Social Investment in the Ageing Populations of Europe

Thomas Lindh (Institute for Futures Studies and Linnaeus University, Sweden)

**Introduction**

At different points in the life course families and individuals differ in both their needs and in terms of the resources they can command. Large shares of children require large expenditure on education and family resources. Large shares of young adults put the labour and housing markets under strain. In a stable population that would not make much of a difference to public policy since the relative shares of different age groups in that special case remain the same. But modern populations are far from stable. The demographic transition from high mortality and high fertility to a state of low mortality and low fertility results in a secular change where the initial population pyramids undergo what demographers call a ‘rectangularisation’.

To begin with this is a highly beneficial change where an economy increases its economically active population in relation to the dependents. This demographic gift can be tracked in the old European welfare states as well as in the emerging economies of Asia. This gives ample room for social reform and in most countries, especially in Europe, the public sector has taken over more and more responsibility for intergenerational transfers of many different kinds; public pension schemes, public care systems, education and a variety of family support systems.

As the structure of the population changes these public commitments often come under strain or, more rarely, tend to become overly generous in some cases. In any case the slow inertial change of the population structure, not only with respect to age, but also in ethnic composition and, and even in some Asian countries in gender composition create new challenges to public policy in terms of financing as well as in terms of new needs arising from the demographic change.

In Europe fast ageing populations are now emerging and worry public policy makers as tax bases are projected to shrink and demands for decent care and a worthy life for the elderly becomes harder and harder to fulfil. At least that is the picture we have gotten used to from media and politicians eager to save for this bleak future. Change and adaptation will indeed become necessary as the composition of the population changes its point of gravity towards ever older ages. But change and adaptation provides opportunities as well as problems. One of these opportunities is to invest more in health and education in order to improve the future support capacity of the working population. This deserves to be taken seriously when everyone worries about government debts in the wake of the financial crisis. This preoccupation with financial debt risks crowding out investments in education and health, as well as the social inclusion of large groups of young people.

Sweden has already gone through a dramatic ageing episode in the 1960s and 1970s when it became the world’s oldest country. Lena Sommestad discusses more in detail the demographically motivated social policy that is a legacy from the 1930s and the Myrdal’s in Sweden. Here I will focus more on how Sweden’s early ageing led not only to problems but also opportunities for social investment in many different forms. Investment that today bring returns in the form of a very strong economy that could grasp new opportunities as a new
ageing episode is upon us. Could, that is, if public policy makers could abandon the illusion of health care, education and investment in social cohesion as a form of public ‘consumption’.

Most European countries will soon start to age at a faster rate, and it may be fatal for the future of Europe if policy makers cannot embark on more far-sighted agendas than the current preoccupation with short-term stabilisation at the cost of eroding the future productive capacity by increasing social exclusion in particular for young people in the life phase of becoming established in the labour market, forming families and obtain affordable housing.

**Ageing and intergenerational redistribution**

It has over the last decades become clear that macroeconomic performance and population structure are intimately tied together (see for example Bloom et al. 2003). When the population above 65 starts to grow faster than the active population this is associated with declining growth, decreased saving, increasing inflation pressure and difficulties to keep down the public budget deficits.

Ageing European populations have therefore raised concerns about the sustainability of current welfare systems. While some concern is well motivated the doomsday prophecies predicting an end to social welfare as we know it are vastly exaggerated. True enough, economic growth will wane and the support ratio for elderly care and welfare will diminish. But most of the pressure from an elderly population will not come within the next decade and for most European countries not until we are well into the 2030s or even the 2040s. There is plenty of time to prepare for a rational adaptation to the situation. Some adaptations require very long run investments, however, that have to be financed right now so timing of policies is becoming crucial. A central point of this article is therefore that attention to demographic detail and interaction with the economy has to be country-specific rather than EU harmonised.

Even with growth rates of the real economy of a paltry one (or two) percent per capita this means a more than 22 (or 49) percent increase in an already comfortable standard of living after 20 years. To make such a number comprehensible consider that a 22 percent increase in GDP/capita in e.g. Germany represents more than the GDP/capita of Albania in 2008 or in West Germany and Finland in 1950. It is a quite substantial increase in resources per capita and far from any catastrophe scenario. Starting from a rather comfortable level of income per capita today the problem of ageing is not really the average level of income. The problem of ageing is not so much lack of resources but the fact that there will be fewer active income earners relative to the non-active population, hence a need for increased redistribution of resources across generations. This redistribution can take place through adaptations on several different margins1. Longer work lives, tax redistribution, increased female labour force participation, increased education, immigration and related issues have been extensively discussed as “solutions” to the ageing problem.

