A Welfare State for the 21st Century

Ageing societies, knowledge-based economies, and the sustainability of European welfare states

Gosta Esping-Andersen

The history of European welfare states combines brief moments of epochal change with long periods of politics as usual. More than one hundred years have now elapsed since Bismarck launched modern social policy, and over a half-century has passed since the welfare state emerged from war-torn Europe. In both instances, visionary thinkers and practitioners of bold statesmanship redefined public responsibilities and social justice. The architecture of the state was fundamentally altered. But since then, the conduct of social policy has been largely a matter of fine-tuning and incremental adaptation of the existing edifice by the bureaucrats and technicians who usually look after things during normal times.

Epochal redefinitions occur during periods when basic goals are being reconsidered. Over a half-century ago, the designs for modern welfare states associated with Gustav Möller in Sweden and Lord Beveridge in England were responses to the urgent need to consolidate democracy and new social solidarities. While democracy is now an established fact in Europe, social cohesion is not. We are moving toward a new type of economy and society, both of which call for a new model of social policy.

Today, Europe stands at a crossroads which is similar to that of the post-World War II era and the invention of the modern welfare state. Given that the most urgent priority is to better adapt redistribution priorities and social rights to evolving realities, this is not the right time for bureaucrats or technicians to be in charge. Accordingly, the following analysis attempts to redefine the basic structure of the European welfare state. It is an attempt to outline a welfare edifice that is in better harmony with the characteristics of the economy, labour market and family that are currently in the making.

The challenge— an overview

The challenge is immense, because the ongoing revolutions in both the labour market and family structure that are creating fantastic new opportunities are also posing novel social risks and needs. Changing technologies, accelerating global integration, and the upgrading of human capital are essential to ensuring competitiveness. The labour market will be dominated by service occupations, and this means a general bias in favour of professional and technical skills. In response to the new needs of families, however, there will also be an expansion of low-level (and possibly low-paid) personal and social services. The availability of such service jobs offers the only realistic means of achieving full employment. Thus, the emerging economy will be knowledge-intensive in many, but not all, respects.

Note: This is a slightly revised version of a report to the Portuguese presidency of the European Union, prepared for the Lisbon Summit, March 2000.

Accordingly, it will be difficult to avoid new social divisions in society. A knowledge-intensive economy will produce new labour-market distinctions based on skills, possibly with increasing polarization between stronger and weaker groups as a result. The question of how to deal with the ”losers” in such a development is one major challenge. Another is implicit in the fact that a knowledge-intensive economy requires expertise not only among producers, but also among consumers. Therefore, unless Europe succeeds in strengthening the cognitive skills of its citizens on a broad front, one ominous long-term development could be a scattering of ”knowledge islands” amidst a sea of marginalized outsiders.

Europe’s challenge is not simply to catch up with the United States in matters of information technology, but also to ensure that social cohesion will not be endangered in the process. It is a challenge of the first order, one that poses the question of how to democratize skills through education and training. Of course, a society’s ability to develop its human resources to their fullest potential is related to social policy.

More simple-minded advocates of a ”third way” believe that the population can be adapted to the new economy by means of education, and that potential social problems will thereby disappear. This is a dangerous fallacy: Education, training and life-long learning will not suffice.[1] On the one hand, a knowledge-intensive economy will generate new inequalities. On the other hand, investments in education can be inefficient if they are not backed up by investments in the social sphere. The ability of children to learn and to succeed in education depends heavily and directly on the social situation of their families.

Both the new family and emerging life-cycle patterns pose a second formidable challenge. Families are increasingly unstable, and a new structure of households is emerging. Both trends imply new risks and new needs; and, again, there are signs of a growing polarization between the strong and the weak. At one pole, divorce, separations, and single parenthood create risks of poverty. At the other pole, the trend towards two-earner households broadens the base of family resources. Since marriage partners tend to come from similar social backgrounds, inequalities between such family types will tend to increase.

The standard male-breadwinner model that once guaranteed adequate welfare and high fertility is declining, both numerically and with regard to its capacity to effectively prevent child poverty. Indeed, the conventional family may constitute a growing obstacle to flexibility and adaptation, since the welfare of too many citizens depends on the job and income security of one person. Associated with the family revolution are new life-cycle patterns that are much less linear, homogeneous, and predictable.

As a consequence of all this, new risks and resource needs are becoming heavily concentrated among young people and families with young children. Once again, the

[1] This view is equally fallacious (and quite similar) to the classical Marxist idea that socialization of the economy would solve most social problems, or to the post-war meritocracy argument which believed that mass education would eliminate class differences.

challenge is to redefine social policy so that it nurtures strong and viable families, while protecting those most at risk. If the latter happen to be children and young people, the urgency of reform is all the greater, since it is today's children who will comprise tomorrow's productive base-- or, if appropriate measures are not taken, tomorrow's costly social problems. For a knowledge-intensive society, this implies one clear guideline for social policy: Give absolute highest priority to ensuring the welfare of children.

As has always been the case, access to adequately paid work is the single best guarantee of family welfare. Emerging household patterns are such that the family-work nexus has become more problematic. There have been increases in ”no-work households” (currently ca. 10-12 percent of all working-age households in the EU), in young adults' extended dependency on their parents, and in single-parent families. There has also been a dramatic rise in two-income, two-career households.

In every case, households experience (often great) incompatibilities between the demands of employment and family obligations. Such trade-offs cannot easily be resolved by the family, itself, or by the labour market. The modern family requires access to appropriate services in order to avoid dependency on traditional income maintenance. The household and the family constitute the bedrock of social cohesion, but in their modern form they face severe dilemmas. Also, the employment of women is emerging as a vital economic resource and as a basic requirement for maximizing welfare. A second clear policy guideline thus emerges: Place high priority on services to households, in order to reconcile the career and family goals of mothers.

Post-war ”welfare capitalism” functioned well because labour markets and families were the principal source of welfare for most citizens during most of their lives. At present, both labour markets and families are subject to widespread insecurity, which can easily lead to social exclusion. The social-policy instruments that are needed to combat social exclusion in the 21st century are, to a great extent, the same as those needed to secure a work force with strong cognitive skills-- i.e. investments in families and children.[2]

Most contemporary European welfare states place a heavy emphasis on age differences and income transfers. This is not an efficient framework for the profile of risks and needs that is currently emerging. Redesigning social policy implies a need to rethink the life cycle, as well as the balance between income transfers and services and, more generally, the guiding principles of social justice and equality. If Europe aims to strengthen its competitive position in the global economy, and at the same time commit itself to full employment, new inequalities will be difficult to avoid. The burning question is: What to do about them?

The most fundamental conclusion that emerges is that it is necessary to reconsider the concept of social rights. The existing principle-- of guaranteeing maximum welfare

[2] Here we might add yet another policy priority: to rethink our existing accounting systems so as to recognize that many social outlays are direct or indirect *investments* with a calculable economic payoff.

and equality ”for all, here and now”-- cannot be consistent with emerging economic imperatives. If relatively low incomes, poor jobs, or insecure employment cannot be avoided (and, arguably, might even deserve encouragement), there remains the issue of how to soften the consequences for welfare in the short-run. However, the central issue of welfare must focus on the dynamics of citizens’ lives and life chances. Low wages or poor jobs do not pose a threat to individual welfare if the experience is temporary; but they do pose such a threat if individuals become trapped in those circumstances. In short, the essence of social rights should be reconceptualized in terms of effective guarantees against entrapment, as the right to a second chance-- in short, as a basic set of life-chance guarantees.

The diversity of European welfare regimes

These challenges are not identical, nor equally difficult, for all European welfare systems. Two errors must be avoided: One is to ignore the great diversity of European welfare systems. The other is to remain too narrowly preoccupied with the welfare *state,* alone. The total welfare package combines inputs from the state, markets (especially labour markets), and families.

Many view the welfare state as overburdened, inefficient, threatened. or simply malfunctioning. Some advocate that it be radically slimmed down, others that it be strengthened, and still others that it be overhauled. All such opinions imply a corresponding solution which specifies the roles that ought properly to be played by markets and families. Those who advocate decentralization basically suggest a greater portion of responsibility to be assumed by families and the ”local community”. Champions of privatization assign welfare to the ”cash nexus”; but in practice, the result would be a greater burden on many families. To capture the interplay of state, family, and market, it is useful to frame our analysis in terms of welfare regimes..[3]

Turning the clock back to the post-war decades, it is possible to identify two distinct European welfare regimes. The Nordic-cum-British variant was largely financed from general revenues, with the stress on universal flat-rate benefits. The other regime, prevalent in continental Europe, emphasized social insurance programmes financed by employee contributions and linked to the job or place of employment. As social insurance systems evolved, and by the 1970s matured, the differences between alternative regimes emerged much more clearly.

The Nordic countries branched out into a unique model with two main features. First, an earnings-related component was added to flat-rate ”citizens benefits”. Second, there was a shift from cash transfers to family services, policies that stressed activating employment and, above all, the integration of women into the labour market. The Nordic model may be famous for its generosity and universalism, but what really stands out is its emphasis on employment and the ”de-familialization” of responsibility for providing welfare. In contrast, Britain gradually moved toward a

[3] This paragraph draws on Esping-Andersen (1999). International research and policy-making has, in recent years, awoken to the necessity of examining welfare problems in this way. See, for example, OECD (1997; 1998).

greater emphasis on targeted services and income-testing, assigning greater responsibility for welfare to the market-- thus converging with the North American regime.

What is striking about most continental European countries is how little they have changed: They remain firmly wedded to employment-based, contributory social insurance. But they have extended coverage to residual groups via *ad hoc* income-testing programmes (e.g. the RMI in France or the *pensione sociale* in Italy). A second defining feature of continental European social insurance systems, especially those of the Mediterranean countries, is their strong familialism. This means that families have the principal responsibility for their members' welfare, be it in terms of sharing incomes or providing care to those in need. Hence, these countries are: uniquely committed to protecting the male breadwinner via insurance and job protection; highly reliant on social contributions for financing; and, compared with the rest of Europe, very underdeveloped with regard to social services.

Such differences mean that it is not possible to devise general strategies for social reform which apply to Europe as a whole. It also follows that it would be a serious mistake to restrict the focus solely to the welfare role of governments. I believe it is futile to discuss whether public social commitments should be reduced without considering what effects that might have on the delivery of welfare by the family and the market.

A strategy of decentralizing welfare, from government to the community and the family, may sound appealing. But how would it affect women's double role as employees and care-givers? Alternatively, an expanded role for markets may appear more efficient. But if this means that large segments of the population would be priced out of the welfare market, do the potential gains in efficiency outweigh the potential losses of welfare? Reforming European welfare commitments for the coming century implies regime change-- that is, reordering the contributions of the market, the family and the state so that the welfare mix better corresponds to overall goals for a more equitable and efficient social system.

