Pensions Policies for a Just Europe: Individual versus Collective Responsibilities

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Abstract

No serious discussion of possible pension reforms can dispense with some conception of what justice requires, both between generations and within each of them. In this paper we first spell out step by step the implications for pension systems of a conception of social justice that articulates in coherent fashion the values of freedom, efficiency and solidarity heralded in the European project. We next consider in this light a number of important policy issues: Should we move towards more funding and less "pay as you go"? Towards a more private system? Towards a more Bismarckian system? Towards a higher retirement age? Towards a more European system?

Introduction

Which way forward with our pension systems? In Western Europe there is now a wealth of survey material on public opinion relating to this question. It yields the following general picture.[1]:
There remains among the active population a very broad support for the welfare state, including the pension system.
However, many people do not trust the future of the legal pension system, are worried about their future retirement pension, and therefore feel that measures must be taken.
Somewhat surprisingly, there is a genuine willingness to pay higher contributions, with a significant group willing to save for supplementary pensions.
The younger generations feel that the older ones have to bear part of the burden of these higher contributions.
There is fierce opposition against any increase of the official retirement age.
The idea of a substantial minimum pension commands broad support.

The facts about aging and their consequences for retirement pensions are by now well known. Possible solutions to the problem they document have been intensively explored. And a consensus is emerging to the effect that there is no need for panic. True, decisions cannot be postponed, but if they are taken now the problem is under control. But several solutions are conceivable, and we need standards in order to assess them and choose on the basis of such an assessment. The discussion of possible solutions is frequently cast in a technical jargon which tends to obscure these underlying ethical choices. Policies vary along many dimensions — retirement age, benefit levels, contribution levels, relative shares of funding and pay-as-you-go —, and the policy package offered as the best, or the most "efficient" solution must therefore give weights to these various dimensions which reflect value judgments about the contents of and relationships between inter- and intragenerational justice.

The pension problem must therefore not be viewed as a "demographic" or an "economic" problem, but fundamentally as a political problem (Cremer and Pestieau, 2000), which we cannot even begin to tackle without some conception of what justice requires. Hence the importance of ethical argumentation. As the background report by Esping-Andersen & al. states, "*this implies normative questions of justice and visionary ideas about the institutional design of our welfare states*". It requires answering questions such as "*What claims can citizens justly make on society? What principles of solidarity do we wish to realize? What should be the realm of individual responsibility?*" What policy package deserves to be recommended does not just depend on whether widespread ethical views make it "persuasive", but on whether we believe ourselves that it is just.

In particular, to tackle the issue of pensions, we need to articulate a coherent, defensible conception of "intergenerational justice". Such a conception unavoidably touches on issues relating to the environment and the depletion of natural resources. In this contribution, we shall leave this dimension mostly aside and concentrate instead on justice issues that arise between age groups in an aging society. These issues do not reduce to the sustainability of the present pension provisions. The related increase in health care expenditures actually confronts us with harder choices than pension systems. The normative approach we shall put forward must be able to guide us in this area too, and we shall suggest how it can. However, in spelling out, by way of brief illustration, some policy implications of our approach, we shall concentrate on pensions, by raising five of the central issues in today's debate about their future: Should we move towards more funding and less "pay as you go"? Towards a more private system? Towards a more Bismarckian system? Towards a higher retirement age? Towards a more European system? Although we feel that our analysis is relevant for the present political discussions, we do not offer a full-blown package of concrete policy proposals. Our aim has been, somewhat more modestly, to spell out and explain the ethical principles that we believe should guide the European discussion on pension reform.

1. A normative standpoint

A normative perspective is hinted at in various passages of the background report by Esping-Andersen, Gallie, Hemerijck and Myles. The ethical stance we are about to spell out is broadly consistent with these passages, while being somewhat more specific.

The ultimate unit for any sensible theory of justice is neither the generation, nor the professional category, nor the household, but the individual, not at any particular moment in time, but over the whole of her life cycle.

Like the background report, we adopt a "Rawlsian" standpoint, in the sense of ascribing priority to those in society who are worst off. 2 Taking feasibility constraints into account, this egalitarian standpoint yields a criterion of sustainable maximin.

