The Journal of Sociology & Social Welfare

Volume 25
Issue 4 *December*

Article 9

December 1998

A Few Contributions of Economic Theory to Social Welfare Policy Analysis

Michael A. Lewis
State University of New York

Follow this and additional works at: https://scholarworks.wmich.edu/jssw

Part of the Social Policy Commons, Social Welfare Commons, and the Social Work Commons

Recommended Citation

Lewis, Michael A. (1998) "A Few Contributions of Economic Theory to Social Welfare Policy Analysis," *The Journal of Sociology & Social Welfare*: Vol. 25 : Iss. 4 , Article 9.
Available at: https://scholarworks.wmich.edu/jssw/vol25/iss4/9

This Article is brought to you by the Western Michigan University School of Social Work. For more information, please contact wmu-scholarworks@wmich.edu.

A Few Contributions of Economic Theory to Social Welfare Policy Analysis

MICHAEL A. LEWIS
State University of New York
School of Social Welfare

The National Association of Social Workers' (NASW) code of ethics states that social workers have a professional obligation to advocate for social policies that promote the general welfare (NASW, 1996). Presumably, in an effort to provide social workers with the analytical tools that would allow them to do so, schools of social work typically require students to do course work in the area of social welfare policy. Although these courses provide students with valuable information, it is my view that they tend to be limited in one important respect. They usually do not contain a great deal of content on how technical economic theory can be utilized in the examination of many of the social welfare policy issues that are of interest to social workers. This is unfortunate because, despite having limitations of its own, economics provides a powerful set of conceptual tools that are extremely useful in the analysis of social welfare policy issues. The rest of this paper is an attempt to demonstrate the usefulness of economics in this respect.

Competing Ends, Allocation, and Opportunity Cost

Economics is usually defined as the study of the allocation of scarce resources among competing ends. Four terms in this definition need to be explained: *resources, scarcity, competing ends,* and *allocation*. Let's first take a look at resources.

Machines, skills, knowledge, abilities, etc. that are used to produce/provide goods/services are what economists mean by resources. For example, the skills/knowledge of a social worker who provides family counseling are resources.

Scarcity has to do with the relationship between resources and the wants or desires of actors. Economists assume that resources are limited (e.g., there is not an infinite supply of social work skills/knowledge). The wants of actors, however, are assumed

to be unlimited (e.g., our desires for services provided by social workers are infinite). This situation of finite resources and infinite wants is what economists mean by scarcity.

Although scarcity is a core concept in economics (Lewis, 1957) it is my view that it is also one of the discipline's most problematic. To the extent it appears that scarcity exists, it is unclear whether this is due to a situation of finite resources and infinite wants. For example, there are about 40 million individuals in the U.S. who currently are without health insurance (Weiss and Lonnquist, 1997). Presumably, many of these individuals want health insurance but are unable to afford it. It is questionable whether this state of affairs is a result of the U.S. not possessing enough doctors, nurses, hospitals, etc. to meet these wants. Arguably, this state of affairs is more a consequence of *political* decisions than scarcity of resources. There are a number of public financial mechanisms (e.g., income tax increases, corporate tax increases, transfer of federal funds from the defense budget, etc.) that could be used to finance health insurance for these individuals if we had the political will to do so.

Competing ends and *allocation* are other economic terms that need to be explained. As economists see it, actors possess desires, ends, or wants. Some examples of actors are individual persons, families, social service organizations, and the federal government. Let's imagine that there is a single woman who has a two-year old son. She wants to stay home from work so she can raise her son, yet she also wants the goods/services she'd be able to purchase with the money she'd make from working. If this woman decides to stay home, her desire for these goods/services cannot be met. When desires "conflict" as do this woman's, economists think of such desires as competing with one another; hence the concept of *competing ends*. These types of situations require actors to make difficult choices. Our imaginary woman would have to decide whether she wants to indulge her preference for staying home with her son or the one for going to work to make some money. In the language of economics, this woman would have to decide how she is going to *allocate* her time between working and staying at home.

