EEAG (2016), *The EEAG Report on the European Economy,* "Intergenerational Fairness," CESifo, Munich 2016, pp. 54–69.

Intergenerational Fairness

2.1 Introduction

This chapter is concerned with the interaction of generations, the way that generational clashes are translated through the political system, and their long-term consequences for the sustainability of the economy and society. It concludes with a consideration of whether the generational contract is safer on a national or a supranational (including a European) level.

The idea that a contract between the generations lies at the basis of society is fundamental to visions of a just social order. It is also at the heart of any notion of social stability and sustainability. The conservative theorist Edmund Burke famously put the generational contract in a larger perspective: "Society is a contract… a partnership not only between those who are living but between those who are dead, those who are living, and those who are to be born." (Burke, 1790) Burke essentially saw a private contract that was violated by the dramatic political action of the French revolutionaries. The character of the contract has changed remarkably since Burke's time. In modern Europe, families no longer invest in children with the goal of securing their own position in old age, but have collectivised or socialised Burke's social contract (Becker, 1992). In our modern society, government becomes a vital element in the contract. The father of modern welfare economics, Arthur Pigou, envisaged the state as representing those who are "absent" from the discussion: "There is wide agreement that the State should protect the interests of the future in some degree against the effects of our irrational discounting and of our preference for ourselves over our descendants. The whole movement for 'conservation' in the United States is based on this conviction. It is the clear duty of Government, which is the trustee for unborn generations as well as for its present citizens, to watch over, and, if need be, by legislative enactment, to defend, the exhaustible natural resources of the country from rash and reckless spoliation." (Pigou, 1932, pp. 29f.) But we also know after a century of experience that the state is very likely to be captured by those who are present. In that sense, states fail to live up to the promise of yielding an equitable result.

The welfare state is an institutional and formalised version of the contract, the medium for making generational transfers. A welfare state reallocates resources at both ends of an individual's life span, replacing choices in spending that had previously been personal or private. As Becker (1992) put it, "Both the elderly and children need care – in one case because of declining health and energy, and in the other because of biological growth and dependency." The level of investment in children has a powerful effect on future outcomes: on individual well-being, but also on the health and dynamism of society. In the past parents had seen raising the human capital of their children as a way of securing their own security when they became incapable of working and earning. That is no longer needed, because the parents see the burden of their future support as collectivised. The result might well be expected to be that many resource-constrained parents no longer see any advantage to themselves in increasing the earning capacity and economic potential of their children. Decisions on educational spending thus need to be left to public authority: in its absence there is a risk of substantial under-spending. The forward-looking aspect of the socialised contract can be seen as investment in future generations.

Working age adults accumulate either private assets or claims on public support in anticipation of their own old age. The socialisation of old age provision is seen as a backward-looking corollary to the investment in the young. The calculation reflects a need to save for the future of the presently middle-aged generation that is currently investing in education for the future. In the new socialised contract, that saving is the compensation for the incomes foregone as working people finance the educational investment for the future. The socialised contract in nature is Pay As You Go: it implies an implicit return equal to wage sum growth – when fertility goes down, the return falls; when longevity goes up, individuals draw more on the contract (Boldrin and Montes, 2005; Andersen and Bhattacharya, 2015).

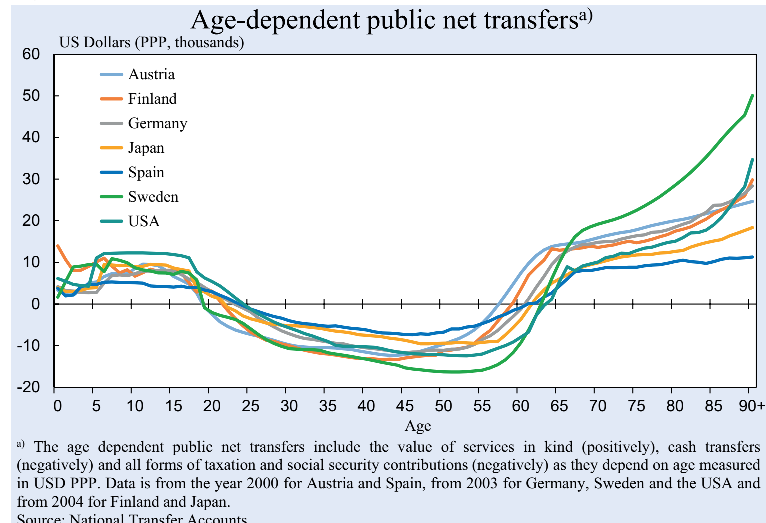
Historically, the socialisation of payments for the first part of the life cycle came earlier than the provision of old age provision. Public investment in education was motivated by the observation that poor people would try to gain from their children as early as they could (in an era of child labour), and that there was a public good in raising levels of skill and sociability. The second half of the nineteenth century was, as a result, at least in some areas of higher education and in skill levels, a period of substantial economic growth, with rising social investment and substantial increases in literacy and skills. Old age pensions – first introduced in Denmark and in Germany – were a way of buying off political discontent that looked relatively cheap, as many industrial workers could not expect to live until the retirement age. Nutritional and medical advances in the twentieth century led to large gains in longevity, and made this side of the bargain more expensive.

The generational distribution of the socialised contract occurs principally in the framework of a national context. Historically, the large expansion of the pensions system and of pension entitlements, usually funded on a Pay As You Go system (PAYG) with defined benefits, took place in the middle of the twentieth century, especially in the third quarter, when borders were very important and there were substantial restrictions to international migration. Productivity increases and population growth together drove wage increases that allowed PAYG to work unproblematically. Then came globalisation, and larger migratory flows. The ability to exit and enter the national setting, however, alters the calculation on which the lifetime promise was built. The nature of the contract will change because of the effects of migration. Emigrants are the beneficiaries of investment in early education, but may be seen as opting out of the repayment phase of the contract (while sometimes still expecting private inheritances, and even public pensions if they re-enter on old age). A society with a great deal of emigration is likely to have additional incentives to underinvest in education. It might be expected that a society that is highly concerned with its old age future might be enthusiastic about immigration. But there are many kinds of migrants, including workers, students, family members seeking family reunification, and asylum seekers, and each group interacts differently with the labour market. In reality the debate is also frequently dominated by cultural concerns about the consequences of immigration and fear that open borders mean low skill immigration and a higher degree of dependency on welfare payments. A declining trend in productivity growth and in fertility also threatens PAYG. In short, the social contract is an implicit insurance contract, and migration holds out the possibility of adverse selection, with selection mechanisms that can undermine or even destroy the contract.

The individualisation of society, and the increasing disintegration of traditional families, have created the expectation that the state should serve as a replacement for the family. It is the public sector that pays considerable amounts for educating young people, and maintaining old people; while the middle generation pays in so as to provide the support for juniors and seniors. There are obvious differences between countries, and Scandinavian countries are especially generous in their transfers to the elderly, but the basic profile is similar across the industrial world (see Figure 2.1).

How does behaviour respond to the incentives created by the availability of transfers? The arrangement of benefits and costs creates inducements for the young to extend education/student life as long as possible, so as to extend their benefits; for them to then exit quickly so as not to pay the costs; and for the middle-aged to retire as soon as they can, in order to extend their benefits. Meanwhile, those still trapped in the working middle feel squeezed, and may not have the same af-

Figure 2.1



Age-dependent public net transfers[a)]

[a)] The age dependent public net transfers include the value of services in kind (positively), cash transfers (negatively) and all forms of taxation and social security contributions (negatively) as they depend on age measured in USD PPP. Data is from the year 2000 for Austria and Spain, from 2003 for Germany, Sweden and the USA and from 2004 for Finland and Japan.
Source: National Transfer Accounts.

fection for the public sector or the state as middle-aged people in previous centuries developed for their families. States are also expected to make complicated selections of the appropriate kind of immigrant, and are blamed when the "wrong" immigrants arrive and the welfare state provisions are depleted rather than replenished.