On the question of the equalisandum, of what it is that needs to be equalised or maximinned, we take a view that privileges opportunities rather than results. However, one should be careful to specify how broadly "opportunities" are to be understood. Distributive justice, in our view, is about the distribution of "positive" or "real" freedom. Individuals have to be compensated for differences rooted in their endowments, as distinct from differences rooted in their preferences (or life plans). In our approach, "endowments" do not only include access to external resources, but also the possession of " internal resources", i.e. any unchosen personal characteristic of the individual with which (unlike preferences) she does not identify. Individuals must be compensated for differences in their endowments; they remain responsible for the differences in their preferences.

To apply this general conception to the intergenerational problem, it is important to define clearly what is meant by a "generation". The political debate sometimes gets confused, because distinct notions of "generation" are being mixed up. It is essential to distinguish between "cohorts", or categories of people born in a particular period, and "age groups", or categories of people who have been living for a particular number of years (Daniels 1988, Gosseries 2001, 2002). In the real world, cohorts overlap — the aged of an earlier cohort co-habit with the young from a later one — and there is, therefore, at any particular moment, a coincidence between the earlier cohort and the older age group, between the later cohort and the younger age group. But whereas an individual never leaves her cohort, she keeps shifting from one age group to another. Remember that we take the position that what matters to justice is the lot of individuals over the whole of their life-cycle. The distribution between cohorts is therefore far more directly relevant to issues of justice than the distribution between age groups.

On this background, we shall now spell out, step by step, the conception of intergenerational justice that makes most sense to us for handling issues of pension (and health care) policy. In order to do so, let us first assume that successive cohorts are equally endowed and that all individual members of each of them are also equally endowed in terms of both external and internal resources. Given the

allocation of consumption over the life-cycle (including the level of the retirement income) will depend on their own labour supply, savings and investment decisions. Suppose, for example, that Jane wants to retire early in life so as to enjoy, if lucky, a period of retirement in reasonably good health. This is fine, but she will then have to save more and/or work harder in her active period of life, and/or be satisfied with a lower consumption level during retirement.

Pension schemes are most likely to develop spontaneously in this world. Since cohorts do not overlap, they will necessarily be of the funded type. And, given our conception of justice, the retirement pensions will need to be of the "defined contribution" type, i.e. the level of one's pension benefits will be determined by the level of the contributions paid in the course of one's active life. Similarly, health insurance will develop, without any ex ante redistributive effect (all people are assumed to be equally endowed, and hence to face identical ex ante health risks), but with a width of coverage that will vary according to people's risk aversion and be strictly correlated with the level of the premium.

As a thought experiment, let us now compare two non-overlapping cohorts A and B in different situations and see how this difference in their situation would influence the decisions to be taken by A and B as regards transfers between age groups:
Suppose first that the average person in cohort B differs from the average person in cohort A in the way in which individual Jane described before differs from the standard case (it is reasonable to suppose that because of external effects there will be some clustering of desired retirement ages in each cohort). The cohort opting on average for a longer retirement period will have to work harder and/or save more during active life and/or accept a lower level of consumption during retirement.
Suppose next that life expectancy is higher for cohort B than for cohort A: Members of cohort B can expect to live longer in reasonably good health. The outcome will be analogous to the previous case. One can predict that in most cases the increase in life expectancy will lead to an extension of both the period of retirement and the period of active employment.
Suppose finally that expected health care costs in later periods of life are larger for cohort B than for cohort A. Individuals in cohort B then face a different trade-off when deciding about their health insurance. In general, they will be willing to pay a larger premium to compensate for the more expensive risk. But as they face a trade-off between consumption and labour when healthy and the degree of coverage, the latter will be kept in check.

In the above, the resulting pattern of pension arrangements is the product of the aggregation of individual choices, without any need for a pension policy. However, even in this very simplified world, the government arguably has a role to play. For in the absence of government intervention, some individuals will save so little that their retirement pension will not be sufficient to guarantee them a decent living standard. To remedy this problem, government can guarantee a minimum pension or impose a mandatory minimum level of savings during the active life. Two main arguments can be used to justify it.

First, even within our freedom-oriented framework, there is room for some mild paternalism. If people are not fully aware of their probability of their becoming very old or very ill, or if they do not fully realise what it means to be destitute in old age or unable to pay for one's medical expenses, then some of them may well insure themselves considerably less than they would otherwise do. Compulsory

respect to retirement age, minimum benefit levels or health insurance coverage, which we are facing now in the real world, would also occur in an abstract world in which distributive justice is assumed (free riding aside) to be unproblematically realised.

