

ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Ageing Populations : High Time for Action

(Background paper prepared by the OECD Secretariat)

1. Ageing : the challenges ahead

Population ageing is gathering momentum

Over the past decade, there has been heated debate on the socio-economic consequences of population ageing. The trends are clear. People are living longer and longevity will continue to improve in coming decades, while fertility has declined and is likely to remain below reproduction rates in the predictable future. As a result, the number of elderly people will rise significantly relative to the number of people of working age (Chart 1). Today, the population over age 65 represents 20% to 30% of the population aged 20-64 in G7 countries.¹ At current trends, this dependency ratio will reach 35% to over 50% by 2030, and 40% to more than 70% by 2050. Population ageing is more pronounced in Japan and some European countries (notably Italy and Germany), than in Canada and the United States, and starting positions are also different across countries. But the process is proceeding everywhere.

It can be argued that population ageing is nothing new. The process is gaining momentum, however. In less than a decade, the dependency ratio will rise in most G7 countries by as much as it did over the past three decades.

Unless policies change, lower growth or absolute falls in the size of the labour force can be expected

The rapid increase in dependency ratios means that it will become harder to maintain continued increases in living standards, unless available labour resources are better mobilised. Assuming unchanged participation patterns, the size of the labour force will practically stop growing in Canada and the United States, and it will stagnate or even fall in the other G7 countries (Chart 2).

Obviously, a slowly-growing or falling labour force will directly affect economic growth through lower labour input. In addition, population ageing in a context of stagnant or declining labour supply may also indirectly affect economic growth to the extent that higher taxes are

¹ By using population aged 20-64 in this calculation, instead of population aged 16-64 (the standard definition of working-age population), the group of teenagers is excluded. The reason is that teenagers are often enrolled in education, which may promote human capital and employability later in life, and employment goals vis-à-vis this group are therefore more complex.

needed to fund pension and health systems, to the detriment of productive investment and work effort. In short, there is a real risk that population ageing will impact negatively on living standards.

This bleak scenario need not materialise: much will depend on whether the G7 and other OECD countries succeed in raising labour utilisation rates (which is a product of employment rates and hours worked) and trend productivity growth. The scope for raising labour utilisation is especially large in France, Italy and Germany. Indeed, much of the income gap between these three countries and the United States (the G7 country with the highest per capita income) is attributable to labour utilisation (Chart 3).

Though demographic trends and their potential socio-economic impacts have been discussed for quite some time,² what is needed now is a policy shift to reduce barriers to employment and work effort, to promote more effective lifelong learning and thus increase the resources available to society.

2. Improving employment prospects for all groups

Many working-age individuals who could work are either unemployed or “inactive”

Some 35% of working-age people are without a job, on average, in the OECD area (Chart 4). Non-employment is lower than the OECD average in the United Kingdom, the United States, Canada and Japan, and higher than average in Germany, France and Italy. Youth, women and older workers are particularly affected by either unemployment or labour market inactivity (Charts 5 and 6).

It is neither possible nor desirable to move all potential workers into employment. Non-employment sometimes reflects individuals' work-leisure preferences. For instance, some mothers – especially those with young children – may prefer to take care of their children or elderly relatives rather than participate in the labour market.³ Young people may want to

² Demographic trends and their possible consequences have been highlighted on several occasions. See for instance *Maintaining Prosperity in and Ageing Society*, OECD, 1998.

³ It should, however, be stressed that such work-family choices among mothers are complex and do not always reflect purely individual or household preferences, but also incentives and disincentives embedded in government tax and benefit programmes.

postpone entry into the labour market by prolonging study, which may lead to better human capital, higher productivity and improved employability later in life. And retirement is sometimes a household not an individual decision: when one partner retires, it is often the case that the other partner withdraws from the labour market, even if this means a loss of income. Clearly, governments should respect these differences in life situations and personal preferences.

Strengthening opportunities for greater labour market participation

However, non-employment is often a matter of policy concern. Non-employed people of working age often receive a welfare benefit. But benefit recipients who can work should not be discouraged to find a job. This means that “benefit traps” –which arise when benefit recipients have weak financial incentives to move to employment -- should be minimised or eliminated. Therefore, tax/benefit reform could help ensure that work pays relative to benefit receipt for as much of the inactive population of working age as possible.

