

New social risks, the life course and social policy

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Abstract

A number of trends change the nature of social risks and increase the importance of human capital, adaptability and flexibility. This calls for developing proactive social policies that better fit the changing life cycles of individuals. This paper emphasizes that longer and deeper involvement in paid employment allows people to exploit their longer life to reconcile the two ambitions of, first, investing in the next generation as a parent and, second, pursuing a fulfilling career in paid work in which one keeps learning. Rather than shielding older insiders through employment protection, labor-market institutions should enable parents of young children to easily enter and remain in the labor market. Moreover, more activating social assistance and in-work benefits should replace the passive income support for breadwinners that results in high minimum-wage floors.

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1. Introduction

Life courses are becoming more heterogeneous in terms of how individuals spend time working, caring, learning and resting. In transitional labor markets, workers move between periods of full-time work to periods of voluntary (part-time) absence from the labor market to enjoy leisure, educate themselves, set up a business, or care for children or frail relatives. These developments are changing the nature of social risks at a time when traditional institutions for insuring social risks are under pressure. In particular, firms can offer less job security to their employees in a dynamic economy with constant innovation and creative destruction. At the same time, governments find that insuring human capital through income replacements is becoming increasingly costly in terms of harming the incentives to accumulate and maintain that capital.

This paper discusses the need to develop proactive approaches to social policy that better fit the changing nature of social risks over the life cycle. We pay special attention to the accumulation and maintenance of human capital over the life course as well as reconciliation of work and family. Human capital becomes more and more the key to personal fulfillment, stable personal relationships and social inclusion. This capital is produced not only in schools but also in families and firms. Reconciliation of work (including workplace learning in firms) and family (including informal care for young children) is therefore essential for safeguarding human capital.

The rest of this paper is structured as follows. Section 2 considers a number of trends that are changing the nature of social risks and points to the increased importance of human capital, adaptability and flexibility. Section 3 considers a number of challenges that endanger the level and quality of human capital at a time when corporations and governments are withdrawing from their traditional roles as insurers of human-capital risks. The trends and challenges described above call for institutional innovation in developing new proactive approaches to social protection over the life cycle. After section 4 develops a life-course perspective, section 5 makes various recommendations for social policy. Section 6 concludes by focusing on the political economy of reform.

2. Trends

Female human capital stronger

Female labor-force participation has increased strongly in almost all OECD countries over the last few decades. A major factor is the increased supply of female human capital as a result of better-educated women, improved birth control, better household appliances, and changing female aspirations. At the same time, increasing employment shares of the service sector and technological developments have boosted the demand for female labor by facilitating part-time work and by raising the demand for communication and creative skills at the expense of raw muscle power in the industrial sector. The increased potential earnings of women in the formal labor market reduce the scope for specialization in home production between male and female partners and encourage more gender equality. As a direct consequence, both male and female employees increasingly combine a career in the formal labor market with family obligations.

Human capital more important

Human capital is the key to a successful career in a modern knowledge-intensive economy. Indeed, several studies indicate that the skill premium has increased as human capital has become scarcer. The additional demand for skills on account of rapid technological change outstrips the additional supply of skills as a result of a better-educated workforce. At the same time, work and career are increasingly important for personal fulfillment and development, life-long learning, the maintenance of social networks and (mental and physical) health. This holds true not only for men but also increasingly for women. Indeed, well-educated women aspire to the independence and fulfillment that paid employment brings. Access to employment, and thus workplace learning, prevents not only social exclusion but also depreciation of skills as a result of rapid technological change.

Longer life and rapid innovation call for life-long learning

Increased longevity implies that human capital has become more durable. Average life expectancy at birth has increased by about 2½ years per decennium since 1950 in most industrial countries. Life expectancy at age 65, which is more relevant for the costs of pensions, rose by an average of one year per decennium. At the same time, knowledge and specific skills age faster on account of creative destruction associated with fierce competition and rapid innovation. The combination of a longer life combined with faster obsolescence of skills and the increased importance of human capital implies more need for life-long learning.

An adaptable labor force enhances the legitimacy of competition

Also the creative destruction associated with a competitive, innovative economy requires greater adaptability and employability of the workforce to prevent a competitive market economy from losing its social legitimacy. By absorbing the risks associated with creative destruction, an entrepreneurial workforce empowered with sufficient skills safeguards the legitimacy of a dynamic market, thereby boosting productivity growth. Moreover, an adaptable labor force can embrace risk, thereby raising the supply of risk-taking capital for additional R&D and risk-taking entrepreneurs who experiment and challenge existing firms. More generally, in a continuously changing and highly competitive environment of a modern economy, intellectual flexibility, emotional resilience and the capacity to work well with others are at a premium.

