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Challenges for social security

The third millennium began after a decade marked by mass unemployment and the crisis of the welfare state, not least among the European countries, and by increasing economic and social inequalities worldwide. Since the beginning of the 21st century, financial markets have been plagued by increased insecurity. But insecurity is increasing also in other spheres of society. Today, the first year of insecurity since 11 September is coming to an end. For these and other reasons, the aim of stimulating debate and discussion on the foundations of social security appears both warranted and welcome. I will approach the subject by advocating a single strategy rather than outlining many different alternatives, notwithstanding that alternatives exist. The views expressed here are my own, based on comparative research on social security in general, and on the Swedish case in the 1990s in particular.

In the most advanced industrialized nations, the systems of social protection are being challenged by many different factors in addition to those mentioned previously. Populations are aging, which means pressure to increase public spending on both transfer systems and care services. People are leaving employment at progressively lower ages, at the same time as it has become more difficult for young persons to get paid employment. Declining birth rates are problematic not only in terms of maintaining a balance between workers and retirees in the future, but also as an indication of a failure to support families in child bearing ages. In addition, divorce rates and single-parenthood are increasing. High levels of unemployment are accompanied by poverty and social exclusion, not least of immigrants. Changes on the international scene are putting restrictions on what national governments can do but may also open up new opportunities. History shows that reforms of social security are responses to changing economic and social structures, as well as political mobilization. The important phases have clearly involved elements of learning from abroad, i.e. dissemination of ideas and models. If today's governments do not respond to the new challenges, important common achievements will be jeopardized. How different countries respond and what they achieve are relevant to both developed and developing nations.

The Nordic model and the crisis of the welfare state

Sweden and the other Nordic countries have established a universal model of social protection, where benefits and services based on residence are combined with earnings-related social insurance. This universalism emerged as a response to the contrasting needs of both rural and urban populations, as well as to political mobilization of these interests. Similarly, in the post-war period, earnings-related social insurance has constituted a strategy to include both self-employed workers and salaried employees, and he public and private sectors, within the same system of protection. The expansion of services has partly been a response to aging populations but is also intrinsically connected to the growth in female labour force participation as well as to women's participation in politics. Hence, social security programs have been founded on universal guarantees of benefits and services, combined with earnings-related social insurance. As a result, broad interest coalitions are embedded in these institutions.

This model has been successful in combating poverty and social inequalities. This is exemplified by declining poverty rates among families with children and among the elderly. These groups represent the phases in the life-cycle that historically have been the most poverty-stricken and where large variations from country to country can still be found, even among the most advanced industrialized nations. It appears that the model of including the better-off in systems of social protection has been more successful in terms of reducing social inequalities than models more exclusively oriented to the poor. But the success of the model cannot be explained without understanding how employment and participation, particularly among women, have been promoted through improved incentives, investment in human resources, expansion of social services and improved opportunities resulting from growth in employment, not least in the social service sector.

Yet social security has recently been in 'crisis' among the Nordic countries as elsewhere. In the 1990s, Sweden experienced the most severe macroeconomic crisis since the 1930s. Between 1990 and 1993, employment declined by 13.0 per cent. Open unemployment rose from 1.7 to 8.3 per cent and, in addition, the proportion of the labour force affected by active labour market policy measures increased from 2.9 per cent to 6.1 per cent. The GDP growth rate was negative three years in a row. The employment crisis had a powerful impact on public finances, as the downturn in employment led to a massive increase in public expenditures, as well as to drastically eroded revenues. This resulted in a rapidly increasing budget deficit. The budget went from a surplus in 1990, to a deficit of more than 13 per cent of GDP in 1993. At the same time, large shifts occurred in the population's age structure that added to the demands placed on social programs. Moreover, numerous conflicts and civil wars around the world meant that Sweden - at a time when unemployment peaked - received the largest waves of refugee-immigrants in its modern history. This immigration brought pressure to bear on many social institutions, especially as many immigrants experienced considerable difficulties in getting jobs.

The employment crisis put heavy pressure on social security, which in turn triggered government review and action in virtually all these programs. During the crisis, a series of large cutbacks were imposed. In the second half of the decade, restorative action was taken in several cases, which means that by and large the difference between the beginning and end of the 1990s was not very marked. The changes varied from area to area but in general they affected the levels and periods of compensation as well as qualification requirements. On the whole, the changes were very large in number and tended to limit generosity, but their magnitude was small.