More generally, a “mutual obligations” approach (sometimes called a “rights and responsibility” agenda) would help improve employment chances of the non-employed. Under such an approach, governments would provide these individuals with effective re-employment services, counselling, training and financial incentives to enable them to find work –the “rights”. Beneficiaries, in turn, should take active steps to find work or improve their employability –the “obligations”. If they do not fulfil their obligations, they could be subject to benefit sanctions.

In addition to a mutual obligations approach, a strategy to raise employment rates should also make jobs more accessible and strike a better balance with family life. These considerations are especially relevant to mothers with young children (or who are caring for elderly relatives) who want to participate in the labour market.⁴ For instance, the opportunity to take paid maternity leave may increase women’s attachment to the labour market –though it should be stressed that extended leave is likely to make more difficult and uncertain the return to employment, especially for women with insecure employment status. For parents with young children, evidence suggests that the availability of child-care services plays a crucial role in the decision to return to work. And the expansion of part-time employment has been very

⁴ See *Babies and Bosses: Reconciling Work and Family Life*, OECD, Volume 1 (2002), Volume 2 (2003), Volume 3 (2004), Volume 4 (2005, forthcoming). See also Chapter 6 in OECD (2005), *Economic Policy Reforms*.

instrumental in countries with high female participation rates, such as the United Kingdom where more than 40% of employed women work part-time.

Likewise, health problems are one of the main reasons for withdrawing from the labour market, especially among workers aged over 50. While a considerable proportion of those no longer in work for health reasons would like to return to work, employment rates among disability benefit recipients are relatively low. Here too, much more can be done to support access to the labour market among people with disabilities. While this is not an easy task, reflecting both the very diverse character of the population of disability beneficiaries and the political sensitivities involved, many OECD countries are now assigning a high priority to mobilising more of the disabled into work.⁵

Removing demand-side obstacles to employment

Also, it is essential to address demand-side barriers to job creation in general. This includes, in particular, reforming employment regulations in countries where they are overly strict, reducing labour taxes on low-paid employment and ensuring that wage formation systems reflect changing economic circumstances.

The role of job-related training

Finally, the career progression of those who get into work should receive more policy attention. Many workers get trapped in low-paid jobs and face considerable employment instability. As the 2003 OECD *Employment Outlook* shows, a person holding a low-paid job in a given year will spend 4 out of the following 5 years in either low-paid employment or out of work altogether. This suggests that policies that help workers move up career ladders, such as vocational education and on-the-job training, should become important elements in any medium-term employment strategy.

Lifelong learning is especially important in the context of an ageing population. Due to the progressive obsolescence of skills throughout the working life, early formal education cannot suffice on its own to meet the challenges posed by technological change and globalisation. Countries are aware of the importance of lifelong learning but it is now time to go beyond the

⁵ See *Transforming Disability into Ability*, OECD (2003).

rhetoric. Indeed, policies can support investment in workers' skills. But given the benefits for firms and workers generated by training, it would be a waste for the public purse to fund training activities that would have been undertaken, even in the absence of the public subsidy. As a general principle, public support is more efficient when it is matched with a contribution from the recipient individual or firm. In other words, there should be an element of co-financing by firms and even individual workers (who can engage in learning outside working hours). In view of existing training inequalities,⁶ a key issue is whether, in the case of disadvantaged groups, co-financing relies more on the public purse and/or firms than is the case for other groups.

And the quality of certain learning activities leaves much to be desired, thereby leading to uncertainty about the returns to training. This is why it is so important to speed up efforts to ensure quality of training provision, which can be achieved by promoting competition among providers, better linking training to labour-market requirements and creating quality certification standards. More generally, policy evaluations are scarce in this area and need to be developed.

3. Older workers: key policy challenges

Promoting employment of older workers is crucial

Improving employment prospects for the over-50s (so-called "older workers") represents a particularly daunting challenge. It is also an increasingly important one. Indeed, reflecting the greying of workforces, the size of the population aged 50-64 in the total working-age population will increase substantially in coming years. By 2030, more than one in three persons of working age will be over age 50 in G7 countries, compared to one in four today. Therefore, in the face of population ageing, it is vital to improve labour market retention and hiring prospects for the over-50s.