In the European discussion of ageing the intergenerational perspective on human society and economies is still quite crude and primitive and all too often based on the strange concept that children and young adults is a social group of individuals competing with another social group of old people. Every individual will, however, live through these stages unless prematurely deceased. It is a basic fact of human life that all of us are born with the need for

---

1 MacKellar (2000) discusses this in detail.
adults to support our consumption needs for many years. In every society redistribution of resources from the economically active population to dependents is a basic economic function that has created constraints within which the human species and societies have evolved (see e.g. Robson and Kaplan 2003). For most of human history very few people survived into a physical state of old age dependency and this is still the case in many countries. Most adults continued to generate surpluses above what was necessary for their own consumption until they died or at worst spent a very short period of illness being dependent on the surplus generated by the adult population.

The capacity of human adult populations to generate very substantial surpluses has also made it both possible and a moral duty to take care also of other individuals that due to handicaps, accidents or old age are incapable to produce enough for their own consumption. As longevity has increased more and more people live long enough for ageing to proceed to a stage where the individual no longer is self-supporting. Institutional responses to this development have created a diversity of social security measures like pension plans and elderly care systems. Often we primarily think of public interventions in this respect but there are a lot of other institutions, within or outside the family, that mediate these intergenerational transfers.

There are essentially three mechanisms for mediating intergenerational transfers. The first and obvious is family transfers primarily to children but also for transfers to elderly parents. For orphans and childless elderly there has always been alternative private, cooperative or public transfer flows that has taken on a much larger scale in modern societies. Across countries we find quite a large variation in institutions mediating these transfers where Scandinavian countries rely on public transfer systems to a much larger extent than other European countries. But there is still another mechanism for intergenerational transfers that is often not recognised as such, viz. the financial markets. Capital reallocation is de facto an exchange of resources across generations. In the case of bequests this is obvious but it holds also for other capital transactions. As one person abstains from consumption by buying an asset another person sells the asset and obtains resources for consumption. Netting out all transactions a capital reallocation across generations takes place.

With increasing longevity elderly dependency expands and a growing proportion of elderly persons are becoming dependent on transfers and redistribution across generations. Through technological change, trade and education GDP per capita has increased exponentially for a long time and with it the potential to also increase the intergenerational resource flows. New research is now mapping out these transfer flows across generations within the National Accounts framework (Mason et al. 2009). The National Transfer Accounts (NTA) provide evidence that the intergenerational flows of resources are no less important today than they have been historically. On the contrary the flows have expanded outside the original family and kinship group and even outside the national context. This holds especially for financial markets but is also true for migration, remigration and generated remittances and social security benefits. EU subsidies is another example of how the intergenerational redistribution system exceeds national boundaries. It is troubling that this function of the subsidy system is very seldom recognised.
The central concept of this NTA accounting is the life cycle deficit, defined as consumption less labour income. This deficit must at every age and time period be financed by public or private transfers, or alternatively by credit or assets and capital income generated by previous saving. In this context it is therefore natural to define net wealth as claims on future income either from existing capital assets or from public or private transfer systems.

Transfer wealth essentially consists of claims on the surplus income of economically active adults, or with another terminology the present value of returns to the human capital stock. Those claims can be realised through taxation in the case of public transfers or by familial obligations, charity or other private or cooperative insurance. From this perspective then much of both public and private consumption is actually investment in the future human capital stock that is needed to sustain the consumption needs of dependents in society.

![Figure 1](image-url)

**Figure 1** Life cycle deficits per capita expressed as part of average labour income between ages 30-49. Source: National Transfer Accounts Project

In Figure 1 per capita life cycle deficits for seven European countries normalised by average labour income between 30-49 years of age are compared. It is obvious that although the general pattern of youth and elderly dependence is common there are strong dissimilarities between the countries. For example in Austria the average young adult becomes independent at a much younger age than in the other countries, a fact linked both to a fairly small share in higher education and a traditional apprentice system with paid professional training. On the other hand Austrians tend to retire early and elderly care traditionally takes place within the family. Thus the patterns of intergenerational transfers within the official economy are strongly dependent on the institutional context in each country.

---

2 The life cycle deficit \( \text{LCD}_{it} = C_{it} - YL_{it} = YA_{it} - S_{it} + \tau^+ - \tau^- \) where \( C \) is public and private consumption, \( YL \) is labour income, \( YA \) is asset income and \( S \) is savings and the last two terms is the difference between transfer inflows and transfer outflows, both public and private.
When the proportion of elderly dependents increase in an economy this creates tensions in the transfer system, no matter what the main mechanisms might be. In a country with mainly public redistribution systems tax revenue and public transfers in cash and kind in the long run must balance and a trade-off has to be made between elderly welfare and welfare and education for the young. In a traditional family system the trade-off has to take place within the family and does not necessarily show up directly in the National Accounts. Family care for the elderly will rather show up in decreasing female labour supply for example. This will certainly have an impact in terms of lower GDP per capita, but the resources spent will not show up in the accounts. Where transfers are primarily mediated by capital reallocation consequences may be even harder to trace, but will still indirectly affect asset prices and the scope for capital accumulation. In both the latter cases inequality within cohorts will be a rising concern.

