An Equitable Social Model for Mid-Century Europe

The contemporary reform debate is mainly preoccupied with financial sustainability and lacks serious attention to equity. I argue that the latter is a precondition for any viable social model, especially because aging will intensify inequities in the nexus between welfare financing and benefits. It is particularly urgent to reform our social accounting practices so that we can better identify social investment with long-term gains, and so that we can figure in the interplay of public and private social expenditures.

How to Analyze Welfare Futures

The debate on a social model for the future is treading water. Perhaps this is because we have been overly focused on the issue of financial sustainability and have accordingly relied too much on the wisdom of our accountants. Allowing actuarial concerns to define the agenda is like putting the cart before the horse. It is a bit pointless to forecast expenditures if we have no clear idea where we wish to go. My contribution, therefore, aims to put the horse back where it belongs.

A sound diagnosis of the challenges that lie ahead requires a suitable analytical method. In the first place, we need to move from the standard, and overly myopic, focus on the welfare state to a welfare regime approach. We will not see the world clearly unless we examine the interplay of family, markets and government in the production (and consumption) of the total welfare pie. These three cornerstones of welfare have reciprocal effects on each other. Markets may fail and this will necessitate recourse to either the family or to government. Similarly, families can fail and this means greater reliance on markets or government. And what if markets and families fail in tandem? Care for the frail elderly is susceptible to double failure since commercial services are expensive while families’ caring ability is eroding. Any given welfare mix will inevitably produce second-order distributional and behavioural consequences that influence equity and efficiency. To illustrate, if childcare is unaffordable prospective parents may reduce fertility or the mother may decide to curtail employment. Low fertility responsibilities we will never succeed in reconciling motherhood with employment. Low fertility deficits within the population. Large-scale immigration adds to the urgency of homogenizing graphic imbalances we can ill afford large skill deficits within the population. Large-scale immigration adds to the urgency of homogenizing children’s learning abilities.

The second upshot is that we need to redesign family policy. Unless we ‘de-familialize’ welfare responsibilities we will never succeed in reconciling motherhood with employment. Low fertility is not a signal that citizens do not want children but rather that the constraints of family formation are mounting. The family remains the key institution of society and the challenge is to forge policies that support it. The family, in its increasingly varied manifestations, is also the key to children’s well-being and, hence, policy that

Adopting a life course perspective permits us, in contrast, to identify the inter-connectedness of citizens’ risks and needs. Social exclusion or old age poverty is not events that suddenly befall an individual but are usually the end-result of a problematic biography. More often than not, the triggers of a social problem are deeply buried in the early stages of peoples’ life course. An effective response to welfare needs requires us to identify when and how in the human life course we might best invest resources so as to minimize the need for later, costlier and often ineffectual remedial policies.

Reform Priorities

The contemporary debate is almost exclusively concerned with retirement reform. Yet, the nature of structural transformation tells us that our first priority must be to invest far more in children. It is no secret that school success and subsequent life chances are powerfully dictated in early childhood. The ability of schools to equalize children’s opportunities and to rectify a bad start is, at best, very limited. The mainsprings of child outcomes lie in the family of origin. To ensure a good life, today’s youth will not only require more education but also the pursuit of continuous life-long learning. This presupposes strong cognitive skills to begin with. Considering the looming demographic imbalances we can ill afford large skill deficits within the population. Large-scale immigration adds to the urgency of homogenizing children’s learning abilities.

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Note 1 This is an abridged version of a paper presented to the Dutch Scientific Council for Government Policy, December 8, 2005.
ensures children against economic deprivation is sine qua non. More generally, the cost of children is rising – and so is the positive externality of children. We need to design an equitable sharing of the costs and benefits of children.

The third upshot is that we need to minimize the child penalty of motherhood. This implies a reconciliation of motherhood and careers but we are mistaken if we believe that the standard menu of ‘mother-friendly’ policy will suffice. Some of the major obstacles are hidden in the labour market, especially with regard to job security. Policy that addresses this problem will easily provoke new dilemmas. At the end of the day we will almost certainly have to conclude that a positive equilibrium necessitates a ‘feminisation’ of the male life course.