Pension systems and welfare systems should not subsidise early retirement

This would involve further reform of pension systems so as to ensure that the effective age of retirement shifts closer in line with demographic developments, as in Italy where a link between pensions and contributions has been provided. Ensuring that decisions to retire before

⁶ For instance, on average, low-educated workers get less than half as much firm-training as their high-educated counterparts (see 2003 OECD *Employment Outlook*).

statutory age are subject to actuarial neutrality is another important issue. Reforms are underway in all G7 countries, but sometimes the measures are too timid or they are being phased-in very slowly.⁷

There is also growing recognition that subsidised early retirement should be stopped –an issue especially important in France, Germany and Italy.⁸ Access to other schemes such as long-term sickness and disability benefits (notably in the United Kingdom and the United States –see Chart 7), which may serve as alternative pathways to early retirement even if this is not their purpose in theory, should also be tightened up. Such practices are counter-productive. They increase social spending, adding upward pressure on labour costs and inhibiting job creation.

If they become openly unemployed, older job seekers should be offered effective re-employment services and support

To the extent that older workers who lose their job will no longer withdraw from the labour market through early retirement or other welfare schemes, they will become openly unemployed. They will therefore need job-search support and effective re-employment services. While unemployed older workers should no longer be exempted from active job search, public employment services themselves should make greater efforts to help these individuals find a new job and provide them with high-quality activation services. The “New Deal 50 Plus” programme in the United Kingdom and “One-Stop Centers” in the United States are cases in point. There may also be a role for wage subsidies or cuts in social security contributions targeted on older long-term unemployed, as is done in France and Germany.

Action on the demand-side

Adjusting pensions and welfare benefits, necessary as it is, may not do the trick if employers and older workers themselves do not change their attitudes and behaviours drastically. Indeed, the fact is that, when firms have to lay-off workers, employers and unions tend to negotiate the most favourable redundancy packages for older workers. Greater emphasis

⁷ Reforms aiming at improving employment prospects of older workers are examined in the OECD thematic review entitled *Ageing and Employment Policies*. All G7 countries, as well as 14 other OECD countries, are covered in these reviews –see www.oecd.org/els/employment/olderworkers.

⁸ For estimates of the subsidy to early retirement, or the implicit tax on continued work, embedded in social security systems, see Chapter 5 of OECD (2005), *Economic Policy Reforms*.

on lifelong learning, as well as changing employment and wage practices, would facilitate the retention and hiring of older workers. However, age discrimination at the workplace may be a factor as well and anti-discrimination measures in this area may need to be strengthened.

This raises the further issue of whether mandatory retirement at a particular age should be regarded as a form of age discrimination. The issue has been much discussed in several countries and action has been taken in Japan to at least increase the minimum age at which mandatory retirement can be applied. But it would seem logical to prohibit mandatory retirement as part of the overall reform strategy intended to ensure that workers have the opportunity to extend their careers in line with improved longevity. Indeed, an actuarially fair pension system would not interfere with the retirement decision of older workers.

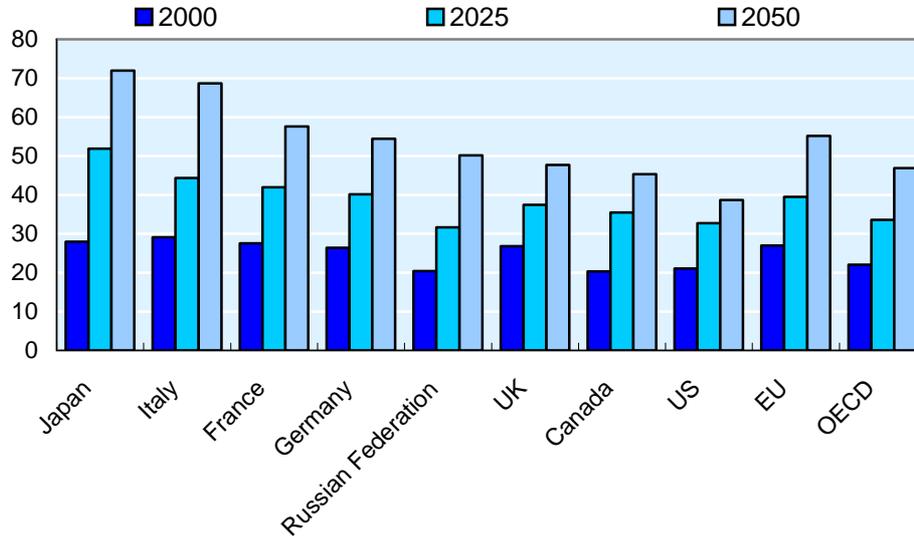
One crucial way to help older workers to find or retain a job is by enhancing their employability. Part of the solution to this is to take a lifelong perspective, ensuring that across the labour market regular training becomes a habit at all ages. The Lifelong Learning Plan of Canada is an interesting recent initiative in this respect. Moreover, more emphasis is needed to ensure that work environments are safer and healthier. All too often, dangerous or stressful workplaces will make it difficult for older workers to stay in existing employment. Promoting good practices in this area would prove very useful.