**European ageing and prospects**

There is a general awareness now both within the EU Commission and most of its member states as well as in the Russian Federation and other countries outside the Union that Europe is ageing and ageing fast. It has long been recognised that this will put pressure on pension systems, elderly care, and in general the social welfare system. In the media this is frequently turned into a major catastrophe story that makes the dismantling of the welfare state a historic necessity, a conclusion that for ideological reasons sounds quite sympathetic in the ears of some people. In evaluating these claims we should first of all recall that “crying wolf” in order to obtain a short-run benefit before the wolf has actually shown up is in general a very dangerous strategy. In this particular case it is important to make three observations:

1. Ageing is a slow inertial process which we in fact can predict much better than climate change. It does not require hasty panic measures but well debated, deliberated and contemplated long-run reforms of social policies. At the same time some windows of opportunity have already opened and others will open in the future while still others have already closed. So focus must be on the windows that are currently open.

2. While all of Europe is ageing its ageing burdens grow at different rates. This is due partly to different institutions and partly to demographic path dependence. Maximum pressures as well as windows of opportunity will come at different times for the European countries and the mix of measures required to adapt will be institution-specific and thus must necessarily differ across countries. Thus EU harmonisation may in this context be a very counterproductive policy.

3. Any ageing country will need to adapt its transfer system no matter whether this today relies on public intergenerational transfers, private family transfers or transfers mediated by the capital markets. The set of adaptations that is appropriate and permissible within different countries will differ but keeping status quo is in no case an option that is available.

In Figure 2 below the ageing of Europe is illustrated in some EU countries by the development since 1980 of the population share above 64. This is commonly taken as the definition of how old a country is. According to this definition Sweden ranked oldest in the late part of the past century but has been replaced by Italy which is currently being caught up by Germany. According to the UN forecasts Italy will, however take the lead again until caught up by Germany again in the late 2030s. Most other countries are projected to converge to a share of 65+ between 20 and 25 percent of the population around 2030, except Ireland who is way behind in its ageing process. It is easy to see that although all countries are ageing the speed and variation in the process is quite large suggesting that different countries will
tend to feel the need for action at rather different points in time. Their fiscal resource bases will also vary in a non-coordinated way.

While 65 and above is a conventional marker of retirement ages, the average age of retirement in fact varies quite a lot, being in general lower in the countries of Southern Europe. These differences in actual retirement age modify the actual dependency burdens and generally put Southern Europe at a disadvantage.

We know that morbidity and mortality accelerates around the age of 80 somewhere and that much of the total care expenditure during life is concentrated to the last few years of life. The groups above 80 are referred to as the “oldest old”. Here the per capita transfers often reach very high amounts, but since mortality is high in this group the aggregate share of transfers in kind and cash is not that high.

In Figure 3 the 80 and above population is depicted for the same EU countries as above. In this sense Sweden was the oldest European country until recently (2007) when Italy caught up. According to the UN projections Germany will be catching up with Italy around 2020 but then Italy takes the lead again. For this oldest-old group we see no tendency to convergence around 2030 but rather increased dispersion.

Figure 2 Estimates and projections of the population percentage 65 years old and above. Source: UN World Population Projections 2007.
Figure 3 Estimates and projections of the population percentage 80 years old and above. Source: UN World Population Prospects 2007

Table 1 Life expectancy in 2005. Source: UN World Population Prospects 2007

<table>
<thead>
<tr>
<th>Country</th>
<th>Life Expectancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>80.09</td>
</tr>
<tr>
<td>Spain</td>
<td>79.99</td>
</tr>
<tr>
<td>Italy</td>
<td>79.93</td>
</tr>
<tr>
<td>France</td>
<td>79.60</td>
</tr>
<tr>
<td>Germany</td>
<td>78.73</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>78.47</td>
</tr>
<tr>
<td>Greece</td>
<td>78.26</td>
</tr>
<tr>
<td>Ireland</td>
<td>77.78</td>
</tr>
</tbody>
</table>

While increasing life expectancy of course plays a role for this ageing process it is not at all the main factor shaping the ups and down that we see in the ageing trends. In Table 1 current life expectancy for both sexes (2000-2005) in some of the countries in the graphs is listed and it is quite clear that current accelerations in the age share measures has little or nothing to do with life expectancy. It is differences in the fertility rates both currently and historically that provide the main explanation of differences in the pace of ageing.
Figure 4. Estimates and projections of the dependency rate in percent: population 0-14 and 65+ divided with the population 15-64. Source: UN World Population Prospects 2007.