It would hence be misleading to conclude that Sweden has abandoned its model of social security. Universal social services and benefits, in conjunction with earnings-related social

insurance, still dominate the system. However, certain decisions, as well as non-decisions, might trigger more systemic change in the longer run by changing the constellation of interests surrounding social institutions. It might be that non-decisions are most important from a model perspective. As ceilings in social insurance systems remain fixed in nominal terms, and real wages increase, an increasing number of citizens have earnings above the ceilings. This in turn might in the long run transform earnings-related systems into flat-rate ones, presumably shifting the responsibility for insurance to private schemes and possibly eroding existing broad support for public systems.

Sweden has often been noted for a low degree of inequality and a high degree of social inclusion. The crisis evidently had a profound negative impact on people's welfare but this was at the same time bolstered by various social programs. Income inequalities did not increase as a result of the crisis as such but rather during the recovery.

Changes and decisions in the outside world undoubtedly affected economic development in Sweden. But with the exception of Finland, the depth and range of the crisis was unmatched among the most advanced industrialized countries. This strongly suggests that decisions and processes at the national level had a decisive impact on the course of the crisis. It should be emphasized that macroeconomic developments in the 1990s had a very appreciable impact on the welfare sphere. This applies both to the resources available to social policy systems and to the living conditions of individuals and families. Unemployment affected all sections of the population but the prolonged labour market crisis had a particularly negative effect on the welfare prospects of vulnerable groups in society. For the future, one conclusion is that when important macroeconomic decisions are to be made, there is every reason to carefully consider their consequences for welfare development in a broad sense, including indicators of health and other aspects of welfare along with the usual indicators of economic resources and employment.

A framework for the reform of social security

I would argue that the crisis has highlighted dilemmas for present and future reforms. What is needed is a strategy for resolving these dilemmas without diluting the socio-political and moral content of the welfare state. In order to identify important elements – a framework - for such a strategy, it may be fruitful to start from the idea that success in meeting new needs with restricted resources, as well as in avoiding trade-offs between equality and efficiency, requires improved incentives, human resources, social services and employment opportunities.

How can this be achieved? The underlying goal in strengthening social security should, in my view, be to maintain, and when necessary restore, the universal approach to social protection. By this is meant, not only that entire populations should be covered within the same framework, but also that benefits and services should be adequate enough to really provide protection for people in different situations and with different income levels. In order to make the system of protection work in practice, it is vital that we find techniques that, in essence, help to increase the number of taxpayers and, whenever possible, to decrease the number of benefit recipients.

A central question when it comes to the incentive structure is how to avoid poverty traps. A rule of thumb is to use universal benefits and services rather than means-tested ones. The reason is that as soon as we start means testing, it will affect the advantages of low-income persons particularly - often women - of engaging in paid employment. Another strategy is to make social insurance provisions earnings-related, making it profitable for people to work

and pay social security contributions. The more they earn and pay, the better their benefit entitlements will be.

The most effective strategy when it comes to human resources is education and training, as well as other forms of active labour market policy, such as public relief work and subsidized employment. The aim of these measures was to improve, or at least maintain, the employability of unemployed persons. In Sweden, this approach has probably contributed to the overall high employment rate. However, when the country was hit by mass unemployment, the problem was that the funds were so small that governments often found it necessary to give priority to cheap, 'passive' measures.

Social services can be seen as vital resources that also make it possible for adults in families with small children, or frail elderly relatives, to participate in the labour market. The Nordic approach to social service resources is to give heavy subsidies to public services, such as day-care facilities. This has undoubtedly contributed to the overall high employment rate among women.

Even if the labour force is highly skilled, and poverty traps as well as high marginal taxes have been avoided as much as possible, this is of little comfort as long as people do not get employment opportunities to exercise their skills. If there are no, or too few, jobs to apply for, good skills might not be enough to get employment. Social policy cannot make up for failures in economic policy. This means that a successful strategy to strengthen social security has to be based on successful macroeconomic policy making. But then, on the other hand, successful macroeconomic policies are not likely to be enough, either, if the skills of the unemployed persons do not match what the new vacant jobs demand.

There is a strong tendency in many countries towards increased female employment and declared political ambition to equalize the participation of men and women. If governments fail to respond to the need for social services, this is likely to reinforce old divisions of welfare and create new ones. Low-income parents are especially dependent on subsidized social services to be able to seek and uphold employment, not to mention lone-parents. I would argue that in this context social services probably provide the most efficient way for lone parents to simultaneously escape 'benefit dependency' and improve the living standards of their families. This should be seen as a double strategy for both improving the resources of lone parents and 'empowering' children. What this boils down to is that family support should be designed to make family life and working life possible for two-earner families. Policies aimed at equal opportunities for men and women on the labour market and equal participation and responsibility in family life should be encouraged.