Re-entry into work for older workers who lose their jobs is difficult. It is therefore tempting to introduce legislation which raise the cost of layoff for older workers. Experience with some measures, however, suggests that their impact on employment of older workers may be limited. Also, they might have serious adverse consequences for workers that would be close to the age at which more stringent provisions came into force. Instead, reforming employment and wage practices and investing in workers' skills throughout career are probably more effective in fostering retention of older workers.

In short, a comprehensive package of measures are required which act both on the demand and supply side to encourage workers to remain longer in the workforce.

Chart 1. Old-age dependency ratios will rise dramatically in all G8 countries

Old-age dependency ratio^a

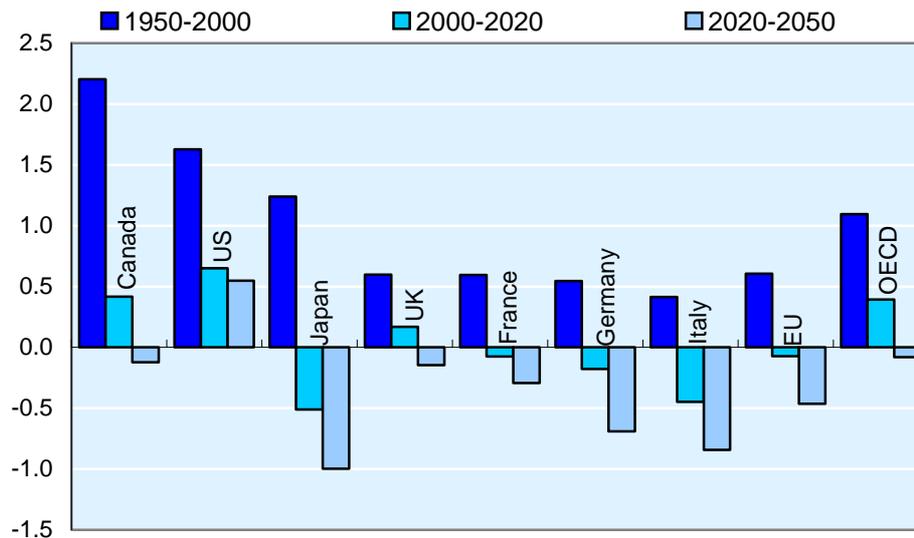


a) Ratio the population aged 65 and over to the population aged 20-64.

Source: OECD database on the “Ageing and Employment Policies” and UN, *World Population Prospects 1950-2050* (The 2002 Revision) for the Russian Federation.

Chart 2. The size of the labour force will grow little or even fall in some G7 countries