The transformation of social risks and needs

Most European social insurance systems were constructed during a time with a very different range and severity of risks and needs than those of today. With two main exceptions-- the Nordic countries and Britain-- the allocation of welfare responsibilities between state, market, and the family has not changed dramatically during the past fifty years. What *has* changed, however, is the capacity of households and labour markets to furnish the basic welfare guarantees that were once assumed to fall within their domains. Indeed, both institutions now generate new risks and also, of equal importance, new needs.

The post-war model could rely on strong families and well-functioning labour markets to furnish the lion's share of welfare for most people during most of their lives. Until the 1970s, the norm was the stable family based on a male breadwinner.

The male could count on secure employment with few interruptions, steady growth of real earnings, and a long working life-- followed by few years of retirement after age 65.

Typically, women would leave the paid labour force after the birth of the first child, to become society's main provider of care for children and the infirm elderly. Welfare was thus assured by a standard household sustained by the combined inputs of two adults in the prime of life, i.e. the father's paid work and the mother's family care. But it was an arrangement that involved substantial risks at the two ”passive” extremities of the life cycle-- early childhood, especially in the case of large families, and old age. Hence, in addition to health care, European welfare states came to place high priority on family-income maintenance and, above all, on pensions.

If, as at present, new risks emerge from weakened families and poorly functioning labour markets, those institutions may fail to fulfil the responsibilities previously assigned to them. As a consequence, the welfare state is burdened with responsibilities for which it was not designed. Accordingly, the welfare state must be adjusted so that labour markets and families will be able to function more effectively in the future.

Family risks

Families today have very few children; yet, poverty among children is rising. Ongoing changes in labour markets and families affect young households most severely, and the reasons for this are well documented. For one thing, unemployment and job insecurity are concentrated among young people and the poorly educated, males in particular. The incidence of ”no-work households” among these categories is sometimes alarmingly high, providing one indicator of an emerging new polarization.

Young people often face serious delays in ”getting started”, i.e. in making a smooth transition from schooling to careers, or in building independent families. Southern European youth can often expect three years' unemployment, and this is one obvious cause of falling birth rates in that region. The consequences of employment insecurity among young people vary, however, depending on national social policies. As indicated in Table 1, the unemployed in general and young people in particular face serious income problems in many EU countries.

The familialism of southern Europe implies that the unemployment problem is internalized within the family, but this is not the case in northern Europe. Where unemployed young people are generally entitled to social benefits, as in Denmark, poverty among them is limited; where they must rely primarily on assistance from other sources, as elsewhere, poverty is widespread.[4]

The new risks are also related to an increase in ”non-standard” households (see Table 2 for an overview). Two types have become especially prominent: the ”no-work-income” and the single-parent household.[5] Both are subject to high risks of poverty.

---

[4] For details, see Bison and Esping-Andersen (2000).
[5] Note that there is overlap between the two.

No-work households are generally dependent on transfer payments, often relying on social assistance. With the exception of Scandinavia, child poverty is alarmingly high in single-parent families.

For all kinds of families with children, including those with two and single parents, the most effective safeguard against poverty does not consist of generous transfer payments, but rather of the mother's employment (see Table 3). The low rates of poverty among single-parent households in the Nordic countries are due less to generous social transfers than to adequate incomes from work made possible by child care.[6] Simply put, mothers' employment is a very effective shield against the risks associated with family instability and labour-market insecurity. That being the case, the most pressing issue of social policy has less to do with income maintenance than with providing services for working mothers.

The new array of life-cycle risks is most evident when younger and older households are compared with each other. Tables 4 and 5 show that the economic well-being of families with children has been eroding, while at the same time it has been improving among the elderly. Higher incomes allow the elderly to live independently which, in combination with rising longevity, has led to a shift by which their greatest need is for care at very advanced ages. Herein lies one of the key transformations taking place: The main welfare needs of both young and aged households have less to do with higher income transfers, and more to do with access to services. Among the very elderly, in particular, the pressing need is for home-help services and suitable residential facilities. For families with children, poverty is best prevented by enhancing the labour-market prospects and earnings capacity of parents.

Nevertheless, the programmes of most European welfare states remain heavily biased in favour of the aged rather than the young, and income maintenance rather than services. Herein lies a growing lack of fit between private needs and public services. The Nordic countries are unique in the priority they place on services to younger families[7] (see Table 6). Put differently, most European nations may be overspending on passive maintenance and underinvesting in the kinds of resources that strengthen their citizens' potential for self-reliance.

Of course, services can also be provided by the market or by families, themselves. In Europe, however, family services such as private day care are generally priced out of the market.[8] In general, where public services or government subsidies are absent-- as is the case in most countries of continental Europe, especially southern Europe-- families must themselves shoulder most of the burden for the care of children and the elderly.

---

[6] Social transfers account for only 1/3 of working single mothers' total income in Scandinavia. For details, see Gornick *et al.* (1997) and Esping-Andersen (1999).
[7] The age bias of social expenditures has *increased* in seven of thirteen EU member-states since 1980.
[8] My own estimates suggest that, due to high fixed labour costs and wage compression, full-time year-round day care in countries such as Germany or Italy costs about half of what an average full-time employed mother can expect to earn. A significant reduction of relative servicing costs can only occur realistically on the backdrop of a radical deregulation of wages and a reduction in fixed labour costs.

The net result of familialism, of course, is to make it more difficult for women to reconcile the demands of family and paid work. Indirectly, it also weakens the ability of families to fend off poverty on their own. Furthermore, since today's young women *are* employed, traditional familialism has another perverse result-- fewer children than are actually desired. With annual fertility rates between 1.2 - 1.5 percent, most of Europe finds itself in a *de facto* equilibrium with low fertility. Considering that European parents desire on average just over two children, such fertility levels signal a widespread lack of welfare.

Welfare differences across generations and the life cycle

It is important to avoid a simple zero-sum trade-off between the welfare of the aged and the young. Of course, there does exist some evidence that the rising welfare of pensioners occurs at the expense of children and young people, at least in countries such as the U.S. and Italy where improvements in the welfare of the aged have not been accompanied by an upgrading of family policies (see Preston, 1984; Easterlin, 1987; Palmer *et al.*, 1988; OECD, 1998; Mirowsky and Ross, 1999). Also, it is clear that income-distribution trends in most countries favour the aged. As shown in Table 7, the median disposable income of households consisting of retired persons is usually at least 80 percent of the national median. [9]

Of course, there remain pockets of poverty among the aged, usually concentrated among widows and individuals with problematic contribution histories. Old-age poverty tends to be higher in countries which until recently have had large rural populations, such as Greece, Italy, and Spain. It is also well known that retirement income declines somewhat with age. Nonetheless, all indications are that the large majority of pensioners in most countries have sufficient (and, in some case, perhaps even ”excess”) incomes. Contributing factors are the reduced consumption and capital expenditures of pensioner households, and the fact that a very large proportion of the elderly own their homes outright (75 percent in the EU as a whole). In addition, pensioners in many countries enjoy preferential tax treatment and are generally exempt from social insurance contributions.

The economic well-being of today's elderly is the result of a unique combination of factors that have produced high retirement income and lifetime asset accumulation.[10] OECD figures for 1998 show that the average household at age 65 possesses wealth equalling 4 - 5 times its annual income. And, although there are only scattered data for

[9] The poverty line is usually defined as fifty percent of (adjusted) median disposable income.

[10] Public transfers account for the lion's share of total disposable income in countries like France, Germany and Sweden (70-90 percent), but far less in others (such as the U.K. or the U.S.A., where private pension plans and accumulated savings play an important role (see OECD, 1998). Earnings (often undeclared) can play an important role in pensioners' income. This may be especially pronounced in countries such as Italy, where early retirement is prevalent and where there are strong incentives to supply and demand workers who do not need to pay fixed labour costs. In some cases, pension schemes are clearly subsidizing the informal economy.

specific countries, there are indications of pension ”overprovision” in some of them. My own analyses of data on Italian family expenditures indicate that income exceeds expenditures by more than thirty percent in the average pensioner household. A recent study by Kohli (1998) on internal flows of money within families indicates a huge volume of transfers from the aged (70+) to their children and grandchildren: 24 percent of income is transferred to their children, and nearly 15 percent to their grandchildren.[11]

Such redistribution down the age scale within the family no doubt varies by income level and by nation. Moreover, excess revenues reflect not only generous pensions, but also home ownership, private assets, and lower consumption needs. Still, the redistributive effect must be considered perverse if the welfare of youth is becoming a function of their retired parents’ and grandparents’ wealth. It is doubly perverse, in the sense that pay-as-you-go pensions are financed by the working-age population. The welfare state was presumably constructed in order to level the playing field; but this is a case where it is helping to re-establish inherited privilege.

Any debate on pension reform must consider the specific life-cycle circumstances of past, present and *especially* future cohorts of pensioners. If the present cohorts are generally well off, it is because they are the main beneficiaries of ”golden age” capitalism. For one thing, most of their careers coincided with decades of strong growth in both productivity and earnings, and with low unemployment among males in prime working age. Second, with the regulation of seniority rights and the emergence of efficient wage systems, the age-wage profile was detached from productivity-- earnings increased with age, even as productivity declined.[12] Third, today’s pensioners are the main beneficiaries of pension upgrades during the 1960s and 1970’s. Fourth, although there has been a decline in the growth of real earnings during recent decades, financial returns on investments have risen.

Any major reform of current pension systems confronts the dilemma that future pensioner cohorts are unlikely to amass similar levels of lifetime assets, either through individual initiative (work and savings) or through the redistributive mechanisms of public pension schemes. In fact, if corrective measures are not taken, it is more likely that the life chances of future retirement cohorts will become far more divided, possibly even polarized.

[11] In some countries, young families’ access to housing depends heavily on inter-generational capital transfers of this kind.

[12] To illustrate this point: Workers at ca. age 60 earn 100 percent of average wage in Denmark and the U.K., fully 140 % in France, but only 80 percent in the USA.

Estimated Age-Wage Relativities for Males. 1990. (Average = 100)

	At age ca. 20-25	At age ca. 50	At age ca. 60
Denmark	85	105	100
France	70	120	140
U.K.	80	125	100
USA	65	105	80

Source: OECD (1996: Chart 4.3)

Today's young people often face serious delays in the transition to stable employment. In addition to longer schooling, a large proportion of them can expect protracted and perhaps frequent unemployment, together with more insecure employment. These labour-market conditions are correlated with skills and education.[13] Also, as deregulation weakens the security of the prime-age "insider" work force, career interruptions and redundancies are increasingly likely, particularly among the less skilled.[14] Yet another factor is that today's cohorts of young people are unlikely to benefit from decades of strong growth in real earnings and, if productivity bargaining becomes increasingly decentralized, wage systems based on seniority may be weakened. Again, there is a clear trend toward greater inequality in earnings power, related to skills. Finally, those who are young today will experience the full impact of ongoing pension reform in EU member-countries, with a shift toward more individualized and actuarially based entitlement calculations. Once again, this will favour the strongest workers in the labour market.