Children don't expect to support their elderly parents, but on the contrary hope for an inheritance from them. The result of socialising the costs of ageing but keeping the benefits of wealth accumulation private has shifted the nature of the generational contract beyond recognition.

Socialising the generational contract has had unanticipated and unintended effects, which interact, through the political system, with long-term demographic developments. Modern Europe is ageing rapidly. The changing demographic pyramid may give politicians incentives to cater for the demands of the elderly, since they are becoming numerically ever more dominant, and to overlook the concerns of young people. They may be encouraged to focus more on paying out savings than in the investment for the future. In many European countries, a majority of voters are either retired or expect to retire within the next legislative period of the elected parliaments. These voters are very heavily focused on the provision of payouts. In addition, younger citizens have lower voting rates. As a result, the political structure is often described as a gerontocracy, and that perception may feed into the sense of younger potential voters that they are disenfranchised. Voting ratios may thus fall even further, indicating that young people wish to opt out of the political system, and further confirming its character as a gerontocracy. Pensions and old age care are more salient politically than education provision, which in some (not all) European countries is quite neglected. Speaking to the European Parliament, Pope Francis memorably described Europe as producing the "general impression of weariness and ageing, of a Europe that is now a 'grandmother', no longer fertile and vibrant."[1] These effects – the marginalisation of the young and the assertion of the self-interest of the old – interact, and these interactions form the subject of this chapter.

It might be objected that a rational middle-aged voter – or even a late middle-aged or early retired voter – might have a far-sighted motive in pushing for more investment in the education of the young in order to guarantee higher returns, and thus facilitate existence in their high old age – in the future. That incentive is reduced, however, by the time gap between the decision and the expected outcome: the rational voter might either hope that technical change may produce unexpected windfalls that make old age more supportable, even on reduced incomes compared to present-levels; or fear that investments are no longer generating the returns that were available in the past. The forecast of a secular stagnation made by John Maynard Keynes and Alvin Hansen in the 1930s has recently found new and influential advocates such as Larry Summers.

The extent to which the balance has shifted in favour of the older cohorts varies from country to country, and is driven by demography, changes in fertility and mortality, but also by migration. One of the most striking developments of post-war Europe has been the increase in life expectancy, with the result that most Europeans look forward to a long period after their retirement, or after they cease to be economically active. Evidence from the second half of the twentieth century shows that increased life expectancy has no positive effect on enhancing per-capita income (Acemoglu and Johnson, 2007). By living longer, people have placed themselves in the position of extracting more resources from the contractual pool.

Since labour mobility is a key feature of the European Union, it might be anticipated that the young will use the exit option from the most gerontocratic societies, making their already problematic social imbalance even more lop-sided and ultimately unsustainable. Gerontocracies thus create a vicious feedback loop, through which they constrain the only sources that could provide a basis for continuation.

2.2 Generational conflict and class conflict

In the nineteenth century, European politics was characterised by class conflict, in which a propertied upper class used the levers of political power to perpetuate its advantages. That polarisation persisted through the twentieth century, although by the beginning of the twentieth century, observers increasingly found that the old ideological divisions had become obsolete. Today, there is a new mood of intergenerational conflict, and a questioning of the way that the current

[1] Ball, D., "Pope Describes Europe as 'Elderly and Haggard'," *Wall Street Journal*, 25 November 2014, http://www.wsj.com/articles/pope-says-europe-needs-new-sense-of-purpose-1416915190.

contract has been constructed. The class conflict of previous centuries is reasserting itself in the generational clash in a new way. Since it is the well-educated and affluent, the major beneficiaries of the state's expenditure in the early life phase, that follow healthier life styles, they also live longer. So they are the beneficiaries of the transfer payments in old age. Striking new data (Case and Deaton, 2015) shows for the US – but not for Europe – an increase in middle-aged mortality, particularly in lower income groups, as a result of suicides, drug and alcohol poisoning. The possibility of analogous developments in response to economic downturns in Europe is clearly worrying. Education and longer life expectancy have generally become the levers used by the privileged to secure and perpetuate their advantages. They live longer, extract greater resources in pensions and medical care, and then expect to leave larger legacies to their children. The most powerful protest movements may be expected to arise precisely where the gerontocracy is strongest, primarily involving a mobilisation of younger generation voters, and the old-established political parties may prove unable to mobilise the young precisely in these areas.

Moreover, there is an asymmetric sharing of longevity risk between the individual and the welfare state. Welfare state provisions like pensions and health are effectively life-annuities, and hence the welfare state carries the burden if an individual lives for a long time. In the opposite case, a large bequest is made to the deceased's heirs, since inheritance taxes are relatively low in most countries.

The housing lock-in also creates a hold-up problem in property taxation. There are powerful arguments why property should be taxed, but such taxes are very unpopular, and old voters in particular strongly argue against such taxes. This problem becomes larger the more the old are locked-in with large owner-occupied houses/apartments. In this way the existence of the lock-in blocks tax reforms, shifting tax from labour income to property. There is an additional reason why a lenient taxation of housing is not youth friendly: such taxes are capitalised in housing prices, and higher property taxation would thus reduce housing values for the old, and lower house prices to the benefit of the young.

A powerful mechanism cementing inter-generational stability in the twentieth century derived from productivity increases. Economic growth could ensure that each generation would realise that it was better off than previous generations, and thus could easily and unproblematically afford to pay for the old. At the height of this confidence, it was easy to agree on a principle of dynamic pensions, in which pensions were regularly adjusted not just to cost of living increases, but also to productivity increases. They were spectacularly popular politically: the West German election of 1957, that followed immediately after the introduction of the dynamic pension principle, is the only one in German history where a party (the ruling party) received an absolute majority of votes. As productivity faded, however, the promises incurred at this time began to look as if they were too much of a burden. Falling productivity growth reduces both market returns (real interest rates) and the implicit return in PAYG. But even in absence of the productivity slowdown, the changing demographic composition of the population was to have adverse effects – the implicit return in PAYG schemes falls when fertility goes down (longevity goes up).

The advantages of the old, and the under-privileging of the young, in modern Europe take the following forms:

1. Labour regulations giving security of employment that fundamentally benefit older workers, and establish disincentives for employers to hire younger people (the dual labour market, that especially characterises Mediterranean Europe).
2. Property ownership, in which older people have real estate, and younger purchasers (especially in urban centers) are deterred by rising prices (and cannot get onto the lower rungs of the "property ladder").
3. Pension schemes, mostly originally designed as PAYG systems, in which the funding of the pension entitlements of younger people looks precarious as demographic projections predict that there will be fewer new earners paying in ("as you go").
4. Socialised medical insurance systems, in which increasingly expensive care for older people dominates the cost structure.
5. Government debt, in many cases incurred in order to maintain the advantages of the elderly, may become unsustainable, so that the following cohorts may not be able to fund themselves in the same way.

6. Environmental damage, in which present output is obtained cheaply at the cost of future generations, who have to bear the burden of the clean-up costs.

2.3 "Bank Papa": how the dual labour market creates dependence

Perhaps the most obvious and politically explosive breach in the principle of the modern social contract is that large numbers of expensively trained or educated young people are excluded from the labour market, and in the course of unemployment or underemployment or engagement in low productivity occupations, suffer a deskilling that reduces their long-term chances of productive employment, and hence their capacity to repay as part of the contract. They have received expensive training (perhaps not enough of it), but they are in no position to repay into the social contract. Relatively high rates of youth and younger generation unemployment have been a phenomenon of crisis economics, but the phenomenon of high rates of exclusion in some parts of Europe preceded the crisis. Even in high pre-crisis employment countries such as Spain, employment growth was concentrated in low-skilled sectors (such as construction) in which there was little stability or potential for skill enhancement.

