



Recenzovaný sborník příspěvků
interdisciplinární mezinárodní vědecké konference
doktorandů a odborných asistentů

QUAERE 2012

vol. II

14. – 18. května 2012

Hradec Králové, Česká republika

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Editor, úprava, realizace | Edit, Published by:

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ISBN 978-80-905243-0-9

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Certifikovaná vědecká konference | Certificate Conference No.: 2259661206
ETTN 085-12-12014-05-2



Reviewed Proceedings of the
Interdisciplinary Scientific Conference
for PhD students and assistants

QUAERE 2012

vol. II

May 14 – 18, 2012

Hradec Králové, The Czech Republic

QUAERE

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ASSET-BASED POLICY: A NEW MEASURE TO REDUCE POVERTY AND INEQUALITY IN BALTIC STATES

Algimantas Laurinavicius

Abstract

The article seeks to establish whether asset-based policy would be useful in Baltic states. A brief outlook of current social situation in Baltic states is made and the social policy in place is evaluated. Then, a new direction for social policy - Asset-Based Policy is presented. Various asset-based policy models implemented in other countries are overviewed and compared. Taking into consideration identified benefits, inefficiency of current social policy, economic crisis and austere fiscal policy it is stated that the asset-based policy should be implemented in Baltic states.

Key words: *assets, asset-based policy, inequality, Baltic states*

Introduction

Current economic research shows that a public well-being depends not only on the amount of personal wealth or disposable incomes but on their distribution (or inequality) as well. Income inequality, high poverty rate prevent development of society and state, have a significant impact on health and education of residents, conditions of housing and delinquency rate. Income inequality and wealth disparity may cause political discontent and lead to severe social disorders.

Income inequality is commonly measured by Gini coefficient, which shows what part of national income is obtained by the wealthiest residents. A Gini coefficient of 0 expresses perfect equality where everyone has an exactly equal income; a Gini coefficient of 1 expresses maximal inequality where one person has all the income. The world's Gini coefficient is 40; Gini index for the US is 47, and it is only 30 for the EU, which has implemented a model of social welfare state. However, huge disparities exist between different EU member states: Gini coefficient varies from 23,8 in Slovenia to 36,1 in Latvia and 36,9 in Lithuania (2010 data from Eurostat).

It should be noted that economies of Baltic states (Baltic states refer to Estonia, Latvia and Lithuania) have grown rapidly in the last decade – which should have ensured a better life for everyone – though changes of Gini coefficient were not significant: a gap between the rich and the poor did not narrow. Thus, it could be stated that Baltic countries, especially Latvia and Lithuania, draw more attention to a rapid growth of GDP and not to the equitable distribution.

Ineffective redistributive policy - which is oriented towards benefits for the poor and not towards development of their capabilities - is one of the reasons of high income inequality in the Baltics. The other reason is that the main livelihood of the Baltic residents comes from work-related incomes (i.e. wages and salaries); therefore they do not take advantage of the growth of their national economies. Only the rich can buy shares, funds and to take advantage of the economic growth of their countries. Thus, one of the measures to reduce poverty and inequality is to reform current social policy, from income support policy to asset-based policy: i.e. to encourage development of one's knowledge, skills and abilities, promote savings, investments and building of assets and to make a possibility for all to become capital owners.

This article seeks to establish whether asset-based policy would be useful in Baltic states. The methods of the research cover a comparative analysis of scientific literature and a statistical computation. The article starts with a brief outlook of current social situation in the Baltic states. Then it presents the concept of the asset-based policy and provides a summary of the asset-based policy models implemented in foreign countries. Later, results of these policy models are discussed. The paper ends in conclusions.