If *de facto* retirement age remains at 59-60, today's young cohorts will find it difficult to accumulate a minimum of, say, 35 years of employee contributions toward their basic pensions. But these cohort-specific disadvantages are offset by three key factors: First, their higher educational attainment and superior cognitive skills imply greater adaptability and retraining capacity throughout their working lives. As they age, an investment in retraining may appear more logical than early retirement. The stronger the skills and educational base of young workers today, the greater the payoff when they become older.[15] Second, each new retirement cohort exhibits great improvements in health and longevity, and all indications are that this trend will continue. Even today, a typical 65-year old male can already expect another 8 - 10 years free of disability (OECD, 1998). Those who are young now will be able to count on many more disability-free years at retirement age. Third, the continuing growth of women's lifetime employment implies that future pensioner households will enjoy the advantages of double pension savings. If divorced, women will increasingly have independent pension entitlements.

Attempting to resolve the looming pension crisis of tomorrow by drastically reducing pensions today would be counterproductive in the long run-- if, as is quite possible, the situation of future pensioners resembles that of their forebears in the 1940s or '60s. If pensioner households now have excess income, it would be a more equitable, and

---

[13] A recent US study finds that employees in non-standard employment (both at the high and low end) are far less likely to have private pension savings (Economic Policy Institute, 1997).
[14] The OECD (1997) estimates that workers with less than secondary education can expect 5-7 years' of unemployment over their lifetimes in the UK, Finland and Spain, and between 3-5 years' in Ireland, Germany, Sweden, France, Belgium, Denmark, and Canada.
[15] The OECD study (1997) cited above indicates that, for those with post-secondary education, the number of years of expected unemployment across the life course is less than half that for the poorly-educated.

certainly a more prudent, policy to simply tax away the excess.[16] Thus, if a major reduction of public pensions is a sub-optimal long-run strategy, attention must be shifted to possible alternatives. As virtually all agree, the key to long-term sustainability lies in population growth and, more realistically, in higher participation rates (OECD, 1996; 1998; Thompson, 1998; Orszag and Stiglitz, 1999).[17]

Fertility and immigration

An ageing population is a consequence of declining fertility and increased life expectancy. The great paradox of contemporary Europe is that birth rates are positively related to women's employment. Many EU nations, those of southern Europe in particular, display the features of a long-term low-fertility equilibrium. Certainly, it will make a difference in the long run if the fertility rate is 1.8 as in Denmark, or 1.2 as in Italy and Spain. But a return to fertility rates at 2.0 or more would not have any appreciable effect on the ratio of the actively employed to the aged by the year 2030 or 2050 (OECD, 1998).[18]

The same conclusion emerges from assessments of the effects of realistic predicted immigration rates: Resolving the retirement burden through population growth will not make a huge difference in the coming 50 years-– unless immigration were to increase substantially over several decades (OECD, 1998). To give an idea of the magnitudes involved: A recent simulation concluded that, in order to ensure long-

[16] The same argument holds for privatizing pensions. Like public insurance schemes, private plans work well for workers with long, stable and well-paid careers. Coverage is low among employees in atypical employment (such as part-time or temporary), and traditional occupation-related employer pension plans are eroding as a result of the decline of large firms. Encouraging private pensions for the top half of the labour market while limiting public pension commitments to the bottom half of the population is certainly one possible long-term scenario. I assume, however, that such a scenario is not on the political agenda in the large majority of EU countries. Targeting public pensions at the poor, only, would reduce the public-expenditure burden dramatically. But to put it bluntly, why should we construct inequalities in the future when it is not necessary? Privatization will never qualify as a Paretian welfare improvement. As far as taxing retirement income is concerned, one should clearly avoid too much taxation since this may produce negative savings incentives among pre-retirement workers. If there is inequity in the distribution of resources between the aged and the young, a system which taxes excess incomes among the aged would be acceptable and more incentive-neutral, if it were designed to cover other risks among the elderly (such as disabilities and intensive-care needs).

[17] Forecast simulations suggest that a move to strictly targeted public pensions (covering the bottom third, only) would bring most countries' pension finances into balance by 2050 (see OECD, 1996).

[18] It is possible that the net effect of encouraging more children would be stronger, indirectly, since all indications are that very low fertility in southern and continental Europe (but *not* in Scandinavia) is concentrated among the most highly-educated women.

term financial equilibrium, the present annual rate of immigration to the United States would have to double (or quadruple, if a family-unification policy were pursued), *and* immigration would have to be limited to educated males aged 40-45 (Storesletter, 2000).

Nevertheless, a permanent low-fertility equilibrium would worsen age-dependency ratios.[19] It would have serious consequences for macroeconomic growth; and, perhaps most importantly, it is a symptom of welfare problems within modern families. The simple fact is that families are no longer capable of or willing to assume the full costs of rearing children. Therefore, if children are a high-priority welfare goal in their own right, EU member-states cannot avoid addressing the issue of how to distribute the costs of children.

In Scandinavia a large portion of the costs is assumed by society as a whole, and this is undoubtedly one of the main reasons that fertility rates in those countries approach the levels actually desired by families. It is crucial to recognize that a knowledge-intensive society must maximize its future human potential in order to be competitive. It follows that the costs of children are not only outlays for current consumption, but also a capital investments with potentially huge future returns, some of which benefit the individual and some the collectivity. Accordingly, a central component of any feasible win-win policy must be to set a high priority on investments in children and young people, to redistribute the costs of rearing children, and to more efficiently mobilize reserves of human capital.

Labour-market participation

European employment rates vary widely. Rates of female employment range from over 70 percent in Scandinavia to less than 40 percent in Ireland, Italy and Spain. The differences are much less among younger cohorts, but these also suffer disproportionately from unemployment. If a 60-percent activity rate were selected as a target level, six current EU member-states would fall far below it.[20] Very low rates of female employment often coincide with sharp declines in the employment of older males. Seven EU nations now display rates below 40 percent for males aged 55-64. Again, the spread is enormous, with Portugal, Sweden, the U.K. and the U.S. at or above 60 percent. In some nations, early retirement accounts for up to 30 percent of total pension expenditures (Thompson, 1998). The single most effective policy for promoting sustainability would be to increase labour-market participation; but the logic and consequences of altering employment rates are very different for females than for older males.

---

[19] Further decline should not be ruled out. Current Italian and Spanish fertility is about 1.2 and, in Lombardia and Galicia, it is hovering around 0.8! Golini's long-term demographic projections (1994: 54) suggest that, if the Italian rate of 1.2 continues throughout the 21st Century, the Italian population will decline to less than half its present level by 2092.

[20] Such a targeted norm corresponds to the average between EU and North American rates

The work-retirement nexus

In the past, male workers normally retired at age 65, and could expect to enjoy very few years of benefits prior to death. Average retirement age in the EU is now 60 or below, while life expectancy has increased to 74 among males, and 81 among women. With a longer and healthier life, the average 65-year-old male will be free of disability until about 74, and even longer in the future.[21] The seeming paradox is that the average age of retirement continues to decline.

Were retirement age to be progressively increased to age 70, in annual increments of 0.5 years, it would be possible to maintain pension entitlements at present levels up until the year 2040 (see Table 8). Given ongoing health improvements, it would not be unrealistic to gradually raise retirement toward age 70. Higher employment rates among older workers may also become necessary in the long run, since future cohorts of young people are expected to be very small, indeed.

Retirement is the purchase of leisure on the basis of earnings throughout the life cycle. Omitting poor health and similar factors, it is a question of preferences and opportunity costs. The incentives system of contemporary pension schemes is, however, strongly biased in favour of early withdrawal. According to Table 9, all EU citizens (except those of Denmark) have nothing to gain from delaying their retirement decision until, say, 65. A shift to actuarial neutrality, alone, would boost labour-market participation rates of older workers and, in at least one case, dramatically so. Delayed retirement would obviously be much more prevalent with positive incentives. [22]

It is possible that early retirement is driven more by incentives to employers than to workers. The motives are many, including the education gap between older and younger workers-- an important issue in an era of rapid change in technology and skills.[23] A second factor is the relationship between wage costs and productivity. Seniority-based wage systems in combination with strong job security give employers huge incentives to utilize the retirement option. If relative wages were more closely linked to productivity, this incentive would probably be substantially weaker.[24]

---

[21] At age 65, French men can expect ten years free of moderate disabilities, German men twelve years (Jacobzone *et al*., 1998)

[22] At least in some EU countries, the early-retirement incentive is additionally problematic if retired workers return immediately to work in the informal economy at sharply reduced-real wage rates (in Italy, where this pattern is widespread, fixed-labour costs represent approximately half of the total wage bill). Although hard data is impossible to come by, there is ample reason to believe that early retirement has become an invisible wage subsidy to older workers, one that perversely augments tax avoidance and black-market activity.

[23] The education gap is generally very large between current retirement-age workers and the 25-34 age group, but the gap already starts to disappear with those in the 45-54 age range. In other words, we might expect that the education-deficit effect is temporary, and that it will decrease considerably during the next 10-20 years (based on author's calculations from the OECD Education Database).

[24] However, such a level of wage deregulation is difficult to imagine, given the industrial-relations systems in most EU member-countries. Here, one must also

There is, then, a convincing case for making the retirement process more flexible, instead of slashing pension benefits or coverage. It would be far more equitable if a voluntary decision to retire early were to be clearly linked to a price for doing so. As long as pension systems do not penalize workers who are compelled to retire (e.g. for health reasons), it is perfectly logical for workers to be rewarded for delaying (or gradually sliding into) retirement, even till age 70.

Several countries have begun to experiment with flexible retirement, in such forms as part-time work combined with partial pension benefits. However, considering the interest of firms in divesting themselves of costly older workers, both employees and employers require inducements.[25] Solutions involving ”lifelong learning” or retraining are alternatives for older workers with a substantial base of skills to begin with, but are less realistic (and overly expensive) if labour markets are flooded with low-skilled older workers, as is often the case today.[26] As better educated cohorts enter the labour market, such a policy is likely to become more effective, eventually. Another option might be to uncouple the wages of older workers from pay-scales based on seniority, or to gradually reduce the fixed-cost component of wages as workers become older.[27]

Obviously, a shift toward flexible and delayed retirement cannot take place overnight, given existing expectations and, too often, the absence of alternatives for both employers and employees. All credible reform proposals emphasize a gradual transition over two or three decades, primarily involving the alteration of incentives in favour of delayed exit without directly penalizing those who opt for earlier retirement.

---

consider the welfare consequences of gradual earnings decline; but this effect may be more neutral than it appears at first glance, since the alternative of early retirement *also* produces a reduction in real income. As an alternative policy, one might consider indirect subsidies such as a gradual reduction in the fixed-labour cost component of older workers’ earnings.

[25] Part-time employment among males aged 60-64 is high in Austria, the Netherlands, and Sweden (about 35%), and it is also substantial in Denmark, Finland, and the U.K. It is virtually non-existent in Greece, Ireland, Italy, and Spain (European Union Labour Force Survey, 1995).