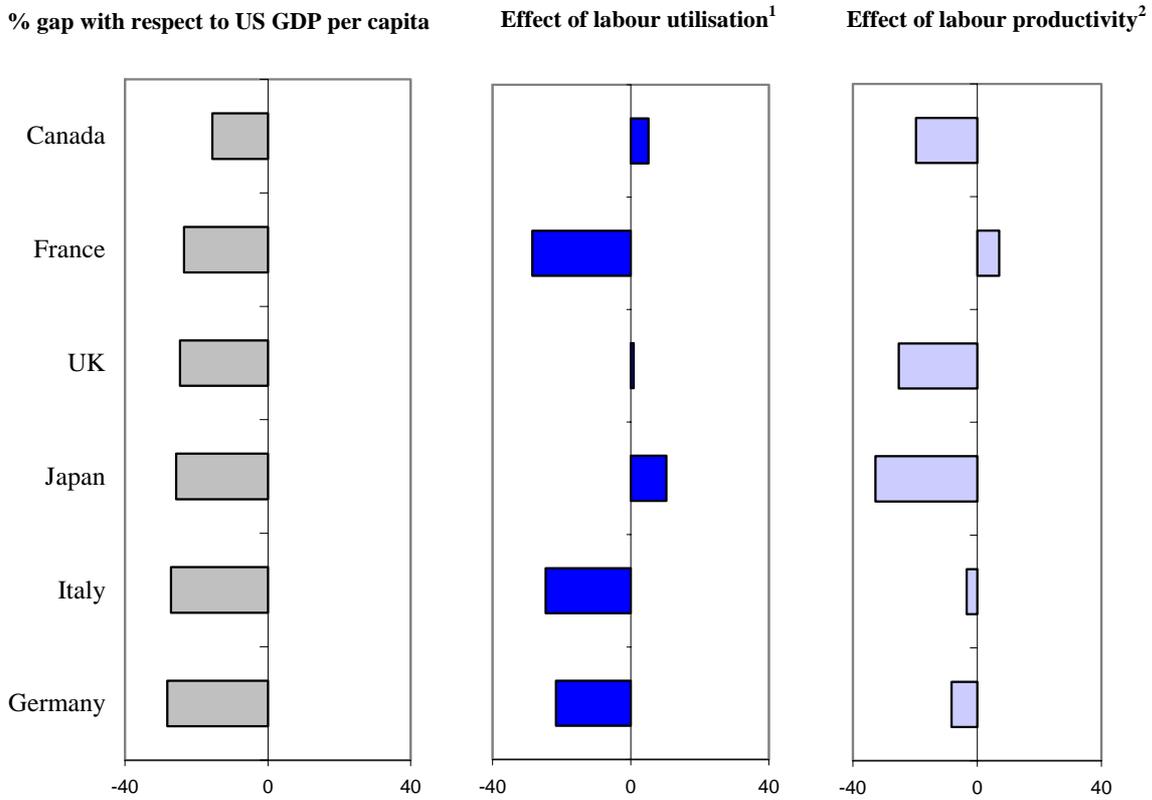
Labour force growth, under the assumption of constant participation rates^a



a) The projections of labour force growth over the period 2000-2050 assume that participation rates by five years age-groups and gender remain constant at their 2000 levels.

Source: OECD database on Labour Force Statistics and OECD estimates.

Chart 3. Lower labour utilisation largely explains Continental Europe's relative performance
In 2002, at 2000 PPPs

