

The ageing issue What do we have to do ?

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Itinera

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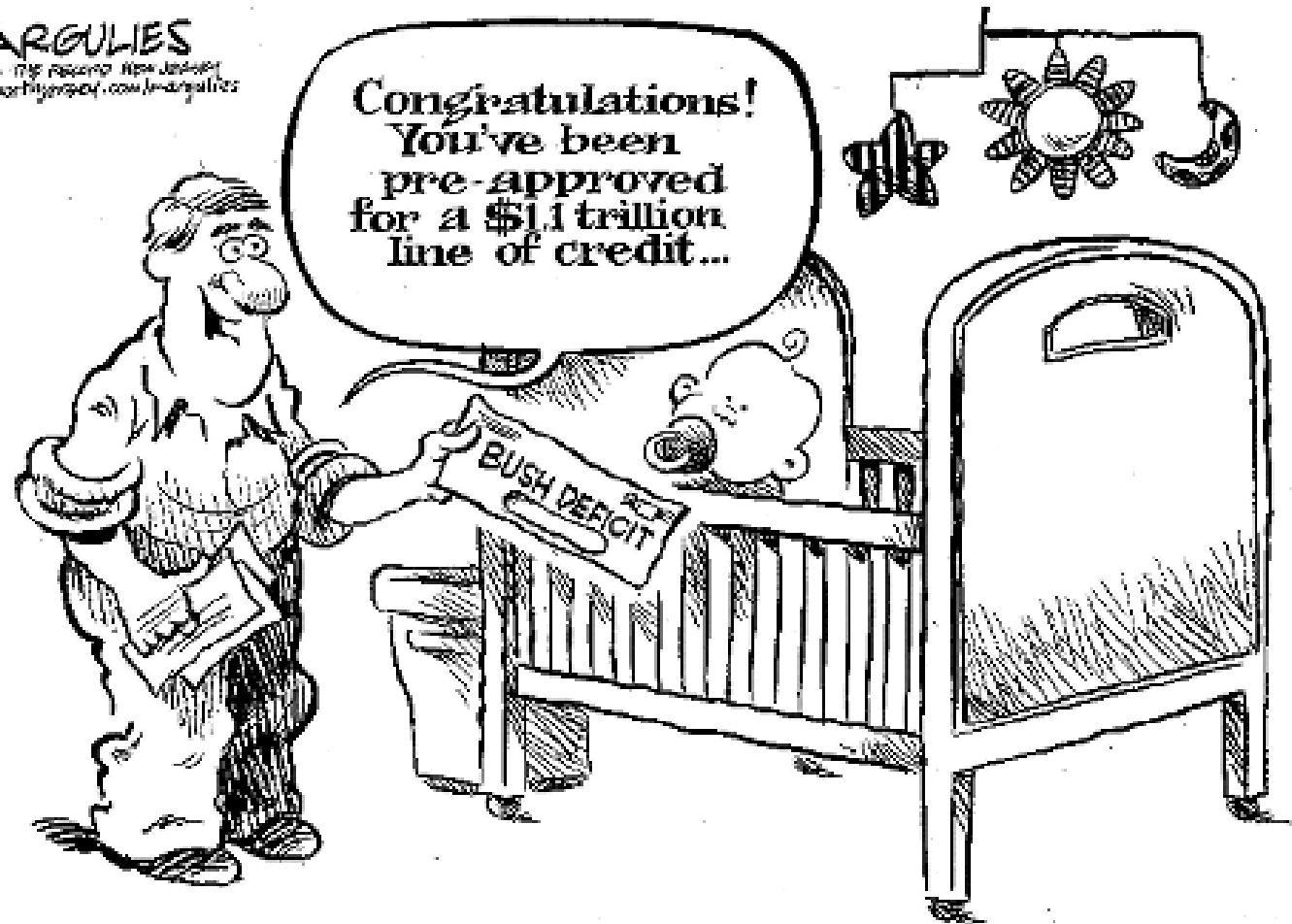
Overview

