



Title: Public goods and social welfare

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Short version

In general, countries are created by the people with the aim of increasing their well-being. In the European cultural space, well-being is based on good health; comfortable living conditions; personal liberty; safe working conditions; and guarantees in case of unemployment. These elements of well-being can be divided into economic well-being and general cultural well-being, which in turn are associated with fundamental societal values. Well-being can be achieved by satisfying people's needs and/or eliminating their unnecessary desires.

Based on economic principles, meeting peoples' needs requires the consumption of different types of goods and services. We are much less aware that well-being depends on the consumption of goods but it also depends on the quality of our social and natural environment. A sense of security is created by a state with an independent judiciary, a free media, internal and external security guaranteed by police and army, state support to education, science, transport, environmental protection and culture, and a functioning social security system. All the aforementioned goods and services are called 'public' or 'common goods'. In terms of a market economy, public and common goods are a market failure. According to Neoclassical economics, the solution to this problem would be to turn public and common goods into private goods. According to Keynesian economics, the government must intervene and organize the supply of public and common goods itself. How governments organize the provision of public and common goods depends on governmental policy.

Social welfare is a system aimed at securing various freedoms in society and towards creating better opportunities for economic development via human resource development. To achieve this aim, the state organizes the distribution of public and common goods. Social welfare includes also a social security system that supports people in case of sickness, accidents at work, incapacity for work, and unemployment. A country that takes responsibility for social welfare is called a welfare state.

How governments organize the delivery of public and common goods depends on the government's political approach. The specific goals the government chooses in order to increase the well-being of its citizens, and the means it uses to do so, depend on the socio-political views of the ruling party or coalition. Based on socio-political approaches, the Danish sociologist G.



Esping-Andersen (1990) has developed three main clusters of the welfare state: liberal, social democratic and conservative. ¹

After acquiring this study material the learner has an overview of how well-being is defined and the consumer goods on which it depends; why the market cannot cope with the distribution of public and common goods; what the options for addressing these market failures are; and how welfare states are classified according to how they address the delivery of public and common goods. In conclusion, the learner is able to perceive how the government of their country organizes the provision of public and common goods and has improved their skill of making an informed choice in the next round of elections.

¹ Esping-Andersen, G., 1990



Long version

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Introduction

The goal of all governments is or should be to increase the well-being of their citizens. Generally, well-being means just feeling well. Well-being can be achieved by satisfying the needs and / or eliminating unnecessary desires and dreams. In economic terms, ‘meeting needs’ implies facilitating the consumption of different types of goods. There are different opportunities for classifying or grouping goods. Here we divide the goods into types based on two characteristics: rivalry and excludability. On the basis of the existence or non-existence of these characteristics, the goods can be divided into four classes: private goods, club goods, common goods, and public goods. The market economy is relatively successful in providing private and club goods but fails in the provision of public and common goods. This situation is called market failure. In a market economy, governments deal with solutions to market failures. The organization of the distribution of public and common goods depends on the government's socio-economic policy. According to Esping-Andersen (1990), such an approach may be liberal, social-democratic, or corporate-conservative.

The main purpose of this study material is to provide an overview of how different types of welfare states deal with the provision of public and common goods and in doing so increase the well-being of citizens. To achieve this goal we will cover the following topics:

1. How to explain well-being?
2. How is classifying goods and services based on rivalry and excludability?
3. Problems with supply of common and public goods.
4. Social welfare and the welfare state.
5. Three types of social welfare states and their vision of the provision of public and common goods.



6. How to measure well-being and the success of social welfare policies.

1. Well-being

In every economic system, companies target maximizing their profit and households target maximizing their well-being.² According to the publication *Psychology Today*, well-being is the experience of health, happiness, and prosperity. It includes having good mental health, high life satisfaction, a sense of meaning or purpose, and an ability to manage stress. More generally, well-being is just feeling well.³ In the European cultural space, well-being is based on the following values: good health; comfortable living conditions; personal liberty; safe working conditions; and guarantees in case of unemployment. These elements of well-being can be divided into economic (economic well-being) and general cultural well-being, which in turn are associated with fundamental societal values.^{4,5,6} Well-being can be achieved by satisfying societal needs and/or eliminating peoples' unnecessary desires.