The lack of adequate social services, such as child care and care for frail elderly relatives, are effective barriers primarily for the participation of women in the labour market but also in society in general. Social services may be seen as investments that provide people with a dynamic opportunity to become tax payers and thus to contribute to balancing public finances. Social services are also needed to ensure the full participation of all citizens in society in general and not only in the labour market. Access to services is therefore crucial to a democracy.

Equality and efficiency

With regard to economic efficiency, the administrative cost-efficiency of universal programs is of course one clear advantage. Another strength of universal systems that are fully earnings-related is that they reduce 'transaction costs' on the labour market. Individuals, firms and unions do not have to spend time on negotiating about the provision of basic insurance and

services like health care. Furthermore, such systems promote mobility and flexibility on the labour market because the universal character of the system means that workers do not lose their earned rights when they move from one job to another – the portability of social insurance is high. One neglected aspect and advantage of public systems is that it is in principle possible to control their incentive structure. Another important role of institutions is to promote stability and predictability in society. There are good reasons to think that stable economic institutions not only for property rights but also for social security rights are important for growth. In addition, public expenditures can of course promote growth and equality simultaneously by affecting the distribution of education and health in a positive way. Yet the potential of social policy institutions to contribute to economic growth appears to have been forgotten.

Universal social security programs coupled with earnings-related social insurance that covers a majority of the labour force require high levels of social expenditures. But if we are interested in improving the efficiency of welfare state programs, then we should worry less about aggregate social spending and taxation, and more about the actual design of both programs and methods of financing. This is at least what macroeconomic, as well as empirical research on the behavioural impact of the welfare state, suggests - notwithstanding that there are constraints on the financing side.

Social security, globalization and democracy

What constraints does globalization impose on systems of social protection? The globalization of the world economy is most often perceived as a threat to national systems of social protection. It is not all that clear, however, why the welfare state project as such would not be possible for nation states with open economies. Quite on the contrary, the conventional wisdom used to be that the most open economies among advanced industrialized societies had developed the most generous social security systems, as an alternative in fact to the kind of social protection that high tariffs and other import restrictions offered domestic employment. The globalization process is still often used as an argument, or excuse, for welfare state retrenchment. Seeking reform strategies that can make welfare state commitments compatible with exposure to a globalized economy is thus an important challenge. What appears clear is that the liberalization of capital markets implies that the profitability of investments in any given country would roughly have to follow what applies in the rest of the world, otherwise foreign and domestic investors will move their capital. This puts clear constraints on the financing of social protection. The mobility of labour also puts restrictions on how far wages can be compressed, and how high levels of taxes can go in relation to the kinds of benefits and services that are provided.

The financing of the welfare state is central since the increased needs of aging societies will put heavier demands on the public purse and the various sources of financing. Another reason is that critiques of the welfare state are based on claims about (i) lack of cost control and (ii) eroded incentives to work. In these respects, the Swedish pension reform of 1994/98 has obvious advantages. The Notional Defined Contribution formula combined with automatic balancing mechanisms is an effective device both in terms of cost control and improved incentives. The latter effect is also reinforced by the new way of coordinating the universal basic pension with contributory benefits. What is rarely recognized in this context is that the public pension system is insulated from other sources of income. This means that income from work or from private pension plans will not reduce public pension entitlements, which strengthens incentives for both work and saving.

Systems of social security will only serve their purposes well if they are reformed without weakening their social impact and if they are designed to promote efficiency. Whether or not

it is possible to collect the necessary taxes in the future will depend on what people want, and probably on international co-operation. This makes modernization of social security essential to any democracy. However, good intentions and political commitment are not enough to make reform successful; the design of existing programs needs to be critically evaluated. We need to investigate, not only whether social policy goals are actually being achieved but also the unintended consequences of social programs.

In the end, social security should be put into the context of democracy and political security. In democratic politics, different and divergent values and interests are expressed in various ways. But behind these differences there must be common values about what constitutes a democratic society. Failure to reform social security systems threatens to leave many people in poverty and despair and disable many children from achieving their full potential in the future. It also threatens democracy insofar as it hampers the full participation of all persons as citizens and members in society. If democracy is threatened, this means that political security is on shaky ground. If governments are serious about promoting security in the world, then they have to be serious about the social security systems of their own and other countries. This calls for serious discussion of the foundations of social security worldwide.