The hypothetical example about the woman is related to another important economic concept. In order to be able to stay

home with her son, the woman would have to forgo the goods/services she'd be able to purchase with the income she'd receive from working. This notion of the need to forgo some things in order to attain others is captured by the concept of *opportunity cost*. In economic terms, the opportunity cost of the woman's indulging her desire to stay home with her son would be the goods/services given up as a consequence of her choice not to work.

From a social welfare policy point of view, a program could be enacted that would provide this woman with an income she did not have to work outside the home to receive. Such a policy could be based on the recognition that raising children is valuable work. If such a program existed, this woman would be able to raise her son *and* obtain some of the goods/services she desires. My intention here is not to argue the merits of such a policy. It is merely to illustrate how the concepts of *opportunity cost, allocation,* and *competing ends* are relevant to the social welfare policy concerns of social workers.

Market Failures

In economic theory, the term *market* refers to a set of sellers and buyers who exchange goods and services. Markets serve as the means by which many of the goods/services produced in our economy are distributed. Those willing and able to purchase specific products at specific prices at specific points in time are allowed to receive those products. Those unwilling and/or unable to do so are not allowed to receive them. One of the primary concerns of policy oriented economists is the following question: under what conditions is government justified in "interfering" with market distribution of goods/services (Stevens, 1993 and Stiglitz, 1988)? This is obviously a question social workers are interested in too, and economists' answers to it constitute some of the most important contributions of economic theory to the examination of social welfare policy issues.

According to economic theory, markets ought to be the sole mechanisms of distribution unless at least one of the following three conditions are met: 1) the good/service in question is a *public good* 2) the good/service generates *externalities* in production or consumption or 3) the market in which the good/service is distributed is characterized by *imperfect information*. Public goods,

externalities, and imperfect information are examples of what economists call *market failures*. When such failures exist, economic theory tells us that governmental actors can justifiably intervene into markets and effect the distribution of goods/services (Stevens, 1993). Let's first take a look at why public goods are thought to justify governmental intervention.

In order to make clear what economists mean by *public goods* and why they think government can justifiably provide them, it is necessary to first discuss the concept of *private goods*. Private goods are goods/services that possess one crucial characteristic: the characteristic of excludability. If one individual consumes a private good, others can be excluded from simultaneously doing so. The excludability characteristic that is associated with private goods means that markets can be relied upon to distribute them. This is because those who value private goods can be excluded from enjoying the benefits of such goods if they are not willing to pay for them (Johansson, 1994).

Let's consider an example. Suppose Jack is wearing a shirt. While he is doing so, no one else can simultaneously wear this shirt. In other words, others can be excluded from the benefits of wearing the shirt while Jack is wearing it. The only ways others could enjoy these benefits would be to buy shirts for themselves or receive shirts as gifts. Thus, those in the business of selling shirts (and other private goods/services) stand a good chance of profiting from doing so because they don't have to worry about the problem of people being able to benefit from wearing shirts without someone having to pay for them.

Public goods are goods/services that are *not* characterized by excludability (Johansson, 1994). The classic example of a public good is a lighthouse. If the crew of one ship consumes the light provided by a lighthouse, other ships' crewmembers cannot be excluded from simultaneously doing so. The crewmembers of ships probably regard the light derived from lighthouses as beneficial to them. Suppose a firm tried to provide lighthouse service through the market, that is to say suppose it tried to charge a fee for this service. Would this firm be likely to profit from this provision? Economic theory predicts that the answer to this question is no.

Because the lighthouse is a public good, all ships' crewmembers would be able to simultaneously utilize its service whether or not they paid for it. If crewmembers could receive lighthouse service without paying for it, there would be little incentive for them to pay for this service. Consequently, most, if not all crewmembers would choose not to pay the lighthouse firm. But if the lighthouse firm were not paid or paid very little, it would be impossible or difficult for it to make a profit. And if the firm faced difficulty making a profit, it would most likely leave the lighthouse business. Thus, if we left lighthouse provision to the market, the result would probably be that a service that would provide clear social benefit would not be produced. This analysis of lighthouse provision applies to all public goods. If we tried to distribute them by way of the market, even though they would provide clear social benefit, they would probably not be produced. This is because no firm would have an incentive to produce them because no consumer would have an incentive to pay for them.