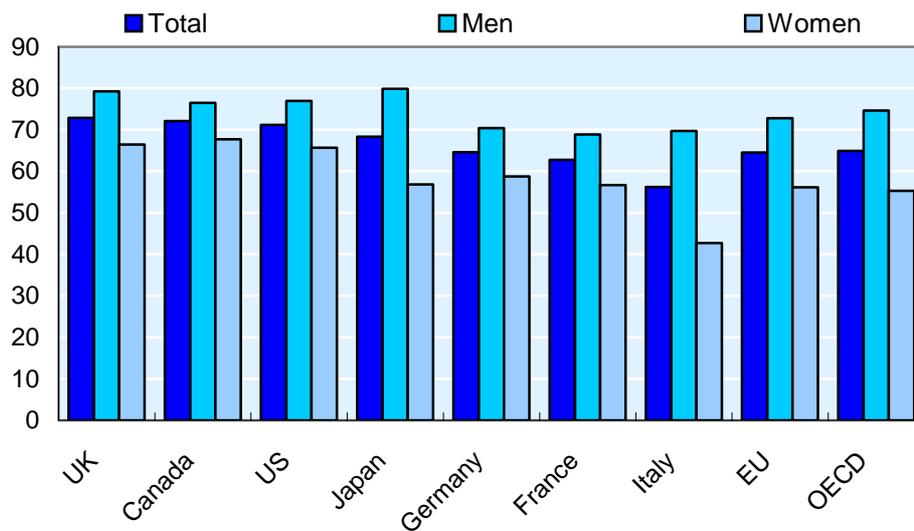


1. Labour utilisation is measured as total number of hours worked divided by population.

2. Labour productivity is measured as GDP per hour worked.

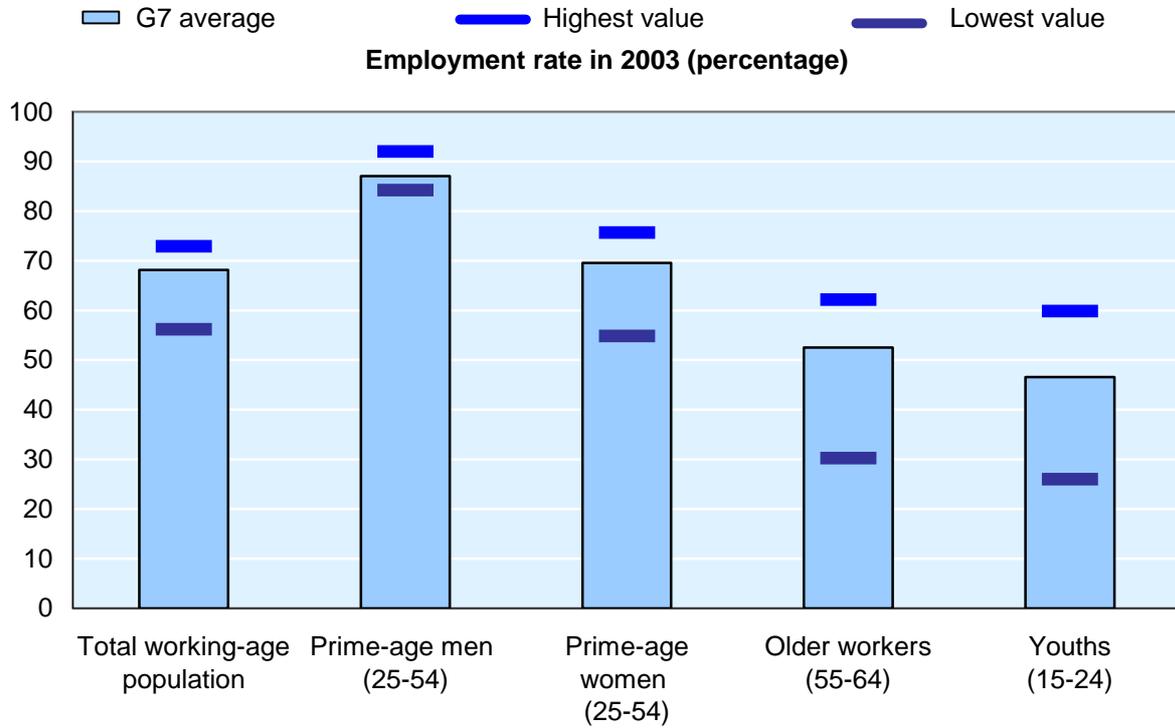
Source: OECD.

Chart 4. Employment rate for persons aged 15-64, 2003



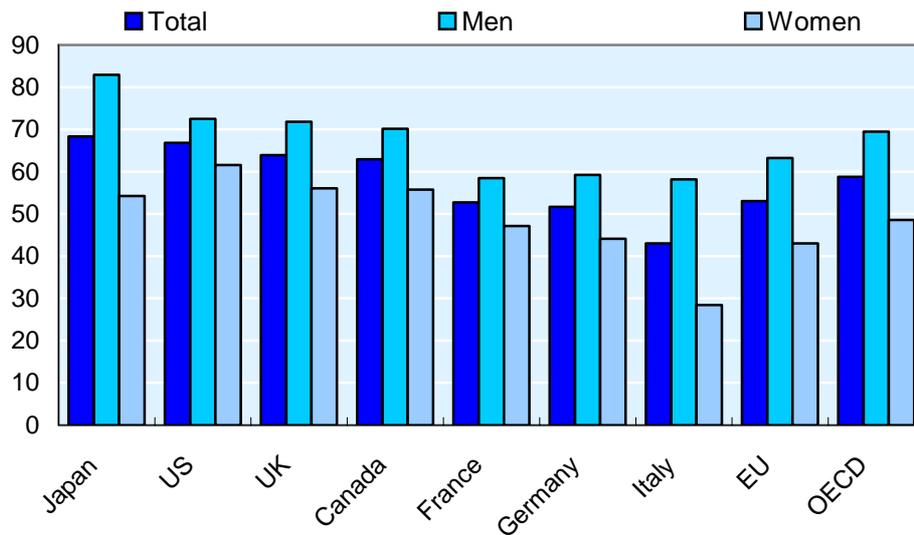
Source: OECD database on Labour Force Statistics