A simplified schematic overview of our needs is shown on Maslow's hierarchy of needs in Figure 1. Abraham H. Maslow (1908–1970) was an American psychologist who was best known for a theory of psychological health predicated on fulfilling innate human needs in priority, culminating in self-actualization.



Figure 1. Maslow's hierarchy of needs⁷

According to Maslow's hierarchy of needs, human well-being is based on physiological and safety needs being met. Physiological needs are needs we cannot live without (food, water, air, sleep, etc.), and safety needs include feeling safe (physical and financial safety, job security, health). These two groups of needs are also called basic needs. When basic needs are satisfied,

² Kerem, K., Randveer, M., 2007

³ Psychology Today (05.05.2020)

⁴ Sutrop, M., 2016

⁵ Stiglitz, J. E., Sen, A., Fitoussi, J.-P. 2009

⁶ OECD Better Life Index (25.08.2020)

⁷ Professional Academy, (08.05.2020)



a person strives for realizing their social needs. We all look for social connections with friends and family and want others to respect us. In doing so, we try to increase our self-esteem and self-confidence. Self-realization is the realization of one's full potential. This is the highest level of the hierarchy that we strive for.⁸

Unfortunately, needs and desires are often mistaken for synonyms and so are used interchangeably. In fact, a need refers to something that is needed for survival, and desires refer to the things and phenomena that people desire in life. A person's survival is not in danger if he is unable to fulfill his desires, especially given that desires are endless because we are never completely satisfied. It can be said that desires distort our self-esteem and ultimately even reduce our well-being.⁹ At the same time, all people strive to fulfil their needs but also their desires to be happy.

In economic terms, people need to consume different types of goods and services in order to meet their basic and social needs. In the following chapters we explore on which bases the characteristics of goods are classified, and whether or not the market can handle the distribution of these goods.

2. Private, club, common and public goods

These two characteristics are **rivalry** and **excludability**.¹⁰ In economics, a good is said to be rival if its consumption by one consumer prevents simultaneous consumption by other consumers, or if consumption by one party reduces the ability of another party to consume it. A good is considered non-rival if, for any level of production, the cost of providing it to an additional individual is zero. If you buy a bottle of water and drink it, nobody else can drink it. If you buy a computer, nobody else can buy the same computer. The bottle of water and computer are rival goods. However, if you create a beautiful flowerbed in front of your house and you have no fence, people on the street enjoy looking at your flowerbed. The beautiful flowerbed is non-rival as it does not matter how many people look at it, they are not “using it up”.

A good is called excludable if it is possible to prevent people who have not paid for it from having access to it. By comparison, a good is non-excludable if non-paying consumers cannot be prevented from accessing it. For example, you need a ticket to go into the cinema hence the cinema is excludable. Streets and street lighting are not excludable though because anybody walking down the street at night benefits from lighted streets. It is impossible to make users of lighted streets pay for walking on the street and ban those, who do not pay, to walk on lighted streets.

⁸ Ibid

⁹ Purju, A., 2004

¹⁰ Mnmeconomics (30.09.2020)



On the basis of the existence or non-existence of these two characteristics, the goods are divided into four types¹¹:

1. Private goods
2. Public goods
3. Club goods
4. Common goods

Figure 2 shows the formation of these four groups of goods on the basis of rivalrous and excludability, together with examples. Most goods that people typically think about are both excludable and rival in consumption, in other words, the seller is able to prevent consumers from accessing the product. These goods are called **private goods**. Private goods are, for instance, mobile phones, clothes, cars, fridges, watches, consumer goods, and private services such as hairdressing and beauty services, etc. The distribution of private goods takes place on the market, as a result of supply and demand.