1.2. Overlapping cohorts and the possibility of pay-as-you-go

The fact that (still ex ante identical) cohorts are overlapping, i.e. that the younger age groups of a later cohort live together with the older age groups of an earlier cohort, has one crucial implication: we are no longer confined to “funded” schemes, it is now possible to set up arrangements of the pay-as-you-go type, i.e. arrangements in which the income of the old, instead of being provided by their savings, is supplied by transfers from the young. The traditional family structure is basically a pay-as-you-go institution: parents care for their children when these are still too young to work, and, through a sort of differed reciprocity, children take care of their parents when these have become too old to work. The long period of socialisation and the substantial transfers implied by it are important characteristics of the human animal, and pay-as-you-go pension schemes may therefore be conjectured to have deep biological roots.

From an economic point of view, the most significant advantage of pay-as-you-go institutions is the possibility of risk-sharing between successive cohorts. Suppose the economic and social environment of each cohort is subject to unexpected shocks, i.e. generates so-called collective risks. If cohorts did not overlap each of them will have to bear the full consequences of these shocks. But since they do overlap, intergenerational transfers can be linked in one way or another to the economic situation of the cohorts, in such a way that collective risks can to some extent be covered. It is possible for the less lucky generations, when retired, to get a larger income from the younger (fortunate) generations than the one they could have derived from their own savings. It is also possible, when the unpredictable shock hits the younger generation, for the latter to lower its transfers to the retired. Starting from the notion of an optimal life-cycle consumption pattern and taking into account that consumption needs are lower during retirement, economic theory suggests a specific risk sharing rule. A rule which keeps invariant the ratio of the income of the retirees to the (net) income of the active working population would optimally allocate over the whole life-cycle the consequences of the unpredictable shock. This criterion is essentially the one proposed by Richard Musgrave (1986) and also endorsed by John Myles in the background paper. In the present context with equally endowed cohorts, it does not imply a specific stance on distributive justice, but is only offered as an efficient risk sharing device.

If there is a chain of generations thus linked by pay-as-you-go schemes, each of them, when active, can reasonably be expected to accept the rules, because it knows that it could itself be hit by a negative shock later on. Such risk sharing between overlapping cohorts should therefore not be construed as redistributive ex ante. Like an insurance system, it is redistributive ex post, but can be justified ex ante as a Pareto-improving deal between cohorts which relies on nothing but self-interest. This does not apply to predictable collective risks, which can give rise to ex ante inequalities between cohorts and to which we shall return shortly.

Pay-as-you-go schemes do not need to be restricted to the intradynasty context. To increase

overlapping cohorts, we shall have to take into account that different age groups from different cohorts are living together. Given our maximin perspective, justice requires us to focus on the fate of the least well-off within each cohort. Remember that we take a life-cycle perspective. Justice does not imply a comparison of annual incomes, but of the total of what individuals are given over their whole lifespan. Allocation of that endowment over life remains each individual's own responsibility.

Yet, when thinking about pensions within our maximin framework, the most straightforward policy proposal is the introduction of a guaranteed minimum pension, at a level that is as high as is sustainable — subject to whatever justice requires be done for earlier ages. An alternative proposal, even more straightforward and at first sight more consistent, would be to "maximin" initial endowments as much as possible and then rule that individuals have to look after their own pensions. There are different arguments, however, for direct redistribution through a guaranteed minimum pension system.

The main one is the mildly paternalistic argument mentioned earlier, to the effect that some individuals will not save as much as they would if they were adequately informed or fully able to process the information they possess. This argument is particularly strong as regards the provision of a minimum pension to all members of a cohort, whatever career their lifetime endowments enabled them to pursue. Empirical research shows that inter-temporal discount rates, although no doubt in part a matter of taste not to be interfered with, are highly correlated with internal resources and external circumstances beyond the control of the individuals concerned: people from upper classes or scoring higher on intelligence tests have a lower discount rate (Warner and Pleeter, 2001). It therefore makes sense to "protect" individuals with an extremely high discount rate by shifting part of the redistribution to the retirement period in the form of a guaranteed minimum pension.

Should this guaranteed minimum pension be means-tested? In our maximin perspective, it should not. In part, because the means-test tends to trap the elderly in various ways, for example by heavily penalising co-habitation and various types of activity and saving. In part, because of the effect of means-testing on the rate of take up, either directly because of insufficient information about entitlements or indirectly because of the stigma attached to claiming or the wish to avoid bothering one's family if the means test is understood to extend to the claimant's children's income and wealth.