[26] In fact, workers older than 55 are half as likely to participate in adult education as those aged 25-34 (with Sweden as a major exception). Also, adult training and education is twice as likely among better-educated workers.

[27] There is some evidence, albeit old, to suggest that a decrease in earnings as workers become older is viewed as legitimate (Rainwater, 1974)

In fact, OECD's 1998 calculations assume that a 55-year-old worker will gradually increase his or her additional working years from 6.6 in 2005, to 11 years in 2030.[28] Simply put, some thirty years from now there will probably be a return to traditional retirement patterns, but in a new context of much healthier and more educated older workers employed in much less disabling jobs. The question of altering lifelong participation necessarily presents a work vs. leisure trade-off: How can a policy be regarded as promoting welfare if it calls for less leisure and more work during the individual's lifetime? I shall return to that question toward the end of this discussion.

Redistribution from the aged to the young can be equitable and efficient if it improves the relative welfare of the young without harming the old. Delayed retirement means that the aged contribute more toward their own retirement, but also that the burdens of taxes and personal contributions on young workers decline-- a vital issue for raising demand for youth workers. In the final analysis, any reallocation of resources and responsibilities between generations, of the sort contemplated here, must meet two criteria: It must be able to satisfy conflicting welfare goals, and the net result should be an overall improvement in efficiency. I shall turn to this issue later.

Female employment and the two-earner household

The single most promising component of a long-term win-win strategy is the maximization of female employment opportunities. Besides corresponding to women's own demand for careers and economic independence, the gains to society include the reduction of child poverty and a higher ratio of active contributors to pension systems.

Child poverty is rising, due not only to weakened families, but also to the erosion of the conventional male family wage. Increasingly, a single income is simply not sufficient to lift families out of poverty. The erosion of the stable, well-paid, lifelong job for males can be and is offset by increasing female employment. This, in turn, is an inevitable development, given women's higher educational attainments and better job prospects in the evolving service economy. The same applies to female-headed households where the mother's employment is an excellent hedge against child poverty. Again, combating child poverty is not merely an investment in welfare today, but also in the future productive potential of society.[29]

---

[28] Although any reform of retirement age must be implemented gradually, there is no reason not to immediately abolish compulsory retirement at age 65.

[29] At this point, the empirical evidence concerning the effects of low income during childhood on later achievement in school and careers is very strong. See, for example: G. Duncan and J. Brooks-Gunn, eds. *Consequences of Growing up Poor*. New York. Russell Sage (1997); R. Haveman and B. Wolfe, *Succeeding Generations: On the Effects of Investment in Children*. New York: Russell Sage (1994); and S. Mayer, *What Money Can't Buy*. Cambridge: Harvard University Press (1997); and the series of publications based on the Swedish Level-of-Living Surveys.

To illustrate the impact of female employment on the ratio of pensioners to workers, consider the example of Italy and Sweden, two countries with a similar share of total population aged 65 and older, but with very different rates of female employment. At 0.52, the Italian ratio of pensioners to workers is nearly twice the Swedish ratio of 0.27. This huge difference is due entirely to the difference in employment rates.

The link to labour markets

The new welfare priorities that emerge from the preceding analysis boil down to one basic issue, namely that social policy must maximize citizens' productive resources and life chances. It is important to recognize that any "work-friendly" policy must be suited to the dynamics of a service-dominated economy.

The service economy tends to be dualistic, combining knowledge-intensive professional and technical jobs with low-end, low value-added, labour-intensive service jobs. The former are concentrated in the business sector and in some social services (teachers, doctors, etc.), the latter in sales, consumer services and some social services (restaurant workers, home helpers, nursing assistants). Europe, like North America, is very dynamic as far as business services are concerned. But with the exception of Scandinavia, the development of social services in Europe is sluggish. Private consumer services in Europe are stagnant, if not actually in decline. [30]

Contrary to popular belief, services are everywhere biased in favour of skilled and "good" jobs. The dilemma is that a significant reduction of large-scale unemployment also means stimulating low-productivity services, which implies a reliance on personal consumer and social services. The good news is that such services are protected from international competition; the bad news is that they compete directly with unpaid household "self-servicing". The problem is that many services are extremely price-sensitive. They will expand if wages and costs are relatively low and thus affordable, as in the United States, or if they are subsidized by government, as in Scandinavia. [31]

Herein lies a great European policy dilemma. The task of forging a more equitable and efficient social insurance system, as outlined above, pales in comparison with the trade-offs involved in stimulating employment-intensive services. Yet, no solution is possible unless it is understood that social insurance and service jobs are directly linked. The essence of the problem is simple: Strong growth in services implies a need for increased taxation if the emphasis is on public services or, alternatively, more wage inequality (and lower fixed labour costs) if the emphasis is on market-based services.

---

[30] The following is based on Esping-Andersen (1999).

[31] In the Nordic countries, up to one-third of total employment is in the public sector, fuelled by social service growth. There, as across the European continent, private consumer services are generally 'priced out of the market; indeed, they have been declining over the past decades.

Most European welfare states and industrial-relations systems have, for decades, committed themselves to a degree of security for prime-age male workers, and also a degree of earnings and income equality, neither of which is compatible with a large low-end service economy. Moreover, the current financial pressures on most European welfare states make it difficult to replicate the expansion of social services which took place in the Nordic countries some twenty years ago.

This dilemma is now well recognized by EU member-states. Witness the extension of targeted wage subsidies (usually aimed at young people and contingent on training), and recent EU proposals to stimulate labour-intensive services through a reduction of the value-added tax (VAT).[32] There is virtually universal agreement that any expansion of lower-end service jobs is hindered by strong wage compression, a high tax wedge (especially through mandatory contributions) and, perhaps as well, overly rigid labour-market regulations. The great dilemma, though, is that the kind of abrupt, U.S.-style deregulation that would fuel such jobs is unacceptable to European policy-makers.[33]

The stagnation of low-end services in Europe is directly related to the link between families and social insurance. On the one hand, employment-based social insurance systems impose very high fixed labour costs whose marginal effect is especially strong in low-wage, low-productivity jobs. In effect, a large tax wedge prices such jobs out of the market. On the other hand, the majority of service jobs compete with households' own service capacity. Where the female employment rate is low, households service themselves; where the rate is high, households' demand for externally-provided services increases. In short, the double-earner family ”externalizes” its service needs and thereby creates jobs.[34]

As noted above, two-earner families have an obvious need for services. Herein lies the basis of a win-win policy scenario, in that more caring services are a key instrument for combating poverty, and, potentially, a very effective employment multiplier. High-quality day care is crucial if the aim is to optimize the life chances of children; but markets cannot generally guarantee affordable, high-quality care for either small children or the elderly. In other words, public subsidies or direct public delivery of services is a basic requirement, offering an excellent opportunity for shifting welfare priorities to favour services to families. An investment in women's opportunities for gainful employment is also an investment in family welfare and in job creation.

---

[32] Individual countries, like Denmark, have experimented with alternative subsidy schemes to induce more consumption of service labour. Frequently, such subsidies are an attempt to prevent lower-end services from ending up in the ”black” economy.
[33] Also, such deregulation would almost certainly have adverse consequences for the entire labour market, and it would necessarily imply a major roll-back of existing welfare guarantees.
[34] Hence, the average amount of time spent by Spanish women on unpaid domestic labour is almost twice that of Danish women.

Since the traditional welfare state has defined its obligations primarily in terms of income maintenance for those who are unable to work, social insurance has been viewed as ”unproductive” consumption involving a problematic redistribution of wealth. By and large, this income-maintenance philosophy has also been applied to contemporary social problems. But the case presented here is that providing services families is the single most effective policy for combating poverty and welfare dependency, while at the same time it is also an investment in human resources. In short, family services should be regarded not only as mere ”passive consumption”, but also as active investments that yield returns in the long run.

There are bound to be three kinds of sceptical reactions to this analysis. One would argue that the costs of a ”woman-friendly” welfare policy, including day care and paid-leave programmes, far exceed the marginal productive contributions of mothers (see especially Rosen, 1997). The answer to this objection depends on the type of analysis employed. Within the kind of ”static” framework that Rosen adopts, it is undeniably true that the costs of maintaining mothers-with-small-children in the labour market exceed their contributions.

With a dynamic analysis, however, Rosen’s objection becomes invalid, because women who do not interrupt their labour-force participation will lose far less in accumulated lifetime earnings than women who do experience interruptions. The cumulative effect of remaining in vs. leaving the labour market can be dramatic, and it also influences the long-term tax contributions of mothers. Presented in the Appendix are some estimates which suggest that the public subsidies received by mothers via day care and paid leave are efficient: Such investments pay off, because the initial outlays are recuperated and society gains from the additional labour inputs.

The second type of scepticism is based on the lump-sum-of-labour thesis, i.e. that work is disappearing. Any glance at comparative statistics reveals that this is not the case, so the question becomes: How many jobs, and what kinds? Let us here examine more narrowly the possible net effect of female employment on the supply of jobs. There is an automatic, immediate effect that results from providing the caring services for children and the elderly which are a basic precondition for women’s participation in the labour market; most likely, those services will be provided by women.

The issue is whether the net result of publicly subsidized jobs and additional employment effects will be significant-- a very tricky question. Two-earner families should, in principle, require more external services due to higher incomes and more severe time constraints. But, again, the issue is one of relative costs. In Scandinavia, where the two-earner household is now nearly universal, private services are stagnant (the costs are too high). In the United States, however, they are not. A very rough statistical ”guesstimate” suggests that the net effect is both positive and significant: For every 100 mothers who remain employed, an additional fifteen service jobs may be generated.[35]

---

[35] This estimate is based on time-series analyses for the U.S., France and Spain. For details, see Esping-Andersen (1999: 118).

The third source of scepticism is related to the emerging low-wage / bad-jobs scenario which is inevitably associated with a large and growing low-end service economy. Since households can utilize time-saving devices such as microwave ovens, and compensate for the reduced time that wives spend on household chores by increasing the efforts of husbands in that area, there may be no effective demand for external services if costs are too high. What, then, is the case for stimulating low-end service jobs, either with subsidies or by accepting much greater wage inequalities? The answer depends essentially on the consequences of low-end service employment for individuals and society.

The advantages of low-end service jobs are clear: They provide easy-entry jobs for young people, immigrants, low-skilled workers, and women returning to the labour market. Such services could fulfil a very positive function *if* they do not become lifelong traps. A brief period of low earnings and relatively unrewarding work need not inevitably harm individuals' life chances. On the contrary, it could provide a bridge into the labour market or help supplement income. The criteria by which to assess the costs and benefits of low-end jobs cannot be based on snapshot notions of equality for all, here and now. The only reasonable frame of reference is the entire span of working life.

This, in turn, raises the question of preconditions for occupational and income mobility. Research has firmly established that both are related to the effects of three main factors: social origins, skills and natural endowment. The most authoritative recent studies conclude that investments in child welfare can diminish the impact of inherited privilege, '"social capital" (Shavit and Blossfeld, 1993; Erikson and Goldthorpe, 1992; Haveman and Wolfe, 1994).