In spite of their small cohorts of children the predicted total dependency rates of our country sample rises much more steeply in low-fertility countries as Germany, Italy, Spain than in countries with more moderate fertility trends like France, Sweden and United Kingdom. While Sweden, and maybe France, needs to set young people in their 20s in focus for investment in education and labour market entry, the low-fertility countries need to consider their family policies a main priority.

At this point it is prudent to note that there is a tendency in the public debate to take demographic projections far too seriously. The actual development is, however, far from deterministic and projections in 2050 have a wide margin of uncertainty, see Lutz and Scherbov (1998) for an example. Although the general age structure projections are highly reliable for a decade or two and for the older population many more years, the uncertainty surrounding the projections for the young population increases strongly as time goes by. It is the inertia of demographic structural change that makes projections reliable and not any deep knowledge about what drives demographic change. Inflows and outflows into the population are very hard to predict with any reasonable degree of accuracy, and the smaller the country the harder it gets. The more borders are open for migration the harder it gets, and so forth. Having pointed out this it is obvious that demographic change, at least in part, also is susceptible to policy interventions both in terms of actions to make it easier for people to achieve their desired fertility and in terms of migration policies. From a more negative view negligence of appropriate health policies also affects mortality. In an ageing Europe the question of immigrant integration into the labour force becomes a matter of welfare preservation.
The ageing of populations in most developed countries has been going on for many years already. The problem is neither new nor unavoidable in the very long run although in Europe it will persist for many decades ahead. Demography is not fate incarnated but a reaction, a kind of memory resulting from social and economic events. An unfavourable ageing trend often has its roots in baby booms and busts generations ago. The trend of ageing and its economic and social consequences will not be avoidable in the near future (of this century) but consequences can be substantially ameliorated by political action. Immigration and fertility can be affected by political measures and current status of these variables is, among other things, also a result of the current social policy regime. Increased labour force participation and education can, at different time horizons, economically shore up shortages of people in active ages. Even the age boundaries for phases of the life cycle can be changed by ensuring incentives for later retirement and faster education.

Policies that make society to a nicer place to have babies in will decelerate the ageing trends in the long run secular scale. In the shorter run decadal time scale integration of immigrants also helps slow down the economic consequences of the ageing trend.

In either case it is no universal panacea to rejuvenate the population. Sooner (immigrants) or later (babies) also grow old. There are other adaptations that will help though to sustain social welfare. We can work longer, a reasonable proposition if we live longer and healthier lives. Current work places and work life demands may not today be consistent with that but this can change too. Although a common EU policy against this background seems rather unrealistic there is clearly scope for learning between the EU countries about how to deal with ageing problems. Policies have to be adapted to the specific timing of demographic change and the institutional setup in different countries because transition problems will arise in the adaptations that are idiosyncratic to each country. Nevertheless it is clear that youth unemployment and difficulties in integrating immigrants on the labour market are common European stumble stones in preparing for the ageing society.

The European community can learn from each other but simple best-practice reasoning should, however, be avoided with great emphasis. The ageing challenge is common to all industrialised societies. It is a challenge with no simple solutions but with a wealth of potential adaptations available with the common denominator that a society has to reproduce itself in order to sustain increasing needs for intergenerational redistribution. Whether through native fertility or foreign immigration is not the crucial issue but different strategies in social policy will tend to force either the one or the other to dominate. Moreover it should be noted that reproduction of a society should be defined as reproducing the production capacity necessary to maintain the intergenerational redistribution system. This does not imply that the population maintains its current size; education and technological change may very well uphold the necessary capacity with a lower number of workers. Prolonging work life or increasing labour force participation are other measures that increase productive capacity per capita.

Measures designed to simply increase the labour input of the current population have rather immediate effects and will in general not be very costly financially although the political costs may be substantial. Measures like increasing education or raising fertility require quite long gestation periods and may be quite expensive. Only when the individuals are middle aged will

---

3 In Sweden the prime factor at this time may be to speed up education in order to prolong work life by starting it earlier. In Austria it may be more important to offer more higher education and instead improve incentives to work longer, see Figure 1.
the investment costs be recovered and thus such measures have a planning horizon stretching from twenty to fifty years ahead. Immigration is intermediate between these cases but the details depend on source countries and the capacity of the host country to integrate immigrants into the labour market.

**Macroeconomic effects of ageing**
The changing age structure in Europe will have macroeconomic effects that are much more pervasive than just increasing the number of dependents to be supported (Lindh and Malmberg 2008). Space does not permit a detailed argument but based on empirical regularities observed in the relation between age structure and macroeconomic variables, the following scenario has a high likelihood.