1. Income inequality and efficiency of social policy in Baltic states

In 2000-2010 Baltic economies have maintained a rapid growth; incomes grew as well. However not all types of incomes grew at the same pace. As it could be seen in Figure 1 below, in 2000-2010 nominal GDP grew in Estonia by 132%, in Latvia – by 170%, and in Lithuania – by 107%. Average net salary (not adjusted to inflation) grew at the same pace, while stock market – even taking into consideration a deep downturn in 2007-2009 - grew much more: from 294% in Latvia and 310% in Lithuania to 456% in Estonia (the change of stock market indexes OMX Riga, OMX Vilnius and OMX Tallinn in 2000-2010; not adjusted to inflation and paid dividends). Thus, if we imagine that our human capital (i.e. our experience, knowledge, talents etc.) is an asset which gives us work-related incomes, we could say that its value grew 2-3 times in the last decade, while the value of financial assets invested in Baltic stock markets, rose 4-5 times.

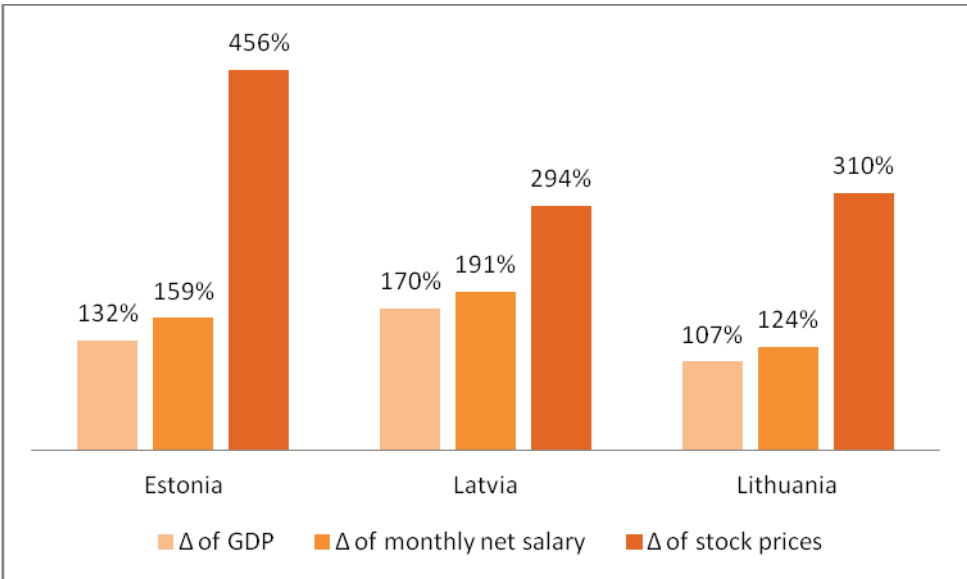


Figure 1. Change of nominal GDP, monthly net salary and stock prices in Baltic countries in 2000-2010 (not adjusted to inflation) (Source: Statistics Estonia, Central Statistical Bureau of Latvia, Statistics Lithuania and authorial computation)

However, neither rapid economic growth, nor stock market boom have reduced social inequality in the Baltics. In a table below, it could be seen that only Estonia in 2005-2010 decreased its Gini coefficient from 34 to 31, while it remained stable in Latvia and rose in Lithuania. Poverty rate decreased only in Estonia, it remained stable in Lithuania and it rose in Latvia. It should be noted that Gini coefficient and poverty rate of all 12 New Member States converged towards EU average, while in Latvia and Lithuania they remained far from European average.

Table 2. Gini and At-risk-of-poverty rates in Baltic countries

Country	Gini coefficient (for incomes), %			At-risk-of-poverty rate, %		
	2005	2010	Δ in p.p.	2005	2010	Δ in p.p.
Estonia	34	31	-3	15	12	-3
Latvia	34	34	0	18	20	+2
Lithuania	34	36	+2	15	15	0

EU	30,6	30,5	-0,1	16,4	16,4	0,0
New Member States (12)	33,2	30,3	-2,9	18,9	16,9	-2,0
Estonia	34,1	31,3	-2,8	18,3	15,8	-2,5
Latvia	36,1	36,1	0,0	19,2	21,3	2,1
Lithuania	36,3	36,9	0,6	20,5	20,2	-0,3

Source: Eurostat and authorial calculation

Taking into consideration these indicators, it could be concluded that the social policy in place didn't bring a break-through in a fight against poverty and inequality in Baltic states, especially in Latvia and Lithuania. It should be noted, that different growth rates of different assets (e.g. stock prices vs. work-related incomes from human capital) and ineffective redistributive policy amplifies social inequality even more.