There is less agreement on the kinds of skills that will guarantee decent careers in tomorrow's labour market, but it *is* known that: adequate levels of cognitive skills may be as important as formal schooling; social and cultural skills play an ever more important role; and brief task-specific training yields a far lower payoff than longer, individually tailored programmes with theoretical content (Martin, 1998; OECD, 1997). To cite a recent Danish study, chances of moving out of social marginality increased by 30 percent with some vocational training, and by all of 50 percent if also accompanied by some theoretical training (Bjorn, 1995). As for natural endowments, there will always be a segment of population for which investments in childhood conditions or the later activation of human capital will have little effect. No one, I presume, would propose that such individuals be abandoned to a life of poverty.

In the following and concluding section of this report, I argue that a low-end labour market need not be incompatible with a new welfare state scenario. Or to put it differently: It will not be possible to devise a win-win welfare model for Europe unless we accept a different notion of equality than that which has applied in the past.

We have become accustomed to an overly static, here-and-now concept of redistributive justice by which the welfare state must ensure that all citizens are always protected. A far more realistic principle for the future would be the acceptance, and perhaps even sanctioning, of inequalities here and now in order to maximize life chances for all. If the knowledge society and the modern family give rise to inequalities, the most effective social policy would be to guarantee that citizens do not become trapped in social exclusion, poverty, or other forms of marginal status throughout the life cycle.

A welfare state for the 21st Century

Debates on how to construct the edifice of a new welfare state often lead to paralysis, for three reasons. The first is that any reconsideration of the system as a whole inevitably raises technical issues related to this or that policy. One quickly loses sight of the broader picture as soon as one seriously begins to contemplate reforms of components such as pensions, unemployment benefits, or home help services for the elderly. It is my understanding that the Portuguese presidency, for which this report has been prepared, favours a debate on the entire system rather than on technicalities.

The second reason is that comprehensive reform scenarios often contain more ideology than relevance. Calling for privatization of the welfare state or a return to family and community is hardly realistic, and therefore not helpful. Of course, neither is the inevitable rear-guard defence of the hard-won *status quo*. The kind of project that the Portuguese presidency has in mind would be poorly served by an ideological approach.

The third reason, which may be the most difficult to surmount, has to do with the short-term imperatives that European politicians and governments face with regard to sustaining existing commitments. If the first priority is to restrain expenditures, contemplating new principles of justice and efficiency would appear to be a luxury.

The issue before us has to do with the long term-- with the kind of society that our children will live in. If this means redefining welfare priorities, it is impossible to escape the need for some common, basic criterion of what is desirable, given known constraints. What are the common goals to be achieved? What do we seek to accomplish? What are the first principles that must guide policy-making? In short, what can serve as a common yardstick for measuring justice, equality, collective guarantees and individual responsibilities? And, once agreed upon, how can our commitments to equity best be employed in order to maximize efficiency?

Basic criteria for policy choices

It is probably safe to assume that most EU countries have reached their maximum limits of public expenditure and taxation. In fact, convergence toward the EU's ”Maastricht criteria” compels expenditure reductions, not bold and expensive reforms. The need for restrictive policies already limits the extent to which nations can promote the knowledge society with investments in infrastructure, education, training, or improved social welfare.

The resource dilemma becomes considerably worse when the new inequalities and social risks that knowledge-based economies inevitably provoke are taken into account. By now, the evidence is clear that the emerging structure of opportunities, rewards and life chances creates new winners and losers and, most likely, a deepening gulf between those with marketable skills and those without. The new service economy can create jobs, but it cannot guarantee good wages and jobs for all. Existing social insurance systems will therefore be put to a severe test when it comes to promoting efficiency while at the same time ensuring social cohesion, welfare and equity.

It is necessary to set new priorities for the allocation of the existing welfare package, and this means accepting at least two ground rules for policy making. One is that it is not possible to pursue a strategy based on human capital and an overly one-dimensional ”learning society”, in the belief that a tide of education will lift all boats. Such a strategy inevitably leaves the less-endowed behind and, equally important, it requires a redistribution of resources and welfare to families and, especially, to children. The modern family is an integral part of the new economic scenario, and its welfare risks are mounting. Children’s ability to make the best of schooling depends not only on the quality of schools, but also on the social conditions of their families. Today, women are often better educated than men, but they will have difficulty making maximum use of their educations without the support of caring services and generous paid-leave programmes.

The second ground rule is that new social-policy challenges cannot easily be met through additional taxation or spending in relation to GDP. Accordingly, it is necessary to concentrate on how to improve the *status quo*. Entitlement conflicts and equity issues become less urgent when the total pie grows. But when the pie must be divided differently, clashes of interests are difficult to avoid. Thus, if the task is to identify an optimal balance between promoting efficiency and preserving equity, it will not be possible to proceed without agreement on a basic, consensual yardstick of justice.

Decision-making rules for equity and efficiency

Presumably, everyone involves is interested in devising a ”win-win” strategy, one which implies that any changes will produce a situation in which all are better off, or at least no worse off. Based on that assumption, there is a choice between two alternative yardsticks of justice.

The first and most conventional is based on a ”Paretian” principle which, crudely put, defines welfare optimization as any arrangement that produces greater efficiency without anyone losing as a result. One example of this might be wage deregulation, which would undoubtedly increase income inequalities. But if it created more jobs, many would benefit; and if the lowest paid were compensated with subsidies, their real disposable income might not decline as a result.

The second and more ambitious alternative would be a ”Rawlsian” principle of justice, one which insists that the greatest advantage of any gains in efficiency should accrue to the poorest and weakest. Using the same example as above, a deregulatory policy would only become a ”win-win” strategy if the combination of additional jobs and wage disparities were to produce a comparative gain for the worst off, and this were regarded as to the benefit of all.

Since the EU has firmly and explicitly committed itself to placing a high priority on combating social exclusion, its appropriate yardstick of justice would appear much closer to the Rawlsian principle. I take it for granted that Europe is not willing to promote the kind of knowledge society which, even if more competitive, would leave large groups behind.

Principles of reform: toward a social-investment bias

Like the popular distinction between active and passive measures, current policy slogans such as work-friendly or women-friendly benefits, lifelong learning, and social-investment strategies all have in common an implicit distinction between (a) policies that somehow promote citizens’ self-reliance and capacities, as well as the efficiency and productivity of economies, and (b) policies that do the opposite. Such slogans reflect a growing unease with existing policy biases toward: compensating the losers of economic change with passive income maintenance; reducing the supply of labour; and ”parking” surplus workers on public benefits. The new terminology mirrors a growing consensus that social policy must become ”productivist”, to borrow an expression traditionally used by Swedish policy-makers. That is, social policy should actively mobilize and maximize the productive potential of the population so as to minimize its need for, and dependence on, government benefits.

The paradox is that welfare measures are needed in order to minimize the need for welfare measures. That paradox dissolves, of course, if distinctions are made between different types of policy. Some policies can be regarded as investments in human resources, i.e. in people’s capabilities and self-reliance. Others, while enhancing welfare, clearly consist of passive income maintenance. Obviously, such a distinction is necessarily ambiguous. Unemployment benefits may appear to be passive, but they do assist workers in their search for new employment, and they do improve the labour-matching process. Similarly, child allowances add to families’ spending power and diminish poverty, thus enhancing children’s future life chances.

The important point to stress is that contemporary fashions in policy tend to place far too narrow a stress on the wonders of ‘”activation”, while ignoring income maintenance. The need for so-called passive measures will not disappear, not even in the best designed, ”productivist” welfare state: There will always be individuals and groups that must depend primarily on redistribution; and activating citizens’ productive potential often necessitates income subsidies. Nevertheless, a basic principle of any win-win strategy must be to favour social investments over passive maintenance.[36] A related principle is that the highest priority should be assigned to social investments in children, who represent the future productive potential of society.

Designing a new welfare state

Assuming agreement on a Rawlsian principle of welfare optimization, the preceding analysis points to a set of concrete policy priorities:

- maximize the ability of mothers to reconcile the demands of employment and children
- encourage older workers to postpone retirement
- increase the state's share of responsibility for the costs of rearing children, primarily through investments in children and young people
- redefine the mix of work and leisure throughout the life cycle
- reconceptualize ”equality” and fundamental social rights, primarily in terms of life-chance guarantees.

In general, these priorities imply a stronger emphasis on protecting households with children and young people, and on providing services to families.

The limitations of learning

Accelerating the pace of transition to a knowledge-intensive economy implies heavy investments in education, training and cognitive skills. Those with limited human and social capital will inevitably fall behind and be marginalized in the occupational structure. The problem is twofold, because such an economy requires both producers and users of knowledge who are highly skilled. It is therefore essential that investments in education be as broadly based as possible. In this regard, much recent research indicates that specific expertise may be less important than the basic cognitive skills required to learn, adapt, and benefit from training (see especially OECD, 1997). Activation measures, such as training or retraining, will have a low payoff if workers' basic cognitive skills are low. Such measures are much more likely to be effective if they are designed around a more comprehensive and individualized ”activation package”.

---

[36] Contemporary systems of national accounts are unable to distinguish between social expenditures which play an ”investment role” and those which do not. It could be argued that, parallel to the distinction between capital and consumption accounts, social expenditures enhance a nation's capital stock and reap a dividend. The actual task is daunting, and full of ambiguities; but this is also the case in conventional national-economic accounts (should a tank or a jeep for the military be classified as investment or consumption?).

One pervasive problem throughout Europe today is that reserves of poorly educated ”excess” workers can be very large due to three factors: delayed decline of the agricultural sector; heavy job losses in traditional, low-skill industries; and an often wide education gap between generations of workers. A massive investment in education would probably reap its greatest benefits among cohorts of younger workers.

The dilemma is how to manage present reserves of mostly older, low-skilled males. Thus far, early retirement has been the predominant and, perhaps, the only realistic policy. Lifetime learning is an attractive alternative, but may be too costly and ineffective if the main clientele consists of older low-skilled workers. A third alternative would be to deregulate job-protection and seniority provisions so as to relate wages more directly to productivity, as is generally the practice in the United States. This would cause the incomes of young people and older workers to decline, perhaps dramatically so.

There exists no ready-made formula for a win-win policy in this regard-- largely because the problem varies widely from country to country. An obvious first step is to ensure that future generations of workers will have a sufficient base of cognitive and other skills so that the dilemma eventually resolves itself.

The problem arises with the second step, namely: What to do with existing reserves? If it is so that early retirement in preceding decades succeeded in managing a temporary excess of elderly low-skilled workers, there is no dilemma and the process of restricting early retirement can be accelerated. If that is not the case, the situation would appear to call for a mix of early retirement, retraining (where possible), downward wage adjustments, and re-employment.

