Structural Dilemmas in Existing Welfare Systems and a Possible Direction for Redesign

— Starting from the Functional Bundling of ‘Subsistence Guarantee’ and ‘Purchasing Power’

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Abstract: The core aim of this paper is to conduct a systematic diagnosis of several mainstream welfare schemes currently in use, arguing that they share a common root cause: while providing subsistence guarantees (the ‘floor’ function), welfare programs also, directly or indirectly, assume the function of supplying beneficiaries with freely disposable purchasing power. Because these two functions are bundled into the same transfer payment or the same supply mechanism, welfare levels, work incentives, and fiscal sustainability become locked in mutually reinforcing constraints that are difficult to reconcile. This paper successively examines the incentive dilemma of cash-based welfare, the paternalism dilemma of in-kind/service-based welfare, the hidden costs and stigmatization arising from means-testing, and the problem of cost escalation caused by the blurred boundaries of welfare coverage. On this basis, the paper puts forward its central argument: these dilemmas do not stem from the poor design of any particular welfare scheme, but rather from a fundamental design flaw — the structural non-separation of the ‘subsistence guarantee’ function from the ‘purchasing power’ function. The paper concludes by briefly sketching a possible direction for redesign — confining welfare to a materially minimal subsistence supply while leaving purchasing power entirely to be provided by the labor market — leaving the specific institutional details and operational mechanisms for future research.

Keywords: welfare system; welfare trap; paternalism; stigmatization; subsistence-guarantee function; purchasing power

1. Statement of the Problem

Since its inception, the welfare system has carried a task that appears simple but is in fact inherently fraught with tension: it must prevent those unable to sustain a basic livelihood on their own from falling into desperation, while at the same time avoiding excessive protection that would weaken the work incentives of those who are able-bodied, thereby eroding the very fiscal base that sustains the welfare system itself. Related research has long extended the classic welfare model to dimensions such as in-kind transfers, incomplete take-up, labor-supply responses, and saving behavior, which shows that the welfare problem has never been simply a matter of ‘how much money to give,’ but rather a holistic issue concerning institutional boundaries, incentive structures, and governance costs.[1]

Within this framework, the central tension in existing welfare systems is not merely ‘insufficient protection’ or ‘excessive incentive distortion’ taken in isolation, but rather the fact that welfare simultaneously performs two functions — ‘subsistence guarantee’ and ‘purchasing-power provision’ — without these two functions being structurally separated within the system’s design. Once cash welfare operates as income replacement, it immediately triggers problems of marginal tax rates and work incentives; once in-kind welfare attempts to directly prescribe the content of consumption, it in turn raises issues of paternalism, category definition, and administrative cost. Means-testing, meanwhile, places recipients in a state of continually having to prove their poverty, so that the very act of claiming benefits acquires hidden costs and a stigmatizing character. This paper therefore argues that many institutional difficulties that appear, on the surface, to be separate problems can in fact be traced back to the same root cause: the structural bundling of the subsistence-guarantee function with the purchasing-power function.[1–8]

2. The Incentive Dilemma of Cash-Based Welfare

2.1 The Welfare Trap and the Marginal Tax Rate Problem

Cash-based welfare (including unemployment assistance and minimum-income guarantees) is most often criticized for its tendency to create a so-called ‘welfare trap’: as a beneficiary’s earned income rises, welfare benefits are typically reduced proportionally, which is equivalent to imposing an extremely high implicit marginal tax rate on the additional income of low-income earners. As a result, ‘working one more hour’ yields almost no gain in actual take-home income, and may even produce a net loss once a particular eligibility threshold is crossed. Chan and Moffitt’s review extends the classic labor-supply model to welfare reform, in-kind transfers, incomplete take-up, and several other directions, showing that such incentive problems are not the result of isolated policy failures but one of the core themes of welfare-system analysis. Moffitt and Zahn's study based on AFDC further shows that changes in administrative thresholds significantly affect labor supply at the margin of welfare participation; on average, the work-disincentive effect may not be extremely large, but at certain margins it can be quite pronounced. Bargain's study of France's RMI found that welfare reduces employment among uneducated single men by 7–10%; Kwon and Han's study of South Korea's EITC did not find a welfare trap in the classic sense, but did observe evidence consistent with 'adverse selection.'[1–3] This issue has already been extensively discussed in the academic literature, yet its root cause has never been directly addressed: as long as welfare is provided in cash form, and cash itself is a direct source of purchasing power, a trade-off relationship between the welfare level and the market wage is unavoidable — any design of a benefit-withdrawal (taper) curve can only mitigate this substitution effect, never eliminate it.