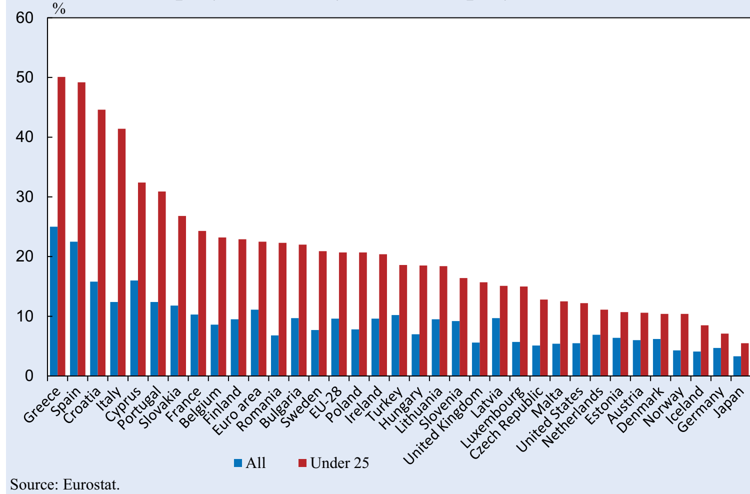
The conjunction of employment guarantees for established employees together with poorly developed social security systems is a feature of southern European labour markets, while northern Europe has moved to greater overall flexibility in labour contracts while maintaining security (protecting people rather than jobs). The difficulty of dismissing established employees can mean that poorly motivated workers are trapped in low productivity jobs, and that employers are reluctant or unwilling to hire new workers. Both effects depress the possibility of economic growth, and thus limit society's capacity to create and open new opportunities for a next generation. Younger workers are excluded from the regular or protected market, are frequently unemployed, and when they do find employment move rapidly through a succession of short-term contracts, in which it is harder to accumulate skills.

But this development is not only characteristic of southern Europe. Throughout the industrial world, the development among young people of a culture of short-term "gigs" fosters the development of what is often termed the "precariat" (Sennett, 2006; Standing, 2014). Changes in economic structure and the advent of new technologies have produced a corporate instability, which means that the old assumptions of secure life time employment with one employer are no longer realistic. In some cases, "gigs" are presented as lowly paid, or unpaid internships, in which the sole motivating goal for the young worker is supposed to be a valuable work experience, but where interns require financial support, usually from parents.

The problem of excessive job security as a source of inflexibility has been recognised for a long time, and in most southern European countries during the 1990s and 2000s there was a vigorous debate about reforms to create more flexible labour markets. But it remained a largely theoretical debate. Tackling the issue required real courage: indeed, in Italy just as anti-mafia judges and prosecutors were assassinated, there were two notorious cases in which economists were killed because of their identification with the cause of labour market reform. In May 1999, during the Romano Prodi administration, Massimo D'Antona, a centre-left law professor who advised the Minister of Labour on reform, was killed in Rome. In 2002, under the centre-right Berlusconi government, Marco Biagi, was killed as he cycled to work in Bologna. He had been calling publicly for a reform of the pension system, but also for a reform of Article 18 of the 1970 Labour Statute, which required the reinstatement of dismissed workers if the dismissal was judged unfair by an adjudication panel. The Biagi case in particular highlighted the variety of the opposition to reform. Biagi, like D'Antona, was killed by left-wing terrorists, the so-called New Red Brigades; but Biagi had received multiple threats, and the Minister of the Interior withdrew his police protection a few months before the killing.

The failure to reform before the crisis is one explanation for the striking rise in youth unemployment during the economic crisis, which was most characteristic of southern European crisis countries, but was also evident in central and eastern Europe (see Figure 2.2). In both areas, it has produced a widespread sentiment that political process is failing younger people. By contrast, the Scandinavian countries, the Baltics and Germany are doing much better, and they look like more of a magnet for the young (see Chapter 4). Statistics on youth unemployment tell a similar story to the measured ratio of those not in employment or education; in other words those who are so discouraged that they opt out of the formal labour market and training altogether (see Figure 2.3). But even the

Figure 2.2



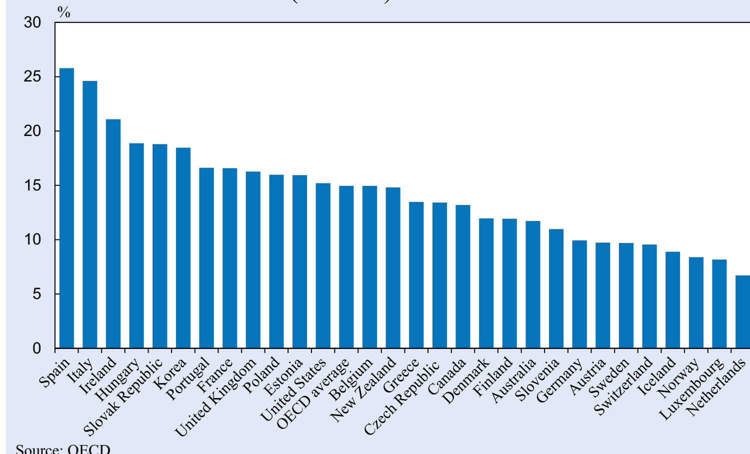
Source: Eurostat.

continued education of the non-NEETS may not be an altogether positive sign, as it may simply represent a way of escaping the dismal realities of the labour market. The cyclical response of youth unemployment (relative to aggregate unemployment) was generally not that different during the Great Recession to past business cycles – but clearly the large number makes the problem more visible. The Great Recession thus highlighted a fundamental pre-existing weakness (and perhaps spurred reform initiatives).

The stasis and rigidity of labour markets also interacts with a deficiency in human capital. It is difficult to establish which is cause and effect: it could be either that poor employment prospects act as a deterrent to obtaining better qualifications, or that the absence of qualifications makes young people less attractive on the labour market. Improving education might be a way around the problem of the gerontocratic society and polity, but it obviously needs to be the right education and not simply a diversionary substitute in the absence of employment (see Chapter 3). Educational attainment in Italy was poor by international comparison: in 2000, only 36 percent of adults had finished secondary education, compared to an EU average of 42 percent; for higher education the figures were 10 and 20 percent respectively (although there has since been some improvement in the Italian figures: the respective proportions were 42 and 16 percent in 2012). Other indicators of skill levels demonstrated a lag compared with northern Europe. Three quarters of Italian enterprises carried out no vocational training.

But we do know what happens to the most skilled young people: many of them emigrate from societies with high levels of youth unemployment, indicating that the causation may flow from the institutional features of the labour market to the proclivity to seek qualifications. About 60,000 young people are thought to emigrate annually from Italy, over two thirds of them with college degrees. The outflow of the young is driven partly by very high rates of youth unemployment; but also by a sense that society is organised to marginalise them. The high rates of outflow are also characteristic of central and eastern Europe, where the "brain overflow" even affects economically dynamic countries such as Poland (Kaczmarczyk and Okólski, 2008).

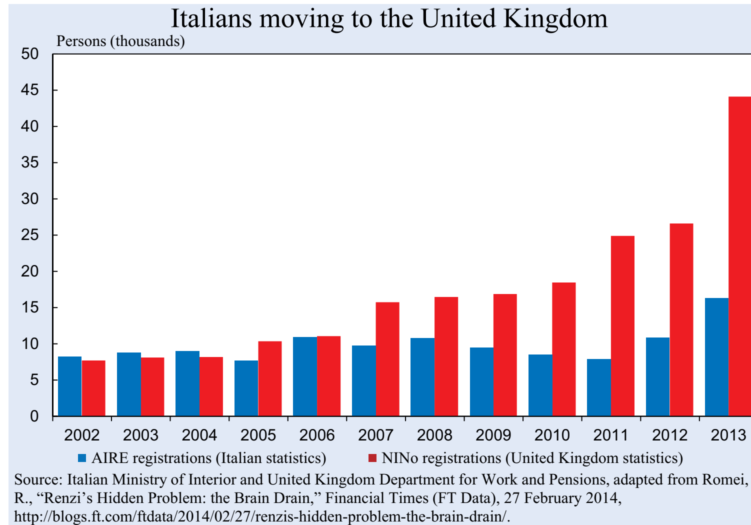
Figure 2.3



Source: OECD.

