

Maintaining prosperity in an ageing society

Summary

Population ageing in OECD countries over the coming decades could threaten future growth in prosperity. Governments should take action now across a broad range of economic, financial and social policies to ensure the foundations for maintaining prosperity in an ageing society. While reforms are already underway, much deeper reforms will be needed to meet the challenges of population ageing.

In the past 25 years, the number of people of pensionable age (65 and over) in OECD countries rose by 45 million, but the population of working age rose by 120 million. As a result, population ageing has so far posed no major economic or social problems for our societies. This will change dramatically in the next 25 years when the number of persons of pensionable age will rise by a further 70 million, while the working-age population will rise by only five million.

Critical policy issues for the future stand out as a result of the inevitable ageing of our societies:

- will it continue to be possible to share societies' resources between the working generation and its dependent non-working members in ways that do not give rise to unacceptable societal and inter-generational conflicts?
- how can the contribution of older people to society and economic prosperity be enhanced?
- how should pension, health and long-term care best be reformed?
- which changes in the financial infrastructure are needed to support the development of funded pension systems?
- to what extent will ageing OECD countries be able to improve their well-being through growing trade in goods and services and assets, in particular with younger, faster-growing non-OECD countries?

Based on recent and [on-going analysis at OECD](#), this *Policy Brief* addresses these questions and sets out seven principles to guide the reforms needed to address demographic pressures that will start to emerge about ten years from now. ■

[Why must spending on public pensions, health and long-term care be contained?](#)

[How should the structure of retirement income be changed?](#)

[What about health and long-term care spending?](#)

[Why should incentives for early retirement be eliminated?](#)

[Why is "active ageing" important?](#)

[What about financial market reforms?](#)

[Can higher economic growth alleviate pressures?](#)

[How should reform be approached?](#)

[What role can international co-operation play?](#)

[For further reading](#)

[Where to contact us?](#)

Seven Principles to Guide Reform

1. Public pension systems, taxation systems and social transfer programmes should be reformed to remove financial incentives to early retirement, and financial disincentives to later retirement.
2. A variety of reforms will be needed to ensure that more job opportunities are available for older workers and that they are equipped with the necessary skill and competence to take them.
3. Fiscal consolidation should be pursued, and public debt burdens should be reduced. This could involve phased reductions in public pension benefits and anticipatory hikes in contribution rates.
4. Retirement income should be provided by a mix of tax-and-transfer systems, advance-funded systems, private savings and earnings. The objective is risk diversification, a better balance of burden-sharing between generations, and to give individuals more flexibility over their retirement decision.
5. In health and long-term care, there should be a greater focus on cost-effectiveness. Medical expenditure and research should be increasingly directed to ways of reducing physical dependence, and explicit policies for providing care to frail older people should be developed.
6. The development of advance-funded pension systems should go hand-in-hand with that of the financial market infrastructure, including the establishment of a modern and effective regulatory framework.
7. Strategic frameworks should be put in place at the national level now in order to harmonise these ageing reforms over time, and to ensure adequate attention to implementation and the build-up of public understanding and support. ■

Why must spending on public pensions, health and long-term care be contained?

In most OECD countries, sharing societies' resources between working people and retirees importantly involves public pension systems, which are usually financed by payroll taxes. Even though many Member countries have already taken steps to reform their public pension systems, these are insufficient to cope with demands on them in future. The public pension accounts in most Member countries will start to go into sustained deficit in about ten years time. Public provision of health and long-term care for retirees will add to the burden.

Fiscal consolidation should be pursued, and public debt burdens should be reduced.

Countries could finance future social spending obligations by raising payroll taxes to whatever level was necessary, but these would be so high as to discourage work effort and would cut deeply into working people's living standards. These considerations point to the overriding importance of curbing the growth of spending on public pensions, health and long-term care. ■

How should the structure of retirement income be changed?

The provision of income in older age should take account of all the resources available to older people including public and private pensions, earnings and assets. Existing public pension systems which enable older people to maintain adequate standards of living are likely to remain the major source of old-age income for many retirees for some time to come.

Retirement income should be provided by a mixed system.

However, other sources may have to play a growing role, with the objective of spreading the burden across generations and enabling individuals to diversify risks across the different sources of retirement income. Such reforms are likely to mean that middle and high-income earners will want to supplement their public pensions. Hence, it will be important to establish a sound regulatory framework for private pension funds, including occupational pension schemes. Reforms along these lines would change the current "implicit contract" between many governments and future retirees, and must therefore be implemented with enough warning to allow people time to adjust to the new "contract", i.e. now to begin to anticipate prob-

lems only likely to arise two or three decades down the road. In addition, there are limits on the speed that a country can move to a funded-based scheme because of inter-generational equity considerations: current workers will be "paying twice", into their own pension fund and for the pensions of the current retired. ■

What about health and long-term care spending?

