Workshop: The sustainability and adequacy of pensions. How to cope with demographic change?

(PES-Convention, 24.-26.Nov 2011)

- **The ageing of the population is one of the key challenges throughout Europe. A stagnating (or even shrinking) number of persons of working age and high rates of unemployment and under-employment are further main issues.**

- **In this context, raising employment rates, with quality jobs, is the best strategy with which countries can prepare for demographic change.**

- **Mobilizing the full employment potential would considerably alleviate the financial burden of ageing (higher revenue / lower number of benefit recipients)**

- **Furthermore, better labour market integration of vulnerable groups such as young persons, women, immigrants, persons with reduced work capacities, elder men and women would help significantly to achieve adequate pensions and to avoid negative fragmentation of our societies**

- **Particular attention has to be paid on improving employment opportunities for women. Obviously, lower employment rates and lower pay are key roots of gender inequalities in pension entitlements.**

- **Labour market goals (such as 75 % employment rate of the EU-2020 strategy) have to be integrated in the pension debate.**

- **Economic dependency ratios (benefit recipients relative to contributers) are much more eloquent than purely demographic ratios (age group 65+ relative to age group 15-64) and should be brought to the fore in long-term projections and in the public debate.**

1. Introduction

For many years, public debate of the future of pensions has focused on the rising number of elderly people, on the increase of dependency ratios and on the resulting pressure on public budgets.

However, even basic documents include misleading data and misleading arguments – mainly because no clear distinction has been made between purely demographic and economic issues.

In the Austrian Chamber of Labour a so-called 'Dependency Ratio Calculator" was developed to illustrate

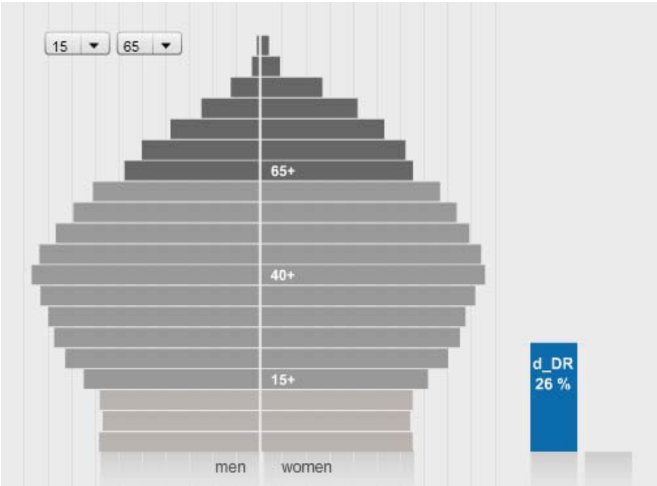
- demographic change
- the difference between demographic and economic dependency ratios
- the impact of labour markets on economic dependency ratios
- the impact of labour markets on public cost of ageing

2. Demographic Change

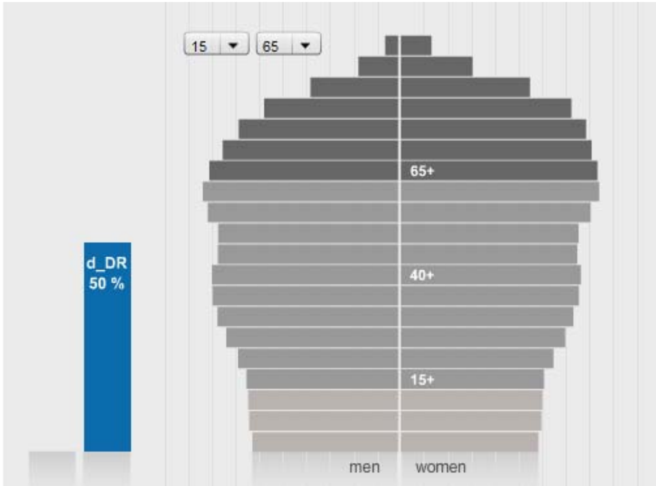
Demographic projections show a major increase of the number of elderly people. Now, there are 87 million in the age group 65+ in EU-27. For 2050, Eurostat projections show 148 million in this age group. At the same time, a declining number of people in the age group 15 to 64 are predicted. Currently, the EU has about 335 million in this age bracket. This number is projected to fall to 294 million in 2050.

The following pictures show the age structure of the population in 2010 and 2050 (EU-27).

EU-27
Age structure 2010
Demographic dependency ratio: 26 %



EU-27
Age Structure 2050 (Eurostat Projection)
demographic dependency ratio: 50 %



Source: AK-Wien, Dependency Ratio Calculator (database: Eurostat/europop 08)

The dark blue bars show the demographic dependency ratios (people aged 65+ relative to people aged 15-64)[1]. According to Eurostat-projections, this ratio will have nearly doubled by 2050. It is expected to increase from the current level of 26 per cent to 50 per cent in 2050.

Attention should be paid to the fact that the European Union average does not reflect the situation in each Member State. There are widely differing current age structures and widely differing predictions of evolution in the forthcoming decades.