The figures on the flows are very unreliable, and thus only give a rather impressionistic view of the phenomenon. The data in the countries of origin are strikingly incomplete, as many of the emigrants (unlike in the classic emigrations of the nineteenth century) do not announce their intention to emigrate. A comparison between the official Italian figures and applications by Italians for United Kingdom National Insurance Numbers (NINos) shows

Figure 2.4



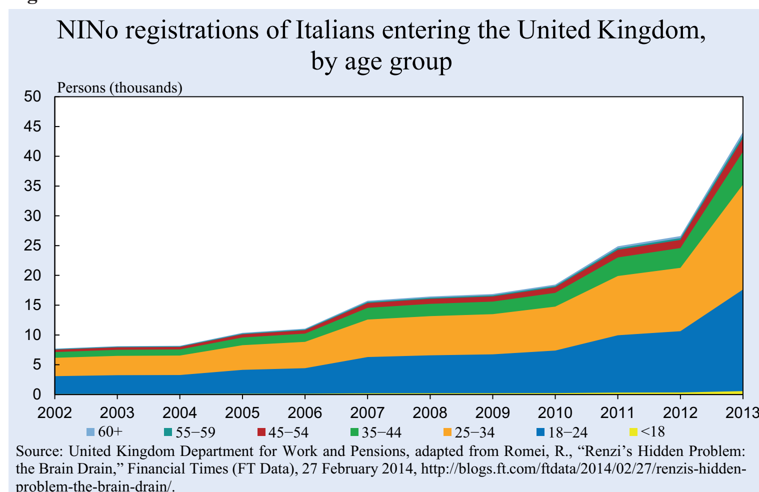
Source: Italian Ministry of Interior and United Kingdom Department for Work and Pensions, adapted from Romei, R., "Renzi's Hidden Problem: the Brain Drain," Financial Times (FT Data), 27 February 2014, http://blogs.ft.com/ftdata/2014/02/27/renzis-hidden-problem-the-brain-drain/.

a discrepancy of a factor of four, as well as different trends: the United Kingdom data suggests a consistent rise in outflows during the period of the financial crisis (see Figures 2.4 and 2.5). The overwhelming (and increasing) share of this outflow is young, aged 18–24, with a smaller share of 25–34. There are almost no over-35s. This data is merely illustrative: the United Kingdom receives fewer Italian immigrants than Germany, Switzerland, France and Belgium.

The emigration of the young and talented makes the demographic pyramid even more problematical, and raises the question of how social security systems will be financed in the future.

The phenomenon of youth exit as a response to gerontocracy was evident even prior to the euro crisis. In a widely discussed public letter to his son published in 2009 in the newspaper *La Repubblica,* the head of Rome's LUISS university Pier Luigi Celli wrote: "This country, your country, is no longer a place where it's possible to stay with pride ... That's why, with my heart suffering more than ever, my advice is that you, having finished your studies, take the road abroad. Choose to go where they still value loyalty, respect and the recognition of merit and results."[2] After the outbreak of the crisis, the exodus increased.

Figure 2.5



Source: United Kingdom Department for Work and Pensions, adapted from Romei, R., "Renzi's Hidden Problem: the Brain Drain," Financial Times (FT Data), 27 February 2014, http://blogs.ft.com/ftdata/2014/02/27/renzis-hidden-problem-the-brain-drain/.

The exodus of the young is obviously a phenomenon that could be reversed: Ireland, for instance, suffered from this problem in the 1980s, but as the economy grew sharply at the end of the twentieth century, many skilled Irish workers returned and contributed to economic growth. In order for that reversal to take place, however, the societies of origin have to change in order to become more open and more innovative. The more their politics is under the sway of the old, the less likely that is to happen. This is the first feedback loop that makes for the self-reinforcement of the gerontocracy.

The newer northern European model of greater labour market flexibility with higher benefits for those seeking work (a safety network) has been more effective in reducing the potential for the exclusion of younger people from the social contract. That model also deals more successfully with the education part of the social contract. By contrast, the gerontocratic politics of southern Europe protect vested (middle-aged) interests, and have been counterproductive and endanger long-term sustainability.

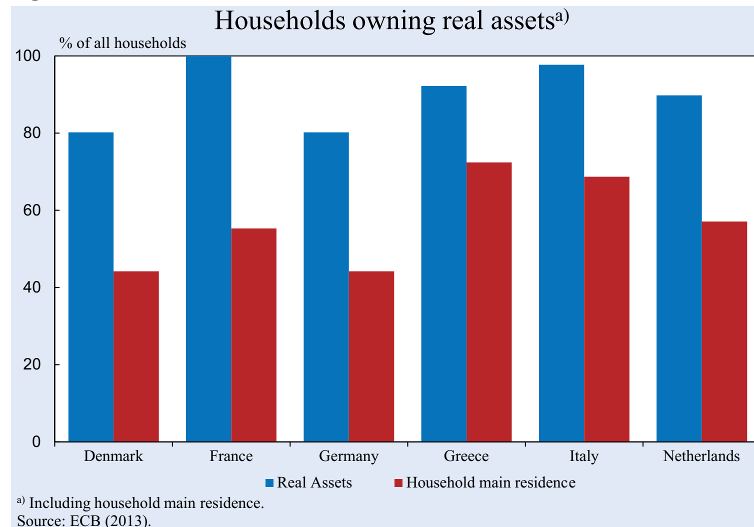
2.4 "Hotel Mama": property ownership

If the labour market in gerontocratic countries pushes young people out, they are sometimes kept back by the structure of

[2] Celli, P. L., "Figlio Mio, Lascia Questo Paese," *La Repubblica*, 30 November 2009, http://www.repubblica.it/2009/11/sezioni/scuola_e_universita/servizi/celli-lettera/celli-lettera/celli-lettera.html.

property ownership: not that they own property, but rather that they expect to inherit property. Property accumulations are held largely by older people, who might be thought to provide for their old age in realising the assets accumulated over their lifetime. But home ownership is particularly problematic. In the absence of financial innovations such as reverse mortgages it is hard for the elderly to realise their assets; and old people may be locked into over-ample housing that they cannot use and, in some cases, even maintain as a result. Habit formation may imply that the old stay on in "large" houses/apartments – or smaller alternatives may not be available in the neighbourhood. There is thus an inefficient allocation of housing resources, with dwellings that are too big for the old and unavailable to the young. The locking in of property means that it becomes harder for subsequent generations to make their own starts on the property ladder; and the younger employed or unemployed (Section 2.3) are especially disadvantaged.

Figure 2.6



[a)] Including household main residence.
Source: ECB (2013).