- 1. The background**
- 2. Long-term view about ageing**
- 3. Impact of the crisis**
- 4. The policy agenda**
- 5. Conclusion**

1. The background



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Background - global

- **Demographic evolution**
- **Environmental challenge**
- **Economic globalization, without effective political coordination**
- **Stagnating purchasing power over last decades and risks of decline over the coming decades**
- **Intergenerational transfers**
see next slide

The debt power three

- **High official public debt**
- **High overall tax pressure, in particular on regular labor**
- **High implicit debt**
 - **Environmental debt**
 - **Large but no precise estimate**
 - **Still growing**
 - **Social security debt**
 - **unfunded liabilities towards people at work**

Background – Belgium – pensions (1/2)

- **Purchasing power of the elderly :**
 - **Low first pillar replacement rate ... for those with full career in the private sector**
 - **Purchasing power on average in line with the one of the population at large**
 - **Higher poverty rates ... and higher assets**
 - **Uneven access to private pension schemes**
 - **Large gap between statutory public sector pension and other regimes**

Background – Belgium – pensions (2/2)

- **Low participation rate of the elderly**
 - **Impact of the pension system**
 - **Impact of the business cycle**
 - **Impact of the Solidarity Pact (2005) : too little, too late**
- **Low rate of return on social contribution / high implicit tax rate on extra year at work**
- **Lack of actuarial neutrality – lenient “malus” in case of early retirement**
- **Generous treatment of “assimilated” years**
- **High degree of redistribution (uncapped contributions but capped benefits)**

2. Long-term view about ageing

EU 2009 Ageing Report

	(in % of GDP)		Belgium		EU15	
			level	change	level	change
			2007	to 2035	2007	to 2035
• Pensions			10.0	+4.4	10.2	+1.8
• Health care			7.6	+1.0	6.9	+1.0
• Long-term care			1.5	+0.7	1.3	+0.6
• Unemployment			1.9	-0.4	0.8	-0.2
• Education			5.5	-0.1	4.3	-0.3
• TOTAL			26.5	+5.6	23.5	+3.0

Belgium – Annual Report Of the Aging Study Group

(in % of GDP)

change 2008-2060

**central
scenario**

**with end
early retirement**

• Pensions	+ 5.3%	+ 4.7%
• Health care	+ 4.2%	+ 4.2%
• TOTAL	+ 8.2%	+7.0%
Vs. previous year	+ 2 %	

Belgium, an European country

Changes in age-related expenditure (2010-2060, percentage points of GDP)

	Pensions	Health care	Long-term care	Unemployment	Education	Total
BE	4.5	1.1	1.3	-0.4	0.1	6.6
DE	2.5	1.6	1.4	-0.2	-0.2	5.1
IE	5.9	1.7	1.3	0.0	-0.2	8.7
EL	12.5	1.3	2.1	-0.1	0.2	16.0
ES	6.2	1.6	0.7	-0.4	0.2	8.3
FR	0.6	1.1	0.7	-0.3	0.0	2.2
IT	-0.4	1.0	1.2	0.0	-0.2	1.6
CY	10.8	0.6	0.0	0.0	-0.6	10.7
LU	15.3	1.1	2.0	0.0	-0.3	18.2
MT	5.1	3.1	1.6	0.0	-0.6	9.2
NL	4.0	0.9	4.6	0.0	-0.1	9.4
AT	1.0	1.4	1.2	0.0	-0.2	3.3
PT	1.5	1.8	0.1	-0.3	-0.2	2.9
SI	8.5	1.7	1.7	0.0	0.7	12.7
SK	3.6	2.1	0.4	-0.1	-0.5	5.5
FI	2.6	0.8	2.5	0.0	0.0	5.9
EA	2.7	1.3	1.3	-0.2	0.0	5.1

Source: Commission services and EPC.