According to economic theory, the way to increase the likelihood that public goods will be produced is to create a mechanism by which people are "forced" to pay for them. Taxation is such a mechanism. By requiring people to pay taxes or face negative sanctions, governmental authorities put themselves in a position to assure that most people will "back up" their preferences for public goods with the resources required for their production/provision. Because people do benefit from public goods and governmental actors are in a position to force people to pay for the provision of them, governmental production/provision of public goods can be justified (Stiglitz, 1988). Let's take a look at another public good that might be more of interest to social workers.

Imagine there is a large firm that manufactures cars. Imagine further that this firm chronically dumps chemical waste into a city's water supply. Medical experts have found that ingesting this chemical is strongly correlated with the development of a certain type of cancer. Suppose that a private sector firm is created to clean up the city's water supply and that it is *not technically possible for the firm to prevent the city's residents from obtaining the cleaner water from their faucets*. This technical impossibility results in the cleaner water being a public good because the inability to

prevent them from drinking it means that city residents could not be excluded from doing so. Would the firm be able to profit from cleaning up the city's water supply? Economic theory predicts that the answer to this question is no.

If the firm were able to successfully clean up the water supply, this, other things being equal, would reduce the chances that city residents would develop the type of cancer associated with the chemical that was found in the water. But since the firm would have no way to prevent those who did not pay for its service from drinking the clean water, most, if not all, city residents would be unwilling to pay the firm for the privilege of doing so. And if the firm were not paid by most of those benefiting from its service, it would not be able to profit from providing it. From an economic point of view, since removal of the chemical from residents' drinking water would result in the production of a public good, the city government would be justified if it taxed its residents to finance a public sector firm to conduct this removal.

Market generated externalities are other conditions that justify governmental interventions. In order to understand the concept of *externality*, one needs to reflect a little about why people *voluntarily* choose to consume, produce, and exchange specific goods/services. They do so because they expect that the positive consequences or benefits from doing so will outweigh the negative consequences or costs of doing so. For example, a person voluntarily chooses to buy a car because he or she believes the benefit from owning the car will outweigh the cost of owning it.

In many cases, only those who have voluntarily agreed to participate in consumption and production enjoy the benefits or incur the costs associated with these activities. When benefits are enjoyed by or costs incurred by those who have *not* voluntarily agreed to the enjoyment of these benefits or the payment of these costs, externalities are said to exist. Externalities can be positive or negative. A negative externality is one that is costly, while a positive externality is one that is beneficial (Stevens, 1993). I have already discussed an example of a negative externality although this term was not used in the discussion.

The automobile manufacturer that dumps waste into the city's water supply imposes a negative externality onto the city's residents. These residents have not voluntarily agreed to drink water

with a dangerous chemical in it. The consequences of drinking this water are costly in terms of premature deaths, increased health expenses, etc. The firm doesn't appear to have a clear economic incentive to develop a production process that doesn't endanger the city's water supply. In fact, if the development of a "cleaner" production process would significantly increase the firm's cost of doing business, it would have an economic incentive *not* to adopt this cleaner process.

According to economic theory, since markets don't necessarily provide firms with incentives to curb negative externalities, governments can justifiably enact policies that require firms to do so or that require them to pay taxes that provide governments with the resources necessary to do so (Stiglitz, 1988). To return to the example about the chemical waste, the city government would be justified if it passed a law that required the firm to develop a cleaner production process. It would also be justified if it required the firm to pay a special tax that helped to finance the work of a public sector company that specialized in removing the chemical from the city's water supply.