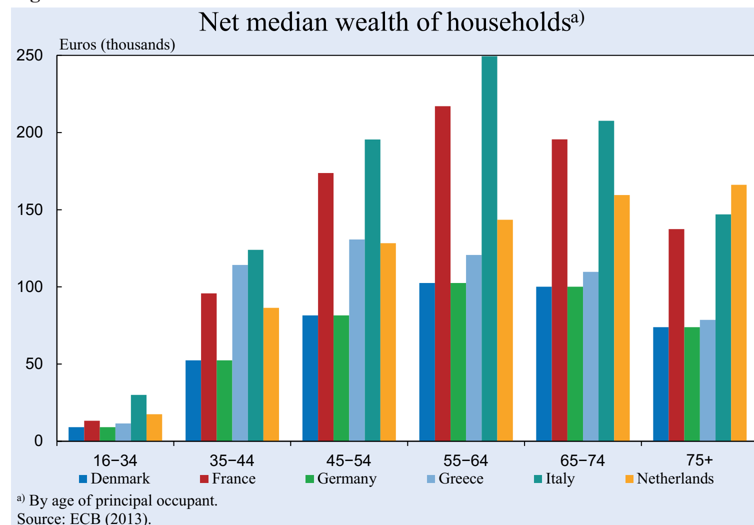
These developments and their effects differ substantially throughout Europe. Property ownership, and in particular real estate, plays an important part in the accumulation of family wealth, but not everywhere. Real estate ownership varies substantially from country to country; it is notoriously low in Germany and Austria, relatively low in France, but higher in southern and (perhaps surprisingly) in eastern Europe (see Figure 2.6).

The ownership is concentrated in the older age cohorts. It falls off after the age range 55–64, but by less than the classic life-cycle hypothesis of Modigliani and Brumberg (1954) would lead us to expect: in other words, heads of household tend to retain substantial assets that they intend to pass on to future generations.

The phenomenon of high concentration of property in older cohorts is particularly striking in the Benelux countries, but also in some Mediterranean countries (see Figure 2.7). In Germany and Austria, the wealth of the 75+ year-old age group is strikingly lower than elsewhere, a phenomenon which the Bundesbank has tried – slightly oddly – to explain in terms of the legacy of a wartime generation (the 75+s in 2010 were born before 1935) that was not able to make an initial accumulation of wealth because of migration; more importantly perhaps, this generation did not inherit substantial amounts from its predecessor (Deutsche Bundesbank, 2013, p. 23).

Children have to "wait" a long time, often until late middle age or even after their own retirement, before they can realise the wealth that they think of as part of the family contract. With increased longevity, the waiting period grows longer. In the classic form of the family transfer union, the children are thus held in a

Figure 2.7



[a)] By age of principal occupant.
Source: ECB (2013).

state of dependency for a long time (unless they seek to escape).

In the gerontocratic societies in particular, young people find it hard to afford housing, and young men in particular often stay at "Hotel Mama" into their thirties or forties as a result. They form a "boomerang generation" or "jilted generation", gathered in "accordion families" (i.e. they are continually contracting and expanding). In France, the outcome is known as the "phenomène Tanguy" (after a popular film depicting a nerdy son), while in Japan it is referred to as that of "parasite singles". This pattern of behaviour is common to both southern and eastern Europe (formerly communist economies), with surprisingly high proportions of 25–24 year olds living with their parents; it is rather rare in northern Europe. The United States and Japan lie in between these extremes. In every country, men are more likely to boomerang than women. The Hotel Mama occupants are also less skilled, and more likely to be unemployed.

There may be reasons to think that Hotel Mama is a good outcome in that it strengthens inter-generational solidarity. Multi-generational households were also a striking feature of the pre-industrial world. But today, it generally does not look like a very attractive option, and in reality, it often coincides with family breakdown that is more characteristic of lower income groups. As the rapper Macklemore put it: "It's not dope to be 25 and move back to your parents' basement."[3]

In fact, the Hotel Mama phenomenon is part of the overall individualisation of society, and a reflection of the increasing fragility and disintegration of the concept of the modern nuclear family: however unattractive the return to the parental home is, it is easier than leaving it to form a new couple/family. The marrying age rises sharply, and the formation of family units decreases. The family – a central part of the traditional picture of the contract across generations – is thus subject to what amounts to an effective penalty, a penalty that is higher in lower income groups and that, in this sense, contributes to enhanced inequality.

Many explanations have been given for the rise of Hotel Mama. They include shortages of affordable housing, including rentals, as well as difficulties in registering new residences. Rent control can obstruct an adequate supply of new apartments. Declining rates of marriage and higher ages at first marriage might play a role. There are more singles among the middle and old age groups, and city living (agglomeration) seems to make a single existence more attractive. The non-availability of child care could also be a factor in keeping married children with their parents (an especially eastern European phenomenon). The property price trap particularly affects the inhabitants of big booming metropolitan centers; it can scarcely hold true for a great deal of rural Europe, where – out of easy range of big cities – property prices are falling, and villages and small towns are being depopulated. But in the United Kingdom, London has the lowest proportion of adult children living with their parents. The precarious labour market for young people is also to blame (see Section 2.1). Some argue that the phenomenon of the precariat that produces this outcome is the result of big companies and globalised capitalism; and that only effective Nordic welfare states can provide any amelioration (Newman, 2012). There are also cultural explanations that seem much older: for instance that Italy has a well-developed culture of *mammismo*.

Here we can identify a second vicious cycle diametrically opposed to the first: in this cycle, young people are trapped by the interaction between the labour market and the housing market, so that they stay at home, and do not search for the kind of jobs that might generate greater overall prosperity. If the first cycle identified was that of the exit or exile option, this is the internal exile choice.

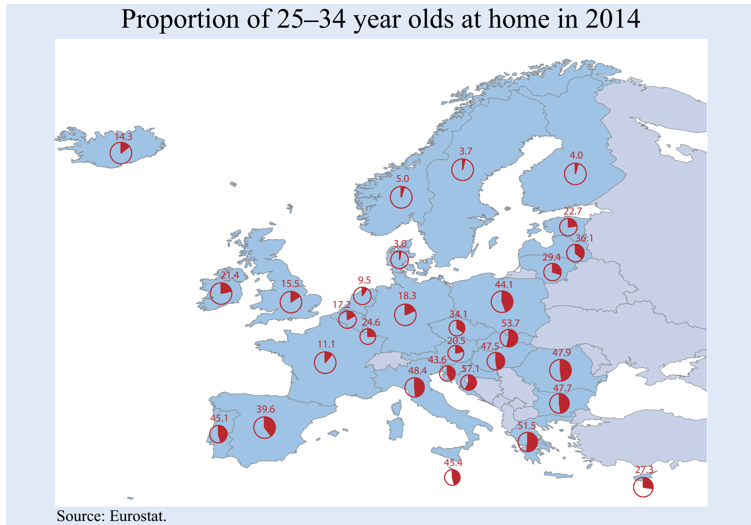
Ultimately, the phenomenon reflects some aspect of the inadequate economic opportunities and capacities open to young people. Some analysts conclude that the state has a responsibility to make expand those opportunities, by orienting the welfare state more towards the young and by providing greater encouragement of job training and searching for productive employment.

The discussion of how the welfare state might contribute to the hotel mama phenomenon requires some refinement. It is in cases where the principal element of the welfare state consists in payments to the old – largely through pensions – that the mobility of young people and their ability to set up independent households are most reduced.

The over-dependence on property, and particularly on real estate as the preferred safe and high yielding mode of asset accumulation, leads to a misallocation of resources and a trap that helps to keep young peo-

[3] From the song "Otherside".

Figure 2.8



Source: Eurostat.

tee a certain increase, even when there is a low cost of living increase. Between 2007 and 2014, in every European country except Poland (where there was a slight decline) and Malta (no change), the relative median income of pensioners has risen, in many cases significantly. In France, Greece, Hungary, Luxembourg, Romania and Spain the ratio is over 1. In many countries, the increase was a result of the phasing in of labour market pension schemes, and was thus an intended consequence to increase replacement rates. In the United Kingdom, where the Eurostat figure for the ratio is only 0.86 for 2015 the Institute for Fiscal Studies estimated that the median income of pensioners (394 British Pounds per week) was higher than the median income of the rest of the population (385 British Pounds per week). A prominent conservative politician David Willetts responded to the publication with the comment that the United Kingdom had become "a country for older generations."[4] In many countries, including Europe's most dynamic economies, the cost of the financial crisis in terms of reduced earnings has fallen on the young, rather than the old (see Figure 2.9). A recent report by the Resolution Foundation (United Kingdom) on the income effects of the financial crisis accordingly reported a 12.5 percent decline in the in-

[4] Willets, D., "Pensioners Prosper, the Young Suffer. Britain's Social Contract Is Breaking," *The Guardian*, 24 October 2015, http://www.theguardian.com/commentisfree/2015/oct/24/young-bear-burden-of-pensioner-prosperity.