Saving goes down as the number of people saving for retirement decreases. The prediction of the pure life cycle hypothesis (Modigliani and Brumberg 1954) that elderly people will live off their assets has been largely falsified, they are generally found to keep on saving after retirement (Börsch-Supan and Stahl 1991). Still it is found on the macro level that national savings generally decrease as the 65+ age group increases. One of the reasons why elderly people can keep on saving is that pension income is sufficient for their consumption and increasing numbers of retirees deplete pension funds or government budgets. In many European countries the pensions are paid on a pay-as-you-go basis and represent claims on the active population that are not backed by assets and thus pressure builds up on public budgets as well as on corporate pension funds. At the same time other public expenditure on elderly care and health care starts to expand and the tax base in the active population decreases relative to expenditure.

Some countries need to expand the education system either for demographic reasons or to increase competitiveness in production. Increasing pressure on the government budget then becomes unavoidable. Strict budgetary discipline will depress aggregate demand dangerously close to a depression situation so the most likely outcome will be to finance budget deficits either by loans or by issuing new money. Loan financing also have depressing effects on the economy so at some point inflationary pressures start to build up.

The depressing forces will tend to dampen growth with further repercussions into the vicious circle of a weakening tax base and increasing public expenditure. The most sensible way to deal with this situation is an increase the taxes, but this option will also be limited, at least politically. Economically tax hikes will in many cases disrupt efficient allocation of resources but given the expansionary effects of government expenditure the final outcome is far from clear.

Connected to the above scenario is a deterioration of the current account and increased dependence on the global environment, while increased redistribution of resources is required both across birth cohorts and across regions, since the ageing trend will be stronger in economically weak regions.

In fact we recognise in this scenario many of the ingredients in Swedish macroeconomic development in the 1970s and 1980s (Lindh 2000). Swedish post-war developments illustrate both problems and opportunities in designing appropriate policies to meet the challenges of ageing. Thus it is of some interest to go into a little more detail regarding the social policy changes that Swedish politicians met this early ageing wave with.
Swedish post-war social investment in human capital

Sweden was ageing faster than other countries in the post-war period mainly because of the very low fertility experienced in the 1930s. As Nikolai shows Sweden was an outlier by 1980 in terms of social investment spending. This was very much the result of a public policy with roots in the 1930s that focused in investing in the population when ageing became fast. Pension reforms were combined with school and education reforms, expanded elderly care systems were combined with highly subsidised housing programmes, public day care was introduced and expanded fast as female labour demand grew with the growing care sector.

Without a healthy and educated population that also reproduced itself the protection of social rights as well as the productivity of the economy could not be sustained. Providing good health care, healthy housing and expanding the investment in education of children were important parts in this endeavour that has survived as a mainstay in Swedish political debate notwithstanding that a more individualistic policy perspective has become dominant.

Fertility started to rise in Sweden already in the end of the 1930s and in the midst of World War II a baby boom occurred that peaked in 1945. This baby boom substantially increased the demand for welfare services and family transfers. As the large cohorts born in the beginning of the 20th century started ageing towards retirement, demands for pension reform grew and were satisfied in the end of the 1950s in a prosperous economy.

When the large cohorts born in the 1940s started to enter the labour market in the 1960s and onwards, the education system was expanded in several dimensions. This had as a consequence that (unlike American Baby boomers) the Swedish boomers were not at all or to a much smaller extent victims of cohort-crowding due to explicit education policies as emphasised by Nelson and Stephens in their text. Expansion of the care and education systems in turn provided females with labour market opportunities. This set off a demand for child care facilities that was met with a heavily subsidised public system of high quality day-care much along the lines advocated by Kimberly Morgan in her chapter to this book.

Total fertility rates (TFR) then again fell to low levels towards the end of the 1970s due to factors such as increased higher education for females, higher female labour force participation and economic crisis. 1974 the previous maternal leave system was replaced by parental leave with 90 percent income replacement for 6 months. In 1980 parental leave was further extended to 9 months with income replacement at 90 percent and 3 months at a flat rate. At the same time a speed premium on having the next child within 24 months is introduced together with two months of paid leave to attend to sick children and some other minor changes. In the mid 1980s a new baby boom wave started and peaked in 1990 (TFR 2.1). After the 1993 collapse of the Swedish economy benefit levels were first limited to 80 percent of income in 1995 and 1996 to 75 percent. TFR fell dramatically over the 1990s and although the 80 percent level was restored in 1998 fertility hit an all time low (TFR 1.5) in 1999 when recruiting to the public sector had grinded to an almost full stop. Then birth rates resurged concurrent with further improvements in family policy. In 2002 two months were reserved for each parent and paid leave extended to 13 months and a special child allowance for parents in higher education was added to the system. In the child care sector unemployed

---

4 Easterlin (1961) put forward the hypothesis that labour at different ages are not perfect substitutes and thus relatively large supplies of young labour would compete within the cohort and put downward pressure on wages. In the US this has been largely confirmed but evidence in Europe is mixed.