That is why, in order to reduce inequality, current social policy should be reformed, and the current income support (or income security) policy should be replaced by the asset-based policy which stresses development of capabilities, savings, investments and building of assets.

2. New direction for social policy

It should be noted, that traditional methods dealing with poverty and social inequality focus on issues of income and consumption, with particular importance given to the idea of progressive taxation and increase of various benefits to the poor. These actions, called income security or income support policy, have to support individuals when they have insufficient income, face difficulties, whether temporary or constant ones, including unemployment, health problems, accidents or old age. Notably, income security was effective policy measure at the time, when national economy offered a number of stable and long-term jobs, providing regular income to majority of its population. Income security policy however is a passive one: it supports individuals in distress; however, it is not intended to develop their possibilities (Sherraden, 2002, 2003). Besides, income support policy ignores several especially important aspects:

- 1) various support and benefit programs, aimed at exclusively the poor, strongly reduce the stimuli to work in official labor market, are stigmatizing and are deepening social gap between different social groups more than promoting solidarity
- 2) even very progressive taxation cannot ensure proper equality since a considerably larger inequality exists not in the income of individuals but in their accumulated assets. The US research showed that a median white had about 50% higher income than a median African American or Latino, meanwhile, the net assets of a median white was even 1000% (11 times) higher than those of an African American or Latino (Oliver, Shapiro, 2006; Lawrence et al., 2007);
- 3) transfer of benefits to the poor does not reduce a pre-transfer poverty rate (Danziger, Plotnick, 1986);
- 4) instead of introducing additional taxes for the rich which would promote evasion and giving new additional benefits to the poor frustrating their initiative, it would be better to give everybody more or less equal starting possibilities.

Modern, post-industrial economy needs active social policy, encouraging personal development and providing motivation for development of one's knowledge, skills and abilities. Latest proposals no longer limit themselves with idea of consumption as a measure of well-being going toward what A. Sen (1993, 1999) identifies as *capabilities*. According to A. Sen, a concept of capabilities is closely related to personal freedom of choice and ability to carry out one's potential to the fullest.

Therefore, despite the fact that income or consumption are still most widely used measure of poverty in social policy, lately efforts were made to develop a vision on combating poverty and social inequality, based on saving, investment and accumulation of asset. Concept, stressing long-term individual possibilities, based on certain asset level, is called *asset-based policy*. (Sherraden, 1991). Notably, asset-based policy does not envisage replacing current income security policy, which is a core idea of a welfare state. Both policies can mutually contribute, seeking their goals: benefits received maintain consumption, while the asset accumulated may encourage personal financial freedom and recovery from poverty. To put it briefly, asset-based policy is one that encourages individuals to save and accumulate asset, to improve, develop one's knowledge, skills and capabilities, thereby contributing to the growth of the national economy and progress of its society (Emmerson, Wakefield, 2001; Loke, Sherraden, 2006, 2008). Therefore, only both policies, based on asset and income, when applied together, can help reaching mutually contradictory goals of fair social policy and high economic efficiency, thereby cutting the price of trade-off between economic growth and social development.

In the last decade, several countries have focused their social policy in this direction and have started implementing universal asset-based policy. Unfortunately, Baltic states are not on that list, neither are other Central and Eastern Europe (hereinafter CEE) countries.