People are living longer and healthier lives. Nevertheless, population ageing means that health and long-term care costs are likely to rise, although perhaps by less than was once feared. The central challenge is to ensure that these expenditures are cost-effective and meet the most pressing requirements – reducing time spent in dependence and time in chronic care.

In health and long-term care, there should be a greater focus on cost-effectiveness.

This means that medical research and technology should be focused on the reduction of dependence arising from conditions which particularly afflict older people, such as senile dementia or arthritis.

Care-giving for frail older people is now often fragmented and unnecessarily costly. As demographic trends point to a particularly large growth in the numbers of people in the oldest age groups, it will be

important now to develop explicit policies and financial arrangements for care-giving that deliver quality and cost-effective services. ■

Why should incentives for early retirement be eliminated?

Material standards of living, and hence the tax base, would also be higher if people worked longer. It is not a question of "forcing" older people to work longer. The current trend to early retirement is, in part, a reflection of a rising demand for leisure as societies become more prosperous as well as a response to high and persistent unemployment.

Public pension systems, taxation systems and social transfer programmes should be reformed to remove financial incentives to early retirement.

But current public pension systems, tax systems and social programmes interact to provide a strong disincentive for workers to remain in the labour force after a certain age. Removing these disincentives, perhaps even providing positive incentives to work longer, coupled with effective steps to enhance the employability of older workers, could make an important contribution to sustaining the growth of living standards.

But an increased willingness on the part of older workers to work longer will have to be matched by a sufficient number of job opportunities for them if higher unemployment is to be avoided. This, in turn will require a major change in the attitudes of firms towards hiring and retraining older workers. Since these changes will have to be reflected in wage and labour cost structures, the co-operation of the social partners could play a very useful role in this process. ■

Why is "active ageing" important?

A more flexible work-retirement transition is one example of "active ageing" – the capacity of people, as they grow older, to lead productive lives in the society and economy. Active ageing implies a high degree of flexibility in how individuals and families choose to spend their time over life – in work, in learning, in leisure and in care-giving.

A variety of reforms will be needed to ensure that more job opportunities are available for older workers.

Public policy can foster "active ageing" by removing existing constraints on life-course flexibility. It can also provide support that widens the range of options available to individuals via effective life-long learning or by medical interven-

tions that help people maintain autonomy as they grow older. Indeed, the available evidence shows that the more active older people are, the better the quality of life they enjoy. ■

What about financial market reforms?

Ageing will change saving and investment patterns nationally, including through the build up and subsequent unwinding of private pension assets by the retiring baby-boom generation. Differences in ageing patterns across countries – particularly between the OECD and the non-OECD regions – will give rise to shifts in patterns of savings, investment and international capital flows.

The development of advance-funded pension systems should go hand-in-hand with that of the financial market infrastructure.

A more efficient global allocation of savings and risks could raise productivity, and therefore the goods and services available to consumers in OECD countries as the baby-boom generation retires. The consequences of these global economic linkages for living standards in OECD countries are likely to be positive, but perhaps not very large. These considerations call for:

- strengthening of financial market infrastructure through improved legislation and codes of conduct and the introduction of rigorous

rules of transparency, fiduciary responsibility and disclosure;

- improved supervision, an upgrade and modernisation of pension asset investment rules, and better domestic co-ordination among the different regulatory and supervisory agencies involved in the provision of retirement income;
- structural reforms in emerging market economies to ensure efficient allocation of savings into the most productive investment opportunities in the mutual interest of OECD and younger, faster growing non-OECD economies. ■

Can higher economic growth alleviate pressures?

Higher economic growth will alleviate pressures arising from population ageing. Taxes to support the retired will be easier to bear, when the working-age population can look forward to rising prosperity. Encouraging people to work longer would raise economic growth, increase the tax base, and reduce the numbers of dependent older persons, a triple gain. The higher national saving, if used productively, will result in higher capital stock and thus more output over the long term.

Although higher productivity is central to increasing living standards of the whole population, it does not directly address all of the economic, financial and social pol-

icy aspects of ageing populations discussed above. Nevertheless, while an increasing proportion of national output will need to be transferred to retirees, the higher economic growth is, the easier it will be to ensure that making one group better off does not entail making another group worse off. ■

How should reform be approached?

