Intergenerational Solidarity
Pontifical Academy of Social Sciences, *Acta* 8, Vatican City 2002
www.pass.va/content/dam/scienzesociali/pdf/acta8/acta8-llach.pdf

A NEW SHAPE FOR THE WELFARE STATE

JUAN J. LLACH

It is very difficult to make critical comments on a paper when there is a so close agreement with the author. This is precisely what happens to me with the thoughtful paper by José Raga Gil, "A New Shape for the Welfare State". For this reason the following comments will be divided into two parts. First I will briefly mention a couple of suggestions that could help to further develop the paper. Secondly, I will refer to some weaknesses that, from my point of view, underlie both the analytical and behavioral paradigms of modern economic development and that can help us to explain the crisis of the welfare state analyzed by Raga Gil.

The severeness of the crisis of pensions systems in developed countries

The paper mentions that two types of reforms are needed in order to overcome the actual and, particularly, the potential crisis of pensions systems in developed countries. The first type includes changes in methods of calculating pensions and, particularly, the increase in the age of retirement. The second type is the transformation of the pay-as-you-go systems that currently prevail in most developed countries into capitalization systems that, as we know, could be either private or public, individual or collective. My comment on this point is that the crisis is so severe that the second reform is unavoidable and, for that reason, should have deserved a stronger emphasis in the paper. For the same reason, the inclusion of tables with the present value of the actuarial debt of pension systems in developed countries would have helped to emphasize the point. These debts greatly vary among countries. The average of twenty OECD countries is astonishingly high: 193,4% of GDP. Excluding the less indebted countries, i.e., USA (69%), United Kingdom (36%) and Ireland (28%), the OECD average amounts 219,8%.[1] These figures show with incredible eloquence the magnitude of the crisis of the welfare state in developed countries. Finally, since the assessment of the true situation of pension systems is very dependent on population projections I wonder if the demography that underlies Raga's paper include, and to what extent, different immigration hypothesis. These are very critical, because as we all know, not only pension systems but also economic development per se is under risk in the present demographic context of developed countries, and particularly in Europe. Immigrations are and will be more and more badly needed in spite of the serious political troubles that we can read almost everyday in the press.

Weaknesses of some behavioral assumptions of modern economic development

1. *The assumption of perfect (or wise) foresight and the permanent income hypothesis (PFPI)*. One of the most critical assumptions of the utilitarian-rationalistic model of the economic man is that agents act as if they had perfect foresight, or at least a very wise one. For that reason, personal (or familiar) savings and consumptions depend not on the current income but on the (assumed) permanent income. This is clearly illustrated in the following quotation by Menger included in Raga's paper:

> But men in civilized societies ... plan for the satisfaction of their needs, not for a short period only, but for much longer periods of time ... Indeed, they not only plan for their entire lives, but as a rule, extend their plans still further in their concern that even their descendants shall not lack means for the satisfaction of their needs.

Sociologists and humanists, on the other hand, have normally been more skeptical on this point. With his wonderful penetration, Tocqueville wrote more than a century and a half ago that conditions in modern secular societies foster "a brutish indifference to the future, an attitude all too suited to certain propensities in human nature" and predicted that in times of religious skepticism men would be more inclined to "give themselves over to the satisfaction of their least desires without delay".[2]

[1] Taken form the central projections presented in Deborah Rosevaere, Willi Leibfritz, Douglas Fore and Eckhard Wurzel (1996), *Ageing Populations, Pension Systems and Government Budgets: Simulations for 20 OECD Countries*, Paris, OECD, Table 1.

[2] Alexis de Tocqueville, *Democracy in America*, edited by Mansfield and Winthrop, Chicago, University of Chicago Press, 2002, 521. Taken from Mary Ann Glendon Comment in this same Plenary Session.

Even taking into account that for the last decades the PFPI assumption has been relaxed through methodological devices like bounded rationality and different forms of decision making under uncertain conditions, the basic premise still holds.[3] In contrast, the historical process of the development of the welfare state happened in such a way that we did not have the opportunity to know if the PFPI assumption really applied or not to the behavior of people regarding pensions. Why governments gradually and all over the world behaved replacing the (assumed) individual responsibility regarding the future? What is evident is that they did not trust in the PFPI assumption. Was it just demagoguery or were governments at the end more wise than citizens would have been?

We have some evidences, on the other hand, that not all social actors or economic agents behave in the way predicted by the model. Let me give just one example. Evasion of the contributions to social security in Argentina have been roughly the same in the pay-as-you-go system and in the individual and privately managed capitalization pension funds. Theory, on the contrary, would have predicted higher compliance in the second since the contributions are savings owned by the contributors. Another evidence of less than perfect foresight arises from the fact that the so-called Ricardian equivalence (after David Ricardo) does not hold most of the times. According to it, when governments begin to run a deficit and this is financed through an increase in public debt, private savings should increase because people will know that in the not so far future taxes must be increased to service the public debt. However, there is no evidence of an increase in private savings to compensate the huge increase in the actuarial debt of the social security systems.

2. *The price of time and the economization of human life.* The price of time has different operational definitions. Most of them, like the interest rate, are associated to its' opportunity cost. We define here the price of time as the opportunity cost of domestic (and other forms of) non-paid labor, proxied by the average wage or workers on own account income. The "secular" increase of this price is in the essence of economic growth. One of its consequences is the gradual replacement of domestic labor by services offered in the market. This has, in turn, positive and not so positive outcomes. The main one of the first category is the increase in the opportunities given to women to develop their marketable abilities and vocational

[3] As can be seen in the recent contribution by R. Guesnerie, "Anchoring Economic Predictions in Common Knowledge", Econometrica, 70, 2, March 2002 (439-480).

careers. On the negative side we can count at least two. One is the fact that, through the same process just described, the market is not only replacing domestic "services" but also other things, like affection, than can not so easily be substituted for. Secondly, the facts analyzed by Raga Gil, and associated to a huge decrease in fertility rates can also be interpreted as a consequence of the increase in the price of time: this is so high, and increasing, that it is not worth it anymore to have babies.

It seems that the time has came to put the following question. Has the increase in the opportunity cost of domestic labor reached a critical point beyond which a "sustainable development" at the national level, that naturally requires the reproduction of human life, can not take place anymore? This question, of course, it is not only referred to capitalist societies. On the contrary, it applies even more properly to XXth century socialism that, for ideological reasons too, had an explicit policy of replacing the family by the state, combined or not with the market.

My conclusive point is a conjuncture, and it is referred to a normative question related not only to Raga's paper, but also to the presentation of Professor Zampetti in this same session. If it were true that the welfare state development has gone to far and beyond its logical limits, invading in that way the responsibilities and developments of the families, would not it be convenient to completely rethink it? Would not it be better to give more economic resources directly to the families and, at the same time, to give them more freedom to choose their own children's education, the health services they want or the retirement plan they prefer? This could be perfectly performed maintaining at an income redistribution policy through progressive taxation. But, at the same time, it would allow families to be more *sovereign* (Zampetti's words) and, on the other hand, to reduce the high bureaucratic costs and to avoid authoritarian face of the welfare state.