The fourth upshot is that we need to redefine the nexus between working life and retirement. The really difficult challenge of aging is not so much to finance it as to ensure equity. It is a pretty safe bet that earnings will become increasingly unequal and that a sizable group will find itself locked into a carousel of low wages and unemployment, possibly passing through any number of activation measures. This will spill over to the distribution of household income. Stable high-educated couples will accumulate a formidable retirement wealth, but this is less likely for the low educated and the divorced.

It is easy to envision a retirement regime that is sustainable while equitable in inter-generational terms. It is far more difficult, and also far more urgent, to design one that delivers intra-generational equity. The current system is, almost everywhere, inherently inequitable simply because those with high lifetime incomes live far longer. The mortality gap between managers and workers is typically 7+ years. In other words, the ‘rich’ end up receiving a disproportionate share of pension and care expenditures. As the retirement population and caring needs grow, the inbuilt financial inequities will provoke growing tensions. A positive equilibrium necessitates some form of basic pension guarantee and a far more progressiv-system of financing aging and dependency.

The fifth, and final, upshot is that current social accounting systems fail to provide us with a clear and relevant picture of the financial implications of welfare reform. We need to move towards consolidated welfare regime accounts and we need to be able to identify the investment character of key social policies.

A New Welfare Mix? Back to the Accountants

A paradox of our times is that family well-being presupposes ‘de-familialization’. This obviously does not imply coercive intrusion in family life. The essence is to give families realistic options. Nor does it automatically threaten the quality of family life, more likely to the contrary. As I noted, the incidence of caring for, and interacting with, frail elderly kin is not lower in Scandinavia than in any other EU country. Additionally, recent Danish data show that parental time dedicated to their children is actually greater today than it was in the Golden 1960s.

What, then, are the relative merits of markets or state in terms of substituting for familialism and meeting the challenges ahead? The debate on privatization frequently pits opponents, who insist that all private is bad, against supporters, who maintain that all public is bad. The truth lies in the details, not in ideology. The menu of privatization is ample, ranging from a purely commercial regime to quasi-market principles in public provision. In between exist non-profit, regulated or subsidized private providers, voucher schemes, and so forth.

The first point to hammer down is that, macro-economically speaking, total welfare costs will probably not change much however we combine markets and state. Denmark and the United States occupy the polar ends in terms of public spending but end up virtually identical when we examine total net social outlays: Net Danish social expenditure is 26% of GDP and 25% in the US. (Adema and Ladaique, 2005:Table 6). If the market is truly competitive we may expect a quality dividend and, in some cases, it is demonstrably possible to achieve cost savings via private provision. Home help services staffed by public functionaries will inevitably prove more expensive than if provided by contracted personnel. But in most commercial welfare establishments the per unit service cost will normally exceed the public sector equivalent. This is partially due to the profit margin but mainly to higher transaction costs (such as marketing or billing administration). If commercial welfare providers are pri-cier this does not automatically imply that government provision is the only alternative. Both protestant and catholic welfare organizations play a massive role in some countries’ welfare delivery. In Denmark a third of childcare centres are established and run by parental associations, and in Sweden one-in-ten schools are independent. The real issues we should address are, instead, the distributional and behavioural second-order effects of any given mix.

Unless subsidized (say by tax concessions or by vouchers), commercial social services are typically priced out of the market for most households below the median income. The same goes for private health insurance and retirement plans. A tragic example is health insurance in the US: 40+ million Americans have no coverage whatsoever. The important point here is that we must always measure any potential efficiency dividend against equity. As a rule-of-thumb the equity price we pay will almost invariably overshadow any efficiency dividend.

In terms of second-order behavioural effects, there are three kinds that especially merit attention. One kind refers to incentive effects – primarily the incentives to save and to work. Although unambiguous empirical findings are hard to come by, it is a plausible argument that a publicly financed welfare model implies a level of taxation that will distort work incentives and reduce household savings. Vice versa, we should expect more savings and labour supply if citizens need to personally finance their welfare. Until we have credible estimates of the relative savings and labour supply effects of either alternative for each and every welfare item we will be in no position to make an educated choice one way or another.

A second has to do with information deficits and asymmetries. Competition may be very positive for quality but many welfare fields involve substantial expertise that citizens are unlikely to possess. Very few are able to choose between competing heart transplant offers and even selecting between alternative schools may pose major difficulties. Asymmetries arise because customers become captive to the sellers’ expertise. Citizens’ ability to inform themselves is also highly unevenly distributed. The resourceful may do well in a competitive market but the low educated can be severely disadvantaged. The weak may be additionally disadvantaged if competitive markets lead to client creaming and exclusion. Any rational private insurer would shun high-risk clients.