Demographic assumptions

- **Fertility**
 - **Increase from 1.54 births per woman in 2008 to 1.60 in 2030**
- **Life expectancy at 65**
 - **Slowing down of the increase**
 - **in 2060 : 21.8 years for men (+5.5 years vs. 2008)**
 - **In 2060 : 25.1 years for women (+5.2 years vs. 2008)**
- **Migration**
 - **+ 46 million people in Euro area over 2008-2060**

(source : 2009 Ageing Report, pp. 35 -69)

Labor markets assumptions

- **Participation rates**
 - + 9 percentage points in 2020 (Euro area)
 - +13.5 percentage points in 2060 (Euro area)
- **Structural unemployment**
 - From 7.5% in 2007 to 5.9% in 2020 (Euro area)
- **Productivity**
 - +1.6% per annum over 2007-2060 (Euro area)
- **Average hours worked**
 - Status quo over 2007-2060 (Euro area)
- **GDP growth**
 - +1.6% per annum over 2007-2060 (Euro area)

(source : 2009 Ageing Report, pp. 35 -69)

Comments about assumptions

- **Favorable demographic evolution**
 - **Fertility, life expectancy, migration**
- **Favorable economic assumptions**
 - **Higher participation rates ?**
 - **Despite the crisis – recent improvement owes a lot to strong labor markets**
 - **Despite the voting power of the elderly (median age set to increase from 40.4 years in 2008 to 47.9 years in 2060)**
 - **Lower structural unemployment ?**
 - **Unchanged productivity gains ?**
 - **Not impacted by ageing**
 - **Not impacted by the crisis**

Uncertainty

- **Demographic trends are relatively predictable BUT nevertheless long-term projections are fragile**
 - **Worsening of the projections**
 - **Belgium : year after year higher ageing costs according to the Annual Report of the Ageing Committee, partly due to discretionary measures**
 - **Euro area (change over 2007-2050) :**
 - **Ageing Report 2006: +4.1 %**
 - **Ageing Report 2009: +5.0%**
- despite a lower increase in old-age dependency ratio vs. 2006 report**

(source : 2009 Ageing Report, p. 33)

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3. Impact of the crises

Impact of the financial crisis – short term

- **Rescuing of financial institutions**
 - **Huge amounts, partly in exchange of assets**
- **Stimulus plan**
 - **Limited magnitude in Belgium**
- **Impact of economic recession**
 - **Automatic stabilizers (mostly through lower tax revenue)**
 - **Lower GDP means higher public debt ratios**

Impact of the financial crisis – long term

Structural evolution

- **Some activities are gone, forever**
- **Greater risk aversion,**
 - >> lower trend output growth**
- **Push for structural reforms**
 - **Higher retirement age**
 - **Higher consumption taxes**

BUT

- **Risk of giving the priority back to direct concerns**
 - **early retirement likely to be back in fashion (Carrefour, Godiva, Opel, ...)**

