdictions", as each state attempts to spend less than the others on social programmes.

The dynamics of North American economic integration, as well as the strengthening of regional rivalries and concern over the rising public debt, are moving Canadian welfare politics in the direction of US-style fiscal competition. The governments of both Canada and the United States also face enormous revenue constraints. While electoral competition in earlier periods typically took the form of bidding for votes through offering expanded social programmes, in the 1990s parties vie with one another by promising tax cuts.

Myles discusses proposals to "adjust" social programmes to the current low-wage strategy of development, and to reduce welfare expenditures. These include "workfare" (the requirement to work in return for public support); active labour market programmes, providing job training and improvement in the quality of human capital; and "negative income tax" schemes through which subsidies are provided to individuals and households whose income falls below the established minimum.

The latter — which in effect subsidizes low earnings of "working poor" families — is favoured by many employers but has perverse effects. It subsidizes enterprises that pay low wages, thus biasing investment decisions toward technologies and production processes which take advantage of this premium. While employment gains are won in the short term, productivity growth and the expansion of a skilled work force are thus sacrificed in the longer run.

Myles finds it unlikely that North America will be at the forefront of progressive social policy experiments in the near future. In his view, both Canada and the United States suffer not only from a fiscal deficit, but also from a "democratic deficit". He concludes that "the comparative weakness of political institutions able to represent competing social and economic interests [now] makes the search for non-zero sum solutions difficult".

John Myles is Professor of Sociology and Director of the Pepper Institute on Aging and Public Policy, College of Social Sciences, Florida State University. Work on **The Future of the Welfare State** has been co-ordinated at UNRISD by Cynthia Hewitt de Alcántara.

June 1995

Dharam Ghai
Director

◆ Contents

◆ Abbreviations and Acronyms

AFDC	Aid to Families with Dependent Children
C/QPP	Canada and Quebec Pension Plans
CTB	Child Tax Benefit
EITC	Earned Income Tax Credit
FAP	Family Assistance Plan
GI	Guaranteed Income
GIS	Guaranteed Income Supplement
LIS	Luxembourg Income Survey
NIT	Negative Income Tax
NLRB	National Labor Relations Board
OAI	Old Age Insurance
OASI	Old Age Security Income
SSI	Supplemental Security Income
UI	Unemployment Insurance

INTRODUCTION

Like Scandinavia, North America occupies a special place among modern welfare states. Compared with their European counterparts, Canada and, especially, the United States are typically portrayed as welfare state "laggards" (Kudrle and Marmor, 1981). Modern social legislation came later than elsewhere and, when it did, often retained an adherence to traditional "liberal" principles of means-testing and modest social benefits (Esping-Andersen, 1990). North American levels of income inequality are high by international standards (Smeeding, 1991), and until the 1980s unemployment ranged well above European levels (McBride, 1992; Therborn, 1986).

To a much greater degree than elsewhere, twentieth century North Americans have looked to the market as their primary source of "welfare". And for most of this century, they have had good reasons for this view. The resistance by early American labour leaders to European-style social insurance programmes had a real material base. As the American labour leader Samuel Gompers (1910) observed at the turn of the century, the average American city-dweller could hardly imagine the poverty then prevailing among European workers.

For most of this century, Americans have believed in the market because, for many, the market worked. Despite modest social programmes, North American workers enjoyed enviable levels of "welfare" during the "Golden Age" of post-war expansion. With wage levels well above European levels and an expanding economy, North America was still the "land of opportunity". The "great wage compression" of the 1940s and 1950s reduced inequality in the labour market (Goldin and Margo, 1992) and rapid productivity growth brought "middle class" living standards to North American workers and their families (Levy, 1988). An active veteran's administration provided housing programmes, educational allowances and a plethora of other social benefits for a generation returning from war (Amenta and Skocpol, 1988:108). Despite a weak welfare state, unionized and public sector workers won increasingly generous pension, health care and other income security provisions at the bargaining table (Stevens, 1988).

Since the 1970s, all this has changed. By the end of the 1980s North America, and especially the United States, had consolidated its reputation as the "land of inequality". Wage and earnings levels have been stagnant since the 1970s. Workers in the lowest earnings decile in Canada and the United States earn about 40 per cent of median earnings compared to 70 per cent or more in Germany and Scandinavia (see table 1). Labour market incomes have polarized, expanding the ranks of the "working poor".[1]

[1] For the United States, see Levy and Murnane, 1992; for Canada, see Morissette, Myles and Picot, 1994.

Table 1
Earnings inequality (c. 1990), selected countries
(Ratio of lower and upper earnings deciles to the median)

	Canada	United States	Germany	France	Sweden	Norway
D1/D5	.42	.40	.71	.65	.74	.76
D9/D5	1.85	2.22	1.64	1.96	1.54	1.50
Average 5-year change in the 1980s						
D1/D5	-.01	-.03	.03	.01	-.02	.02
D9/D5	.03	.03	.01	.02	.00	.02

Source: OECD, 1993 (table 5.2)

In the United States, "market failure" has resulted in real declines in aggregate social welfare. Family incomes have become more unequal and child poverty has returned to 1965 levels, the year Lyndon Johnson declared America's "War on Poverty". Between 1973 and 1987, the income of the poorest 20 per cent of families fell by 22 per cent while that of the richest 20 per cent increased by 25 per cent (Gottschalk and Danziger, 1993:167).

To date, rising labour market inequality in Canada has been offset by social transfers (Economic Council of Canada, 1991). The final distribution of family incomes and child poverty has scarcely changed since the 1970s (Love and Poulin, 1991; Myles and Picot, 1995). Nevertheless "market failure" has meant a sharp rise in demand for transfers and added to the growth of a public sector debt that is now well above the OECD average (OECD, 1994a:43).

Paradoxically, however, the very weakness of North American labour market institutions and welfare states is now regarded as the reason for the comparative success of both national economies at generating jobs and restraining the growth of long-term unemployment (OECD, 1994b). The low levels of North American labour market regulation, payroll taxes and social benefits are now held out as models of labour market "flexibility" to be emulated by the high-unemployment European economies. As the OECD (1994b:35) remarks, allowing wage differentials to widen could be expected to increase employment growth and North America appears to provide evidence that it does.[2]

But widening wage differentials create a new set of dilemmas for welfare