

CHAPTER 6. CONCLUDING REMARKS AND POLICY IMPLICATIONS

6.1 Concluding Remarks

The primary purpose of this study is to look into whether more unequal local governments spend more on social welfare spending out of their total local expenditure. Furthermore, this study also considers other determinants of social welfare spending and the quadratic term of Gini index to further examine whether there exists a nonlinear relationship between Gini index and the dependent variable, the proportion of social welfare spending to total local expenditure (SW).

By using the county-and-city panel data of 23 cities and counties of Taiwan during 1994-2006 period and a 2SLS model, the primary finding of this study is that income inequality affects SW negatively and significantly at a 1% significance level. In addition, this study also finds that the square of Gini index has a positive and significant impact on SW. Namely, there is a U-shaped relationship between income inequality and social welfare spending. The negative impact means that more unequal societies will spend less on social welfare, and the U-shaped relationship means that the negative impact of income inequality on SW will weaken with the deterioration of income distribution. This implies that when the Gini index is larger than a critical value, more unequal societies will finally turn to spend more on social welfare.

With respect to other independent variables, it is found that both the proportion of population over 65 years of age and the total local expenditure have a significant and positive influence on SW. Besides, this study also considers the ruling party of local governments. And the estimating result indicates that the SW is larger if the city/county is governed by a pan-green party. What is more, this study also found that the

election of county magistrates and city mayors has a positive impact on SW because candidates want to please voters through providing social welfare services to win more votes. Finally, the regression results of area dummy variables implicate that the SW of north area, middle area and south area are all lower than that of east area. That is to say, the SW is largest in the east area of Taiwan.

Finally, several tests have been conducted to ascertain whether the empirical regression model is robust. Based upon some econometric tests, it is ascertained that the 2SLS model is free from endogeneity, misspecification and multicollinearity problems.

6.2 Policy Implications

According to the empirical model, the main finding of this study says that if Gini index is below the critical value, which is estimated as 32.77% in this study, the impact of income inequality on social welfare is negative. However, if Gini index is above the critical value, the impact of income inequality on social welfare turns to be positive. That is, when the income inequality problem is not too serious, cities and counties with higher income inequality will spend less on social welfare. However, if the income inequality problem is serious to some extent, cities and counties with higher income inequality will spend more on social welfare. This result is consistent with the theory of capital market imperfection brought up by Benabou (2000) and the empirical test of Mello and Tiongson (2006).

The explanation of the negative impact before Gini index attain to the critical value is that in an imperfect capital market, people, especially the poor, can not completely access to capital markets to prevent themselves from suffering adverse economic shocks or to make long-term investment to improve their wealth. Meanwhile, the rich is easier to become richer through investment in an imperfect

market. Thus, the poor becomes poorer and the rich becomes richer, and income inequality problem gets more serious in the end. Then, the political support on social welfare spending decreases since redistribution which would increase ex ante welfare leads to less support in an unequal society than in a homogenous society.

In other words, the opposition of the rich might be the leading cause of the negative impact of income inequality on social welfare spending in Taiwan. This situation might send us a warning of elite politics of Taiwan. Namely, social welfare policies are controlled by the elites, usually the rich, in Taiwan. Because the rich usually have more political power than the poor, they can utilize their power to oppose social welfare policies through rent-seeking. However, social welfare should not go like this because it is the poor that need social welfare resources. As a result, cities and counties with more serious income inequality problem should spend more on social welfare. Hence, the negative impact of income inequality on social welfare might imply that the social welfare situation of Taiwan is a kind of unhealthy.

Apart from the elite politics, the negative estimating result of Gini index on SW might also imply that the income inequality of Taiwan is still not too serious on average. Since the U-shaped relationship implies that when the inequality problem is serious to a certain extent, more unequal societies will finally turn to redistribute more. Luckily enough, our model still shows a negative impact of income inequality on social welfare spending. Hence, it might implicate that the income inequality problem of the cities and counties of Taiwan has not been so serious yet. However, the data still points out a warning of rising income inequality, so governments of Taiwan should still maintain vigilance and keep an eye on this problem continuously.

Finally, because the negative impact of income inequality on SW is explained by the theory of capital market imperfections, it can be concluded that the capital market

of Taiwan is imperfect. In fact, almost no capital market is completely perfect in the world. The result might suggest that the imperfection of the capital market is a substantial cause of income inequality problem in Taiwan. Therefore, this study suggests that the government of Taiwan can improve the income inequality problem by correcting the imperfect capital market first. Then, the political power of the rich might become weak and they will not have enough power to control social welfare policies any more. In consequence, more unequal cities and counties of Taiwan will turn to spend more on social welfare.