Unavoidably, this guaranteed minimum pension will need to be financed by intra-cohort redistributive taxation. Depending on the institutional and political context of the country concerned, this guaranteed minimum pension may or may not take the form of a distinct unconditional basic pension. In some cases, it may be administratively more convenient or politically more astute to incorporate it into a broader public pension system. Essential is that it should form a floor guaranteed even to those who have had no career whatever, and that its level, relative to other pensions, should be made as high as is sustainable. Introducing a guaranteed minimum pension at the level of or slightly above the poverty line would already be an important step forward. As argued by Myles, the financial means required for the elimination of old age poverty are rather modest and well within the possibilities of European nations.

Note, finally, that the provision of such a (substantial and non-means-tested) guaranteed minimum pension is meant to affect not only the options open to the worse off in old age, but also earlier in life.

maximise the endowment of the least well-off cohorts, so as to allow them to make the situation of their own least well-off member as good as possible.

The basic principle of maximising the endowment of the least well-off cohort immediately suggests a solution to the problem of intergenerational justice in the context of the protection of the environment. What do we owe to future generations? Without elaborating, it seems to us that the most adequate answer to this question is: we have to leave them a stock of physical, human and environmental capital which is at least as valuable as the stock of capital which was at our disposal (see Van Parijs, 1996). This general principle also applies to the evaluation of explicit and implicit government debt. The latter concept refers to the claims of retired people on a retirement pension in a pay-as-you-go system, the cost of which will have to be born by later generations. Explicit and implicit government debt are added (negatively) to the stock of later cohorts and therefore redistribute in favour of earlier cohorts. As such, this is perfectly acceptable (and even desirable) in our maximin setting, if the implicit or explicit government debt bequeathed to later cohorts is compensated for by an increase in the value of their human, physical and environmental capital. If later cohorts have a better endowment, justice requires to redistribute in favour of earlier cohorts. Let us now apply these general principles to some more specific questions related to the retirement pensions.

Consider first the question of how to adjust retirement pensions if there is an increase in the productivity of the active generations[4]. Of course, if the changes in productivity are "unpredictable" we are in the risk-sharing argumentation developed before and the Musgrave-rule is an adequate device to let different generations share the risk. The analysis may be different, however, if the changes in productivity are not due to unexpected shocks. If the increase in the productivity of the younger generations is due to the investment by the older generation in the physical or, more importantly, human capital of their children –and if this increase in the value of the endowment is not compensated by, e.g., a decrease in environmental capital- it is justified that the investing generations improve their own position through the accumulation of government debt and/or pension wealth. On the contrary, if the increase in the productivity of younger generations, is due to their own savings choices –different from the savings choices of the previous generation- there is no reason to increase the retirement pension. It is not easy to evaluate these different effects and/or to incorporate them in a stable intergenerational contract. We can therefore follow Myles'proposal to treat the Musgrave-rule as a kind of litmus test, as an attractive and transparent intermediate solution. Note, however, that in this context its rationale is less strong than in the risk sharing setting and that there may be good reasons to depart from it.

More important perhaps are the challenges resulting from the increase in the dependency ratio. If this increase in the dependency ratio can be seen as an "unexpected" shock or as a collective "risk", the Musgrave-rule is again applicable without qualification. However, is the increase in the dependency ratio really a collective "risk"? Consider the two different demographic forces causing it. The *increase in longevity* is not really a problem of intergenerational justice and we have suggested already that the obvious response to it is an increase in the age of retirement. We return to this point below. The second factor is the *decrease in birth rates.* Can this decrease in the birth rate be seen as a collective risk (as in Myles)? Then the Musgrave-rule still applies. Or must it rather be interpreted as a deliberate choice, as suggested by Sinn (2000): "*Burden smoothing in the presence of the demographic crisis requires the*

using the Musgrave-rule as a kind of litmus test. But, again, this endorsement is not based on a "hard" efficiency reasoning about risk sharing, but it is contingent on the evaluation of a set of specific factors and there is room for a broader social debate. In any case our approach is perfectly in line with the emphasis on demographic and family policy which can also be found in the background report.

With our set of ethical principles we try to give a positive and broad content to the idea of intergenerational justice. Our approach goes further than only safeguarding the sustainability of the present pension arrangements. It is also broader than the popular economic approach of "intergenerational accounting" and its spirit is completely different. Intergenerational accountants calculate the ratio of benefits to contributions for cohorts born at different moments of time and (implicitly or explicitly) take for granted that these ratios should be equal. There can be no doubt that this approach gives useful factual insights, but as a theory of justice it is really a non-starter. It concentrates exclusively on the intercohort transfers through the government budget. It largely neglects the crucial problem of intracohort distribution. Most importantly, it starts from the implicit idea that generations have the right to a "just return" on their contributions to government. In our view, however, it is ethically legitimate to compensate a cohort that is characterized by an unfavourable endowment (or unfavourable circumstances).