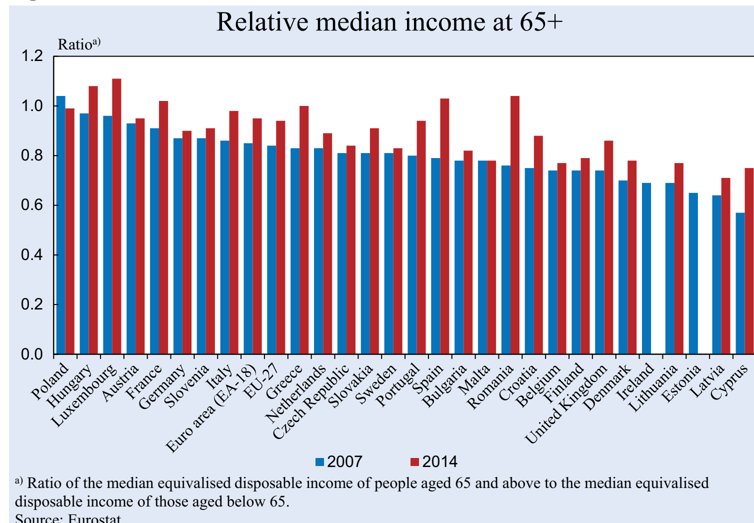
ple at home. Incentives to reduce the blocking of housing by the old include the possibility of reverse mortgages, but also higher rates of property taxes (which are often a political taboo in southern Europe). The generational allocation of housing is another area where the northern or Scandinavian social model performs better (see Figure 2.8).

2.5 "Bank Grampers": pensions

Old age pensions amount to a considerable part of government spending on social transfers. In most countries – the exceptions are Italy and Spain (where the share falls dramatically after 2000) – the tendency is for that proportion to rise. There are two causes of this tendency. In part the trend simply reflects the ageing demographic pyramid, but this fact and the general improvement of health in late middle age in industrial societies suggest an obvious solution to the problem: that retirement ages should be raised. This conclusion has been reached by almost every commission or think tank that issues reports on the pension funding problem (for example Pensions Commission, 2004), and many countries have introduced some form of age indexation pushing up pensionable ages.

In addition, pensions have increased because of provisions that often both index and guaran-

Figure 2.9



[a)] Ratio of the median equivalised disposable income of people aged 65 and above to the median equivalised disposable income of those aged below 65.
Source: Eurostat.

comes of 22–29 year olds between 2009 and 2014, and identifies them as a "jinxed generation;" while the incomes of over-60 year olds only fell by 3.7 percent.[5]

The problem is not simply one resulting from the financial crisis, but also a longer term question of the adjustment of pensions in the light of changes in economics and demography (lower expectations of growth, higher longevity). Many countries are trying to tackle pension sustainability by moving away from defined benefits systems to defined contributions for supplementary pensions (above a welfare minimum), in other words by transiting from PAYG to funded schemes. The debate over raising retirement ages is going on almost everywhere. But social benefits for old age as a proportion of total social payments have been rising in many countries (with the striking exceptions of Germany and Greece) (see Figure 2.10).

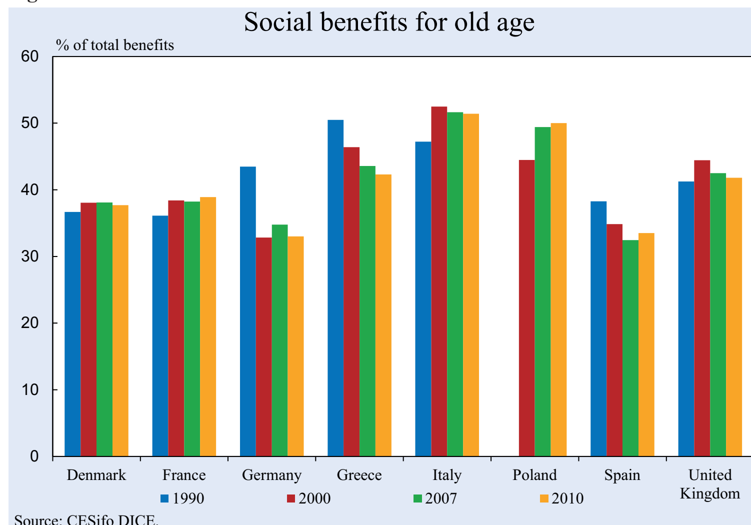
There are two obstacles to tackling even a simple issue such as adjusting the retirement age to demographic development. One is actuarial, and follows from the uncertainty surrounding projections of future life expectancy. It is hard to predict the future development of mortality and longevity, and hence to calculate an appropriate pension base. Thus an OECD calculation suggests a 4.5 year increase in longevity by 2050, with an implication of an increased pension cost of 3.4 percent of GDP, while an alternative calculation by Tuljapukar et al. (2000) suggests 7.5 years and a cost of 4.4 percent; and a simple extrapolation of the linear trend in declining mortality gives 11.0 years and 5 percent (Lee 2007). Population projections in recent years have tended to be upwardly adjusted as regards longevity, i.e. increases in longevity have been higher than anticipated.

[5] See Resolution Foundation (2015) and Cosslett, R. L., "Does the Government Hate Young People? It Certainly Feels that Way," *The Guardian,* 16 October 2015, http://www.theguardian.com/commentisfree/2015/oct/16/government-young-people-student-loans-housing.

The second barrier to tackling the retirement age is the fact that the future of public pensions is intrinsically connected to developments in other modes of pension provision: company schemes and individual pension savings plans. Both were widely hailed as a desirable reform that would secure the adequate funding of retirement in a new demographic environment, and were at the heart of many countries' pension reform plans that sought to move away from a dependence on publicly-funded PAYG schemes. The adoption of alternatives was part of an attempt to move away from defined benefits. But both the alternatives are currently under pressure. Public policy requirements that company pensions (the second pillar) meet certain guaranteed performance criteria have made it increasingly unattractive for companies to offer such provisions. While older workers may be grandfathered into older and more generous schemes, these are not available to new hires. Private pension schemes will equally be endangered by continued low interest rates. Both developments mean that more retirees will be dependent on public schemes, and the political pressure not to cut such schemes is higher.

In normal times pensions became a political third rail: an attempt at adjustment (by raising the retirement age, for instance) was politically impossible. Some countries that introduced such a reform later had to retract the change, because opposition featured prominently in the election campaigns of parties that were propelled into government by the voters of the elderly. Germany undertook such a move in 2007, with a provision for a gradual raising of the retirement age from 65 to 67. After the formation of a new Great Coalition government in 2014, the measure was retracted and provisions introduced for full pensions – under certain circumstances – at 63. In 2015, as one of its first acts, the newly elected right populist Law and Justice (PiS) government in Poland reversed the 2012 pension age increase. Other countries like the United Kingdom have introduced

Figure 2.10



Source: CESifo DICE.

special pensioners' bonds that pay a higher rate of return in order to try to preserve private pensioner earnings in the face of the general reduction of interest rates. It is not difficult to see that both the German and the United Kingdom measures are driven by competitive electoral pressures to woo the "grey vote".