There is an evident unwillingness to accept across-the-board deregulation of job security and wages, but such measures might yield sufficient gains in efficiency to prolong the employability of older workers. which could be supported by subsidizing some portion of their wages. This is clearly preferable to the currently widespread alternative by which retired workers return to work in the ”shadow economy”. As with younger workers, high fixed labour costs tend to price older workers out of the market.

A lifetime-learning strategy can be effective when basic cognitive skills are already present; this suggests the need to ensure that future generations have the resources required to benefit from investments in training and education throughout the life cycle. In many EU countries, the generation gap is enormous, and it is paramount that it not be perpetuated into the future.

Equitable retirement

The main problem with today’s excessively aged-biased welfare systems is that they provide incentives that have inequitable results. Workers, in collusion with employers, are encouraged to opt for early retirement because they will gain little or nothing by postponement. At the same time, the pay-as-you-go nature of pension schemes means that retirement with high benefits is heavily financed by the active workforce. Reinstating actuarial incentives to delay retirement would clearly be more equitable and efficient, and it would greatly increase the transparency of the costs involved in pensioning off older workers.

Since workers can expect to be disability-free until age 75, using incentives to increase the flexibility of retirement age and raise it to 65 in the medium term, and possibly to 70 in the long-term, could be positive for individual workers and for welfare-state finances. Abolishing mandatory retirement age and developing flexible mechanisms for gradual exit could be pursued immediately. Due to increased longevity, the proportion of the ”utlra-aged” (80 and older) nearly doubles every two decades. This creates a need for extensive, costly caring services. If, as previously suggested, pensioner households often enjoy ”excess” income and wealth-- which, if not taxed, results in perverse distribution effects-- an incentive-neutral and far more equitable policy would be to earmark pensioners’ taxes to their own needs for care. Since the wealthy tend to live longer, such a taxation mechanism is also likely to be neutral in its distribution effects on all pensioner households, even if it is highly progressive.

Altering the welfare-work nexus among the aged cannot be an end in itself, but is primarily a means for achieving more inter-generational equity and a more efficient utilization of public resources. The advantage of an approach like the one outlined above is that it is demonstrably far more Rawlsian (and, in fact, also Paretian) than any alternative. There are essentially only two genuinely effective policies for combating the long-term economic consequences of ageing: sharp reductions of pension entitlements, and higher rates of labour-market participation.

For large segments of the population, reducing entitlements would have the effect of stimulating private pension plans. The problem with a pension mix dominated by private plans is that it tends to replicate life-cycle inequalities. Also, the greater the reliance on private plans, the greater the likelihood of downward pressure on public benefits for low-income households. Even if a system dominated by private schemes augments national savings rates (thus increasing ”efficiency”), it could possibly lead to non-Paretian outcomes: The weakest may end up being worse off. Discernible trends in labour markets also threaten the viability of a predominantly private pension structure, since declining job security and growing inequalities will negatively affect the ability of workers to accumulate individual savings.

Harmonizing labour markets and family welfare

Post-industrial, service-dominated labour markets cannot avoid generating new inequalities. The problem can be traced in part to systems with strong protection for ”insiders” with secure employment and, possibly, a growing proportion of ”outsiders”. Included among the latter are the unemployed and temporary workers with insecure employment. Insider-outsider cleavages tend to affect young and female workers most adversely. A second source of new inequalities is the rising relative-wage premium on skills. A third will emerge when and if labour-intensive consumer services expand.

The standard trade-off between jobs and inequality, epitomized by differences between the U.S. and Europe, is far too simplistic. But it is difficult to imagine a return to full employment in Europe unless also low-paid and, often, low-quality service jobs are encouraged.

European welfare policy and industrial-relations are generally based on a commitment to wage equality and job security. For this reason, minimum wages, contractual regulations, and high fixed-labour costs are difficult to budge. There are two principal arguments against creating a low-wage labour market by deregulation. The first and most convincing is that U.S.-style deregulation not only creates huge inequalities, but also threatens the basic fabric of trust and co-operation built into European models of social partnership. The tradition of broadly negotiated ”efficient-wage” arrangements constitutes one of the greatest comparative advantages of the European model. The second, and far less convincing, argument is that a low-wage service economy poses a direct threat to families. The standard defence of existing regulations is often based on the traditional assumption that the welfare of families depends almost exclusively on the wages, job security, and accumulated entitlements of the male breadwinner.

This traditional family model is in rapid decline. Unfortunately, some of its current successors, such as single-parent households, entail great risks; but the risks are much less if the parent is able to work. Two-income families enlarge the tax-base and minimize the welfare gaps that arise when wives’ entitlements are derived from their husbands. In addition, the two-earner family provides the single most effective means of minimizing child poverty. Moreover, two paid workers comprise an effective household buffer in the event of interrupted employment.

It follows that a strategy based on investments in education must be combined with a revised family policy, the cornerstones of which must be guarantees against child poverty. Such guarantees must rest on affordable care for children and the aged, on adequate child benefits, and on maternity- and parental-leave benefits which minimize the disruption of mothers’ employment and maximize their incentive to have children. Therefore, if the goal is to sustain long-term welfare obligations to the aged while effectively combating social exclusion, the most persuasive ”win-win” strategy in the long run is to redirect resources to families with children.

Whether ”externalized” family care is consigned to the market or furnished by the public sector is a matter of little importance, as long as quality standards and affordability are guaranteed. If the objective is an explicitly Rawlsian family policy, there would be a strong case for emphasizing high-quality childcare services for the weakest families, as this might offset inequalities stemming from the unequal distribution of social capital among families.

Life-chance guarantees

Any assessment of the pros and cons of greater labour-market inequalities must be based on a dynamic analysis encompassing life chances, and not (as is usually the case) on a static view of fairness and equality. Even at near-poverty wages, low-end, low-paid jobs are not by definition a welfare problem. The acid test of egalitarianism and justice is not whether such jobs exist, or what share of a population may at any given moment be employed in them. Low-end employment is compatible with Rawlsian optimization if it does not negatively affect people's life chances. The issue here is one of entrapment and opportunities for mobility.

On this issue, alas, research has not yet provided much indisputable evidence. It is known that a sizeable minority of low-wage workers in the U.S. remain trapped for many years; the rate is higher than in Europe, where comparable low-wage jobs are much less common. Those most likely to become trapped are the low-skilled. There is also fairly clear evidence that a combination of skills, education and advantageous family origins provides the most favourable conditions for mobility.

Accordingly, the expansion of low-wage service jobs, in combination with heavy investments in developing skills, would be a win-win policy for the majority. The problem lies in the risk of entrapment for a minority which may be ”untrainable”, or incapable of mobility for various other reasons. It is for this reason that a learning strategy needs to be accompanied by a basic income gurantee.[37] But the problem of inequality would disappear if the welfare state were to provide a basic life-chances guarantee to all citizens. This would guarantee either occupational mobility by means of education, or protection from poverty in the event of low wages throughout the life cycle.[38]

At the risk of repetition, the greater the investment in social resources for children, the greater the subsequent payoff in terms of the capacity for lifetime learning and retraining, and the smaller the burden of compensating the ”losers”.

Leisure and work

The kind of ‘win-win’ scenario presented above appears heavily biased towards work. Despite sluggish growth, Europe's *per capita* GDP is now 50 percent greater than before the ”oil shocks” of the 1970s. Such wealth ought to translate into more leisure time. Clearly, no Rawlsian scenario is possible without a convincing balance between leisure and work. On this point, prevailing thought is extremely muddled, often combining both a static and a dynamic perspective.

---

[37] Whether such an income guarantee is based on the Anglo-Saxon formula of work-conditional income supplements or along more traditional social-assistance lines is left open.

[38] It is very important to distinguish this ”life-chances” guarantee from conventional ”guaranteed citizen-income” plans which many advocate. Above all, the life-chances guarantee is meant to be based on work and not, like the latter, on the assumption that there will not be sufficient work available. Indeed, the main principle here is to reward the incentive to work. This is not the place to discuss the practical design of such life-chance guarantees. Clearly, active training and learning policies will come to play a central role. One might consider a variant of the U.S. ”earned income credit” subsidy, or similar ”negative income tax” models, as a means to guarantee welfare for those who become trapped in inferior employment.

Current European political debate is dominated by the controversy over the 35-hour week, which is being promoted for its supposed positive effects on job-creation. If the main goal is, indeed, to stimulate employment, this strategy is at best controversial, and at worst self-defeating. If the goal is to increase leisure time, the question seldom posed is: Why focus on weekly or monthly hours, rather than on the lifetime distribution of work and leisure?

The irony is that the call for a shorter work-week follows several decades of significant reductions on a yearly and life-cycle basis. The typical EU member-state’s working time is now down to an annual average of 1600-1700 hours, which is mainly attributable to the spread of part-time work, vacations, holidays, paid-leave arrangements-- and, unfortunately, also to unemployment and exclusion from the labour market. Much more dramatic have been reductions in lifetime employment. In 1960, the average male employee worked for roughly 45 years; his contemporary equivalent will work a total of perhaps 35 years. The extent to which more leisure is desired and voluntary, or reflects an inability to acquire gainful employment, is not altogether clear. In the case of women, ”leisure” often takes the form of unpaid housework.

Is more leisure favourable on all counts? Should there be fewer weekly hours, annual hours and lifetime hours? If so, is their agreement on the associated economic-opportunity cost? Will it be equitable if the costs of leisure for some are transferred to others? Do leisure-time arrangements sufficiently maximize the productive potential of everyone? Is it possible to envision alternative, more equitable and more efficient, distributions of work and leisure? These are questions that hardly anyone raises in the current debate on social policy, but they are crucial to the formation of any new welfare order.

To some extent, the prevailing leisure-work mix has been intended, as in the case of maternity and parental leave. But to a large extent, it has also resulted from the unintended consequences of policies designed (and possibly unable) to solve completely different problems. Early retirement and unemployment are obvious examples.

Leaving aside the problem of ”unwanted” leisure, is there an adequate understanding of citizens’ leisure-work preferences? I think not. Individual early retirees may be content to leave the labour market prematurely, given existing constraints and incentives. But if these are harmful to society and are therefore eliminated, would the motivation for early retirement remain? Would the employment rates of Italian women come to resemble those of The Netherlands, if restrictions in Italy against part-time work were eased? Or would the working hours of Dutch women approach full-time if, as in Scandinavia, affordable day care were made available?

The main problem is that past policy has resulted in an overly rigid leisure-work mix which allows individual workers little choice on how to optimize their own personal arrangements. At the same time, work-leisure incentives for some groups are gained at the cost of others. Essentially, existing practice reflects a social order that no longer predominates. At this point, leisure time is concentrated in the work week, vacations and holidays, and at the tail end of the life cycle. If the goal is to optimize life chances within a dynamic framework, such a state of affairs may not be compatible with the requirements of an evolving knowledge society.

Emerging trends in the behaviour of families and the labour market suggest that citizen demands for leisure and work may be spaced out across the life cycle in a radically different manner than heretofore. Paid maternity and parental leave are among the few examples of policy-making that seeks to address emerging incompatibilities. A full-fledged lifetime-learning model will require similar arrangements, including paid leave for education and training.