5 The TFR is defined as the sum of the fertility rates at each age in a given year.
parents in 2001 got the right to have children in day care. 2002 also parents on parental leave got that right, and a ceiling on day care fees (previously income related) was introduced. Mörk et al. (2008) estimate that just this latter reform explains a substantial part of the increase in fertility 18 months after the reform. The latest official TFR calculation in 2009 has almost reached the fertility levels around 1990 (TFR 1.94).

This short story of the Swedish fertility “roller-coaster”6 omits a lot of details (e.g. housing subsidies) but illustrates my argument that fertility in Sweden has been shaped by a number of social policy responses to circumstances making it harder to achieve the desired norm of at least two children per woman. Desired fertility in Sweden has been firmly anchored around 2 children for a very long time (and completed fertility is actually close to 2 for all cohorts born since 1900).

It is, however, easy to understand why a forward-looking government wanting to preserve welfare for the elderly also would like to keep fertility not too far from the reproduction rate. I will not argue that the policies I describe were fully premeditated and implemented for rational reasons of amending ageing problems. That was certainly not the case, and the roller-coaster variation is per se not a very rational response because it causes excessive variation in public budgets as well as public employment. I do believe that it was a long term ingrained political tradition in Sweden to see fertility falling below reproduction rates as a symptom of social problems, and not without good reasons (see Lindh et al. 2005 for more elaborated arguments).

It is now the case that although Sweden still has a very old population compared to most other countries and in spite of massive immigration (13 percent of the population was foreign-born in 2009). Nevertheless, Swedish demographic projections look less dramatic and less worrisome than those of countries that have viewed fertility as a completely private issue.

Deliberate or not, the policy reactions to Swedish ageing in the past resulted in investment in the young. That does not involve only fertility, of course, it was also a matter of expanding health care and education for the young, allowing labour immigration in the 1950s and 1960s and in the 1960s and 1970s to provide good housing opportunities, study loans, pensions etc. Sometimes this was done to ridiculously high costs that could not be sustained in the long run. Many policies were later abolished such as most of the housing subsidies but many are still very much with us like the child care system and the parental leave transfers.

Although these investments in both the human and social capital of the young baby boomers from the 1940s caused temporary costs in terms of the GDP level—as the ageing burden increased in the 1970s—they are also a very important factor behind the recovery of the Swedish economy in the late 1990s when the pay-off to higher educated middle aged boomers from the 1940s stimulated the economy. This is a much more important lesson to learn from the crisis than budgetary caution in the present situation.

Most of these investments in the young generation are not generally recognized since they go under the headings of “public consumption” or “government transfers”. This terminology is grossly misleading. No farmer would fail to differentiate what he can eat from the harvest from that which he must sow in the spring. Such mistakes would put his survival at stake.

6 The expression comes from an article by Hoem and Hoem (1996).
Where does Sweden stand today?

Sweden is now in the middle of a generational shift. A large chunk of the working population is retiring from work life while another large chunk of the population is entering adulthood. If the entrants could simply enter into the vacancies created by retirement there would not be much of a problem to discuss. In reality this will, however, set in motion a very complex chain of promotions, new vacancies and closing of some of the old job slots. Not least will it deepen the regional disparities. Thus, in Sweden today demography will further contribute to the factors mentioned in the chapter by Lundvall and Lorenz that speed up the rate of change in different social and economic dimensions.

From a long-term perspective an older population will require more of services and less of goods production. Globalisation further reinforce the same pattern of replacing labour intensive low skill and not place dependent jobs through import substitution and replacing the lost jobs with specialised services and skill intensive export production to pay for the imports. For example the Swedish private (although publicly financed) schools are now following the banks into the international market. Structural change of the economy is therefore implied both by domestic demographic change and global competition. The re-matching of the labour force needed in order to implement this change could be favoured by the generational shift providing lots of mobile and well educated labour to help it along. The text by Giuliano Bonoli gives reason to question much of the traditional thinking regarding labour market policies in this new situation, in particular the failure to integrate immigrants should lead to deep reflection.

In Figure 5 below the annual changes in the number of people in age group 15-29 and 65+ are displayed. Like in 1970 we now have a group of young adults that has been increasing in numbers and at the same time strongly increasing numbers of retirees. This was not the case in the 1990s. Although there was an increase in young adults it was not as strong and the increase in the 65+ group was slow and even decreased towards the end of the decade.
Figure 5. Annual changes in the number of young adults (15-29) and in the elderly (65+). Estimates and projections from Statistics Sweden.