2. Five issues

On this simple normative background, let us now consider five prominent policy issues in connection with the future of European pension systems.

2.1. Go funded?

The distinction between "funded" and "pay-as-you-go" does not coincide with the distinction between "private" and "public" arrangements. Public pensions can be funded. Private pensions can have pay-as-you-go features. We will return below to the private-public choice. First, we ask whether there is any general case for shifting drastically the current balance between pay-as-you-go and funded pension systems.

The main advantage of pay-as-you go systems has been described before. They allow for intergenerational (more specifically inter-cohort) sharing of collective risks and are therefore ex ante Pareto-improving. At the same time they allow for some ex post intergenerational redistribution, which may be required by justice considerations. Recognising these potential advantages does not imply that there is no room for funding in the overall structure of retirement pensions. Quite the contrary. Each cohort remains free to set up new retirement arrangements which will often most conveniently take the form of funded schemes. There is, moreover, an efficiency case for combining pay-as-you-go and funding. Over the long run, the trend in the returns on capital and the growth of real wages (or the trend in the return on human capital) are negatively correlated. As the efficient financing of retirement

empirically important.[6] Yet, it remains true that the sustainability of pay-as-you-go arrangements is more directly threatened by the increase in the dependency ratio.

This argument in favour of a shift to funding is sometimes strengthened by referring to the fact that the real rate of return in a pay-as-you-go system is equal to the growth rate of the economy, which is in the present circumstances much lower than the real interest rate, i.e. the rate of return in a funded system. It is wrong, however, to conclude from this fact that moving towards funding would imply an unambiguous efficiency gain, in the sense of a Pareto-improvement. The additional burden imposed on participants in an existing pay-as-you-go system cannot fully be ascribed, if at all, to the inefficiency of the system. It should rather essentially be viewed as a tax which is needed to service the implicit government debt created with the gift to the first generation at the time the system was introduced (Breyer, 2001, Orszag and Stiglitz, 1999; Sinn, 2000). The transition to a funded system does not remove this tax burden. All it can do is change its time path. More specifically, a drastic shift towards funding will imply a drastic shift in the distribution of this burden at the expense of today's active generation[7]. We do not want to enter the intense technical debate among economists about the magnitude of this burden shift. To us the most important conclusion is that a move towards funding will always raise a problem of intergenerational distributive justice. We therefore cannot do without ethical principles. And on the ethical background sketched above, one could not justify a drastic shift in the burden of the implicit tax towards the cohorts that happen to form today's active population.

What are we to think, however, about the gift to the first generation of retirees at the time Europe's pay-as-you-go systems were introduced after the Second World War? Was this an unjustified "free lunch" for a generation that received a pension without having contributed to it? The pejorative connotation usually associated to this notion is altogether unwarranted however. The "free lunch" offered to the retirees of the time was rather a well deserved modest supper for a cohort that lived through the Great Depression and the War and had to cope, moreover, with a considerable depreciation of its savings. The implicit tax that travelled through time all the way to us is not the product of an original sin we should resent, but a sound implication of intergenerational justice.

To sum up, a strong pay-as-you-go component in the pension system remains desirable from the point of view of intergenerational justice. However, this pay-as-you-go component should be adapted to the increase in the dependency ratio. First, shaping it in accordance with the Musgrave rule is a handy risk-sharing device and an "automatic stabiliser", which may improve the transparency and flexibility of the system. It does not stipulate automatically what intergenerational justice requires, but it offers a useful baseline when debating transfers across cohorts. Second, the desirability of a strong pay-as-you-go component does not exclude some shift in the direction of more funding. Such a shift can take different forms, however. It does not need to entail greater reliance on private arrangements. The setting up, within the government sector, of ear-marked trust funds to pay for future pensions is also a form of funding. From an economic point of view, they are equivalent to a reduction of the government's explicit debt, but adopting this formula may increase the political feasibility of debt reduction. Mentioning the existence of these alternative ways of "going funded" takes us straight to our second issue.

capital accumulated (interest or return on equity). They are therefore intrinsically unable to achieve inter-generational risk sharing.