In crisis countries, with high rates of youth unemployment, the pensions of older people (grandparents) are used as a source of income for much wider family groups, and cuts consequently generate an even greater degree of political resistance, so that not only the grey vote threatens actuarial calculations on the adjustment of pensions.

Pension reform, especially in southern European countries, has become a standard part of the response to the government debt crisis. One of the reasons that it has been so sensitive politically is that it interrupts the family transfer union. In most of the crisis countries, pension reforms involve a raising of the retirement age, usually involving an equalisation of retirement ages between men and women, the limitation of provisions enabling enhanced payments, and adjustments to provisions for earlier retirement on public pensions if a specific number of years' payments has been made.

Greece had a uniquely complicated system, with 133 separate public pension funds before the crisis. As part of the agreement with the troika (European Commission, International Monetary Fund and European Central Bank), the government embarked on an initial round of reforms in 2010, whereby the retirement age for women was immediately set at 65, the same as the age for men, and pensions after 2012 were linked to GDP fluctuations. In addition, there were reductions and special taxes on higher pensions, with penalties for early retirement before 60, a practice that had been widespread before the financial crisis. In 2012 Greece made further cuts in higher level pensions and increased the retirement age to 67; it was only then that a hard commitment to coordinate pensions through the use of a social security number was undertaken. In 2014 Greece committed to the requirement that, as of the beginning of 2015, supplementary pension funds would only be financed by own contributions.

In Italy, the 2011 reform set the retirement age for men at 66, with women reaching that age by 2018. The payment moved to a defined contribution *(contributivo)* for employees hired after 1996, while the defined benefits were kept for earlier payments of older workers. But many of the additional commitments to a long-term schedule of raising pension ages, such as in Spain where 67 is the age that will be mandated by 2027 or in both Italy and Spain where the retirement age is to be linked to life expectancy, are problematic in the sense that they may be reversed. In both Greece and Portugal, constitutional courts were used to reverse important parts of the pension reforms. (This is not just a European issue: courts in the United States have also intervened to block cuts in public sector pensions.) As European countries exit from crisis programmes with the International Monetary Fund, there will be more political leeway to reconsider the pension question. In addition, reductions in pension entitlements are also often compensated for by increases in other forms of transfer, notably disability payments.

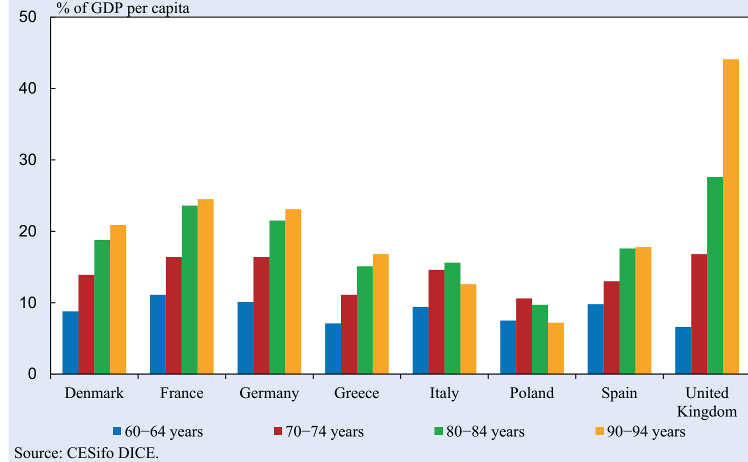
Shifting the bulk of pensions (including public sector pensions) from defined benefits to defined contributions is a prerequisite for the long-term sustainability of the pension system. Sustainability also requires a shifting to higher retirement ages. The easiest way of protecting both moves from political pushback is by setting Europe-wide norms, but that mechanism is also susceptible to political pushback.

2.6 Paying for grampers: medical insurance

Medical insurance is also a way of making transfers to older people. For most of their lives, people pay in to explicit or implicit (welfare state) insurance schemes, including state schemes. In old age, and in especially at the end of their lives, they become recipients of payments. Technical change means that an increased variety of treatments and procedures are available that are also more expensive. Most medical expense occurs in the last years of life, although obviously it is not always clear with medical interventions whether they will be made or not in a terminal case. The rising costs are putting medical care systems under pressure in every country.

Medical payments – both in absolute terms and expressed as a proportion of per-capita GDP – are higher in the richer countries (with the United Kingdom as an outlier on the high side), and very low in most formerly communist countries (see Figure 2.11). Advances in medical technology, with a wider and more expensive range of treatment options, are pushing up costs. Prosperous societies are in a better posi-

Figure 2.11



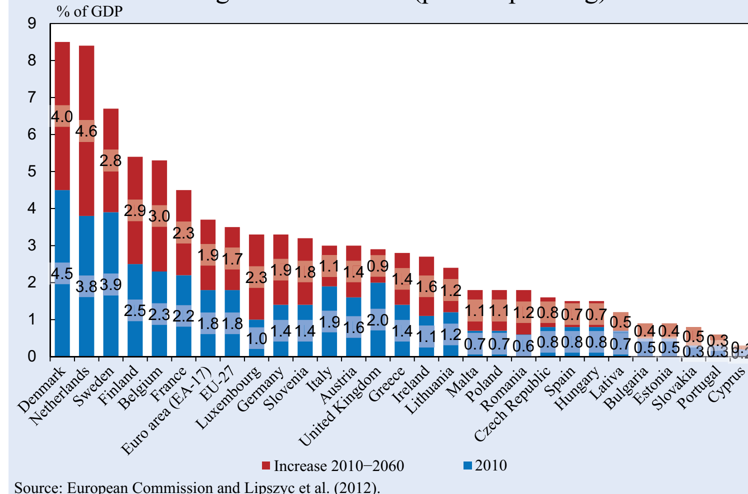
Source: CESifo DICE.

tion to realise the benefits and general welfare gains, but the advances also clearly pose a funding problem.

Like pensions, state provision of medical insurance was intended to help people escape from dependence on their family in old age. In practice, the combination of pensions and medical benefits has allowed individuals to preserve larger shares of their accumulated assets, which are then available as legacies. In this way, the young are held in a kind of dependence.

The United Kingdom, which is comparatively an outlier in terms of the high cost of care and medical treatment in old age, has been propelled by the expense of the medical liability to embark on a much stricter programme whereby old people's assets are used to pay for their long-term medical care, and hence leaving less available as bequests to children. But the reform was also linked to a ceiling on the amount that an individual would pay for long-term care, so as to preserve some assets that could be bequeathed.

Figure 2.12



Source: European Commission and Lipszyc et al. (2012).

Medical costs are also rising due to the individualisation of societies: in many countries, hospital beds are occupied by elderly and fragile people who are not critically ill, but cannot safely be released because they live on their own without anyone to care for them. There is more generally the probability that an increasingly large sector of the elderly population will require long-term care (see Figure 2.12). The rise predicted is especially steep for the Scandinavian countries. That care can either be financed through the development of an insurance system featuring higher payments by current mid-generation individuals; or through the rigorous enforcement of a means-tested and means-based payment system, designed to mobilise the locked-in assets of the elderly (Section 2.2).