Club goods are excludable, which means that the consumer cannot use the product unless they directly pay for it. Club goods are non-rival, which means that the consumption by one person does not prevent others from consuming it. Club goods are, for example, Wi-Fi, Internet, satellite TV, private parks, private roads, etc (see Fig. 2). As a rule, club goods are available to club members and exclusion is based on the payment of a club membership fee.

Common goods are characterised by non-excludability and rivalry. Non-excludability means that it is practically impossible to prevent the consumption of these goods by those who have not paid for it. However, these goods are rivalrous - the more one person consumes, the less there is available to everyone else. For example, wild fishing is considered non-excludable as it is impossible to prevent others from fishing there and it is rivalrous as the more one person fishes from a wild lake, the fewer there are available to others (see Fig. 2).

Public goods are characterised by non-excludability and non-rivalrous. This means that once a benefit has been made available to one consumer, each additional consumer does not reduce the ability of others to benefit from it, and it is virtually impossible to exclude non-payers. National defence is one representative example of a public good as it is not possible to selectively protect paying customers from military attacks, and one person consuming national defence (i.e., being protected) does not make it more difficult for others to consume it too (see Fig 2).

¹¹ BoyceWire. Behavioural economics (30.09.2020)



	Excludable	Non-Excludable
Rivalrous	<p>Private Goods Food, clothes, cars and other consumer goods</p>	<p>Common Goods Fish, timber, coal</p>
Non-Rivalrous	<p>Club Goods Cinemas, private parks, satellite TV</p>	<p>Public Goods air, national defence</p>

Figure 2. Four types of economic goods and services. (Source: <https://boycewire.com/>)

The best-known public and/or common goods and services are, for example, air, the ozone layer, oceans, the greenhouse effect, as well as state and local governance, creation of the judicial area and justice, national defence, ensuring public order, ensuring the country's international representation, and citizenship. Examples of goods and services that can be public, common or private goods are: roads and streets, traffic lights, museums, historic buildings, but also environmental protection, health services, education services, social protection network, culture, etc. However, it is possible to turn most goods and services classified as common goods into private or club goods.

In the next chapter, we will look at the problems associated with the supply and consumption of common and public goods.

3. Problems related to the consumption of common and public goods

A notable feature of public and common goods is that free markets produce less of them than is socially desirable. This is because public and common goods suffer from, what is called, the **free-rider problem**. The free-rider problem is a type of market failure that occurs when those who benefit from goods or services do not pay or under-pay for them. At the same time, it is impossible to exclude non-payers from accessing or using these goods. Thus, the public and common goods may be under-produced, over-used or become degraded. Furthermore, if the marginal cost of serving one more customer is essentially zero, it is socially optimal to offer the



product at a zero price. Therefore, producing public goods is not a business model, which is why private markets do not have an incentive to provide them.¹²

As public and common goods have no supply in the market sense, their price is not formed on the market. There is a demand for these goods in society, as a result of which the value of these goods can be assessed. The higher the value of these goods in society, the greater the demand and the greater the pressure on the consumption of these goods, which ultimately leads to the over-consumption of public and public goods, which G. Hardin (1968) explains as a "tragedy of common good".

“Tragedy of the commons” is an economic problem in which every individual has an incentive to consume a resource at the expense of other individuals. It results in overconsumption, underinvestment, and ultimate depletion of the resource. As the demand for the resource overwhelms the supply, every individual who consumes an additional unit directly harms others who can no longer consume. “Tragedy of the commons” occurs when individuals neglect the well-being of society in the pursuit of personal gain.¹³

Overconsumption of public goods leads to **pollution and pollution damage**. Pollution is the introduction of contaminants into the natural environment that cause adverse change or pollution damage. Pollution can take the form of chemical substances or energy, such as noise, heat or light. Many activities that are useful to people produce pollution: burning coal to create electricity pollutes the air; both industries and homes generate garbage and sewage that can pollute the soil and water; pesticides leach into groundwater, rivers and lakes and harm wildlife. Polluted air, soil, and water cause different pollution damages, for example, various human diseases, damage to buildings and structures, destruction of nature, etc. Pollution damage in monetary terms is called **external cost**. More specifically, an external cost is a cost that an individual, company or community incurs as a result of an economic transaction in which they are not directly related.¹⁴ Therefore over-consumption of public and common goods that leads to external costs may result in reduction of the well-being of society.