2.2 The Difficulty of Calibrating Cash-Benefit Levels

Cash-based welfare also faces a persistent governance cost: benefit levels must be continually recalibrated in light of price levels, regional disparities, household composition, and other factors — yet this calibration is itself always lagging behind changing realities, and easily becomes an object of political contention. Setting the benefit level too high invites accusations of 'coddling the idle'; setting it too low invites accusations of inadequate protection. This recurring administrative recalibration is, in essence, an attempt to use a single figure (the cash amount) to simultaneously satisfy two mutually conflicting goals — 'providing a floor' and 'not exceeding market incentive levels' — and the very difficulty of calibration reveals the underlying contradiction in how the goal itself has been defined.

3. The Paternalism Dilemma of In-Kind and Service-Based Welfare

To avoid the incentive problems of cash-based welfare, some schemes instead substitute cash with in-kind goods or designated services (food stamps, housing subsidies, education vouchers, and the like). Such schemes do, to some extent, limit the possibility of welfare being diverted to other uses, but they introduce new problems: the welfare provider must decide in advance 'what beneficiaries actually need,' a judgment that is itself strongly paternalistic in character and ill-suited to accommodating the diversity of individual needs. The same in-kind benefit may be exactly suitable for some beneficiaries while being wasteful or poorly matched for others.

Cunha's 'Testing Paternalism: Cash vs. In-kind Transfers,' along with the research by Cunha, de Giorgi, and Jayachandran on the price effects of cash versus in-kind transfers, both suggest that in-kind welfare is not inherently superior to cash: cash does not automatically lead to so-called 'profligate consumption,' and the effects of in-kind transfers are better explained by changes in prices, market frictions, and consumption patterns than by any simple notion of morally superior control. In other words, the problem with in-kind welfare is not that it is 'too generous,' but that it transfers the beneficiary's power of choice to the institutional designer. Once the categories of welfare goods expand beyond basic subsistence needs, the provider is forced to continually judge which forms of consumption are 'reasonable' — a judgment that lacks any objective standard and readily drives up administrative costs.[7–9]

More critically, once the categories of in-kind or service-based welfare expand beyond the most basic subsistence needs (for example, to cover education, vocational training, or improvements in housing quality), the welfare provider is inevitably required to make continual, fine-grained judgments about the boundaries of 'reasonable need.' Such judgments not only lack objective standards but also readily become an entry point for runaway welfare costs — the richer the range of categories, the more complex the supply chain, and the greater the resulting administrative cost and scope for rent-seeking.

4. Means-Testing and the Problem of Stigmatization

Whether cash-based or in-kind, any welfare scheme that involves determining 'who is eligible and how much they may receive' inevitably requires beneficiaries to prove their state of poverty or eligibility. This process itself constitutes what welfare economics terms a 'hidden cost': queuing, preparing documentation, repeated review, and waiting periods together form an additional cost that beneficiaries must bear before receiving welfare — a cost that never appears on the welfare system's books, yet genuinely reduces the accessibility of the system. Currie's review of welfare take-up notes that low take-up rates cannot simply be attributed to lack of information or transaction costs; Herd and colleagues' study of Medicaid proposes that shifting the administrative burden from the individual to the government can raise take-up without compromising program integrity; and a recent meta-analysis found that interventions reducing compliance requirements raised actual take-up rates by an average of 8.31 percentage points.[4–6]