3. Economic dependency ratio

The economic dependency ratio describes the relationship of the number of those who are economically dependent (i.e. in receipt of transfer benefits) and those who are economically active.

Here, this ratio is defined as the number of pensioners and unemployed persons as a ratio of the number of those in employment. As such, the major group set against those in work are retired persons (old-age, early retirement, disability pensions), but also included are persons in need of public support on grounds of unemployment.

[1] This is the most common definition of the (old-age) demographic dependency ratio.

It has to be noted, that people employed in mini-jobs (i.e. working just a few hours a week) should not be counted as employed in this context, since they make no significant contribution to the financing of pensions and unemployment benefits. Moreover, persons employed in such jobs are often themselves dependent on some form of transfer. However, the labour force data from Eurostat do not allow this refinement.

Concerning the financial sustainability of pension/social systems a main question is to what extent will the increase of the demographic dependency ratio translate into an increase of the economic dependency ratio?

Obviously, there are several determining factors for the economic dependency ratio. Of course, the changing age structure is one of these factors. However, it is not the only one. Another key element is the employment rate. In simple words: the higher the employment rate, the smaller the economic dependency ratio.

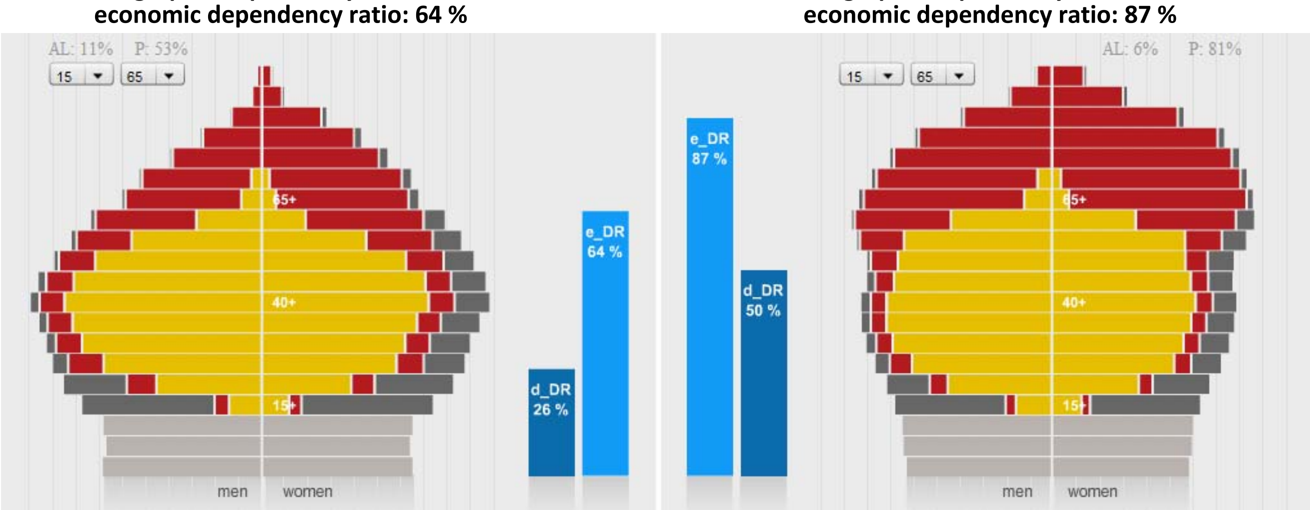
The “Dependency Ratio Calculator” allows to illustrate different labour market scenarios and to calculate their impact on the economic dependency ratio. For this purpose, the population is structured according to the economic status in

- employed persons (yellow areas)
- benefit recipients (red areas)
- “neutral” persons, i.e. neither employed nor benefit recipient (dark grey areas)

The pictures below show the current situation (left) and the situation in 2050 (right) based on the **“Standard-Scenario”.** This scenario mainly reflects the projections in the EU-Ageing Report 2009 (based on a “no policy change” assumption). The key labour market assumption is that employment rate in the age group 15-64 rises from 64.1 % in 2010 to 69.7 % in 2050 (in this scenario, even in 2050, the 75 % employment goal of the EU-2020 strategy is not achieved).

EU-27 (2010)
demographic dependency ratio: 26 %
economic dependency ratio: 64 %

EU-27 (2050 – Standard-Scenario)
demographic dependency ratio: 50 %
economic dependency ratio: 87 %