This is not quite the case for *collective* private pension funds, which can in principle set up a reserve fund and propose "defined benefit" schemes, i.e. schemes in which the benefit level of a retired person is not strictly determined by the contributions she paid while active. If the level of the pensions is indexed to prices or to earnings, for example, the risk is shifted away from pensioners to the active population. Of course, like pay-as-you-go schemes, such funded "defined benefit schemes" will also have difficulty coping with an increasing dependency ratio. More importantly, if these collective private funds are subjected to unregulated market competition, their risk-sharing potential will be severely limited. For in the case of a negative shock, the existing funds which intend keeping the promises they made will have to raise their contributions. And newcomers to the market will then be in a position to offer far more attractive conditions to the active population.

Obviously, the government does not face this constraint. It can set up its own (legal) pay-as-you-go system (or "first pillar"), or so strongly regulate the collective funded schemes in the second pillar that they are forced to integrate an inter-generational risk sharing element. It follows that, even strictly on efficiency grounds, at least part of the pension system will have to be either explicitly of the publicly organised pay-as-you-go type or incorporate pay-as-you go features through a strong public regulation of funded schemes.

Once intra-generational justice considerations are brought in, and hence the need for a guaranteed minimum pension, the case for an explicit "first pillar" government component in the pension system is made much stronger. For government regulation of the "second pillar" could conceivably require a minimum pension but could not reach those whose lack of inclusion in the labour market leaves essentially uninsured. Even with a guaranteed minimum pension, different individuals may of course opt for different life-cycle allocations. Some may work harder and earn and save more. A just and efficient overall pension system will therefore contain more than the provision of a minimum pension. The risk-sharing advantages of pay-as-you-go remain relevant, also for these additional components. Hence, there is no a priori reason to suppose that the minimum pension must be the only pay-as-you-go component in the whole system. Yet, the minimum pension must be given a privileged status. In applying the Musgrave rule to regulate intergenerational risk sharing through pay-as-you go transfers, the downward adjustments must not affect indiscriminately all pension levels. Priority must be given to the safeguarding of the minimum pension at the highest sustainable level (subject to the usual provisos), and it is therefore to be expected that a negative shock will lead to a compression of the pension structure.

While government intervention is necessary to guarantee distributive justice and intergenerational risk sharing, private pension arrangements are perfectly legitimate from our normative standpoint. To a large extent, individuals can be held responsible for the allocation of their endowment over their life cycle. On the background of a just distribution of endowments, a restriction of individual freedom as to the allocation of a person's endowment over the life cycle is only justified if the efficiency gains generated for everyone's benefit are such that it is reasonable to suppose that all would agree *ex ante* to the restriction. Therefore, there is room for third-pillar pensions. And second-pillar pensions may

A second argument emphasises the fact that the level of the minimum pension will be set through the political process. As a first approximation, we could say that the generosity of the pension system will be determined by the position of the median voter. It is conceivable that this median voter will opt for a public pension system that guarantees a higher minimum pension if a link is retained between contributions and benefits: under such a ("Bismarckian") system, the median pensioner is entitled to considerably more than the minimum pension, while also paying higher contributions than would be the case if public pensions reduced to the minimal one[8]. This enhanced political support may be due in part to an illusion about how much of a difference social contributions make to the level of their pensions. But it may also derive from the income security which above-minimal pensioners owe to such a Bismarckian system: arguably, the safer one feels, the more altruistic one becomes (Goodin, 1993) and therefore also the more favourable to a generous minimum pension.[9]

Whatever the exact reason, there is empirical evidence that workers and their organisations are more willing to accept a lower net wage as a result of higher taxes if there is a perceived link between contributions and benefits (Montgomery et al., 1992; Gruber, 1994; Summers et al., 1993). If taxes on labour income are used for benefits whose levels are unrelated to the taxes each pays, they are perceived as a real burden, shifted, if at all possible, onto the employer and hence incorporated into an enhanced wage cost. By contrast, if higher contributions translate into higher benefits, they are to a larger extent "internalised". In this case, distortions are therefore less pronounced and the optimal level of taxes/contributions can be higher.

From our maximin standpoint, the best way for the government-organised pension system to combine Beveridgean and Bismarckian features will therefore be contingent on the specific circumstances of the country considered, in particular on the way in which its labour market responds to different ways of structuring the system. The current situation, sometimes quite intricate, as developed out of an idiosyncratic national history, will always need to be a crucial point of reference. Transparency is desirable, but we need not be purists. Improving the system so as to sustainably maximise the minimum might mean putting up forever with a significant level of complexity and misperception.