The example of chemical waste is an example of a negative externality that results from the *production* of a good. Sometimes *consumption* leads to negative externalities as well. Suppose Enrico enjoys smoking and decides to "light up" in a crowded office. Enrico's co-workers, however, hate being around smokers because they have learned that "second hand" smoking is carcinogenic. In this case, Enrico's choice to smoke results in a negative externality imposed onto his co-workers. From the point of view of economic theory, the government would be justified if it enacted a law that proscribed smoking in offices and other public establishments or required owners of such establishments to construct separate smoking and non-smoking sections.

The examples about chemical waste and smoking should make it clear that social workers concerned about the negative effects of pollution on the welfare of clients could draw upon economic theory to justify policies intended to prevent or curtail these effects. Given the role economics often plays in social welfare policy debates, this would be a most useful rhetorical strategy.

Now let's take a look at a positive externality. Imagine there is a man who suffers from tuberculosis (TB). As most social workers

are probably aware, TB is a highly contagious disease. Imagine further that the man is aware that he has this problem and goes to see his physician to obtain treatment. Obtaining treatment for his condition is of obvious benefit to the man. But since TB is such a contagious disease, by receiving treatment, the man benefits others through decreasing the probability that they will contract it. Yet others who benefit from the man's receiving treatment did not voluntarily take part in an exchange in order to do so. Thus, the benefit others derive from the man's receiving treatment is an example of a positive externality.

Now suppose there is an indigent homeless man who suffers from TB. Because of his impoverished status, the man is unable to purchase treatment for his disease in the health care market. From the point of view of economic theory, governmental actors could justifiably enact a policy that subsidized the man's purchase of treatment or paid for it entirely. This could be justified because the benefit of the treatment would not simply be enjoyed by the homeless man but by members of the public in general.

Not only could the positive externality concept ground justification of public sector financing of TB treatment but it could justify public sector financing of immunization against a host of other highly contagious diseases.

The astute reader has probably realized that positive externalities are actually examples of public goods. Even though this is the case, economists often discuss public goods and externalities separately. This is because positive externalities are considered distinct from "normal" public goods in the sense that positive externalities are public goods that result as *by products* from the production and consumption of private goods/services (Weimer and Vining, 1992). For example, in the case of the man who went to see his physician to get treated for TB, the benefits received by the public result as by products from the man's purchasing the *private* services of his physician. In the cases of the lighthouse and cleaner water, these services are not by products of consumption or production of private goods.

A third type of market failure that is relevant to the social welfare policy concerns of social workers is imperfect information. When it comes to many goods/services, consumers usually have a pretty good idea about what constitutes quality. One can

tell if a book she is considering buying has all its pages or if a table she is thinking about buying has all its legs. When it comes to goods/services where individuals are knowledgeable about their quality and other relevant matters, economic theory states that governmental actors should allow markets to distribute such goods/services with little or no interference. Markets that distribute goods/services of this nature are characterized by perfect information. Markets that distribute goods/services where individuals lack information about quality or other significant matters are characterized by imperfect information (Stevens, 1993). Let's take a look at a market characterized by imperfect information.

Currently in the U.S., some people pay "out of pocket" for medical services. Consumers of such services are typically uninformed about their quality. Most of those who are not physicians are not in a position to know if they are getting a high quality breast exam, a high quality x-ray, high quality out patient surgery, etc. Thus, they are vulnerable to being harmed by incompetent physicians; that is to say they might end up paying for substandard care. By the time consumers realize their care has been substandard it might be too late; they may have developed a grave condition.

One way the public sector has attempted to address the problem of imperfect information in the health care market is through licensing. That is physicians are required to pass licensing examinations in order to practice. It is believed that physicians who pass these examinations are more likely to be competent clinicians than those who do not do so are.

The Efficiency/Equity Distinction

Social workers tend to examine social welfare policy issues from the perspectives of fairness and need. They ask do particular policies generate fair distributions of goods/services or do specific policies meet people's basic needs? Economists refer to such concerns as equity concerns and although they too are interested in these types of questions, they readily admit that their economics training provides them with no special competence in addressing them. Those economists who address such questions tend to draw heavily upon the sub-discipline of moral philosophy.