Sovereign debt crisis – mindset

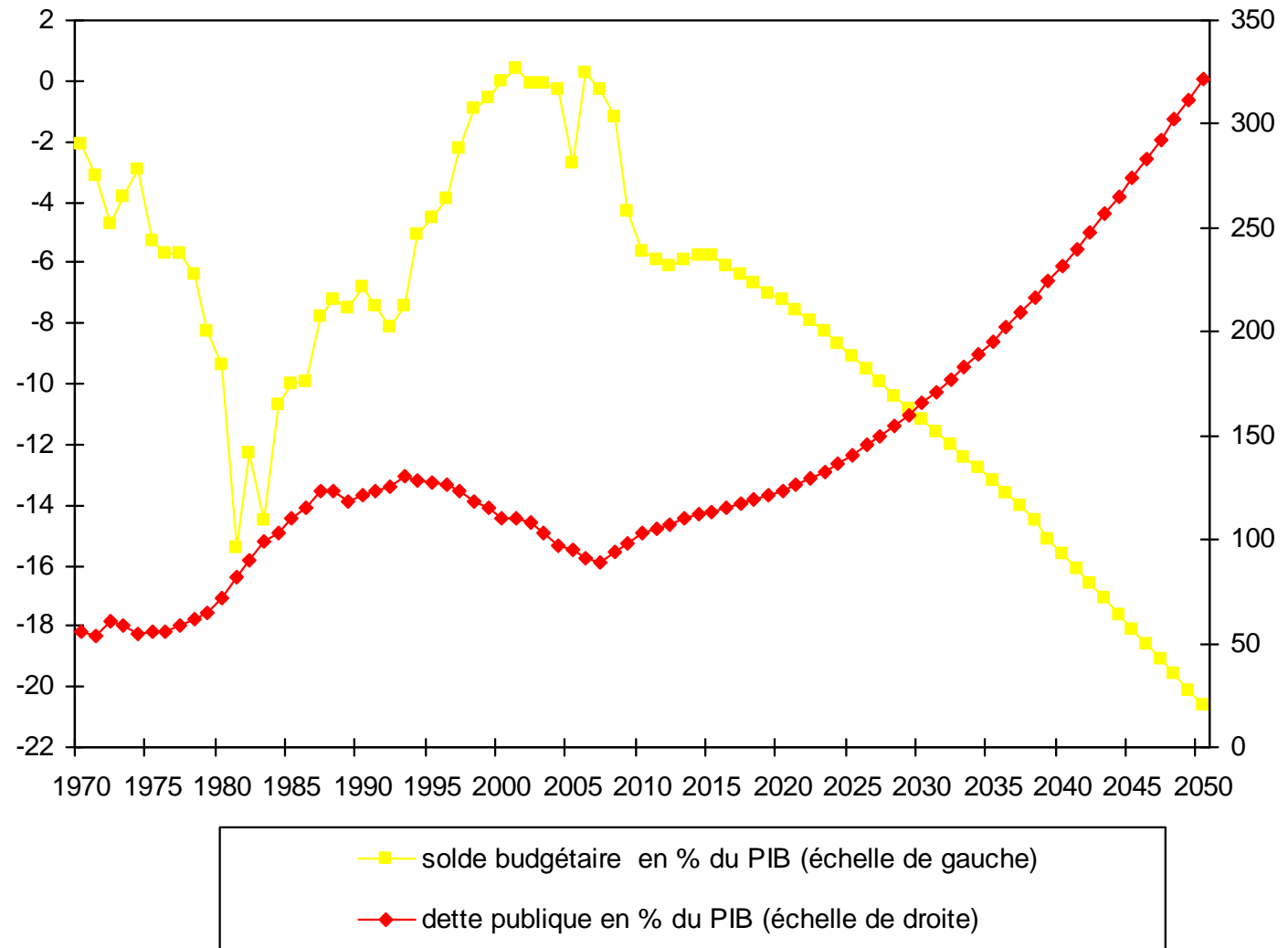
- **“The fiscal issue is a consequence of the financial crisis”
thanks scapegoats**
- **“Fiscal austerity will lead to a double dip”
financial markets are Keynesians !**
- **“Wrong moment to increase the retirement age”
individual interests dominate the common good**

Sovereign debt crisis – economic analysis

NEED for explanations

- **The sovereign debt crisis is only to a limited extent due to the financial crisis; it is first of all a governance crisis**
- **Ricardian equivalence : deficits are fuelling private savings**
- **High debts leads to monetization fears, i.e. to higher interest rates**
- **Low retirement age leads to more youth unemployment**

Unchanged policy scenario, a non-scenario



We are all Athenians



4. The policy agenda



Step 1 : to acknowledge the issues at stake

- **There is a not marginal risk of impoverishment over the coming decades**
- **Elderly workers are often tired of working and keen to retire early**
- **Our social security system is no longer best-in-class**
 - **Poverty rates**
 - **Structural unemployment**
 - **Discriminations**
 - **Health care costs**
 - **Social mobility**

(not only the social security to be blamed)

