

## Intergenerational arrangements on the European welfare model

**SUMMARY:** The need for policy thinking on a new welfare state model comes at a time when the EU and national governments are already concerned about the impact of a decreasing and ageing population on the economic growth and fiscal sustainability. An evidence base is urgently needed not only to acknowledge the *challenges and opportunities* but also the available options for policymakers and governments. We are witnessing how public spending on all welfare policies and its redistributive impact is being profoundly affected. Given that the *demographic transition* has a cross-cutting nature which affects policies over the lifecycle, we require a framework capable of seizing the dynamics of citizens' lives and their economic behaviour. This *lifecycle framework* allows us to interconnect elements because individuals' conditions at one stage of their life are often linked to events earlier in life – and many have a huge impact on well-being later in life.

## Results

### The Elderly Bias of the Welfare State (Spain case study 1958–2012)

Spain is one of the many countries which welfare policies focus significantly on protecting the older.

An *elderly-oriented state* has two main negative effects:

- **a lower capacity to reduce poverty** among the very young which may have implications in terms of lower rates of human capital accumulation and economic growth;
- **less able to reduce inequality**, because they tend to reproduce market differences in labour income after retirement.

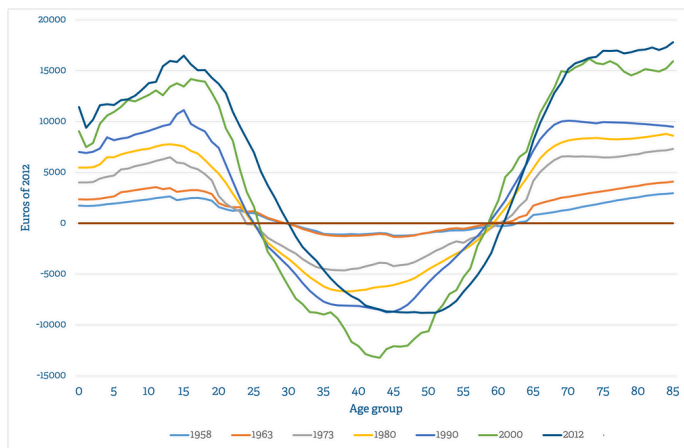


Figure 1. Per capita life cycle from 1958 to 2012

This analysis shows the evolution of the *lifecycle deficit* (LCD) - consumption minus labour income - and focus on the role of public transfers in its funding. The LCD is positive in the extreme ages - because individual consumption exceeds labour income for children and the elderly - and negative during the central working age period, indicating a surplus. An increase over time in the size of the deficits of the youngest and eldest age groups and the surplus of the working age population is also unveiled. This rise, which was especially striking during the high growth decades of the 1960s and 1990s, is the joint reflection of the rise of labour income and consumption per capita between 1958 and 2012. We also observe some significant changes in the duration and cut-off points of the surplus period over time. The upper cut-off point was maximum in the earliest benchmark year (1958) at 62 years old.

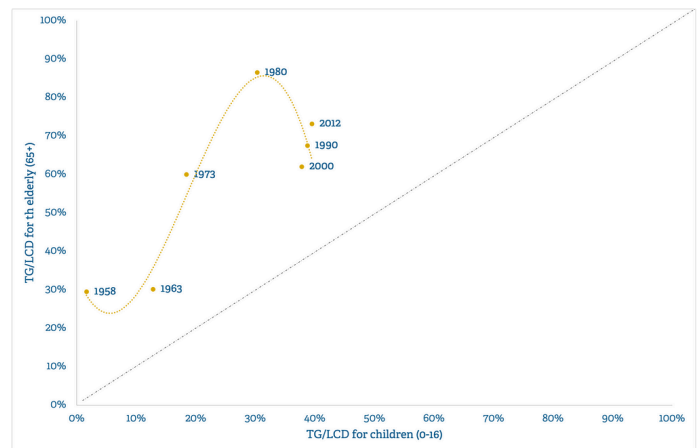


Figure 2. Participation of public transfers (TG) in the funding of children's and elderly's LCD (aggregate, percent)