Non-cognitive skills are becoming more important and are shaped early in life

Adaptability and the ability to learn are important components of human capital. The same holds true for non-cognitive skills (such as social and communication skills facilitating stable relationships, self-discipline, self-control and self-esteem, perseverance and other virtues, emotional security, time preference, motivation to learn, openness to change) and values stressing creativity, personal growth, responsibility, and readiness to meet challenges. These skills and values, which enhance adaptability and the ability to learn throughout the adult life, are shaped early in life, mainly in families.

3. Challenges

We can identify several challenges involving the need to create more room for investments in human capital, particularly those that foster the adaptability of parents and their children.

Maintaining the intergenerational contract

A first challenge is to maintain social cohesion in the face of a population that is aging on account of increased longevity and declining fertility. In particular, aging threatens the intergenerational contract according to which each generation invests in the human capital of the next and is taken care of at the end of its life by the generations in which it has invested. Hence, each generation cares twice (once for the previous and once for the next generation) and is taken care of twice (as a child and in old age). Within a family context, women are the traditional brokers of the intergenerational contract, providing most of the informal care to children and aged relatives. The higher potential earnings of women in the formal labor market have increased the opportunity costs of these activities at a time when most elderly have fewer younger relatives who can care for them as a result of shrinking family size. Moreover, those in middle age face a heavy tax burden as the large baby-boom generation starts to take advantage of pay-as-you-go (PAYG) pensions and health-care provisions. This threatens the sustainability of the public intergenerational contract according to which middle-aged agents must care not only for the very old but also for the very young.

Stopping the vicious circle of early retirement and rapid depreciation of human capital

The so-called work-age paradox exacerbates this threat. Whereas life expectancy is increasing and people are enjoying better health at 65 years of age than ever before in history, the effective retirement age, in Europe especially, has fallen substantially below 65. Biological aging and social aging have thus moved in the opposite direction. As a direct consequence, the expected retirement span has increased substantially while the working life is being compressed.

Maintaining investments in younger generations

With increased longevity, earlier retirement and the compression of the working life, the aging European continent risks becoming entangled in a vicious circle of early retirement and lower fertility in which politically strong older generations favor generous passive spending on pensions and health care at the expense of investments in the human capital of younger generations. The decline in fertility in various European countries implies that current generations are investing less in future generations. The opportunity costs of raising children in terms of foregone career possibilities seem excessive for many high-skilled women, who opt for a career in paid work rather than raising children.

Insuring human capital while protecting the incentives to maintain human capital

Various developments increase the dangers of moral hazard and hence make human-capital risks less insurable. As the economy shifts from blue-collar work in industrial sectors to white-collar work in service sectors and knowledge-intensive activities, mental causes of sickness and disability have become more prominent. These forms of sickness and disability can be less easily verified than physical disabilities. Moreover, an increasing number of workers now moves between periods of full-time work to periods

of voluntary absence from the labor market to enjoy leisure, educate themselves, set up a business, or care for children or frail relatives. In such a transitional labor market with a growing diversity of life courses, it becomes more difficult to separate voluntary periods of inactivity from involuntary unemployment. At the same time, individuals can increasingly affect the probability that they become unemployed or sick by investing in their own employability or by the way in which they organize their life. In other words, the dividing line blurs between the contingencies that people are responsible for (the so-called manufactured or voluntary risks) and those for which they are not (the so-called external risks). More and more periods in which people experience a cut in income are in part 'manufactured,' increasing the risk of moral hazard in social insurances that protect people against these losses in income.

These changes in the nature of and the responsibility for social risks make it more costly to insure human capital through income replacements in terms of harming the incentives to accumulate and maintain that capital. At the same time, a more dynamic world economy and a decline of the extended family as an insurance device have increased the demand for such insurance as people experience more substantial economic insecurity.

Empowering workers to become less dependent on corporations

Also corporations can offer people less job security. Fewer and fewer employees work for 40 years for the same company. More intense competition implies that companies exhibit shorter life spans. In a dynamic economy, constant innovation results in substantial creative destruction. Firms can thus offer less security to their employees. Within firms, employees have to update knowledge and qualifications regularly as they move between different jobs on the internal labor market. These developments point again to the importance of continuously maintaining and updating skills in order to guarantee income security. Making workers less dependent on their employer requires more employable workers through more general human capital.