3. Asset-based policy: from theory to practice

Various authors have come up with several different methods to implement asset-based policy:

- 1) benefits to new-borns: one-time transfers by the government to *child development accounts* opened to all new-borns (hereinafter CDA) (Kelly, Lissauer, 2000);
- 2) matched savings accounts for the poor and transfers by the government, that match at a certain ratio and to a certain limit the personal savings, transferred to these accounts (Sherraden, 1991);
- 3) one-time grant to all individuals reaching majority (Nissan, Le Grand, 2000; Ackerman, Alstott, 2005);
- 4) regular monthly benefits for all citizens of a country, after reaching majority (Van Parijs, 2005).

It should be noted, that these proposals envisage fairly different implementation of asset-based policy, however all of them focus on the same goal, i.e. to accumulate a certain amount of asset, escape from regular cycle of benefits, consumption and poverty, encourage development of personal capabilities and as a result, a better development of entire society and national economy.

Interest in asset-based welfare became increasingly popular throughout the world in the last decade of 20th century. Efforts have shifted from scientific research to practical implementation of ideas:

- 1) In Great Britain, in 2005 the program of the Child Trust Fund (hereinafter CTF) was introduced which ensured that all children born on or after 1st September 2002 would receive a voucher of 250 pounds (an extra 250 pounds voucher was given for newborns from low-income families) and an additional voucher when reaching 7 years (and possibly 11 years). CTF funds were intended to be invested for a long-term period and managed by parents/legal guardians until a child reached the age of 16. At this point, a child would have an option to take over the management of his account but he would still not be able to withdraw funds from the account until he reached 18. It should be noted, that this program was stopped since 2011 due to the financial crisis.

- 2) Since 1998 in 40 states of US a program of Individual Development Account (IDA) has been active. It ensures that the savings of low-income families are in a certain ratio (1:1 to 1:3) matched with public funds. In a certain time (usually once in 4-5 years) savings can be used to purchase a first home, to pay post-secondary education, or to start or expand small business.

Other industrialized nations which have more or less developed models of asset-based policy include Canada (CDA), Singapore (coherent program of life-long asset accumulation), South Korea (CDA and savings accounts to the poor) and Hong Kong (CDA). There are pilot programs in Taiwan (savings accounts to the poor) and USA (CDA in Oklahoma; draft legislation for universal CDA policy at national level).

The table below briefly presents key features of these policies.

Table 2. Asset-based policies in selected countries

Country	Name of accounts / program	Status	Beneficiaries	Scope	Benefits
UK	CTF	terminated	children (0-18 years)	universal	Benefit by the Government at birth and reaching 7 and 11 years
Canada	RESP (CESG and CLB)	in progress	children (CESG: 0-18 years; CLB: 0-21 years)	universal	Benefit by the Government to the new-borns from poor families; matching funds for private savings
USA	KIDS	expected	children (0-18 years)	universal	Benefit by the Government at birth; matching funds for private savings (for the poor only)
USA	SEED OK	in progress (pilot)	children (0-7 years)	1360 newborns in Oklahoma, USA	Benefit by the Government at birth; matching funds for private savings (for the poor only)
USA	IDA	in progress (pilot)	low-income individuals	selective; low-income families	Matching funds for private savings
Singapore	Baby Bonus, Edusave, PSEA	in progress	children (Baby Bonus: 0-6 years; Edusave: 6-16 years; PSEA: 7-20 years)	universal	Benefit by the Government at birth and until the age of 20; matching funds for private savings
South Korea	KCDA	in progress	children (0-18 years)	as at the end of 2010, ~41 000 institutionalized children	Matching funds for private savings
South Korea	Hope Accounts	in progress	low-income individuals	~13 000 individuals from low-income families in Seoul	Matching funds for private savings
Taiwan	TFDA	in progress (pilot)	low-income individuals	selective (not specified)	Matching funds for private savings
Hong Kong	CDF	in progress	children (10-16 years)	Intended for ~13 600 children from low-income families	Matching funds for private savings

