CATALAN SOCIAL SCIENCES REVIEW, 5: 11-16 (2015)
Secció de Filosofia i Ciències Socials, IEC, Barcelona
ISSN: 2014-6035
DOI: 10.2436/20.3000.02.22
http://revistes.iec.cat/index/CSSr

The redesign of social policy in a time of economic crisis

Guillem López-Casasnovas*
Universitat Pompeu Fabra

Original source:
***Anuari de la Societat Catalana d'Economia*, 21: 125-129 (2015)**
(http://revistes.iec.cat/index.php/ASCE/index)
Translated from Catalan by Mary Black

Abstract

Demographic trends, with the relevant ageing of the population, are mostly determining the direction of social policy (in terms of healthcare, social services, pensions, future proposals to cover dependence, etc.). This is unfortunate, as the social policy agenda should be much more focused on poverty than on age, equal opportunity policies, fighting unemployment, combating social exclusion and guaranteeing the basic rights of all citizens. If current trends do not change, the elderly will become the main beneficiaries of an increasing proportion of social expenditure over GDP.

Key words: Social policy, economic crisis, ageing of the population, inter-generational welfare

1. Introduction

The economic crisis in which we are still currently enmeshed, which effects will probably remain long enough to change the way we understand the State involvement in our lifes, spurs us to embark upon these reflections to make several proposals for action that should inform new forms of social policy. Until today, social policy has focused more on the intra-generational aspects of welfare (variations between rich/poor, educated/illiterate, professionally trained/less trained, the healthy/the ill and between citizens with debts or savings!) that on the inter-generational aspects of the young and elderly cohorts. This has taken for granted that what social policy had to do for the elderly it was compensated for what technology did for the human capital, productivity and improved salaries of the younger population. This balance is being broken today given the evolution in the job market (young people are suffering from more unemployment, their training is stagnating and low-salary jobs go with precarious jobs) and demographics. The reflection below aims to provide a brief overview of the effects of demographic ageing, bearing in mind the behaviour of the job market and its effects on different aspects of our lives. We should note in advance that the rise in life expectancy is a valuable social fact in itself, and that

* Contact address: Guillem López-Casasnovas. Office 20.297, Departament d'Economia i Empresa, Universitat Pompeu Fabra. Ramon Trias Fargas, 25-27. 08005 Barcelona, EU. E-mail: guillem.lopez@upf.edu.

the goal is that by reorienting public social policy, to restore an acceptable balance for overall welfare of our generations.

2. Effects of the new state of affairs: The ageing of the population

The ageing of the population affects the intergenerational balance of welfare through the following elements of economic policy:

— The impact on income/assets bearing in mind the effect of the investment first, and then the liquidation of assets throughout the life cycle.

— The balance between consumption and savings.

— Some components of consumption: entertainment, housing, transport, personal services, etc.

— Finally, the mix of public/private consumption.

Ageing affects the following elements of social policy: pensions, healthcare, benefits for long term care and other social services. This intergenerational effect is due to their impact on the ordinary budgets, and its fiscal response: either higher taxes, the substitution effect they exert on other public policies if the goal is to keep a balanced budget, on the public debt if it is financed in this way. In any event, this would lead the elderly incomes to depend mostly on public benefits at the expense of the young contributors.

The proportion of the population older than 60, as a proportion of the total population of Spain, will double by 2040 according to some forecasts. Without changes in public policies, this is, maintaining the current policies, this will mean that the proportion of public spending on benefits for the elderly will rise from 12.6% to 33.1% of the GDP. In terms of total public spending, this would crowd-out other (current or future) public policies targeting the share of those groups from their current 68% to only 28% of the GDP. If total public spending increased in such a way to prevent this substitution effect, the fiscal pressure would have to rise from its current 38.2% to 57.2% by 2040: this is, a fifty per cent. If these benefits are financed through deficit and debt, by 2029 we would enter into what is called the “snowball effect” (150% of the GDP). Finally, from another vantage point, 68% of the net incomes our elderly would depend on social spending. What is more, the tax-free incomes of the passive classes would even exceed the incomes of actively employed persons (because of the burden of taxes and payments on the latter). This makes for a clearly unsustainable situation.