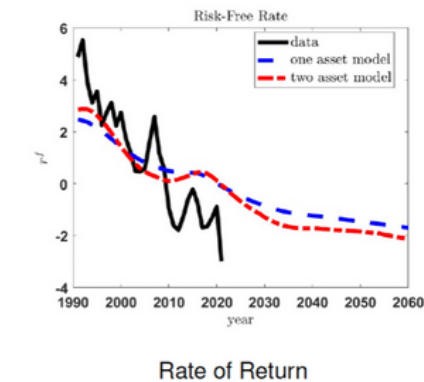
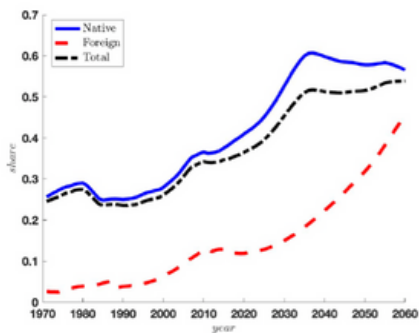
NTA estimates reveal that children's funding has mainly relied on *private transfers*, although their importance has decreased over time, thanks to the increase in public funding - especially through education expenditure. Yet, by 2012 the public sector supports most of the funding of the elderly consumption, compared with less than 50% of children's. Private transfers are negligible as a source of funding for old age groups and remained essential to cover the consumption needs of younger generations. By 2012, the bulk of the baby boomers were in their working age - intensively paying taxes - and only 15% of the Spanish population was less than 15 years old, while those over 65 were already 17%.

Souto, G; Herranz-Loncán, A.; Espuelas, S.; Abio, G.; Patxot, C.  
*The Elderly Bias of the Spanish Welfare State (1958–2012)*. European Review of Economic History, 2024. <https://doi.org/10.1093/ereh/haeae015>

Demographic change might reduce economic activity and welfare state sustainability - fewer employees mean less production. Real net income and productivity will fall, not rise, despite rising gross wages. There will be less innovation. This might also lead to lower returns on capital. Technical change based on new technologies such as AI might have a cushioning effect.

We found four impact channels on the *capital intensity* and thus on the *equilibrium risk-free interest rate*:

- **lower raw labour supply** due to fewer people in working age.
- **higher savings of households** in anticipation of prolonged life in retirement.
- **lower average saving rate in the economy** due to higher share of dis-savers.
- **lower saving ability of households due to higher contribution rates** to the PAYG pension system.



We put the emphasis on the **period from 2020 to 2060** and the main finding show the importance of distinguishing between different assets when analysing the impact of demographic change on interest rates. We project the risk-free rate to further decline to -1.7% to -2.1%, which implies that the nominal *Ultimate Forward Rate* (UFR) will be at most at 0.3%.

The impact of demographic change on pushing up inflation is being discussed.

- The first argument is that a shortage of labour increases wages and thus costs for companies. This leads to higher prices. On the one hand, however, this is a real cost push that could lead to a real price push. However, this has nothing to do with a gradual decline in the purchasing power of money, i.e. inflation. On the other hand, the transfer of such a real cost push to real output prices is not perfect: instead of increasing prices, a company can also reduce profits if costs increase or cut costs in other ways, e.g., by substituting away from labour to other factors of production.
- The second argument is that older people consume a lot. Therefore, an increase in this population group would increase overall demand. This ignores the fact that the consumption of older people must be financed. And a large part of this is financed by rising social security contributions from the working population.

### Reference

Ludwig, Alexander and Otte, Niklas. *Demographic Change and the Ultimate Forward Rate (Book Chapter)* appears in: Van Hulle, Karel, Gründl, Helmut, and Kraft, Mirko (eds.), *Solvency II: Present and Future*, Oxford (Oxford University Press) 2025.

### Implications and Recommendations

- Measuring the roles of the **market**, the **government** and the **family** in reallocating resources during the lifecycle will address the structural changes needed in face of ageing, accounting for intergenerational solidarity;
- Monitoring the main decisions affecting **socioeconomic status** (education and continuous training, fertility, work effort, home production, savings and retirement) made by **individuals** and **households** and its consequences will help to identify incentives and boost investment in human capital, productivity and employment, reaping the benefits of a longer life expectancy in the market economy;
- Identifying the factors of the **decision-making process** to better understand how **family altruism** is affected by welfare policies and how **job design** improves social preferences in the workplace;
- There is a need for governments to **rethink the design of policies** focused on **intergenerational arrangements** to effectively address the social, health and economic challenges of the ageing populations;
- To leave no one behind, it is pivotal to drawing up **policies distinguishing population in different age cohorts**.