The third kind refers to social externalities. If a large segment of the population is priced out of welfare services this may have non-trivial societal repercussions. Take access to childcare. If low-income parents are unable to afford quality care, they may respond by placing children in subsidised care (parked in front of a TV for example) or by withdrawing the mother from employment. The former is undeniably harmful to children. The latter reduces aggregate employment (and tax revenues) and raises child poverty (that necessitates public income transfers). Alternatively, if childcare is inaccessible fertility may suffer.

My argument is that we must factor all such second-order and distributional effects into our accounting practices. And we must compel the advocates and enemies of either preference to furnish us such a complete kind of social accounting.

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tion of ‘quasi-market’ principles in public (or pub-

licly regulated) services may yield the same

benefits. Julian Le Grand makes a very persuasive

argument that greater choice is fully compatible

with egalitarian goals, too, if competing providers

are adequately regulated and consumers are

adequately informed. Empirical research is replete

with good and bad practice from which we can

learn a lot. If providers are permitted to cream

the best risks or to set fees as they like, the result

is very likely welfare segregation. The question

boils down to a consistent and effective regulato-

ry framework.

**Financing the Future**

The welfare equilibrium that I am promoting will certainly not come cheap. The main items in my

design will require an additional spending burden

that, realistically speaking, may run to 10 or 12 percent of GDP

The real problem we face is that current accounting practices are simply not up to the task of

furnishing the kinds of numbers we really need. I therefore argue that we need to revamp our soci-

al accounting systems so that we can think more clearly about substance.

**Investment Accounts**

Expenditure on childcare will, in a dynamic pers-

pective, pay for itself. Indeed, my own estimates for

Denmark suggest that the government reaps a 50% return on its initial investment. More

broadly, the upshot of my future scenario is that we shall be moving towards a more investment

oriented social policy. It would accordingly be

helpful to distinguish what is of an investment

character from what is current consumption and

then be able to estimate the real returns. This is

no mean challenge, considering that existing

social accounts (dating basically to mid-20th

Century) consider public social spending as purely

consumption expenditure. There are good reasons

why we might promote a separation of current

and capital accounts in our welfare state, just as

we do in private companies.

It is not easy to separate social investment from

consumption. It is only modest progress to distin-

guish ‘passive’ from ‘active’ policies. It would

appear obvious to classify income support as a

passive ‘consumption’ that yields few economic

returns. Yet, things get complicated when we

consider that transfers to families may enhance

child outcomes. Or, take programs in support of

working mothers: once again, simply the fact that

they work means sharply reduced child poverty,

an implicit job-multiplier, and additional tax

revenue to governments. Care for the elderly is

likewise Janus-headed: taking care of the frail

may not constitute an investment in our future

productive potential and, yet, failure to do so

implies that many women must reduce their

labour supply.

Besides education and training, there are a num-

ber of social policies that are easy to identify as

investments in individual productivity and collec-

tive wealth creation. Most generically, all spend-

ing towards child welfare has a potential pay-

off. Cash benefits to families with children create

financial security and prevent child poverty, two

factors that are crucial for child outcomes. Early

pre-school programmes, and most of all univer-

sal, quality childcare, have a powerful equalizing

effect on children’s learning abilities.

It is more complicated to pinpoint precisely the

investment component of many income mainte-

nance programs for working-age households —

such as unemployment benefits. The reasoning is

more circumscribed, but it has for long been

recognized that strong welfare guarantees stimu-

late greater risk-taking during work life. Also, wor-

kers will arguably be less resistant to change if

their welfare is assured in the event of redundan-

cies. Generally speaking, flexible and dynamic

labour markets require off-setting social security.

This is not meant to be an exhaustive overview of

how to set up a system of social investment

accounts. The idea is simply to pinpoint the need
to revise existing practice so as to construct an

accounting practice that is more realistic for any

21st Century welfare model.

**Welfare Regime Accounts**

Our social accounts are too myopically limited to

public expenditures. The reawakened international

interest in the Nordic model is a case in point: while broadly admired, it is even more broadly

rejected for its huge spending and taxation needs.

In 2001, gross public social expenditures were

34% of GDP in Denmark and 35% in Sweden. To

most accountants this compares unfavourably with

the US’s 16%, the Netherlands’ 24%, the

UK’s 25%, and even Germany’s 30%.