An opportunity to renew and prepare the care and education sector for the future has now opened. The return from investments in human capital is likely to be vast, borrowing is cheap, and a more painless structural adjustment of the economy than Sweden had in the 1990s is possible although not likely as long as budgetary discipline arguments remain unchallenged, and indeed institutionalised in EU treaties. There is not necessarily anything wrong with budgetary discipline, waste should always be condemned. When the accounting in state budgets do not allow for the periodisation of investment expenditure budgetary discipline spells underinvestment, and in particular in such parts as education and family support that still go under the name of ‘public consumption’ in the National Accounts. There is today a growing dissatisfaction with ‘core’ macroeconomics not being able to produce much in terms of answers to the questions of today. Still, there is most likely a long way before any consensus grows about exactly what is wrong.

Opportunities for social investment in the wake of the financial crisis

The financial crisis in 2008 made policy makers even more myopic than they normally are and may very well lead to further short-sighted decisions that undermine the opportunities to safeguard the welfare systems by a well informed productive social policy. Massive investment in the future tax base of the European Union is needed and the financial crisis has already diverted substantial resources to emergency support for banks and automobile industries and strengthened xenophobic tendencies across Europe that makes immigrant integration harder. Sweden held the distinction of being the oldest country in the world for most of the time from the 1960s to the mid 1990s. The baby boomers of the 1940s came into the labour market at about the same time. The boomers helped not only to support this ageing population but to substantially increase the welfare for the whole population and in particular the elderly by contributing to the then new ATP pension system both for themselves and their parents. Extensive labour immigration in the 1950s and 1960s with immigrant labour force
participation rates that even exceeded those of the natives added to the tax base making it possible to substantially increase social welfare in many different dimensions in the 1960s and early 1970s, in particular education was reformed and made accessible to many more than before.

Later in the 1970s and 1980s a vast expansion of health care and elderly care also became possible within the tax revenue generated by the much better educated cohorts which were replacing the retiring cohorts born in the beginning of the 20th century and greatly aided by a quick expansion of female labour supply. Without the expansion of the education system to harbour the boomers the tax revenue would have been substantially less. Thus the investment in the boomers was crucial to the welfare enhancement for the elderly.

But there were also mistakes made in the 1970s in terms of unsustainable subsidies to housing, too lax monetary policies and the use of devaluation to improve competitiveness in the world market. Some, although perhaps not all of the mistakes could have been avoided if long-term planning had not extrapolated the record growth rates of the 1960s, which were caused by the coincidence of a demographically favourable situation and a fast growing and stable world market.

As the boomers from the 1940s now retire, Sweden and its social policy again must adapt to a similar situation as in the early 1970s. Although the concept of social investment as elaborated by Jane Jenson was not defined in the 1970s many of the aims and actions of that time were in the same vein of thought. After the deregulation of the economy in the 1980s and 1990s it is now up to Swedish politicians to decide whether the country will act as warning beacon for other European countries to avoid or serve as an example to follow. An example for how a productive social policy not only can avoid future problems but at the same time solve a number of current social problems like immigrant integration, gender discrimination and youth unemployment.

The celebrated Swedish pension reform in 1994, seen as a model for many other countries, is now facing its first serious crisis by releasing the ‘brake’, i.e. the financial solvency rule guaranteeing the financial integrity of the system. The buffer funds in the system have suffered depletion in the financial crisis. Together with negative income growth and inflation it has become necessary to lower pensions to preserve long-run financial stability. To avoid too large pension cuts in the election year 2010 politicians have already redesigned the system in order to spread out the cut in pension benefits over several years. As the automatic balancing mechanism was introduced everybody was assured that such an event was so highly improbable as to be negligible. But financial crises occur now and then within the life span of a generation and serves as a warning of relying too heavily on capital markets to transfer resources across the life cycle.

At the same time the young boomers born around 1990 are starting to fill up a higher education system that has been shrinking in the 2000s and where large parts of the staff is on the verge of retirement. Other young boomers try to become established on a labour market where both public and private employers have been cutting back. The age at which 75 percent of a Swedish cohort has become established in the labour market increased over the 1990s from 23 years to 28 or 29. Partly due to higher enrolment in higher education, i.e. an

---

7 This unwarranted optimism in the Long-Term Survey at the Ministry of Finance is sometimes referred to as the ‘porcupine’ since if you place the GDP forecasts from the 1970s and 1980s in the same graph the picture will resemble that animal with ever lower revised forecasts.
investment for the future, but partly also due to a swelling of the ranks of unemployed youngsters, undermining the future impact of the investment by marginalising large groups early in life, especially second generation immigrants (Rooth and Ekberg 2003).

A new baby boom wave has been rising since 2000 and now fills the day-care centres and will soon require expansion of the school system again. The strain on the government budget would be hard even within normal economic activity. Starting from budget deficits in the wake of the financial crisis there is clearly a danger that short-sightedness will drain the resources needed for aiding young people’s education, labour market experience and most likely also loom large over their housing prospects and family formation ambitions. The retirement of the baby boomers is at the same time slowly draining the tax base for state income taxes and capital taxes.