Economists suggest two ways to address the free-rider problem and the problem of external cost:

- According to the Neoclassical approach, the government should organize the conversion of public and common goods into private goods.
- According to the Keynesian approach, the government should organize the distribution of public and common goods itself, using various "command-and-control" measures.

The decision as to how the government should intervene in the provision of public and common goods should be based on an analysis of whether the benefits of consuming those goods

¹² ThoughtCo. Social Sciences (12.10.2020)

¹³ Hardin, G. (05.05.2020)

¹⁴ Economics Online. External costs. (12.05.2020)



outweigh the costs to society of taxation. However, such an analysis is not always carried out, instead it is decided by those in political power. The following chapters describe different policy approaches to organizing the distribution of public and common goods.

4. Social welfare and welfare state

Welfare is a type of government support intended to ensure that members of a society can meet basic needs.¹⁵ Often welfare is used as synonymous with **social security** but actually, social security includes a governmental support system only for sickness, accidents at work, incapacity for work, and unemployment. Welfare-related instruments can be both allowances and services. A country that takes responsibility for social welfare is called a **welfare state**.

Historically, the role of the state was limited to providing assistance to those whose needs could not be met by institutions like family, the market or voluntary service, e.g., the church. The state was not directly responsible for ensuring the social security and well-being of people. As a result of social changes that took place at the end of the 19th century and the beginning of the 20th century, the role of the state and its intervention in people's lives began to increase significantly.¹⁶ The history of the modern welfare state goes back to the 1840s when Otto von Bismarck, the Chancellor of Germany, introduced old age pensions, accident insurance and medical care in some German states. These programs were introduced to reduce the emigration of workers to the United States, where wages were higher but welfare did not exist.¹⁷ Over time, the needs of people expanded and besides social security, governments undertook the role of organizing new areas such as health, education and science, transport, environmental protection, agriculture, culture, etc. Governments expanded their activities to the social sphere and the concept of the welfare state emerged.

The welfare state is not designed for the poor, it is designed to protect people from poverty. The term "welfare state" is defined differently in the literature. Esping-Andersen (1999) argued that after World War II the welfare state included primarily state intervention to reduce the economic insecurity people experienced during their "inactive" years of life.¹⁸ Pestieau (2006) focuses on defining the functions of the welfare state. In addition to mitigating social risks, the welfare state also provides social assistance and supports education. Thus, the welfare state does not deal only with "inactive" citizens but also for example low-income families with large numbers of children, etc.¹⁹ According to Sandmo (1995), the welfare state can be viewed from two perspectives: (1) the welfare state refers to the part of the public sector that deals with redistribution through social security and the provision of social benefits that have a strong redistributive function, such as education and health; (2) it describes broadly a country's

¹⁵ Encyclopedia Britannica (10.10.2020)

¹⁶ Ware, A., Goodin, R. E., 1990

¹⁷ Boundless Political Science (5.10.2020)

¹⁸ Esping-Andersen, G., 1999

¹⁹ Pestieau, P., 2006



economic and social policies that prioritize the reduction of inequalities and the protection of the individual against social risks such as job loss or illness.²⁰

The next chapter contains a short overview of different types of welfare states and how they define and organize the supply of public and common goods and services.