Chart 5. Some groups are significantly under-represented in employment



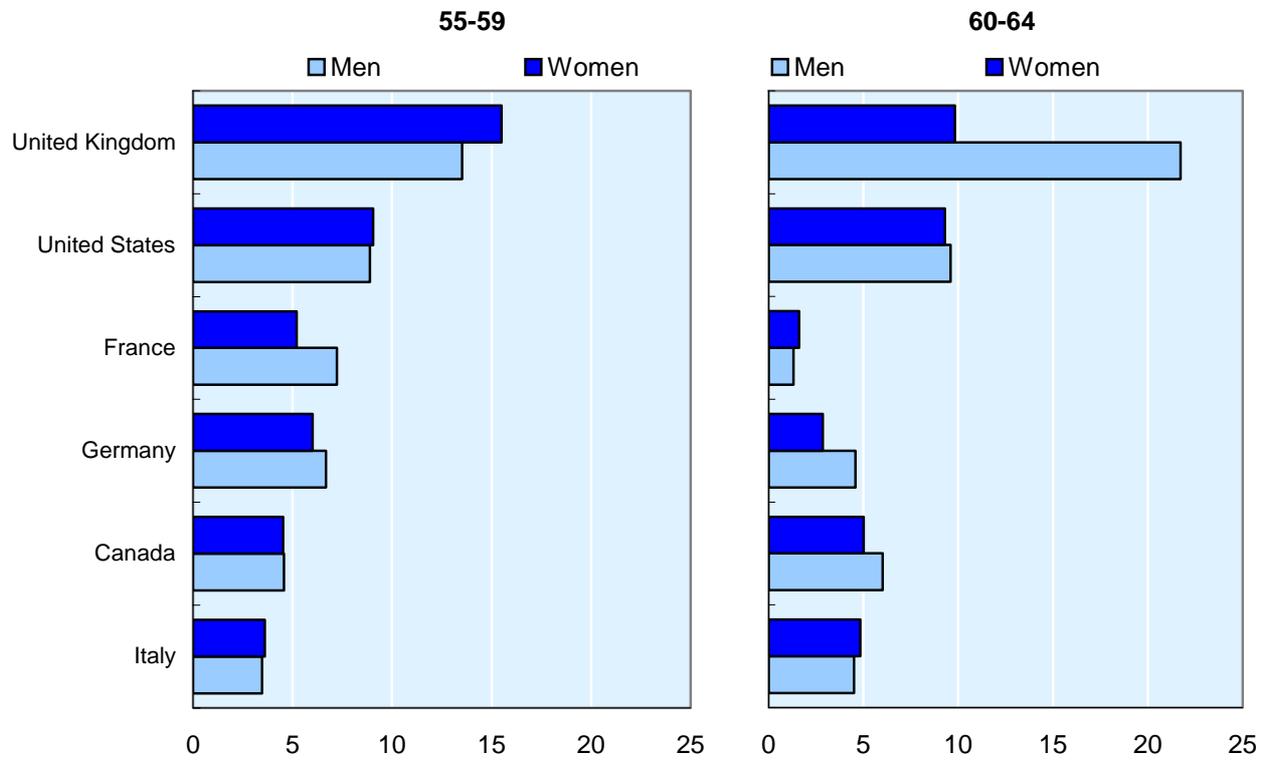
Source: OECD database on Labour Force Statistics

Chart 6. Employment rate for persons aged 50-64, 2003
Percentage



Source: OECD database on Labour Force Statistics

Chart 7. Percentage of inactive persons because of sickness or disability, 2003



Note: the Chart gives the number of persons who declare themselves sick or disabled, as a per cent of total population of the relevant age group.

Source: OECD estimates.