The first problem is that these numbers are

meaningless because they fail to consider that

much spending is taxed back immediately — in

particular in big-spending welfare states like the

Nordic. They also ignore hidden tax-expenditures

for social purposes. Tax subsidies loom large in ‘resi-

dual’ type welfare models. The second problem is

that meagre public provision will stimulate mar-

ket alternatives — in particular if mandated or
given tax subsidies. Private (net) social spending

is predictably marginal in Scandinavia (only 0.8% of

GDP in Denmark) but substantial in the US (11%),
the Netherlands (5%) and the UK (4%).

The Netherlands has experienced very rapid

growth in private welfare in tandem with major
cutbacks in public programmes.

Not all citizens are average and this is where

total welfare regime accounting becomes rele-

vant. If a large chunk of the money must come

from the consumer pocket, access to welfare will
inge on our spending power. The average

American family can, by and large, afford to pur-

chase health insurance and care services but the

same items are priced out of range for most hou-

seholds below median income. This is why 40+

million Americans have no health insurance

whatever, and also why the US exhibits huge

quality differentials in child and elderly care. To
cite a similar example, in the late 1990s the Blair
government embarked on a massive expansion of
day care, establishing within few years 600,000

new places. The policy was based on commercial

centres and since the public subsidy was modest,
families had difficulty accessing the service. As a

result, almost half of all were subsequently closed
due to ‘lack of demand’.

The added spending burden of 10 or 12 percent of

GDP must be considered as a realistic scenario.
The very simple point that needs to be driven

home is that a) if we do want to realize such

welfare goals, this added financial burden is inevi-
table however we combine private and public.

And b) if the added spending is not forthcoming

we should expect major welfare lacunae.

The added financial burden will inevitably vary

across the EU. In countries like Denmark and

Sweden a very large slice of the added spending

needs have already been effectuated considering

that child and elderly care is now virtually univer-

sal. Denmark and Sweden already commit

roughly 5% of GDP to these two items. At the

other extreme are countries like Italy and Spain

where catch-up needs to be huge. This suggests

that the Scandinavian countries are far better

positioned to meet future spending requirements

than are most other EU nations. In net total

spending terms they will probably end up at the

low end of the welfare spending rankings.

In short, we need a consolidated system of

accounts that allows us to a) identify real (and

not misleading) public spending, and b) examine

Note 2 Assuming that pension spending will increase by

5% of GDP, that full coverage of dependency is attained

(another 3-4% of GDP), and that we reach universal (quali-
ty) childcare (another 2% of GDP). Rising health care needs

will require at least another one percent of GDP. In addi-
tion, we should include added costs of extending parental

leaves and providing a guarantee against child and aged

poverty that, combined, might run to ye another 1% of GDP.

Note 3 Based on OECD’s estimates.
the joint expenditure trends in markets and government alike. It is total GDP use that matters. The really important value of such an approach is that it puts us in a far better position to assess the distributional aspects of our social model. The relevant question is not whether we can afford more welfare spending because this will happen anyway. The really relevant question has to do with who are the winners and losers, and what may be the second-order consequences, when we opt for one or another public-private mix. If we could also develop a credible system of measuring the implicit costs of non-monetarized family servicing, we would be able to approach a genuine system of welfare regime accounts.

Conclusion
This paper has focused on what I believe to be the three (plus one) greatest challenges to our welfare model. Since life chances are so over-determined by what happens in childhood, the flagship of our strategy must be a comprehensive child investment strategy that combines a strong accent on early childhood development with a deliberate and explicit commitment to equality of opportunities. Since the future of our family depends on how well we resolve the dilemmas associated with women’s new life course preferences, it is impossible to imagine a positive equilibrium without an effective reconciliation of parenthood and careers. But the battle will only be half-won if we do not accompany standard reconciliation policies with a strategy designed to promote a ‘feminization’ of the male life cycle. Women – at least in countries like the Scandinavian and the US – are reaching the limits of ‘masculinization’ of their life cycle and it is increasingly this which provokes new disequilibria. And, thirdly, since the welfare of tomorrow’s elderly depends crucially on the quality of their childhood and subsequent careers, our response to the aging challenge should “begin with babies” and focus especially on minimizing life chance inequalities.