5. Three main types of welfare states

The general premise (at least in theory) is that all countries are designed to provide physical security, rights and freedoms for their people. Organizing the provision of public and common goods is an important task to achieve this goal. How countries do this depends on the government's views on social welfare

In 1990, the Danish sociologist G. Esping-Andersen developed a model for assigning welfare states to three main clusters: social democratic, liberal and corporative-conservative.²¹ This classification is based on the two key factors: (1) commodification, i.e. the extent to which the provision of care services depends on the market; and (2) the extent of collective allocations. To create the index, the author used the indicators of old-age pensions, healthcare, and unemployment insurance policies. In addition to this index, various welfare indicators were used and countries' consistency with the results obtained was checked.²²

According to this study Australia, Canada, Japan, Switzerland, and the United States are liberal welfare states; Austria, Belgium, France, Germany, and Italy are conservative welfare states; and Denmark, Finland, the Netherlands, Norway, and Sweden are social democratic welfare states. Ten years later R.E. Goodin, B. Headey, R. Muffels and H.-J. Dirven (1999) also divided welfare states into these classes and in general they replicated Esping-Andersen (1990) results.²³

A **liberal welfare system** prioritizes economic growth. The system is characterized by modest universal transfers or social insurance plans. The social benefits tend to cover the needs of the low-income working class. Eligibility is usually stigmatized and the thresholds of support are designed so that people do not choose social assistance over work. The aim of this system is to create a situation where everyone who can do paid work would do so in order to guarantee their own well-being. In a liberal welfare state, both poverty and social stratification are high. The positive values of this system are equal opportunities, competition, and social rights.²⁴

The **social-democratic welfare system** is highly equal in its purpose and conspicuously universal in its political style. The social democrats do not simply seek to eradicate poverty, but

²⁰ Sandmo, Agnar., 1995

²¹ Esping-Andersen, G., 1990

²² Ibid

²³ Goodin, R. E.; Headey, B., Muffels, R., Dirven, H.-J., 1999

²⁴ Ibid



generally strive to promote social equality. This system is characterised by high social spending, decommodification of social rights, and social stratification. The state is also involved in caring for children, the elderly and the helpless. Thus, all residents of the country are connected to one universal insurance system, from which everyone receives earning-based support and, where everyone has the same rights regardless of status or gender. Such a system creates solidarity with the state among the citizens, because everyone depends on the state, they also feel obliged to pay taxes to maintain the system.

At the same time, high social costs can have negative consequences such as the deliberate desire to be unemployed and to receive benefits. A positive fact is that creating favourable conditions helps a person to adapt quickly to a changing situation. Knowing proper support is there in the event of an accident or job loss reduces individual risk sensitivity. The health insurance system is important for the development of health throughout the country. If a person is sick and the sickness benefit is decent, the citizen chooses the most reasonable option – he stays at home to heal himself.²⁵

In a **corporative-conservative system** the market as a potential guarantor of well-being is marginalized, and the guarantee of social rights is not seen as a viable alternative for achieving material well-being. This system seeks to preserve social hierarchies and social statuses. As the state focuses on maintaining status differences, the redistributive effect of the state is not significant. The system is mostly influenced by the church and is committed to maintaining traditional family values. In this system, the family is the main provider of welfare services. The state's intervention consists primarily of distributing financial support to families, who must ensure the functioning of welfare services. Social security usually excludes unemployed women, but family benefits favour mothers. Kindergartens and other institutions providing care services are mostly underdeveloped.²⁶

Irrespective of whether the attitude of the state towards social benefits is liberal, social democratic or conservative, it is the task of all countries to organize the distribution of public and common goods in order to maximize the well-being of their citizens. All governments are engaged in administering courts, providing a police force, and ensuring the continuity of ruling institutions. Also, nearly every nation in history has had a military, all modern states have carried out some environmental protection activities and support research. All governments spend on things like defence, research, clean air, and roads. At the same time, most governments are also concerned with social security. These are supports for sickness, accidents at work, incapacity for work, and unemployment. All services listed above are public or common in nature.²⁷ The differences between countries become apparent only in the choice of means to achieve the objectives.