There is a strong case to be made for a recently revived suggestion, originally floated by Nordic Social Democrats in the 1970s, to reconceptualize the work-leisure mix in terms of lifetime ”leisure accounts”. The basic principle is that citizens, after a minimum number of contribution years, could draw at will upon their retirement-savings accounts for purposes of education, family care, holidays, or whatever.

In principle, there is no reason why retirement should be concentrated in old age. A radical version of the win-win scenarios presented above would, in fact, call for the abolition of retirement as we now know it, and redefine it in terms of the entire life cycle. Individuals who are reluctant to take risks could opt for educational leaves or minimal career interruptions. Others, provided with inducements for leisure, might be more inclined to interrupt their work careers.

The bottom line is that citizens would have much greater individual control over the design of their own life cycles, with a personal mixture of work, education, family, and leisure time. If the financial consequences are made clear, an individual will be able to make rational decisions on such questions as whether or not a choice to take some time off at age 35, in exchange for one less year of retirement, is advantageous.

Postscript

The Portuguese presidency of the EU was clearly a success, in terms of promoting a common European commitment to improving the performance of general-welfare systems. There appears to be broad agreement on what might be called the bare skeleton of a new social model. As characterized by the European Council, the key concepts are: greater investment in people; social policies that activate; and action against social exclusion.

The formulation of these objectives is, of course, quite vague and uncontroversial. However, the documents of the European Council also elaborate some concrete steps to be taken and some objectives to be achieved. There are calls for job growth in the service sector, for delayed retirement, more female employment, and services to families.

In some cases, the objectives are quite precise: By 2010, unemployment should be reduced to four percent, overall employment levels should reach 70 percent, and the rate of female employment should be 60 percent; the poverty rate should drop from today’s 18 percent to ten percent; investments in human resources should increase by 50 percent; and the number of young people with less than secondary education should be cut in half.

If the Portuguese presidency is viewed as the first stepping stone on the way to an ambitious project of building a new welfare-state edifice, what should follow? How to ensure that genuine concrete progress is made during the coming decade? Toward that end, I see two or three issues that call for immediate follow-up.

One has to do with social accounting, which has been briefly touched upon in this report and has two important dimensions. First, it requires a common system of indicators to monitor and define social progress and relevant objectives. Of course, there is already a quite large battery of suitable indicators for employment, the labour market, incomes, poverty, and the like. It appears that the EU has now adopted the median income as a common baseline for measuring poverty, which is a basic first step toward comparability. But the analysis presented here suggests that the truly important measures of welfare have to do with life-cycle dynamics, i.e. with citizens' chances for improvements in their welfare or their risks of entrapment.

To take an example from my own list of policy priorities, child poverty needs to be eradicated in order to maximize children's life chances, school performance, etc. How to design a policy for this objective? A suitable answer requires a clear understanding of precisely how the duration of poverty affects children. Are negative consequences likely to develop if a period of poverty exceeds three months, six months, one year? What are the mechanisms at work? Does an index based on income adequately reflect the multiple dimensions of poverty?

A basic precondition for effective policy in this and most related areas is the availability of reliable information on the *dynamics* of human welfare. As with child poverty, it seems very difficult to design a policy for delaying retirement and making it more flexible, in the absence of better information about which individuals are most prone to early retirement, why, and under which conditions. Again, there is a lack of comparable, Europe-wide data in such matters. It is urgent that the EU take serious steps to re-establish a credible European Household Panel.

A second important requirement is to develop adequate measures of income and expenditures. Existing systems of accounting are not especially relevant for the kind of new social model that is under development. Some current problems of accounting are well known, including the need to distinguish between gross and net social spending. A greater problem is that public social expenditures are routinely defined as current outlays and consumption (unlike airports, for example, which are classified as capital investments).

Nevertheless, as indicated by a number of currently popular buzzwords, the new welfare state must emphasize "investments in people. . . activating human resources", and the like. From the standpoints of both legitimacy and practical accounting, it is crucial to properly understand the nature of social outlays. The costing-out examples of day care and parental leave provided in the Appendix reveal part of the problem: Current outlays to working mothers may appear extravagant in the here and now; but if they are recuperated in the long run due to the improved earnings capacity of women, those outlays bear a rate of return (for both the individual and society) that can be estimated. That being the case, the policy issue is not whether to provide for working mothers. The question becomes, instead: Is it possible to envisage a policy that helps mothers in the same way, while yielding an even better rate of return?

It is also quite urgent to develop a much more complete picture of the emerging structure of risks and needs. It is, by definition, quite difficult to identify emerging realities in an time of radical socio-economic change. Our situation resembles that of the driver in dense fog: We can still clearly envisage the place we recently left, but have great difficulty seeing whatever lies ahead. To be sure, the fog is lifting a bit. and a number of emerging risks are already quite evident, including low-skilled workers and single-parent families.

Other emerging risks and needs appear on the horizon, but with less clarity-- the welfare problems associated with longevity, for example. Still others may remain very difficult to discern. As one example, consider the type of society that will emerge when the employment rates of women match those of males. One possible consequence is that residential neighbourhoods may empty out during the daytime, with parents at work and children at school or day care.

What are the likely consequences of such a model of social welfare? Will it, as Arlie Hochchild suggests, lead to a perverse situation in which the place of work also becomes the focus of social fulfilment? Will it result in even greater marginalization for those who continue to be excluded from work and education? Can such a scenario be averted with policy measures? Or to take another, little understood, trend-- the apparent increase in no-work households. Very little is known about long-run trends in this regard. Do such households represent a growing phenomenon? Nor do we know much about which individuals are most at risk, or why. Are there trends underway in marriage and cohabitation patterns that widen the gulf between winners and losers?

Any effort to better document new risks must be connected to the existing social-policy repertoire of European welfare states. As noted, the overriding challenge is to construct a new social model. A necessary first step in that direction is to develop a clearer idea concerning the exact location of gaps and disequilibriums between the demand and supply of welfare.

In closing, I would like to make yet one more appeal for a strong family- and child-centred strategy for welfare-state reconstruction. A revised social model requires a future-oriented perspective, and must therefore focus on those who will become tomorrow's adults. When goals for the future are defined in terms of maximizing Europe's competitive position in the world economy, the need to invest in today's children becomes obvious.

The European Council's stated goal of "greater investment in people" is uncontroversial-- until the moment when funds have to be allocated among various categories of real, live people, including the young , prime-age adults and the elderly. The EU formulation skirts the thorny but crucial issue of how to define priorities if, as seems likely, it is not possible to make everyone equally happy. The issue is indeed thorny, due to vested interests and the balance of political power. The median age of

European voters is rising, and the electoral balance of power is steadily shifting in favour of the aged. Moreover, interest organizations primarily represent ”insiders” with stable jobs and / or sizeable resources. Hence, everyday politics are increasingly weighted in favour of those who would probably prefer to maintain the *status quo* of the welfare state, rather than reset priorities to improve the lot of those at risk.

This appeal can be interpreted as yet another suggestion for a follow-up of the Portuguese presidency: It is necessary to give concrete shape to goals and targets by making clearer choices among competing priorities. For this purpose, the political leaders of the European Union and its member-states must decide upon and then propagate a decision-making rule of justice-- one that will enable the setting of concrete priorities and the consensual implementation of a social model which is truly dedicated to creating social cohesion that will last well into the future.

* * * * * *

Bibliography

Bertola, G. , Jimeno, J., Marimon, R, and Pissaridis, C. 1999. ‘Welfare systems and labour markets in Europe: what convergence before and after EMU?’. Paper prepared for the DeBenedetti Foundation Symposium, Genova , July.

Bison, I. and Esping-Andersen, G. 2000. ‘Income packaging, poverty and unemployment in Europe’. In D. Gallie and S. Paugham, eds. *The Experience of Unemployment in Europe*. Oxford: Oxford University Press.

Bjorn, L. 1995. *Causes and Consequences of Persistent Unemployment*. PhD dissertation, Department of Economics, Copenhagen University.

Bruyn-Hundt, M. 1996. *The Economics of Unpaid Work*. Amsterdam: Thesis Publishers

Easterlin, R. 1987. ‘The new age structure of poverty in America’. *Population and Development Review*, 13, 2: 195-208.

Economic Policy Institute, 1997. *Managing Work and Family: Nonstandard Work Arrangements among Managers and Professionals*. Washington DC: Economic Policy Institute.

Erikson, R. and Goldthorpe, J. 1992 *The Constant Flux*. Oxford: Clarendon Press.

Esping-Andersen, G. 1999. *Social Foundations of Postindustrial Economies*. Oxford: Oxford University Press.

Golini, A 1994. *Tendenze Demografiche e Politiche per la Populazione. Terzo Rapporto IRP.* Bologna: Il Mulino.

Gornick, J. , Meyers, M. And Ross, K. 1997. 'Supporting the employment of mothers'. *Journal of European Social Policy*, 7: 45-70

Haveman, R. and Wolfe, B. *Succeeding Generations. On the Effects of Investments in Children*. New York: Russell Sage Foundation.

Jacobzone, P. et.al. 1998. 'The health of older persons in OECD countries: is it improving fast enough to compensate for population ageing?' *OECD Labour Market and Social Policy Occasional Papers,* no. 37.

Kohli, M. 1999. 'Private and public transfers between generations'. *European Societies,* 1 (1): 81-104

Martin, J. 1998. 'What works among active labour market policies'. *OECD Labour Market and Social Policy Occasional Papers,* no. 35

Mirowsky, J. and Ross, C. 1999. 'Economic hardship across the life course'. *American Sociological Review*, 64, 4: 548-569.

OECD, 1996. *Aging in OECD Countries.* Paris: OECD.

OECD, 1997. *Literacy Skills for the Knowledge Society*. Paris: OECD

OECD, 1998. *Maintaining Prosperity in an Aging Society*. Paris: OECD

OECD, 1999 *A Caring World. The New Social Policy Agenda*. Paris: OECD

Orszag, P. and Stiglitz, J. 1999. ' Rethinking Pension Reform: Ten Myths about Social Security Systems'. Paper presented at the conference on *New Ideas about Old Age Security*. The World Bank, September 14-15.

Palmer. J., Smeeding, T. and Torrey, B. 1988. *The Vulnerable.*Washington DC: The Urban Institute Press.

Preston, S. 1984. 'Children and the elderly in the US'. *Scientific American*, 251: 44-49.

Rainwater, L. 1974. *What Money Buys: Inequality and the Social Meaning of Income.* New York: Basic Books.

Scharpf, F. 1999 *Governare l'Europa*. Bologna: Il Mulino.

Shavit, Y. And Blossfeld, H.P. 1993. *Persistent Inequality*. Boulder, Col: Westview Press.

Storesletter, K. 2000. 'Sustaining fiscal policy through immigration'. *Journal of Political Economy*, vol. 108, 21: 300-323.