Finally, we should note that at the current pace, the complement from private pensions would only yield a compensating effect of three points of GDP (one-third, for example, of its share in the United Kingdom or Canada). Likewise, the “cushion” brought about by our elderly’s cohabitation with their adult children would continue to be essential: 40% compared to 6% in some Nordic countries, and in this sense the new benefits for dependence would have to level the playing field in the decision on whether or not to institutionalise dependents, at present family and basically females dependency. However policies should be kept neutral towards informal and formal care and on institutionalisation in/outside home.

All of this new situation necessitates the following counterbalances: 1) keeping a global perspective on social spending and finance resulting from the demographic change: who receives what and who finances who. For this, a more horizontal and less “compartmentalised” vision is required of the impact of ageing on public policies by focusing them on their recipients: not who does what, but for what purpose is done; 2) maintaining a fair distribution rule in response to the evolution in the demographic vector (the elderly) and the job market (young cohorts) in an integrated fashion. Otherwise, there is a danger of a substitution effect of the benefits of one group in favour of others; 3) acting via selective policies. The elderly are not on average the poor of the country today. They may be the poor in terms of income, but not in terms of assets. Their real purchasing power is often higher that for the rest of the population, they face less vital expenditures and their public benefits help to improve at least partly their welfare. However, there is significant variation among them. There are major pools of poverty among the elderly. In this sense public policy should be less universal and more selective, more closely tied to proof of need and means.

In short, demographic trends, with the relevant ageing of the population, are determining the direction of social policy (in terms of healthcare, social services, pensions, future proposals to cover dependence, etc.). This is unfortunate, as the social policy agenda should be much more focused on poverty, equal opportunities, active employment, combating social exclusion and guaranteeing the basic rights of all citizens, not unambiguously linked to age.

If the current trends do not change, the primary beneficiaries of an increasingly large share of social spending within the GDP will be unavoidably the elderly (an electorally important group with more concentrated political dimensions). The evolution in pensions and the derived internal rate of return (IRR) for current pensioners, the dynamic of non-contributory pensions, healthcare without equity discrimination in the allocation of resources (fair innings), the evolution in some asset values, and the dynamic of new job contracts dissociated from productivity will be the main causes.

The described situation contrasts with the need for new workfare policies and to reorient fiscal pressure, today still highly concentrated on certain groups of contributors, in order to guarantee social reinsertion, housing, active human capital training policies, efficient salaries, job market security, etc. All of these kinds of policies have at present low relative importance and may even have less in the future.

On the other hand, we should consider the need to coordinate public and private pensions by offsetting fiscal spending regressiveness of private funds, as well as considering the relative price differential in view of the different shopping baskets for pension indexation. We must also assess the importance of delayed retirement, which affects both contributions and pensions, and consider the delay in the entry into the job market and a shorter contribution course, more likely in among those with less training and lower qualifications. Their shorter life expectancy compared to the greater longevity among the wealthy today may create an additional intragenerational unbalance.

Ensuring future retirement today primarily depends therefore on the quality, quantity and distribution of the productive assets – physical, human and environmental – that the new generations have or inherit. More policies

centred on 'ex ante' child investments would guarantee a better future welfare than 'ex post' inherited wealth transmissions.

Otherwise, under the present situation, we face postponing emancipation, extended education and training or unemployment for a longer time, and delaying stable coupledom. All this leads to a drop in the birth rate, with fewer overall opportunities to save for the late stages in life.

We can also see a foreseeable better future (in terms of pensions) for couples in which both work and have more training in a context that favours greater "endogamy" of monogamy among couples with similar educational levels. Otherwise, higher income and more education imply fewer children and thus a further concentration of wealth.

Despite all this, families' financial precariousness is worrisome, not so much because of the financial burden of their debt as because of the distribution of assets by income deciles and how this economic cycle has affected them (Family Financial accounts, Bank of Spain 2015).

We should ammend the unequal opportunities we observe the sooner the better: in childhood, within the family, with a new equilibrium between work – for both women and men – and family assistance, in order to prevent couples from being "penalised" for having children (levelling out the incentives for home care); the uncertainty of poverty (number of children); broken families (single-parent families) and dynastic accumulation. The importance of training human capital from the early years (cognitive skills, discipline, health and motivation to learn, all of which are closely tied to the family and cultural *milieu*) has been proven, as has its influence on job opportunities (likelihood of unemployment), income (salaries) and wealth and its accumulation.