²⁵ Ibid

²⁶ Ibid

²⁷ Lehrer, E., 2018



6. How to measure welfare

In order to understand whether a country has fulfilled its main goal and increased the well-being of its people, it is necessary to measure the well-being of people. How to do it? In order to measure the effectiveness of social welfare systems in increasing the well-being of citizens, various indicators have been developed. The most known indicator is **Gross Domestic Product (GDP)**. Unfortunately, this is not a good indicator for measuring the well-being of society. In order to get an overview of what is happening in society, social and environmental developments must be taken into account in addition to GDP, as intangible well-being is an important criterion for achieving people's general well-being and happiness. For example, an **Ecological Footprint** can be used to measure environmental developments, taking into account the impact of consumption and production patterns on the environment. More information on this indicator is available at www.footprintnetwork.org.

Measuring human well-being and the performance of government social welfare activities is a key priority for the OECD. The latest OECD study, “**How’s Life? 2020**” provides comparable statistics on how the lives of people living in the OECD and selected partner countries have changed. This welfare framework currently contains 11 related dimensions²⁸:

- Material conditions that shape people’s economic options (Income and Wealth, Housing, Work and Job Quality);
- Quality-of-life factors that encompass how well people are (and how well they feel they are), what they know and can do, and how healthy and safe their places of living are (Health, Knowledge and Skills, Environmental Quality, Subjective Well-being, Safety);
- How connected and engaged people are, and how and with whom they spend their time (Work-Life Balance, Social Connections, Civic Engagement).

The latest survey, conducted in 2018, shows that life has improved compared to 2010. People are living longer, safer, the OECD average homicide rate has fallen by a quarter, and people feel safer walking around. Employment rates and incomes have risen and people were more satisfied with their lives than in 2013. There has been a decline in well-being in the field of social interaction and also financial insecurity has increased. 7% of people say that life satisfaction is very low and a significant minority (13%) experience more negative than positive feelings on a normal day. More information from OECD homepage <http://www.oecd.org/statistics/how-s-life-23089679.htm>

The list of indicators for measuring the well-being and social welfare mentioned above is not exhaustive. A wide variety of well-being measurement methodologies can be found on the Internet.

²⁸ OECD Better Policies for Better Life. How’s Life? 2020 (14.08.2020)



7. Summary

The purpose of this study material was to provide an overview of how different types of social welfare states define what constitutes optimal provision of public and common goods, and solve the free-rider and external cost problem. To achieve the goal, the meaning of well-being was explained. The simplest definition of well-being is just feeling well. Well-being can be achieved by satisfying the needs and / or eliminating the unnecessary desires. American psychologist Abraham H. Maslow explained that human well-being is based on meeting people's physiological and safety needs. When basic needs are satisfied, a person strives for realizing their social needs. In economic terms, meeting needs requires the consumption of different types of goods.

Based on the features of rivalry and excludability, goods are divided as private, club, common, and public goods. The market economy is relatively successful in providing private and club goods, but fails in the provision of public and common goods. In terms of a market economy, public and common goods are a market failure, which means that the private sector does not provide these goods and services. The consumption of common and public goods is coupled with the free-rider problem, which leads to over-consumption of these goods and finally causes external costs to society.

To solve the above-listed market failures the government must intervene. Economists suggest two ways:

- According to the Neoclassical approach, the government should organize the conversion of public and common goods into private goods.
- According to the Keynesian approach, the government should organize the distribution of public and common goods itself, using various "command-and-control" measures.

How governments organize the provision of public and common goods depends on the governmental policy approach to social welfare. A liberal welfare state prioritizes economic growth that enables most citizens to ensure their own well-being. A social-democratic welfare states seek to eradicate poverty, and strive to promote social equality. This system is characterised by high social spending. The country's population is concentrated in a universal insurance system, from which earning-based support and universal social services are distributed. In a conservative system, the market as a potential guarantor of well-being is marginalized, and social rights are not included as elements required for achieving well-being. The main idea is that the state intervention is minimal, with a focus on cash benefits that allow the welfare services to be provided by families.

Countries and associations of countries use a wide range of indicators to measure the results and effectiveness of their social policies. Examples of such indicators are GDP, the Ecological Footprint, and the OECD survey "How's Life?" etc. The results are used by countries to shape their social policies in an effort to combine the provision of public and collective benefits in a way that increases the well-being of their citizens.



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