The agenda for policy reform for maintaining prosperity in an ageing society requires a policy response cutting across traditional boundaries of economic, financial and social disciplines, and across traditional areas of responsibility of government administrations.

Fiscal consolidation should be pursued, and public debt burdens should be reduced.

Strategic frameworks, including implementation structures and timetables, should be put in place at the national level now in order to implement these reforms in a coherent way over time.

The central objective of reforms is to ensure that the way societies transfer resources to a rapidly growing number of retired people creates neither major economic nor social strains. This points to the desirability of speeding up the growth of output, reducing the

numbers of dependants, by encouraging people to work longer, and ensuring that the transfer mechanisms operate efficiently. Since the main demographic pressures will start to emerge in about ten years' time, our societies have a very limited window of opportunity to put reforms in place. Seven principles have been identified to guide these reforms (*see box on page 2*). ■

What role can international co-operation play?

Action at the international level can supplement national action. While specific reforms must be tailored to meet the circumstances of each country, there are many common directions and much that can be gained by international co-operation during the reform process. Areas for international co-operation include:

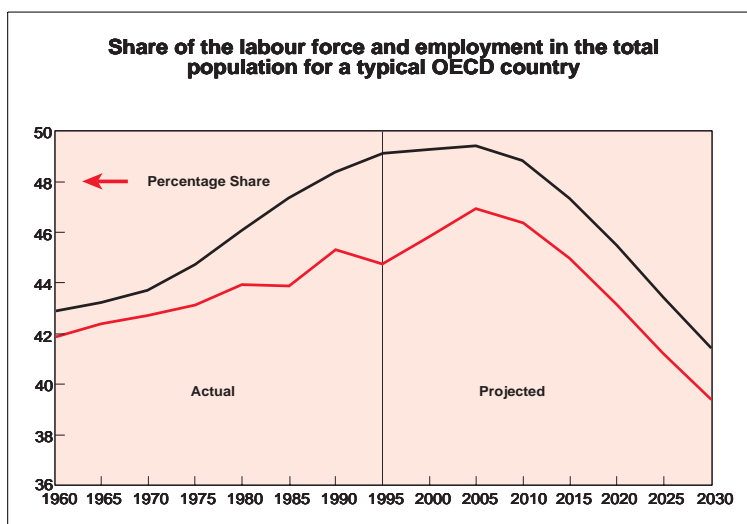
- collection and sharing of new statistical data on an internationally comparable basis and exploitation of existing information;
- monitoring of reforms and sharing of lessons in a multilateral setting;
- and assisting emerging market economies to implement successful structural reforms and sound macroeconomic policies in order to facilitate the mutually beneficial flow of trade in goods, services and financial assets between OECD and non-OECD economies. ■

Trends in ageing and employment

This chart brings the various dimensions of ageing and employment patterns together for a typical OECD country. At the level of the whole population, the trends are dominated by the ageing of the “baby-boom” generation.

- the baby-boom generation is now of working-age, and the number of paid workers relative to non-workers is rising. An additional reason for this is that the number of women entering the workforce is partially off-setting a drop in workforce participation by men.
- during the period 2010-2030, increasing life expectancy, labour force trends (notably a tailing off of the rise of female participation and the continuation of a trend toward early retirement), coupled with the passage of the baby-boom generation from work to retirement, will begin to work together to reduce the amount of time that a society devotes to employment.

The chart shows this combined effect. It projects likely future directions in employment, expressed as a portion of the total population, in the absence of policy change.



- The top line shows that the size of the labour force (the number of employed plus unemployed) will decline.
- The bottom line tracks and projects the ratio of workers to total population.
- The projection assumes that unemployment rates have fallen to 5 per cent by 2005. ■