Even more noteworthy is the social stigmatization that accompanies means-testing — public determinations of poverty are often accompanied by a degradation of social identity, a cost that institutional designers can neither precisely measure nor compensate for through adjustments to benefit levels, yet which genuinely reduces the practical accessibility of welfare for its target population, and may even lead some who genuinely need welfare to forgo applying rather than bear the cost of stigmatization. The burden of means-testing is therefore not merely a matter of efficiency, but a matter of institutional dignity.[4–6]

5. Cost Escalation Caused by Blurred Boundaries of Welfare Coverage

Existing welfare schemes generally lack a clear, stable principle for defining 'to what extent welfare ought to extend.' The expansion of welfare categories and benefit levels tends to be incremental and reactive — whenever a new social need or political demand emerges, the welfare system tends to layer a new program on top of the existing ones, without any endogenous mechanism, grounded in supply-side cost considerations, for contraction. The result of this pattern of expansion is that the fiscal sustainability of the welfare system increasingly depends on whether economic growth itself can keep pace with ever-expanding welfare expenditures. Once economic growth slows, the welfare system faces the extremely difficult problem of cutting back existing entitlements — reform meets enormous resistance, because any cut is perceived not as a reasonable adjustment of the cost structure but as the confiscation of a vested interest.

From an institutional-logic standpoint, this problem is structurally identical to those discussed above: if welfare bears both the subsistence-guarantee function and the purchasing-power-provision function, its boundaries can never be clearly defined. So long as the purchasing-power component continues to be supplied directly by the welfare system, the system is forced to keep answering an unanswerable question — 'which forms of consumption deserve support, and which exceed the scope of the subsistence floor?' The more blurred the boundary, the more complex the governance; the more complex the governance, the higher the cost; and the higher the cost, the more easily the system's legitimacy is called into question.[1,7–9]

6. The Author's View: A Common Root Cause

Drawing together the analysis of the preceding sections, this paper argues that the incentive dilemma of cash-based welfare, the paternalism dilemma of in-kind welfare, the stigmatization cost of means-testing, and the cost escalation caused by the blurred boundaries of welfare coverage are, on the surface, four distinct problems, but their root cause can be traced to one and the same structural flaw: existing welfare schemes generally fail to separate, at the level of institutional design, the two functions of 'guaranteeing basic subsistence' and 'providing freely disposable purchasing power.'[1]

Precisely because welfare simultaneously bears both functions, institutional designers are forced to address, within a single mechanism, two mutually pulling goals — 'insufficient protection' and 'excessive incentive distortion.' Set the cash amount too high, and purchasing power becomes excessive while incentives are undermined; set it too low, and purchasing power becomes insufficient while protection fails. Make the categories of in-kind welfare rich, and continual paternalistic judgment and administrative cost become necessary; make them narrow, and the system struggles to accommodate individual differences. Make means-testing strict, and the cost of stigmatization and hidden costs rise; make it lenient, and the boundary of welfare blurs while the risk of cost escalation increases. It can be said that nearly all of the internal tensions found in existing schemes can be traced back to this same, unaddressed problem of functional bundling.[1,2,4,7–9]

This paper therefore argues that, rather than continuing to seek ever more refined benefit calibration or ever more elaborate means-testing mechanisms within the existing framework, it may be worth fundamentally reconsidering whether the welfare system can be redesigned to bear only the single function of 'providing a floor,' while returning the provision of 'purchasing power' entirely to the labor market. If this separation is structurally feasible, then the various problems discussed above may not be independent issues each requiring a separate patch, but rather consequences that dissolve naturally once this single, shared design premise is removed.

7. A Possible Direction for Redesign (Details Left to Future Research)

Based on the judgment reached in Section 6, if one is to fundamentally resolve the structural dilemma arising from the bundling of the 'subsistence-guarantee' and 'purchasing-power' functions, the most direct approach is to separate the two and design distinct treatments for each.