4. A life course perspective

Reconcile career and family in longer life

A modern knowledge-intensive economy requires longer periods of learning so that young adults start their working lives later. At the same time, older workers terminate their working careers earlier as effective retirement ages decline or stagnate, even though life expectancy increases. People thus increasingly concentrate work effort in the relatively short life season in which they also raise children. At the same time, many parents wish to look after their children, especially immediately after childbirth. The key challenge is to accommodate these preferences by allowing parents to strengthen family life while also maintaining their human capital through continued attachment to the labor force so that they can enjoy long, fulfilling careers.

From dividing tasks in breadwinner model to combining work and family

The traditional breadwinner model relies on a strong division of labor between men and women. In the face of an eroding comparative advantage of men in paid work, young generations increasingly combine various activities by engaging simultaneously in

learning, working, caring and relaxing. The relative importance of these activities varies during the life course, depending on family obligations and idiosyncratic and macro-economic shocks.

Spring and fall complement summer and winter

In the modern longer life course, adults spend considerable time in households without young children as a result of delays in family formation and parenthood as well as death. Indeed, in the “spring” of the modern life course (or early adulthood phase or “playtime of life”), young adults first experiment with relationships and jobs before they take responsibility for raising children during the “summer:” the family season when adults bear the responsibility for raising minors. The summer season in the modern life course is quite hot. The costs of living are high while time is scarce, as parents invest not only in their children but also in their careers. During this so-called “rush-hour of life,” people may experience “combination stress.” Compared to other European household types, families with co-residing children are least satisfied with living conditions, including their work (or main activity), income, housing, and leisure time.² After their children have grown up, adults typically spend considerable time in good health in the “fall” season of their life course (or the active senior phase) before they enter “winter:” the final phase of life in which people suffer from serious health problems.

The modern life course is most apparent in Northern Europe. In this region, many people in the age brackets between 20 and 30 and between 50 and 60 live as singles or as couples without children. In Southern Europe, in contrast, the extended family is still dominant in these age groups.

5. Policy recommendations

The trends and challenges outlined above call for social innovation. At a time when corporations and governments are withdrawing from their traditional roles as insurers of human-capital risks, new institutions should be created to offer workers more durable social protection and lasting security. Indeed, a more dynamic world economy and a decline of the extended family and the firm as insurance devices have raised the demand for new ways to absorb social risks over the life cycle. These new institutions should operate in a transitional labor market in which human capital is the key determinant of macroeconomic performance and personal fulfillment.

5.1 A longer working life

A higher effective retirement age is crucial for a number of reasons. First of all, it raises the return on human capital by lengthening the horizon for investments in human capital. Indeed, raising the retirement age in line with longevity capitalizes the benefits of increased longevity in terms of more durable human capital. In fact, one can argue that all of the ages that are used to measure old age should be linked to longevity so that one, in fact, measures old age from the end rather than the beginning of life. In this way, society

² Avramov, D., 2002, ‘People, Demography and Social Exclusion,’ Population Studies No 37, Council of Europe, Strasbourg.

ensures that social aging and biological aging do not diverge further and that people age actively rather than passively.

The rule of automatically linking public pensions and tax privileges to life expectancy avoids the political costs of discretionary decisions to limit eligibility to public pensions and tax benefits if longevity increases further. Agreeing on a risk-sharing rule *ex ante* also reduces the political risks associated with collective discretionary decision-making. Moreover, it allows individuals and firms to adapt gradually to a longer working life by better maintaining human capital and adjusting the organization of work to the needs of older workers. An increase in spending on disability pensions and unemployment benefits is thus avoided.

Another benefit of a higher effective retirement age is that it allows people to exploit their longer life to reconcile the two ambitions of, first, investing in the next generation as a parent and, second, pursuing a fulfilling career in paid work in which one keeps learning and applying new technologies. A longer active working life better fits the biological clock of women; whereas some men of about 45-50 years of age already look forward to their retirement, women in the same age group would like to return to work when their children are leaving the household. Indeed, a better reconciliation of work and family goes beyond child-care facilities and parental leave schemes during the family phase and involves the way the entire life course is organized.

More generally, a longer working life reduces the need to transfer resources from the summer season of life to the fall season either through intergenerational transfers (such as PAYG pension systems) or through the allocation of resources over the life cycle (for example, through compulsory pension saving). This reduces the time and income squeeze in the hot summer of the modern life course and helps to relieve the liquidity constraints in this life season. Resources are used proactively to maintain and invest in human capital rather than reactively to provide additional transfer income as a compensation for the premature depreciation of human capital.