At the longer horizon looms the need for elderly care and health care for the now retiring boomers some time in the 2020s. The intergenerational transfer and care systems for the elderly are in Sweden almost exclusively administered through the public welfare institutions. Calculations at the Ministry of Finance (Pettersson et al. 2006) attribute 80 percent of the public budget expenditure to transfers in kind and cash over the life cycle. It is of paramount importance for the future welfare state in Sweden that the social investment activity does not trade off welfare expenditure for the elderly against investment in the generation who is expected to finance the elderly care and the pay-as-you-go pension system in the 2020s and onwards. In other European systems the strain of elderly dependency will also increase but depending on the design of the intergenerational transfer system the pressure may be hidden outside of the System of National Accounting. In family reliance systems it is often assumed that children can take care of elderly parents as well as two or more even older relatives. While that might have worked in the old days the resource base for family care has eroded heavily in almost all countries due to decreased fertility, increased labour mobility and female labour force participation and increased higher education. The repercussions on female labour supply, because it will be females mainly who provide family care, will then further undermine the tax base for other social policies. In funded systems long-run returns within the country will wither as the labour force shrinks and domestic asset demand falters with diminishing aggregate saving. Only risky investment in developing and emerging countries provides a vent for these systems.

Sweden has now, somewhat ahead of other European nations, come to a critical juncture where competing resource demands must reach a new balance in the midst of crisis. The current government has learned from the crisis in the 1990s and their Social Democrat predecessor to be cautious with the public budget. Former Prime Minister Göran Persson’s dictum “Whoever is in debt is not free” has become the creed also of the right-wing government.

Unfortunately that is exactly the wrong lesson for the current crisis. The Swedish crisis in the beginning of the 1990s was a home brewed crisis in a more favourable demographic situation. Yet it turned out that the burden of establishing a working public balance again was borne mainly by young adults, low skilled labour, immigrants and families with children (Palme et al 2003). In a situation where a baby boom is entering the labour market and another is withdrawing tight fiscal policies is a recipe that jeopardise our welfare for decades to come, increasing inequality, decreasing potential future growth and undermining the sustainability

---

8 Except in countries with extensive emigration like Sweden in the 19th century.
of both the pension system and the public budget by shrinking the future tax base. In the fourth and concluding section some of the crucial policy choices to be made will be discussed.

**Conclusion**

The challenges of an ageing Europe provides motivation as well as opportunities for social investments equipping our societies with tools to adapt to a historically new situation. Never before have we been able to observe countries where up to a fourth of the population eventually will be above 65 years of age. In this chapter I have argued that this requires massive social investment in the younger population to foster skills and social cohesion.

The experience from how Sweden in the 1970s and 1980s has met ageing emphasise the importance of offensive investment in the human and social capital of the young as crucial for the sustainability of elderly welfare. But the world has also changed since then adding globalisation and climate change to the challenges Europe will meet. Increased labour mobility and immigration trends put new issues on the social investment agenda, many social security policies are designed with the implicit assumption that the individual lives within one system from birth to death. Social cohesion and social investment thus need to be rethought in stretching across previous borders.

The human capital life cycle do look different in the European countries. In family conservative German-speaking and Mediterranean countries fertility is at dangerously low levels, which is also the case for Eastern European transition countries. There is a difference between these two groups of countries though. In the transition countries the population is generally younger making it easier to induce a recovery in birth rates, and also intensify investment in education. In the liberal and Scandinavian welfare states fertility is not of any prime concern, but rather the investment in improving education and labour market entry for the young. In Scandinavia integration of immigrants is far from satisfactory making immigration a net fiscal burden. Rational strategies must be formed according to these differences as well as they must be formed with respect for different histories, preferences and institutions.

Thus, the lesson from early Swedish ageing is not to attempt to duplicate more or less successful strategies (and avoid mistakes) but in the much more general conclusion that public policy and social investment must aim at providing citizens with the tools needed to uphold intergenerational redistribution and at the same time extend social cohesion across current borders. As Bengt-Åke Lundvall and Edward Lorenz argue in their chapter this will also mean redesigning outdated labour market institutions in order to achieve necessary learning flexibility.

The intergenerational redistribution approach in this chapter is obviously tailored for better understanding of the ageing issues but at the same time provides an alternative view of society and the economy, neither as an endeavour for individual satisfaction nor for serving the interests of static class collectives. Social investment from this point of view is investment not in the production but in the reproduction and extension of the intergenerational redistribution system.

Productive social policies have to be designed to fit current demographic structures as well as taking into account their consequences for future demographics and the repercussions the population structure has on both economics and the sustainability of social welfare. This
requires long-term perspectives as well as an integrated view of the policy system. The chapters by Rita Nikolai and de la Porte and Kerstin Jacobson imply that the European Union has a long way to go before achieving such an integrated view on social investment.

References