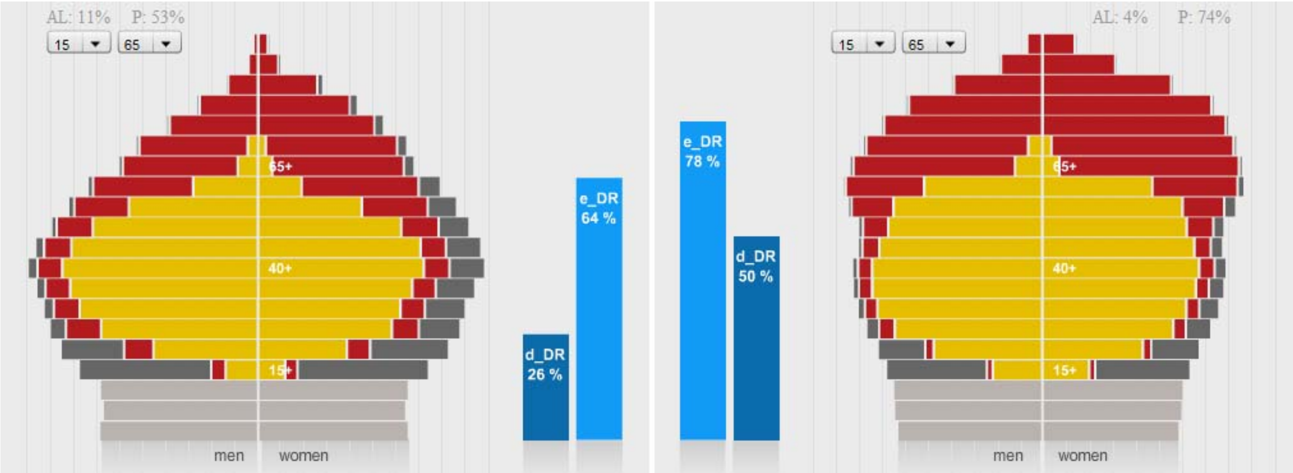
Source: AK-Wien, Dependency Ratio Calculator (database: Eurostat - europop 08 / Labour Force Survey / EU-Commission – Ageing Report 2009; own calculations)

The second scenario shown here is the **“EU-2020plus-Szenario”**, which is based on the EU-2020 strategy. The main assumption is that the employment goal of 75 % in the age group 20 to 64 has been reached in 2020 and further progress (at a lower level) will be achieved in the period 2020 – 2050. In the 30 years from 2020 to 2050, the same employment rate increase is assumed as in the

10 years between 2010 and 2020. In this scenario, the employment rate for the age group 15-64 goes up from 64.1 % in 2010 to 76.1 % in 2050.[2]

EU-27 (2010)
Demographic dependency ratio: 26 %
Economic dependency ratio: 64 %

EU-27 (2050 – „EU 2020plus"-Scenario)
Demographic dependency ratio: 50 %
Economic dependency ratio: 78 %



Source: AK-Wien, Dependency Ratio Calculator (database: Eurostat – europop 08 / Labour Force Survey; own calculations)

Starting from the current level of 64 per cent, by 2050, the economic dependency ratio will have risen to 87 per cent in the "Standard-Scenario" (+ 36 %) and to 78 per cent in the "EU-2020plus-Scenario" (+22 %). Keeping in mind that in the period 2010 - 2050 the demographic dependency ratio is expected nearly to double, this clearly shows both the huge difference between demographic and economic ratios and the huge impact of labour markets on economic relations.

It has to be noted that in both scenarios shown here, employment in the age group 65+ is assumed to stay at a low level in coming decades (based on legal pension age at 65 in most EU-Member States).

4. Employment potential

In 2010, according to Eurostat figures the employment rate among those aged 15-64 was only 64 per cent. This means, about 120 million in this age group were not in employment (among those more than 20 million desperately seeking for a job).

Furthermore, among those counted as employed in these statistics there are many millions of under-employed, of people in precarious jobs, etc. Among women, the integration in the labour market is still much lower than for men.

Obviously, there is a huge potential for more (and better) employment, esp. among young persons, women and older men and women.

Mobilizing the employment potential requires:

- (re)integration of unemployed in the labour market
- high standard of education and training

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[2] In 2008, an employment rate at this level was reached in the three best performing countries in the European Union (Denmark, Sweden, Netherlands).

- reconciliation of employment, family and private life
- better health protection
- adequate jobs for persons with reduced work capacity
- adequate jobs for persons aged 55+
- conversion of precarious and informal work into regular forms of employment
- balanced distribution of employment
- fair distribution of welfare gains

5. Impact on public budgets

In a subsequent step it can be asked to what extent a change in employment rates and in economic dependency ratios translates into cost increase.

It can be shown, that there is an enormous impact of labour market developments on public budgets. Higher/lower employment rates lead both to higher/lower revenue and lower/higher expenditure (cost-effects of different labour market scenarios based on calculations with the "Dependency Ratio Calculator" will be published soon).

In the context of a fast increasing share of older people, intergenerational fairness requires the acceptance of some increase of the social budgets for this age group. The challenge is to slow down this increase without harming social objectives (adequate old-age protection, etc.).

Raising employment levels can help to considerably alleviate the financial burden of ageing. Furthermore, such a strategy facilitates the achievement of a fair distribution of welfare gains.

It has to be added that further productivity growth (which all economists predict) will lead to higher GDP. In coming decades, this will create more room for manoeuvre for distributing a somewhat bigger "share of the cake" to social budgets for elder people.