For further reading

- [Ageing in OECD Countries: A Critical Policy Challenge, Social Policy Studies No. 20](#), 1996
ISBN 92-64-15318-7 US\$20 pp. 112
- [Caring for Frail Elderly People: 2. Policies in Evolution, Social Policy Studies No. 19](#), 1996
ISBN 92-64-14892-2 US\$64 pp. 306
- [The Transition from Work to Retirement, Social Policy Studies No. 16](#), 1995
ISBN 92-64-14555-9 US\$ 43 pp. 134
- [The Labour Market and Older Workers, Social Policy Studies No. 17](#), 1995
ISBN 92-64-14585-0 US\$ 64 pp. 316
- [Maintaining Prosperity in an Ageing Society](#), 1998,
ISBN 92-64-16093-0, US\$20, pp. 144
- [Institutional Investors in the New Financial Landscape](#), 1998
ISBN: 92-64-15980-0, US\$72 492pp.
- [The Macroeconomic Implications of Ageing in a Global Context Working Paper No. 193](#)
Free on Internet: www.oecd.org/eco/eco
- [The Impact of Ageing on Public Policy, The OECD Observer No. 203](#)
Free on Internet: www.oecd.org/publications/observer/
- The following articles from [OECD Observer No. 212](#) are available **free on the Internet**:
 - [Maintaining Prosperity in an Ageing society](#)
 - [Some new Insights for Dealing with Population Ageing](#)
 - [Ageing, Pensions and Financial Markets](#)
 - [The Economic Impacts of Ageing](#)
 - [Retire Early, Stay at Work?](#)
 - [The Policy Challenge of Ageing Populations](#)
 - [Can We Afford to Grow Old?](#)

The OECD Policy Briefs are prepared by the Public Affairs Division,
Public Affairs and Communications Directorate.

They are published under the responsibility of the Secretary-General

The OECD Policy Briefs are available on the OECD's Web site

www.oecd.org/publications/Pol_brief/

Where to contact us?

FRANCE

OECD Headquarters
2, rue André-Pascal
75775 PARIS Cedex 16
Tel: 33 (0) 1 45 24 81 81
Fax: 33 (0) 1 45 24 19 50
E-mail: sales@oecd.org
Internet: www.oecd.org

GERMANY

OECD BONN Centre
August-Bebel-Allee 6,
D-53175 BONN
Tel: (49-228) 959 12 15
Fax: (49-228) 959 1218
E-mail: bonn.contact@oecd.org
Internet: www.oecd.org/bonn

JAPAN

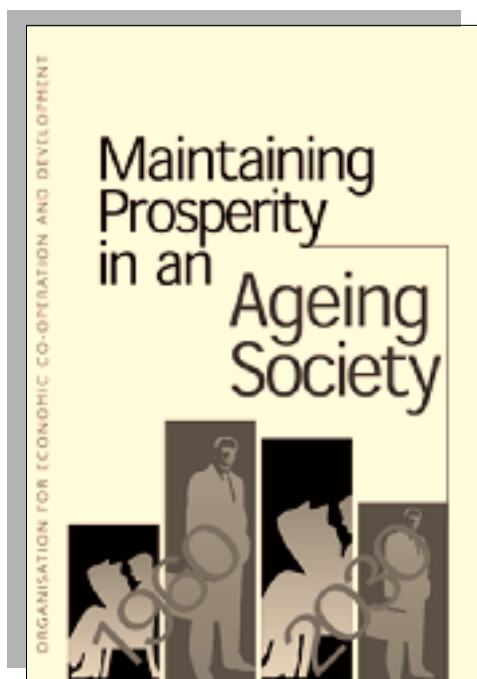
OECD TOKYO Centre
Landic Akasaka Bldg
2-3-4 Akasaka, Minato-Ku
TOKYO 107
Tel: (81-3) 3586 2016
Fax: (81-3) 3584 7929
E-mail: center@oecdtokyo.org
Internet: www.oecdtokyo.org

MEXICO

OECD MEXICO Centre
Edificio Infotec,
Av. San Fernando No. 37
Col. Toriello Guerra
Tlalpan C.P.
14050 MEXICO D.F.
Tel: (525) 528 10 38
Fax: (525) 606 13 07
E-mail: ocde@rtn.net.mx
Internet: rtn.net.mx/ocde/

UNITED STATES

OECD WASHINGTON Center
2001 L Street N.W.,
Suite 650
WASHINGTON D.C. 20036-4922
Tel: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: www.oecdwash.org
Toll free: (1-800) 456 6323



FF120 US\$20 DM36 £12 Y2550
ISBN 92-64-16093-0 128pp.

Maintaining Prosperity in an Ageing Society

Over the next twenty-five years around 70 million people will retire, to be replaced by just 5 million new workers.

This contrasts strongly with the past period where 45 million new pensioners were replaced in the workforce by 120 million baby-boomers.



KEYWORDS:

- Ageing
- Social Policy
- Financial Market Policy and Regulation
- Living Standards
- Quality of Life
- Demography
- Active Ageing
- Pensions
- Long-term Care
- Lifelong Learning
- Disability
- Retirement
- Early Retirement

OECD

A POTENT INSTRUMENT OF GLOBAL CHANGE
www.oecd.org/bookshop