2.4. Get people to work longer ?

We argued before that an increase in longevity is bound to alter the desired allocation of consumption and labour supply over the life cycle. In a hypothetical world with identical individuals and equally endowed cohorts – where there is by definition no problem of distributive justice - some increase in the retirement age is a predictable reaction to the increase in longevity. While the real world of course is more complex, the *prima facie* case for such an increase in the present economic circumstances is very strong and almost self-evident.

However, this is not what we observe. The population is fiercely opposed to any increase in the retirement age and most Western countries have been characterised by a trend towards earlier retirement. This need not be a problem, from our standpoint, if these trends reflect genuine preferences of the population. Concern for real freedom for all makes flexibility with respect to the age of retirement age a crucial feature of policy. Individuals must be able to choose their pattern of life, while

these distortions must be removed, while at the same time, as suggested by Gallie, arrangements for part-time working by aged people must be fostered.

There are however, some issues about the age of retirement which cannot be handled by a right to a guaranteed minimum pension as from a certain age combined with supplements whose levels depend, inter alia, on how early or late one retires. First, because of differences in their talents, some individuals will have to accept jobs involving worse working conditions and yielding less job satisfaction. Arguably, they should have the possibility of retiring earlier without having to pay a cost in terms of a lower pension. However, if an adequate labour market policy – possibly including the introduction of a form of universal basic income - succeeds in widening the range of occupational choice for those who have least of it, the hardship of one's job and its impact on one's life expectancy can be treated — no less but also no more than the level of one's wage and the latter's derived impact on pension benefits, as a matter of choice. This reasoning, needless to say, must operate on the background of insurance institutions covering illness and disability, whether work-related or not.

This may go some way towards reducing or compensating the overall inequality in life expectancies, but is most unlikely to make the gender gap insignificant along this dimension. This raises a tricky issue. As long as men can expect to live less long, or less long in reasonably good health, would it not be fair to allow them to retire earlier than women? As things stand, it can sensibly be argued that the inequalities suffered by women in many other respects (including those affecting pension levels) easily earn them the privilege of enjoying their pensions for a longer time. But present trends, especially as regards gender-based educational inequalities, and vigorous policies may one day shake this premise, and unless driving up the status of women in working life to the level of men's miraculously drives up men's life expectancy to the level of women's, a concern for justice will not allow us to evade the tricky issue just raised.

One way of addressing it if and when it arises could be as follows. To enable households to cope better with the combination of work and family when the demands of the latter are at their peak, it makes sense to allow men and women alike to anticipate a limited number of retirement years at this stage of their lives. If, as is likely in the light of empirical evidence on the impact of related schemes, women make use of this new possibility far more extensively than men, then women's effective age of retirement will automatically be driven up beyond that of men. Would this be fair? The answer will depend, no doubt, on whether the scheme is meant to apply to the first or to the second pillar, or to both, and on many other details in what is being proposed, but also on the nature of what makes the asymmetry between men and women persist, if it does.

2.5. Go European?

In today's European Union, pension institutions differ widely from one member state to another. They reflect a complex and subtle balance between the various considerations introduced in this paper. Homogenising these systems within a foreseeable futue is obviously out of the question. And even it were not, from our normative standpoint, it should be. For national (possibly even sub-national)

nature of the risks that are to be covered and the relative importance attached to them depend on the preferences of the citizens. From our point of view, there is then scope for variation in order to best track these preferences. This does not hold for components of the overall system that are directly justice-driven. Justice comes first. And it naturally takes a transnational dimension, especially in an emerging polity such as the European Union, within which European citizens can move freely and whose national components have become mutually dependent in countless ways. The introduction, across Europe, of a guaranteed minimum pension, of an (unconditional) floor in the distribution of the income of the elderly, would in this view be an important step forward. The second argument is of an instrumental nature. A pension system that incorporates an income floor for all the elderly is necessarily redistributive ex ante. Such a redistributive system is most likely to be considerably more vulnerable to international tax competition than arrangements of the social insurance-type. International coordination in this area is therefore particularly important.