Therefore, attention must be paid to investment inequalities in many areas associated with poverty (single-parent families, immigrants, etc.) and to the challenge of making the measures compatible with s major influx of women into the job market. We should likely focus on "first-year" mothers with low-skilled jobs, avoid concentrations in schools linked to poor housing or by other forms of segregation. We need to grasp that what is fair is different than simple egalitarianism and apply it from a generational perspective (throughout an individual's lifetime, bearing income dynamics in mind).

Intergenerational accounting provides for this purpose the bridge between today's public debate on social deficits and the necessary future financial surplus (under intertemporal budgetary constraints). It identifies the present and future net per-capita transfer for each generation (in current values), given the demographic prospects and taxpaying and the age public spending profiles. That is, it calculates how much a newborn today will have to contribute to public spending (or private spending, accepting a rise in taxes) if they end up with a zero balance throughout their lifetime.

3. Ways to rebalance inter-generational welfare

Musgrave's Rule. Based on the active-passive ratio (workers/pensioners), a referent must be established. This is the case of the so called Musgrave rule. It

requires a predetermined coefficient of relative positions[1] among age groups such that the variation in contributions (payments) vs. benefits (pensions) keeps the per capita (net) income coefficient of the active population constant with respect to the per capita (net) benefits of pensioners. Once the ratio has been determined, the taxes should periodically be adjusted to reflect demographic changes (downward) and productivity changes (upward). Therefore, if the population ages, the taxes rise but pensions drop in such a way that everyone "loses" in the same proportion. Therefore, the past income distribution is initially conserved.

Regarding structural reforms for fiscal consolidation purposes, which can be analysed as substitutions rather than complements, the sovereign debt, has to be considered a sort of postponed tax. Non-structural reforms are today's incomes redistribution within the same generation. The introduction of an entry barrier is in this sense equivalent to wealth that is transferred from future generations towards current generations. The opposite holds true, too: these restrictive regulations must be removed. The scope of laws for employment protection and rent control today extract income from future generations in favour of current ones. Fiscal consolidation is worse for this purpose than structural reforms, since even though both restore the generational balances, the former raises taxes and thus generates an excess burden that enlarges both the current and future consequences. Even though the measures are substitutive, they are not alternative, we have to be able to analyse the optimal composition combining these at any rate both two fronts.

Another way to tackle the unbalanced effects is through the accumulation effects, first, and the liquidation of the assets of the baby boomers, later. In fact, the literature claims that movements in the price/earnings ratio of shares closely follow the coefficient between the middle-aged population and the elderly. When pensioners complement their pensions by selling assets, they put pressure on the price of assets for everyone and hinder young people from accessing wealth.

Likewise, in view of the internal rates of return or the expected net transfers for each incoming cohort, the proportion of debt, both in the sense of the Kotlikoff effect[2]- and the effort to pay it off-, and its magnitude -given the impact that public debt has on economic growth-, other things equal (the 90% of the GDP Reinhart/Rogoff rule), with an average drop in the growth rate is estimated at slightly higher than 1% of GDP.[3] Finally, with contexts of almost zero interest rates such as today, the claim that higher inflation is needed leads to an additional uneven damage, that will depend on the groups' relative degree of indebtedness and financial protection because either the indexing of pensions or the credit conditions.

---

[1] A good description can be found in G. Esping-Andersen, D. Gallie, A. Hemerijck and J.Myles (2002), *Why We Need a New Welfare State*, Oxford, Oxford University Press.

[2] A good description of its application in Spain can be found in C. Patxot and R. Farré (2007), *Evaluación de la sostenibilidad del estado del bienestar en España*, Barcelona, Universitat Abat Oliva, Fundació pel Desenvolupament Humà i Social.

[3] C. M. Reinhart and K. S. Rogoff (2008), "This Time is Different: A Panoramic View of Eight Centuries of Financial Crises", *NBER Working Paper*, no. 13882 (March).

In brief, for all the former purposes, a ‘new-new’ welfare policy needs to be designed. Family structure and workfare strategies are central pieces if we wish to rebalance the equity effects that at present deteriorate the intergenerational equilibrium of welfare for our younger generations.