Discussions of the work of Harvard philosopher John Rawls are frequently found in economists' musings on questions of equity (Rawls, 1971; Stiglitz, 1988; and Stevens, 1993).

Economists feel that another important policy related concept is their "stock and trade": the concept of *efficiency*. Economists use this notion in a number of different contexts. It has to do with attainment of the largest possible outcome given available resources. It is relevant to the decision making of all social actors. Individual persons are concerned with utilizing their budgets to attain as many of the things they prefer as possible. Those who occupy positions of authority in social service organizations are concerned with utilizing organizational resources to attain as many organizational objectives as possible. Elected officials are concerned about utilizing public resources to attain as many public objectives as possible. Let's further explore an example from the political arena.

Suppose it were the case that the U.S. electorate and U.S. elected officials were committed to curtailing poverty. Assume that this commitment has emerged from a sense that such curtailment would make our income distribution more equitable. Economists qua economists would have no unique contribution to make to the question of whether poverty ought to be curtailed. They could make an important contribution, though, by helping us figure out which poverty reduction policy would be likely to be the most efficient or cost-effective.

A guaranteed income and a public jobs program are two different approaches to curtailing poverty. A guaranteed income is an income maintenance policy that assures that no citizen's income falls below a certain level. People are *not* required to work to receive the income guarantee. If the guarantee were set high enough, this policy could curtail poverty.

A public jobs program is an income maintenance policy that assures that no citizen employed in a public job would see her/his income fall below a certain level. If the public employment wage were set high enough, this policy could also curtail poverty.

Both of these policies would cost public dollars. Their cost would depend, in part, on their effects on labor markets, their effects on investment levels, their effects on the price level, their effects on aggregate economic output, etc. Although, it should

not be assumed that non-economists have nothing of significance to say about these matters, it is the case that such questions fall squarely within the domain of economics.

This is not the place to conduct the labor market, investment level, price level, etc., analyses that would be required to formulate a well-grounded prediction of which of the two poverty reduction policies would cost the least. For the sake of illustration let's assume that such analyses have been conducted, and it has been found that the guaranteed income approach would probably cost the federal government about $200 billion/year, while the public jobs approach would probably cost it about $300 billion/year. If it also appeared that both policies would reduce poverty by the same level, the economist would recommend the guaranteed income approach on efficiency, *not* equity grounds. This is because by utilizing the least costly method, we would be freeing up public resources that could be allocated for the attainment of other public objectives.

Conclusion

This paper has attempted to illustrate the relevance of economics to the social welfare policy concerns of social workers. It has placed great emphasis on the relevance of the economists' notion of *market failures*. It has also considered how other basic economic concepts, such as *opportunity cost* and *efficiency*, are pertinent to the policy concerns of social workers. It is my hope that this attempt has convinced readers of the utility of drawing upon economic theory in our analyses of social welfare issues.

Refereneces

Johansson, Per-Olov. *An Introduction to Modern Welfare Economics*. Massachusetts: Cambridge University Press, 1994.

Lewis, Ben W. *Economic Understanding: Why and What*. New York: Joint Council on Economic Education, 1957.

National Association of Social Workers. *NASW Code of Ethics*. Washington, D.C.: NASW, 1996.

Rawls, John. *A Theory of Justice*. Massachusetts: Harvard University Press, 1971.

Stevens, Joe B. *The Economics of Collective Choice*. Colorado: Westview Press, 1993.

Stiglitz, Joseph E. *Economics of the Public Sector*. New York: W. W. Norton, 1988.

Weimer, David L. and Vining, Aidan R. *Policy Analysis: Concepts and Practice*. New Jersey: Prentice Hall, 1992.

Weiss, Gregory L. and Lonnquist, Lynne E. *The Sociology of Health, Healing, and Illness*. New Jersey: Prentice Hall, 1997.