We do not go into the concrete modalities of the introduction of such minimum income guarantee. Can the European Union content itself with defining common targets, or should it help the poorest countries to achieve them by contributing to the funding of the schemes, and, if so, to what extent and according to what sort of formula? Should the target be defined with reference to an absolute (European-wide) or to a relative (country-specific) poverty line? Should one coordinate on a specific type of measure or on specific objectives, as captured by appropriate social indicators? Several of these issues are discussed in the background paper on social indicators (Atkinson, Cantillon, Marlier; Nolan, 2001). For our purposes it is sufficient to emphasize the priority to be given to the fight against poverty among the retired through comprehensive, non-means tested schemes that incorporate a substantial minimum pension, while at the same time giving the individual states the freedom to devise their own pension institutions. Even if one were to opt for the most ambitious version of this programme — the introduction of a unconditional basic pension fixed and funded at the European level —, the aim would not be to build a giga-welfare state, a huge substitute for national welfare policies. It would rather be to restructure the transfer to the elderly so as to fit a firm European floor under the national systems, so as to enable these to survive more easily and to do a better job.

Conclusion

While we have deliberately remained at the level of general principles, the contours of what we believe to be an adequate system of retirement pensions should be clear enough. Government intervention is needed for at least two reasons. First, justice requires that priority be given to the introduction of a guaranteed minimum pension, at a level that is as high as is sustainable, subject to whatever is required to sustain a corresponding minimum for earlier stages in life. Some European coordination is desirable here. By no means does this imply that government pensions in the various member states should be confined to the universal provision of this minimum. Depending on the historical circumstances of each member state, there can be ample room for Bismarckian features. Second, the pension system has to contain a pay-as-you-go component for efficiency reasons, namely to permit the intergenerational sharing of collective risks. Moreover, once a pay-as-you-go-component is in place, it also allows for

A comparison of these proposals with the survey results alluded to in the introduction gives us some idea of their social feasibility. First, although the introduction of a minimum pension at European level will no doubt require a fair amount of political courage, acumen and vision, the idea of a guaranteed minimum is widely supported by the population. Second, a transparent reform of first-pillar pensions and of the regulation of second-pillar pensions should be acceptable to the bulk of the citizenry. Even though most have a preference for the status quo, they are worried about the future of the pension system and are willing to accept changes. It is crucial, however, that the rationale of the reforms should be explained carefully and didactically. A well-structured ethical framework can be very important for the formulation of this rationale. Third and last. Such a framework may also help to implement what is no doubt the least popular of the directions of change we advocate: the increase of average effective retirement age either through a rise of the mandatory retirement age, or, better, through the introduction of greater flexibility on economically realistic terms. On this issue, one may expect fierce opposition from the population. However, at any rate in our view, the introduction of such flexibility is among the most obvious and ethically least debatable policy options.

The emphasis in our analysis was not on the economic sustainability of the pension arrangements. Yet it is obvious that long-run sustainability is a necessary requirement for any pension system. But sustainability can be achieved in many different ways, and a comprehensive ethical framework should give us some guidance about which of them should be preferred and which should be avoided at any price. In our normative framework the most appropriate response to the challenge of the increasing dependency ratio consists of the following package: (a) increasing the retirement age or lowering the pensions for those who are not disabled and who prefer to retire early, with an emphasis on flexibility rather than on mandatory retirement; (b) in order to accommodate unexpected shocks, lowering the pensions and/or increasing the contributions of the active population in line with the Musgrave rule, but with a special concern for the minimum pension guarantee; (c) introducing more funding in dominantly pay-as-you go systems, either through creating a public trust fund or through the development of second-pillar pensions, while keeping a sizeable pay-as-you-go component. Taken together this package of measures looks very much like the moderate proposals which have been put forward to restore the sustainability of the system. We feel, however, that an offensive and creative focus on social objectives is a more attractive and no less responsible way of thinking about the future. It offers a stronger promise to mobilise European citizens than a mere concern for a sound government budget. There is no contradiction between social and economic objectives. The economic side constraints can be integrated into a realistic and coherent way of thinking about and fighting for more social justice

Last but not least, we must emphasise that by concentrating, as we were asked to do, on pension systems, we only considered one component of the global package that is called in response to the rising dependency ratio. Parental leave, child care, schooling, training and retraining, work conditions and rhythms, housing and transportation, immigration and integration, must all enter the comprehensive re-thinking of the current division of tasks between age groups which is structurally demanded by the joint challenge of rising life expectancy and falling fertility. Most regrettably, perhaps, we barely touched the distinct but closely related challenge generated by the ever growing cost of care and health care for all, and particularly the elderly (see Van Parijs 1996, ch.3). The issue of social justice, intra- and inter-generational, which is raised by this growing cost is by no means less acute politically or less tricky intellectually than the one raised by pensions. Quite the contrary. It is

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