Source: Kim et al., 2010; Han, 2009; Zou, Sherraden, 2010; Sherraden, Stevens, 2010; Sherraden, 2008; Richards, Thyer, 2011 and authorial computation

All these policies are characterized by the fact that there is accumulation of funds in an investment account for a certain period of time (in case an account is opened to a new-born, the funds are mostly accumulated until he/she reaches majority; if an account is opened to a low-income individual, funds are mostly accumulated for 2-4 years), using support of the Government (one-time benefits or matching funds); later on, these funds can be used for a predetermined purpose: mostly for education, housing or starting a small business. Only CTF program that operated in the United Kingdom included no restrictions to the use of accumulated funds.

The first results of saving / investment / asset accumulation programs suggest that the asset-based policy increases individual saving rate, financial literacy and may have positive attitudinal, behavioral, and social effects (Scanlon, Adams, 2009). The most important conclusion is that low-income individuals and families can save, if they participate in saving programs and are provided with information, certain benefits and access to corresponding institutional structures (Mason et al., 2009). How can they accomplish it? The studies have showed that families facing severe financial difficulties can modify their consumption habits and come up with various innovative methods in order to save funds in an investment account of their child (Adams, Whitman, forthcoming).

Besides, it was found out that young people who had even a small stake of private equity at the beginning of their full age, 10 years later would have a large advantage over those who had no equity. This advantage is expressed in lower unemployment level, higher salary and better health. Possession of even a small equity encourages people to invest, save and think about future, and gives them psychological and economic independence (Le Grand, 2010).

Overview of key cases of asset-based policy makes an impression that this policy is tested and implemented in Anglo-Saxon countries and South-East Asia, where the countries have historically inherited or try to imitate the same model of society and social protection (it should be noted, that certain products of asset-based welfare are offered in some other Asian and African countries, however they are provided mostly by commercial institutions, therefore they do not amount to a national policy). This impression is mostly correct: so far, no continental Western European country has carried out similar experiments of asset-based policy (they have a strong welfare state and a well-developed social protection in place); neither has any CEE or Baltic country (these countries traditionally follow their Western neighbors, trying to implement the same welfare state models).

When considering, whether asset-based policy would be necessary in Baltic states, one must keep in mind that these countries are relatively poor, so they will find it hard to create and maintain the costly welfare economy given current economic difficulties and ever more austere fiscal policy conditions. Besides, Greece provides a good example, how the welfare economy over-financed for years discourages efficiency and productiveness and ruins the country.

The new social policy based on the principles of saving, investing and asset building could be a good measure to bring a break-through in a combat against poverty and inequality in the Baltics.

Conclusions

- 1) Neither rapid economic growth, nor stock market boom have reduced poverty and social inequality in the Baltics: inequality and poverty indicators in Latvia and Lithuania remain far from European average.
- 2) Current income support (or income security) policy is a passive one: it supports individuals in distress; however, it is not intended to develop their capabilities. Thus, it should be replaced by an active social policy, which stresses development of capabilities, savings, investments and building of assets.
- 3) A concept, stressing long-term capabilities, based on certain asset level, is called *asset-based policy*. During the last decade, several countries started focusing their social policy towards a universal, asset-based policy.
- 4) The first results of asset accumulation programs suggest that this policy increases individual saving rate, financial literacy and may have positive attitudinal, behavioral, and social effects. Even low-income individuals and families are capable to save.

- 5) To-date, no continental Western European country has tried to implement asset-based policy; neither have CEE or Baltic countries.
- 6) Identified benefits of the asset-based policy, high level of poverty and social inequality, economic crisis and austere fiscal policy are the main assumptions to start reforming current social policy in Baltic countries.

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ISBN 978-80-905243-0-9
ETTN 085-12-12014-05-2

Vydání 2., 2012

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