With respect to the subsistence-guarantee function, welfare supply should be confined to material form and should cover only the most basic subsistence needs, avoiding expansion into categories such as education, housing quality, or durable consumer goods. On the supply side, priority should be given to categories with simple raw materials and mature production technology that lend themselves to large-scale, centralized production, so as to reduce supply costs through economies of scale and centralization — allowing the subsistence-guarantee function itself to no longer depend on continual benefit-level recalibration or paternalistic category judgments.[7,8]

With respect to the purchasing-power function, it should no longer be borne directly by the welfare system, but should instead be returned entirely to the labor market — specifically, by not providing beneficiaries with freely disposable cash, so that all consumption needs beyond the subsistence floor can be met only through participation in work. The point of doing so is not to weaken welfare, but to return the welfare system to its most fundamental scope of responsibility. Rather than continually adjusting subsidy parameters, it would be preferable to make the subsistence-floor component more stable and less prone to friction through lower administrative burdens, higher accessibility, and clearer eligibility rules.[4–6]

However, upon further development of these two lines of thought, this paper finds that the two functions, though treated separately, are not in fact entirely independent — their effects can be reconnected. Whether a scheme provides welfare directly with no conditions attached (unconditional welfare) or requires beneficiaries to reach a certain level of consumption in order to continue receiving or to improve their welfare benefits (that is, treating 'higher consumption' as a precondition for using welfare), both schemes appear, on the surface, to produce a fairly clear boost to overall consumption levels — the former by directly increasing disposable resources and thereby releasing latent consumption demand, the latter by tying welfare to consumption behavior and thereby compelling beneficiaries to actively work and raise their income in order to maintain or expand their consumption. Comparing the two, the scheme conditioned on 'higher consumption' is clearly superior: it not only likewise stimulates consumption, but also embeds work incentives directly into the institutional structure itself, allowing the subsistence-guarantee and purchasing-power functions to be structurally reconnected in a positive relationship, rather than operating in isolation from one another.

In other words, welfare would no longer directly provide beneficiaries with freely disposable cash, but would instead require them to obtain greater consumption capacity through work participation. In this way, the relationship between welfare and consumption would no longer be one of one-way substitution, but would instead re-establish the connection of 'work — income — consumption.' Research on cash versus in-kind transfers suggests that simply handing resources to beneficiaries does not necessarily lead to the irrational consumption often assumed; what truly drives outcomes tends to be price, market friction, and incentive structure.[7–9]

More importantly, if 'higher consumption' is set as the condition for using welfare, then the purchasing-power function within the welfare system would no longer be provided directly by administrative agencies, but would instead be accomplished through labor-force participation. In this way, the subsistence-guarantee function and the purchasing-power function would regain a positive structural association: the former would be responsible for preventing basic living standards from collapsing, while the latter would be responsible for incentivizing work and expanding consumption, with work reconnecting the two functions. Rather than describing this as a mere fine-tuning of traditional welfare, it would be more accurate to describe it as a restructuring of the welfare system away from the logic of 'care and substitution' and toward a logic of 'guarantee and incentive.'[1,4,6]

It should be noted that the foregoing is only a preliminary, surface-level conclusion derived from an initial logical deduction. The specific mechanisms involved — including the criteria and enforcement methods for determining 'higher consumption,' the choice of consumption indicators and the design of the relevant statistical units, how to address free-rider problems, the differentiated responses that different groups (particularly different age cohorts) might exhibit under such a system, and the related issues of privacy, ethics, and feasibility — are far more complex than this conclusion itself, and this paper does not elaborate on them further here, leaving them to be examined systematically in future research.[1,4]

8. Conclusion

The main contribution of this paper is to show that the incentive dilemma, paternalism dilemma, stigmatization problem, and cost-escalation problem that are widely present in existing welfare systems are not independent technical flaws each requiring separate repair, but are jointly rooted in a single design premise: the failure to structurally separate the 'subsistence-guarantee' function from the 'purchasing-power' function. This judgment itself constitutes a reconsideration of previous approaches to welfare reform: past reforms have largely focused on adjusting parameters within the existing framework (benefit levels, means-testing thresholds, benefit-withdrawal rates), while rarely questioning whether the framework itself needs to be redesigned. The direction for redesign proposed in this paper is only a preliminary conception; its feasibility, specific mechanisms, and potential risks await further systematic argumentation in future research.[1,4–6]

9. References

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