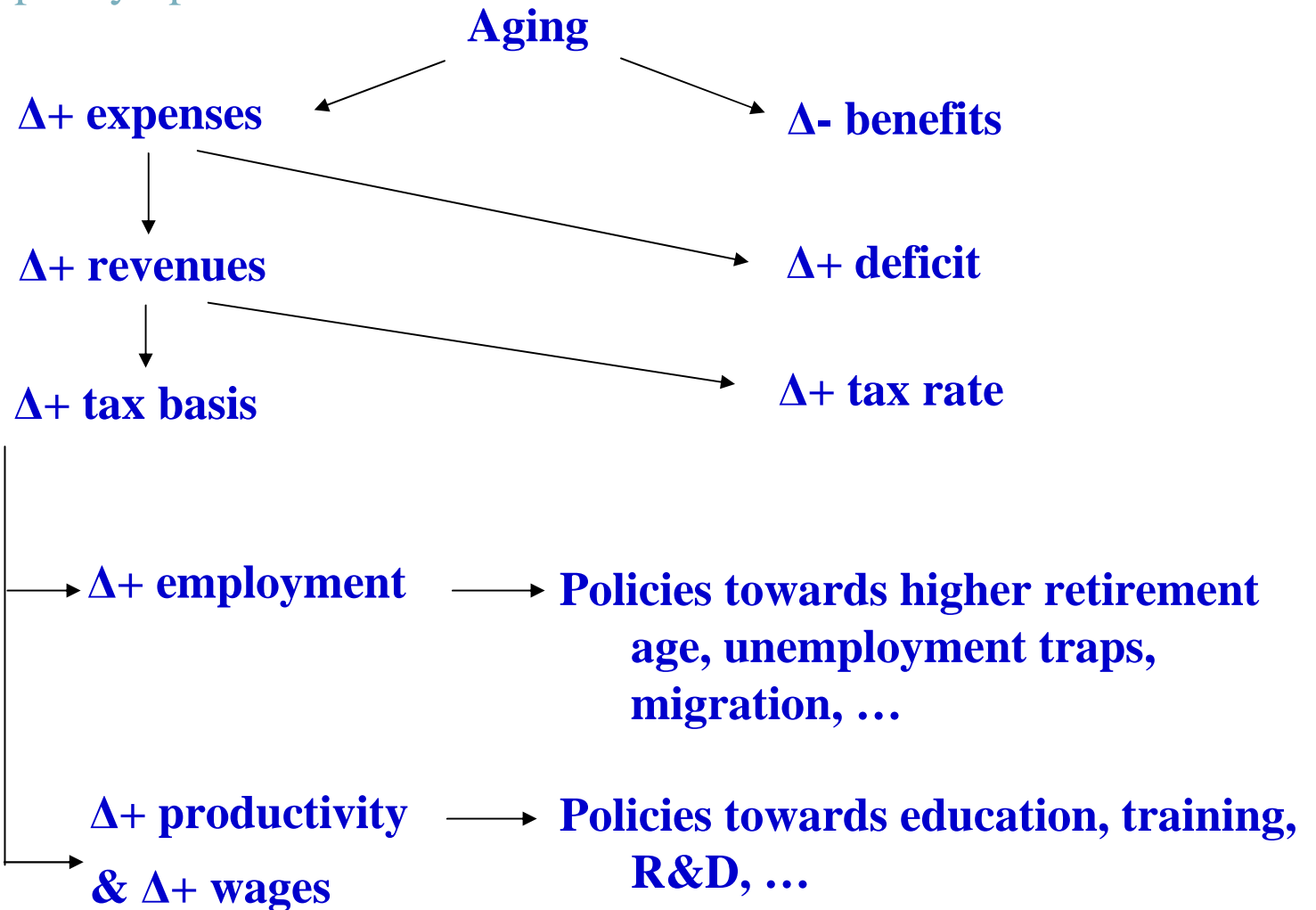
Step 2 : to reject the “don’t worry” approach

- **“Don’t worry, the weight of interest charges will decline”**
- **“Don’t worry, thanks to the GDP growth, the pie will get bigger”**
- **“Don’t worry, the large public debt is matched by the even larger private assets”**
- **“Don’t worry, early retirees free up jobs and provide voluntary work”**

Step 3 : to propose a global and balanced reform

- **To foster the economic rate of growth in a sustainable way and with attention for current and future inequalities**

The policy options



The pension agenda – item 1 : more people at work (1/5)