The ‘plus-one’ challenge lies in the development of a superior system of social accounting and may arguably be our first priority. Accordingly it may have been premature to put the accountants behind the horse.

The quality of jobs can be a major stumbling block for both our child investment and parenthood-career reconciliation strategy. We can promote more equality of opportunities in early childhood, but what if opportunities are not there when youth reaches adulthood? Likewise, even the most brilliant reconciliation policy may fail if women’s job conditions contradict motherhood. And, likewise again, we will have to expect widespread old age poverty in the future if a substantial proportion of tomorrow’s workers find themselves trapped in a life of bad jobs. The quality of jobs is not normally the domain of social policy and should therefore be relegated to a different context. Suffice to say that we should most realistically assume the following scenarios. One is that labour markets will become more flexible, in particular in terms of wage setting and job protection. Two, that post-industrial job growth is highly biased in favour of ‘good’ jobs (that require skills). Three, that flexibilization plus the continuous rise in female employment plus aging will nurture the growth of a sizable amount of low-end (low skill) servicing jobs. Four, that income inequalities are likely to increase.

These trends, in other words, give mixed signals. Greater flexibility and widespread low-wage employment suggest a scenario of overall insecurity for possibly sizable population groups. It is unrealistic, therefore, to believe that the importance of traditional ‘passive’ income maintenance will disappear. Indeed, I would consider it sine qua non that we build a genuine unconditional anti-poverty guarantee for child families and the elderly alike.

Postscript: What about Equality?
My treatment has emphasized equity in the sense of fairness not equality. Should we also pursue an egalitarian agenda? If so, which? Academics and policy makers routinely equate the welfare state with egalitarianism while, paradoxically, this is less so in the general public – for whom the welfare state represents security. In the very good old days the egaliatarian promise was often framed in terms of the class divide. In the post-war era it became a more diffuse and plural idea, embracing meritocracy and equal opportunities but also a redistributive here-and-now equality of condition. Do we need a new egalitarian commitment for the Century that lies ahead?

We must first recognize that ongoing structural change promotes substantial inequality, be it from widening earnings differentials, marital homogamy, immigration, or the evolving household structure. There are also counter-tendencies buried within these same trends. The gender pay gap is narrowing and female employment is becoming more universal. Household income inequalities can be held at bay when less educated women embrace the lifetime employment model. Such counter-movements are important but are, in any case, unlikely to turn the basic tide of inequality around.

There are reasons why we should not be especially alarmed by rising here-and-now inequality. Low wages or bad jobs are not per se problematic if they are transitory experiences. Our poverty headcounts are misleading if many of the poor are simply youth and students. The real question has to do with mobility, i.e. with life chances. When we measure inequality in terms of lifetime incomes we find that there is far less inequality than we were led to believe. To illustrate, the Danish Gini coefficient is reduced to half when calculated on the basis of lifetime incomes but, at the same time, now we discover that 92% of Danes have been poor at one or another moment in their lives!

But there are also reasons for alarm. There is substantial evidence that mobility is negatively correlated with the overall level of income inequality. The notion that inequality nurtures more mobility is simply wrong. Most comparative data show that there is substantially less mobility in the US than in many if not most European countries. Worse, the opportunity structure is adversely affected by prevailing levels of inequality. If there are strong inequalities in the parental generation this implies more unequal abilities to invest in the life chances of children.

All this considered, there are at least two fundamental principles that must underpin any future egalitarian policy. One, it should emphasize life chances rather than here-and-now redistribution. Two, it should centre on those mechanisms that lie at the heart of social inheritance and unequal opportunities. We are well-placed to identify where our egalitarian efforts should focus. We must prioritize child investments and family welfare not because children are sweet and innocent but because the key triggers of life chances lie in childhood conditions. No policy will solve all problems but guaranteeing a strong start to all children is one that surely will pay off. It is for this reason that we should consider an income guarantee and also access to quality child care to all children. Very committed life chance egalitarians might go further and advocate affirmative action for disadvantaged children and mobility guarantees to adults who find themselves entrapped in persistent dis-welfare.

In the end we should expect that an unchecked rise in income inequality will worsen the opportunity structure and this implies that it does, indeed, need to be checked. Government redistribution via taxes and spending is demonstrably a very effective instrument, especially if, as I advocate, we sharpen the progressiveness of old age financing and favour universalist principles of entitlement.

References