More adaptability and employability facilitating a longer effective working life require people to bear more individual responsibility for the maintenance of their own human capital, thereby stimulating life-long learning in firms. To that end, retirement schemes should be actuarially fair. This gives workers also more individual choice about when and how to retire. More generally, if workers are no longer paid more than their productivity when old, the labor-market position of elderly workers becomes stronger so that elderly workers enjoy more discretion to adjust working conditions to their specific needs. More flexible retirement patterns (e.g. part-time and gradual retirement) and more opportunities to change jobs and work patterns (so that elderly workers become less dependent on their current job and the talents of elderly workers can be better used) then become possible. The flexibility to change one's working conditions to better suit changing needs and to find new challenges in fulfilling work can help to extend fulfilling working lives.

5.2 More flexibility of working time over the life course

More flexibility in allocating working time over the life course can prevent stress and excessive time squeeze when workers bear substantial family responsibilities. Moreover, it helps women, who still carry most of the family obligations, to remain attached to the

labor force. Their human capital is thus maintained better, thereby strengthening their labor-market position and raising their labor-force participation when the children have grown up.

More individual discretion in allocating working time (i.e. time sovereignty) over the life course requires more individual responsibility for financing periods of (part-time) leave. This ensures that more flexibility in selecting work times results in more rather than less hours worked over the life course as a whole. In this connection, tax-favored savings accounts for financing (part-time) parental leave can supplement minimum public income provisions (such as child and child-care benefits and publicly financed parental leave schemes) to protect purchasing power during the summer of the family season without resulting in excessive consumption of leave and childcare and large budgetary costs.

By helping agents to take more responsibility for drops in income, savings accounts can stimulate not only a more flexible working life but also a more flexible labor market and better management of human resources. In particular, individuals can self-insure a larger part of the shocks to the value of their human capital by using personal savings accounts. For example, older workers can draw on the account to retire gradually or supplement a reduction in the hourly wage at an advanced age. This facilitates wage flexibility of older workers, thereby strengthening their labor-market position.

Social partners should nurture more inclusive, flexible workplace cultures that reconcile the needs of individual employees who balance work with family obligations with the needs of employers to flexibly respond to fluctuations in demand in increasingly competitive markets. In order to remain competitive in an aging labor market and to promote themselves as good places to work, firms should attune work conditions to the needs of employees who want to remain employable despite substantial family obligations and rapid innovation and creative destruction. They should aim to create workplaces in which workers develop and maintain their talents, skills and health. Moreover, firms should help their workers to plan ahead about how they can remain productive in fulfilling work when they grow older.

5.3 More inclusive labor markets

To allow young adults to build a family, European labor markets should become more inclusive so that workers do not have to be continuously employed full time in order to enjoy a successful career. Rather than shielding insiders through employment protection, labor-market institutions should enable parents of young children, secondary workers and young people to easily enter and remain in the labor market (e.g. through job-protected parental leave) and adjust their working conditions to changes in family conditions. This helps to reduce the opportunity costs in terms of foregone career prospects of becoming a mother and of sharing household work for fathers.

Basing their security on employability and portable saving, retirement and social insurance schemes rather than on employment protection helps workers to better diversify their human and financial capital; emancipated workers become less dependent on the firm for which they work. Endowed with sufficient human and financial capital, adaptable individuals are empowered to embrace the non-verifiable, idiosyncratic risks

associated with creative destruction in a dynamic competitive world economy and a transitional labor market. Moreover, workers enjoy greater flexibility in adjusting working conditions to changing needs during their life courses and in finding fresh challenges from which they can continue to learn.

A more inclusive labor market can help reverse the trend towards a compression of the working life and postponement of social adulthood by facilitating the first entry into the labor market. Condensing the period of full-time education, combining learning with work at an earlier state, and spreading learning more over the life cycle by integrating it better with work could also be helpful in shortening the period of social adolescence, decompressing the working life, and bringing forward parenthood. Activating social policies should induce young adults to build up their human capital through education, work or both.

5.4 From breadwinner support to in-work benefits for parents

Lower minimum-wage floors boost the supply of reliable household services for families and the elderly, while at the same time improving the employment prospects of low-skilled women in the formal labor market. To accomplish this while protecting the income position of vulnerable households, more activating social assistance should be combined with in-work benefits (including child-care benefits) for parents caring for young children. In particular, social assistance based on mutual obligations should be conditional on each adult (including low-skilled women) being available to the labor market --- possibly on a part-time basis while parents care for young children who are not yet of school age. By moving away from breadwinner support (in which the breadwinner needs to earn sufficient wage income to provide for a dependent adult and children) towards targeted in-work benefits for families with young children, governments decouple income policy from the allocative role of wages. This creates more low-wage jobs in the formal sector.