- **We live longer, start to work later, and have fewer kids**
 - **Option 1 : To pass the bill to the next generations**
 - **Option 2 : To increase taxes and social security contributions**
 - **Option 3 : To lower benefits**
 - **Option 4 : To retire later**
- **Option 4 is the less undesirable**
 - **It allows both to reduce outlays and increase revenues**
 - **It boostes potential output growth**
 - **It increases purchasing power**

The pension agenda – item 1 : more people at work (2/5)

- **To retire later ? Not easy**
 - **People like it**
 - **To work is not always that enjoyable**
 - **The net income is not that different**
 - **Politicians like what people like ... and the age of the median voter is getting higher and higher**
 - **Trade unions like it**
 - **It meets the demand from the members**
 - **It shrinks the labor supply**
 - **Corporations like it**
 - **Older workers have higher labor cost per unit of product and to fire them is difficult & expensive**

The pension agenda – item 1 : more people at work (3/5)

- **How to achieve a higher effective retirement age ?**
 - **To eliminate the early retirement schemes**
 - **To move towards actuarial neutrality**
See following slides
 - **To scrap the favorable tax treatment of replacement income**
 - **To raise the age to benefit from the private pension scheme**
 - **To reform the labor market**

See following slides

The pension agenda – item 1 : more people at work (4/5)

- **To move towards actuarial neutrality**
the tax wedge on an additional year at work is way too high :
those with a longer career deserve a more generous pension,
those with a shorter career are entitled only to a more modest pension

how to do it ? To determine a reference career duration (42 years?) and have a bonus/malus around it

how big the differentiation ? The old penalty of 5% per annum gives a rough indication

reference career duration is to be indexed on life expectation (cf. Sweden)

The pension agenda – item 1 : more people at work (5/5)

- **To reform the labor market**
 - **To allow for more professional mobility**
 - **harmonization of social status regimes**
 - **portability of social rights**
 - **To allow for negative promotion (« demotion »)**
 - **To cap wage-earners social security contributions**
 - **To hold cies accountable for their hiring & firing behavior**
 - **To promote life-long learning**
 - **To compensate for painful jobs through higher wages and private pension schemes**

The pension agenda – item 2 : the public sector pension scheme (1/2)

- **The implicit contract with civil servants was :**
 - **Get poorly paid**
 - **Get generous pension (even if no 2nd pillar)**
 - **Get job protection**
- **The contract has changed on all three scores :**
 - **No longer poorly paid (with the exception of bachelors)**
 - **Generous pension worth more due to aging**
 - **Job protection worth more due to labor market evolution**
- **In addition :**
 - **Generous pension is no way to attract the best people**
 - **Job protection goes against efficiency**
 - **Discrimination against contract civil servants**

The pension agenda – item 2 : the public sector pension scheme (2/2)

- **What to do :**
 - **To suppress the specific pension regime of civil servants (75% rate for all, “perequation”, free study years, best last 5 years at max, privileged bonus scheme, low “tantièmes”, ...)**
 - **To suppress special regimes (army, education, ...)**
 - **To hold life-long tenure jobs only where independence is key (judges, f. i.)**
 - **To review wages on the basis of market benchmarks**
 - **To have Regions & Communities footing the pension bills of their employees**
- (with some grand-fathering)**

The pension agenda – item 3 : assimilated years

- **The general statement that “Pensions in Belgium are low” suffers 3 limits :**
 - **Generous civil servants’ pension scheme**
 - **Too limited penalty on early retirement**
 - **Assimilated years**
- **Assimilated years**
 - **On the one hand, don’t penalize twice the one who has an incomplete work career due to illness & involuntary unemployment**
 - **On the other hand, don’t have such a high effective tax rate on labor income**
 - **To be more selective in assimilating non-working years**

Conclusion

Conclusion



Conclusion

- **Major challenges / the status quo is no option**
- **To work longer is a key objective of any reform**
“We need a Generation Pact times 100”
(Luc Coene, Trends, April 2, 2009)
- **We need a global overhaul of our pension system**

Disclaimer

All opinions expressed in this document constitute the judgment of the author, without implying whatsoever his current employer.