Thompson, L. 1998. *Older and Wiser: The Economics of Public Pensions*. Washington DC: The Urban Institute.

Tables

Table 1. Percent Unemployed Individuals with Zero Market or Welfare-state Revenue and Dependence on Familial Support

	% with Zero Income ALL (20-64)	% with Zero Income Youth (20-30)	% with income from family Youth (20-30)	% living with parents Youth (20-30)
Belgium	2.1	3.3	13.7	28.8
Denmark	0.4	0.0	12.6	7.8
France	13.7	20.8	4.8	42.3
Germany	5.4	8.5	15.5	31.0
Greece	48.9	59.6	7.8	55.1
Ireland	2.1	3.0	0.4	67.8
Italy	69.8	81.3	4.2	82.9
Portugal	40.7	54.2	0.0	57.9
Spain	31.8	42.6	2.6	66.3
UK	3.6	2.2	5.2	39.7

Source: Own analyses of 1994 Europanel. See Bison and Esping-Andersen (2000)

Table 2. Percent Non-standard Working Age Families and Their Economic Situation. Mid-1990s

	No work-income households % of all	Relative Disposable income of No-worker Households (all=100)	Single parent Households % of all child families	Poverty rate in Single-parent households 1)
Belgium	13	64	20	13
Denmark	8	63	18	16
Finland	7	60	12	5
France	12	67	16	23
Germany	12	57	16	41
Ireland			18	
Italy	10	51	15	48
Netherlands	14	61	16	33
Portugal			13	
Sweden	8	59	18	7
Spain			13	
U.K.	13	56	21	49
USA	6	39	27	54

1) Poverty is measured as < 50% median, adjusted income (equivalence scale = 0.5). Source: OECD

Table 3. Poverty Rates in Families with Children after Taxes and Transfers. Mid-1990s 1)

	Two adults, One earner	Two adults, Two earners	Lone parent, Not working	Lone parent, Working
Belgium	2.8	0.6	27.6	11.4
Denmark	3.6	1.0	17.7	10.0
Finland	3.5	1.5	37.1	3.0
France			45.1	13.3
Germany	5.6	1.3	49.5	32.5
Greece	15.1	5.0	36.8	16.3
Italy	21.2	6.1	49.1	24.9
Netherlands	4.7	1.2	22.6	17.0
Sweden	6.0	0.8	24.2	3.8
U.K.			69.4	26.3
USA	30.5	7.3	67.0	38.6

1) Poverty= < 50% of median income, using equivalence elasticity= 0.5. Source: OECD

Table 4. Trends in Relative Disposable Income by Household Type. Percentage Change, Late 1970s to Mid-1990s.

	All households with children	Young households	Retired households 65-75
Austria	- 3	-1	+11
Denmark	- 3	- 8	+ 5
Finland	+3	- 9	+ 1
France	0	- 5	0
Germany (W)	-3	- 2	- 3
Italy	-1	- 3	+ 3
Netherlands	0	- 7	- 4
Sweden	-2	-11	+ 9
U.K.	-4	- 3	+ 5
USA	-3	- 5	0

Source: OECD data

(Continued. . .)

Table 5. Trends in After-Tax/Transfer Child-Poverty Rates and in the Ratio of Child:Aged Poverty Incidence, ca. 1980 to Early 1990s.

	Child poverty 1980	Child poverty mid-1990s	1980 child-aged poverty ratio	1990s child-aged poverty ratio
Belgium		5		.45
Denmark		4		.67
Finland		3		.21
France	13	17	.81	1.60
Germany	5	11	.45	1.10
Netherlands	7	9	1.17	1.29
Portugal 1)	28	23	.67	.53
Spain 1)	17	17	.53	.68
Sweden	2	3	.33	1.00
U.K.	11	27	1.22	2.25
U.S.A	23	30	1.05	1.50

Poverty = <50% of median adjusted household income after taxes and transfers (equivalence scale= .5)
1) Last year=1988. Source: LIS data

Table 6. The Service and Age Bias of Welfare States, 1992

	Service Bias: ratio of Services/cash	Aged Bias: ratio of youth/aged
Austria	0.03	0.31
Belgium	0.08	0.61
Denmark	0.33	1.37
Finland	0.21	0.94
France	0.13	0.48
Germany (W)	0.12	0.43
Ireland	0.16	1.12
Italy	0.07	0.79
Netherlands	0.12	0.79
Portugal	0.10	0.55
Spain	0.05	0.67
Sweden	0.45	0.92
U.K.	0.13	0.50
USA	0.06	0.30

Note: Health care is excluded from services. Source: OECD Social Expenditure Database

(Continued. . .)

Table 7. Level of Relative Disposable Income of Persons Aged 65+, 1990s. Percent of Median

	Disposable Income
Belgium	77
Denmark	73
Finland	78
France	94
Germany	86
Italy	84
Netherlands	85
Sweden	88
USA	92

Source: OECD Income Database.
Note: Disposable income is net of taxation and transfers, and includes all income sources

Table 8. Total Public Pension Expenditures (% of GDP) in 2050, according to Two Scenarios: A Baseline Scenario of No Change, and a Scenario Assuming Average Retirement at Age 70.

	Baseline Scenario for 2050 1)	Age 70 Retirement Scenario for 2050 2)
Austria	14.9	10.6
Belgium	15.1	10.6
Denmark	11.5	8.0
Finland	17.7	11.6
France	14.4	7.6
Germany	17.5	12.8
Ireland	3.0	2.0
Italy	20.3	10.2
Netherlands	11.4	8.6
Portugal	16.5	11.6
Spain	19.1	15.2
Sweden	14.5	7.5
USA	7.0	5.7

1) The baseline scenario assumes that present pension rules will remain, a fertility rate of ca. 2 and no change in migration.
2) The delayed retirement scenario assumes all of the above, but also that (as of 2005), retirement age will rise by 0.5 years per annum up to a maximum of 70 years.

(Continued. . .)

Table 9. Early Retirement Incentives and Employment among Older Males. Gains from Postponing Retirement from Age 55 to 64, and Simulated Employment Effect with Actuarial Neutrality. 1995 data.[1]

	Cumulated pension wealth accruals when postponing retirement from 55 to 64	Simulated increase in participation rate among males,55-64, with actuarial neutrality
Austria	-3.4	
Belgium	-2.3	
Denmark	0	
Finland	-2.3	+ 6
France	-1.4	+ 4
Germany	-1.4	+ 3
Ireland	-1.4	+ 4
Italy	- 7.9	+20
Netherlands	- 1.3	+ 1
Portugal	- 0.4	+ 1
Spain	-1.4	+ 3
Sweden	-1.8	+ 4
U.K.	- 0.5	+ 1
USA	-1.2	+ 3

1) Pension accrual estimates include the effect of saving on pension contributions, and are measured as a multiple of annual earnings. Estimates assume 35 years' accumulated social contributions. The simulated change in participation is regression estimated. Source: OECD

(Continued. . .)

Appendix. Costing Out Social Investments in Families

Increasingly, the integration of women into the labour force means a lifelong commitment to paid employment, and this implies a basic trade-off between careers and children. Bluntly put, new types of family are no longer willing to bear the entire cost of children, given the opportunity cost of women's careers and / or household needs for double earnings.

Support to working mothers implies a combination of adequate and affordable day care for children to age six, income maintenance during maternity and parental leave, and coverage during absence from work when children are ill. The heavy expenditures involved have provoked debate on the cost-effectiveness of such programmes. Rosen (1997), pointing to mothers' sharply reduced hours while children are small, argues that they constitute a substantial waste of resources, an exorbitant subsidy of "negative productivity". Critics of this view hold that the temporary cost of subsidizing mothers' labour-force participation should be assessed in dynamic terms, including an evaluation of the effects on accumulated lifetime earnings and tax payments.

A full estimate of the "real" public cost requires data that are not readily available, particularly with regard to mothers' real productivity while they are receiving public support, and also their anticipated lifetime earnings. As to the latter, recent benchmark estimates suggest an accumulated lifetime-earnings loss of two percent annually if the mother leaves the labour force for five years. If, instead, she works part-time during the same period, the loss drops to only 0.5 percent (Bruyn-Hundt (1996). Thus, if the mother can expect to work another 25 years, the cumulative effect of complete interruption can be dramatic (50 percent), but is quite modest in the case of continued part-time work (12.5 percent). Clearly, this has a large effect on associated tax contributions.

Using Denmark as a costing-out example, let us begin with an overview of public costs per child (1995 data; figures in Danish kroner):[39]

- per-child daycare cost, ages 0-3: 41,945
- per child daycare cost, ages 0-6: 57,195
- gross cost of parental leave: 92,638
- total cost per child, age 0-6, if mother is on leave: 100,938
- total cost per child, age 0-6, mother uses day care: 65,495

The annual per-child cost of supporting working mothers is clearly greater for parental leave; but since these benefits are taxed, the net cost is only 62,000 kroner. The cost of the daycare alternative is lower, and in net terms much lower, because the mother

[39] Calculations of parental-leave benefits assume maximum benefit (70 percent replacement) for one year. Daycare costs are estimated by dividing public daycare spending by the number of children covered. Source: *Social Security in the Nordic Countries* (1996).

works and pays taxes. Assuming the mother earns 67% of an average wage, she pays taxes equal to 63,400 kroner, which is more than the daycare subsidy per child.

It may be assumed that the average mother has two children, and that she will make use of day care over a period of, say, five years at an annual cost to government of 114,000 kroner (which, if she works, is roughly twice the amount of taxes she would contribute during that period). The net outlays by government for the entire five-year period is thus 250,000 kroner. Not included in these calculations are additional hidden costs, such as those related to absence from work when a child is ill (in this example, the net cost would be 245 kroner per day).

Within a dynamic, lifetime-earnings framework, the estimated cost-effectiveness of child care's becomes quite favourable. Let us take the example of a mother of two children who stops working completely for five years, conservatively estimating her annual loss of earnings at 1.5 percent. Over a subsequent 25-year career, she would experience a cumulative income loss of 35 percent. At a 67% earnings level, this would amount to 1,400,586 in constant kroner. The associated revenue loss to the government, assuming no change in taxation rates, would be 490,205 kroner.[40]

Put differently, if a mother does not interrupt her career, she will contribute an additional 490,000 kroner in tax revenue (or just about twice the original cost of child care). To this estimate, however, we must also add the public cost associated with two years' paid parental leave (one year for each child), for which the net cost to government is 124,000 kroner. In this case, as well, the government gains an additional 115,000 kroner over the mother's entire working career.

Of course, this costing-out exercise is very general, and the net gain of 115,000 kroner in taxes might be somewhat less if the costs associated with absence from work were included. For example, if the mother were to take 30 days' leave over the five-year period, roughly 7,350 kroner should be deducted. On the other hand, the mother's earnings and her sustained participation in the labour market imply a much lower risk of household poverty, and thus a smaller likelihood of drawing upon public income support.

[40] These are very conservative estimates, since they do not take into account the likely earnings increases that she will experience during the course of her career.