Subsidized (or publicly provided) child care for households with low earnings helps women (including single mothers) to escape poverty, and alleviates liquidity constraints during the summer season of life. At the same time, school times should be attuned to the needs of working parents, with affordable after-school care for children of working parents with low labor incomes. Subsidies for high quality child care internalize the externalities of child development and alleviate the distortions of the tax system on female participation and human capital accumulation in the formal sector and the production of labor-intensive goods and services in the untaxed household sector.

Activating policies facilitate social integration, especially if work obligations for women are combined with programs supporting the development of young children. Indeed, early intervention in dysfunctional families is the key to preventing social exclusion, raising the participation rates of unskilled men and women alike, and encouraging durable two-parent families. A proactive social policy aims at creating equal opportunities at the start of life through an equal distribution of human capital. Early interventions aimed at enriching the family environments of disadvantaged children can carry a high economic return in terms of raising school performance in adolescence and boosting wages and labor-force participation in adulthood.

5.5 Shift public support from the old to the young

The aging of the population is due to increased longevity and lower fertility. Whereas both funded and PAYG pension systems are vulnerable to increased longevity, PAYG pension schemes are especially vulnerable to lower fertility because PAYG systems rely on human capital of the young to finance the pensions of older generations. As generations invest less in the human capital of the next generations by reducing fertility, they should invest more in financial capital. Hence, lower fertility calls for gradually shifting from PAYG financing to funded pension schemes.³ In this way, public support is gradually shifted away from the fall and winter seasons of life towards the spring and summer seasons. This is consistent with a gradual move from a reactive social policy that provides passive income support to those who have depreciated their human capital to a proactive social policy that helps people to build up and manage human talents better.

Countries with large PAYG systems should consider focusing the public scheme on poverty alleviation by gradually reducing earnings-related PAYG benefits for individuals earning higher incomes. This would yield a better balanced portfolio between funded and PAYG schemes, as workers with middle- and higher incomes substitute private, funded pensions for public PAYG benefits.⁴ Reducing PAYG benefits for, and increasing the tax payments by, the more affluent elderly is consistent with the trend towards a more heterogeneous older population. When PAYG schemes were established, the economic depression of the 1930s and the second world war had impoverished the older generation. Since poverty was thus concentrated among the elderly, poverty alleviation called for transfers from the younger to the older generation. At present, in contrast, age is generally no longer a good indicator of poverty, as many elderly have accumulated substantial financial wealth and more risks have shifted to the beginning of the life cycle. Hence, information on age should increasingly be supplemented by other information (particularly on incomes and family status) to identify those most in need of income support.

The currently retired generation has not been able to anticipate lower public PAYG benefits. Moreover, this generation cannot adjust easily because it has already depreciated its human capital. Accordingly, a strong case can be made for changing the rules of the game (i.e. reducing PAYG benefits and increasing taxes on the elderly) only gradually.

6. Conclusions

The policy conclusions imply transforming passive benefits compensating the loss of human capital into preventive, proactive social policies that build and maintain human capital. They point also to the importance of flexibility in wages and work practices. As workers increasingly combine their work with other activities (caring, resting and

³ Sinn, H.W., 2000, 'Why a Funded Pension System is Useful and Why it is not Useful,' *International Tax and Public Finance*, vol. 7, pp. 389-410.

⁴ OECD, 2001, 'Ageing and Income. Financial Resources and Retirement in 9 OECD Countries,' Paris.

learning), new social-protection institutions should facilitate various transitions and changing combinations of activities during the life course. Moreover, substantial human capital contributes to a high level of labor-force participation as the basis for ensuring solidarity with vulnerable elderly, children and disadvantaged adults of working age.

The required reforms confront politicians with a major challenge because these reforms often run against vested interests and the perceived short-term interests of powerful insiders. Moreover, transforming passive, reactive social policies into more proactive policies yields a transitional problem similar to that associated with a shift from a PAYG to a funded pension system. In particular, society still has to pay for passive benefits to the currently old generations; these generations have typically depreciated their human capital because they have not profited from more proactive social policies. At the same time, the human-capital investments in the young generations, which reduce social spending and increase tax revenues only with a lag, must be financed. The combination of passive old-age benefits and proactive spending aimed at especially the human capital of younger generations may create fiscal pressures and give rise to difficult political choices.