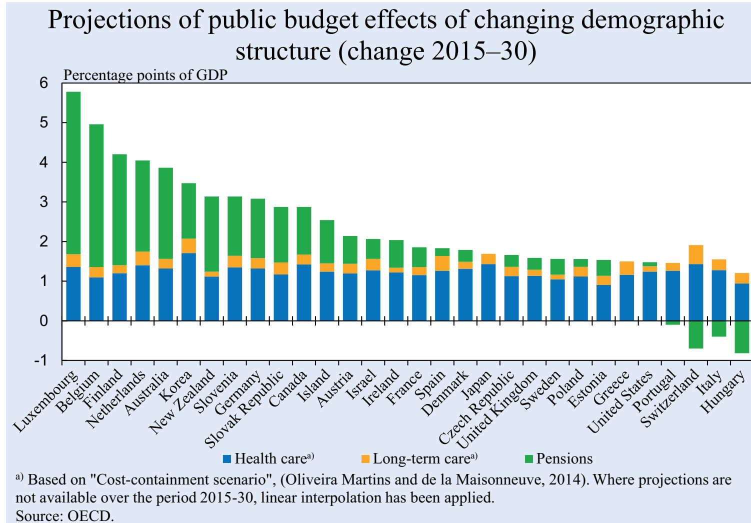
The combination of health and retirement costs is increasing fiscal pressure, which is likely to be particularly severe in some northern European countries, including the Benelux countries, the United Kingdom and Norway (see Figure 2.13).

The health care explosion will disproportionately affect the most prosperous European countries, and they too are likely to face the prospect of exit, especially by skilled younger people (see next section). They will need to consider some combination of importing cheap labour for healthcare or the mechanisation/robotisation of healthcare.

2.7 Running away from grampers: debt dynamics

There is an intergenerational aspect to debt. Public debt represents a commitment by taxpayers in the future to make payments

Figure 2.13



[a)] Based on "Cost-containment scenario", (Oliveira Martins and de la Maisonneuve, 2014). Where projections are not available over the period 2015-30, linear interpolation has been applied.
Source: OECD.

for goods and services that have been supplied in the present. As a result, an argument is often made that debt financed activity should be confined to investments – for instance in infrastructure – that will produce substantial returns for future citizens. Debt financed growth can pay down debt; but in the absence of that growth, a vicious cycle sets in. If debt produces a promise of larger future burdens, it will prompt those who are bound to shoulder those burdens to try to escape: or in Albert Hirschman's terminology to "exit" (cf. Hirschman, 1970). But that choice will make the predicament worse. When productive and innovative (young) people abandon their country, they leave behind a highly indebted country. Now the debt has to be paid off by a smaller, less productive, ageing population. In a sense, individual citizens have the option to "walk away" from their government debt obligation by leaving the country. Emigration can be seen as an individual's "private default option" on government debt.

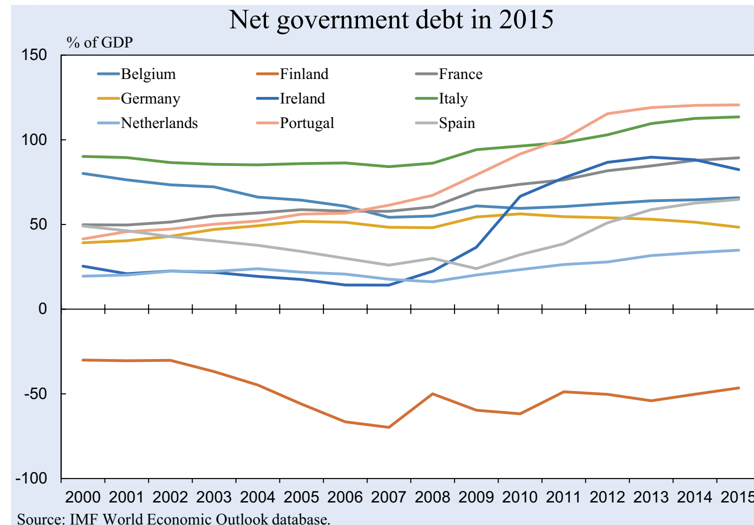
Emigrants also walk away from infrastructure financed by previous generations. If that infrastructure is extensive and well-designed, would-be emigrants have incentives not to move and to stay with a free gift from the past. In cases where, however, flawed investments in inadequate infrastructure in uneconomic areas predominate, the incentives are to move away. The extensive debt-financed infrastructure investments for Greece's Olympic Games in 2004, crumbling stadia and swimming pools, do not constitute a strong argument for young people to stay in Greece.

However, individualised education and the accretion of human capital – another important investment by the welfare state – are movable. Some European countries with education systems that are generally recognised as superior – such as Finland – suffer from the problem that highly educated young people take the exit option and withdraw their accumulated human capital, without contributing in taxes to financing the education of the next generation.

Emigration has strained welfare provision within national states. Germany's eastern Länder and the Italian *Mezzogiorno* are also predominantly areas where the young move and the old remain. In the case of nation-states, social and medical services are provided by budget transfers, so that taxpayers in the more prosperous and dynamic areas shoulder the financial burden. This burden sharing currently does not take place in the case of cross-border or international migration. Debt burdens vary substantially between countries (see Figure 2.14).

The ability to exit debt in an economic area constituted by high labour mobility provides one of the clearest arguments for the partial mutualisation of debt. The

Figure 2.14



Source: IMF World Economic Outlook database.

alternative would be to move to a contributions-based insurance system of old age pensions on a cross-national or European basis.

2.8 There's nowhere in the world to run: sustainability

The phenomena of advantages for the old at the expense of the young, as described so far, exist at the national level and are a result of national choices about education, pension, medical and tax regimes. But there is also a global sense in which today's middle-aged population is living at the expense of subsequent generations. The build-up of environmental damage is often interpreted as a burden that today's generation is imposing on its successors without that cost having been unambiguously calculated. The current generations do not internalise the costs.

Processes such as global warming will require costly adjustments by subsequent generations. Some argue that these high costs could be avoided by relatively small investments today. The failure to make these present day investments is effectively a tax on tomorrow's generation – a generation that is already being starved of life opportunities because of the way in which incentives are currently structured.

The landmark 2006 report by Nicholas Stern suggested that the eventual costs of global warming would amount to around 5 percent, and perhaps – in a catastrophic scenario – up to 20 percent of world GDP, while tackling the problem today would have a much lower present price tag (1 percent of GDP), cf. Stern (2006). But there are major difficulties in devising programmes that will really lead to environmental sustainability.

Some attempts to deal with the problem – like holding out the prospect of a radical reduction in the use of carbon emitting fossil fuel in the future – make the problem worse. Hans-Werner Sinn's Green Paradox examines the way in which the perception that an energy product such as petroleum will not have any value in the future prompts an increase in present production (Sinn, 2012). The resulting price pressure also constitutes a gain for today's consumers at the expense of tomorrow's population. The discussion of long-term sustainability highlights the urgency of current measures to reduce the sources of global threats, particularly in the area of CO_2 emissions.

2.9 Conclusion

Many aspects of the challenge of generational equity have been handled well in Denmark, or more generally by the Scandinavian model (see Chapter 4). This especially applies to labour market and housing issues. The co-existence of successful and unsuccessful models might be seen as a way of showcasing policy best practice, and enhancing the reform drive in less successful cases. But the process of institutional adaptation is complex, and also painful. The more pain exists, the greater the likelihood of a mass exit by individuals – and reduced overall sustainability. That threat is a powerful inducement to a search for overarching cooperation on Europe-wide retirement insurance that transcends national boundaries and corresponds to a high degree of inter-European labour mobility, and in the end to move towards something akin to the fully integrated United States social security system. Global threats (on climate sustainability) also require global solutions, and cannot be resolved on a solely national, or even on a European level.

Europe may be confronting a radical choice over where the responsibility lies for enforcing an effective and just social contract. On the one hand, there is the option of continuing with the old pattern of competing national examples, which has produced very successful institutional adaptation in the past, but which in a world of high mobility is threatened by the possibility of exit from policy failures. On the other hand, there is the option of Europeanising some part of the intergenerational contract and, at the same time, protecting it from political interference – an interference that is characteristic not just of states with poor performance and failed policies, but also of apparently successful economic models. It is currently rather hard – perhaps even impossible – to see the national state in Pigouvian terms as "protecting the interests of the future in some degree against the effects of our irrational discounting and of our preference for ourselves over our descendants."

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