Secretariat of the Economic Council of Finland

Ageing Europe: Implications for the labour market and public expenditure

Helsinki
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The population is ageing rapidly in almost all EU Member States. Although each Member State is responsible for its own policy solutions on ageing, it is also important that we work together to consider the challenges created by the ageing population, and to exchange experiences and pool resources in seeking the best solutions to these challenges. The national Economic and Social Councils and the European Economic and Social Committee are key forums in the search for generally acceptable solutions to the challenges of ageing. Solutions must cover the entire spectrum of the Economic and Social Councils' sphere of operations. Seeking consensus in these matters concerning ageing is the main task of the councils and therefore forms the theme of the meeting of the Presidents and the Secretaries-General of the Economic and Social Councils of the EU Member States and the European Economic and Social Committee to be held in Helsinki on November 23, 2001.

The purpose of this memorandum is to generate discussion at the meeting in Helsinki. It focuses on the dwindling labour supply, which is one implications of the ageing population, and on the growing pension and health care expenditure. This is an amended version of the memorandum issued for the meeting of the Secretaries-General on May 11, 2001. The Secretariat of the Finnish Economic Council wishes to thank the Secretariats of other Member States for their valuable comments and suggestions.

The Secretariat of the Economic Council of Finland

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1. EU cooperation important in preparing for ageing

One consequence of the increase in prosperity in developed countries has been an increase in life expectancy. This has also been promoted by improved working conditions, health and hygiene and a general improvement in health care. The increase in prosperity is also evident in the improved income level of pensioners.

While increased life expectancy is to be welcomed, the ageing of the population does, of course, have a considerable impact on the labour supply and on economic growth in general, as well as affecting the income distribution between different age groups through its impact on pension, medical and health care expenditure.

The large *baby boom* generation, born between 1945 and 1955 and still of working age, dominates the age structure in Member States. Although the balance between contributors and beneficiaries of social protection benefits is currently reasonably favourable in all Member States, the situation will change considerably over the next twenty years. Without immigration of labour from outside the EU, the supply of labour in the EU area will decline. Similarly, the old-age dependency ratio – population over 65 in relation to the working-age population aged 15-64 years – in Member States will rise from the current average of 23 per cent to 49 per cent by 2050, i.e. double the current figure. If, in the future, people retire as early as they do now, i.e. on average at 60, the ratio of beneficiaries to contributors (the economic dependency ratio) will change as dramatically as the old-age dependency ratio.

The aim of pension systems and social welfare and health care services is to secure a fair and reasonable standard of living and adequate services for those who have left working life. Both the rapid ageing of the population and the growth in work-related diseases will place considerable demands on economic and social policy in the future. The increase in people over the age of 80 in the next few decades in all Member States will increase the need for medical and health care services. Pension systems that were put in place during a different, more favourable demographic period must be reviewed critically. Delays in overhauling these systems will make it even more difficult to alleviate the negative labour market impact of ageing, not to mention the effects on financing public expenditure.

Each Member State deals independently with its own social welfare and pension security issues. Almost all Member States have taken corrective measures to seek to balance the increasing pension and health care costs and secure future funding for these costs. Public sector deficits have been reduced. Some countries have achieved surpluses and thus been able to reduce public debt substantially. Budgetary discipline has also been improved by the EMU criteria. Pension systems have been modernised in some countries, and others at least have plans to modernise theirs so as to become financially more sustainable.

The challenges brought by the ageing population are the same everywhere, which is why it has been deemed appropriate to deal with them through EU cooperation. The European Council has drawn attention to ageing on a number of occasions. The Nice European Council, for instance, proposed that an extensive evaluation should be carried out on the sustainability and quality of pension systems in cooperation with Member States and the Commission. Preliminary results of this evaluation were reviewed at the Stockholm European Council in March 2001 (see box).

Conclusions of the Stockholm European Council 23-24.3.2001

The demographic challenge

7. The number of retired women and men will increase rapidly, while the share of working-age population will start to diminish by 2010. This will create substantial pressure on social welfare systems, in particular pensions, health care systems and care of the elderly. The Union and Member States are acting now by defining new approaches in policy areas set out below. The coming decade offers an opportunity to address the demographic challenge by raising employment rates, reducing public debt and adapting social protection systems, including pension systems.

Safe and sustainable social protection systems

32. The ageing society calls for clear strategies for ensuring the adequacy of pension systems as well as of health care systems and care of the elderly, while at the same time maintaining sustainability of public finances and inter-generational solidarity. Where appropriate, the potential of the open method of coordination should be used to the full, particularly in the field of pensions, taking due account of the principle of subsidiarity. These strategies will be facilitated by the parallel effort to increase labour market participation, productivity and mobility.

33. Based on the technical work undertaken at expert level and taking into account all of the above factors, the European Council:

- asks the Council to present the outcome of the study by the Social Protection Committee that takes into account the work being done by the Economic Policy Committee on the sustainability of pensions systems in time for the Göteborg European Council;

- notes the Commission's intention to present a communication on the quality and sustainability of pensions in the light of demographic change. It mandates the Social Protection Committee and the Economic Policy Committee to prepare a report for the Council in view of the Spring European Council 2002. A progress report should be submitted by December 2001;

- invites the Council, by the end of 2001, in the light of a review of options, to agree parameters for the modernisation of Regulation 1408/71 on coordination of social security systems, to enable the Council and the European Parliament to press ahead with its adoption.

47. The Council should regularly review the long-term sustainability of public finances, including the expected strains caused by the demographic changes ahead. This should be done both under the guidelines and in the context of stability and convergence programmes. Higher employment rates must be promoted, especially for women and older workers. Ambitious policies to reduce the debt burden need to be pursued to ensure fiscal sustainability. Public pensions, health care and programmes providing care for the elderly should be reviewed, and when necessary reformed by Member States, while upholding inter-generational solidarity.

In June 2001, the Göteborg European Council proposed that, in accordance with the conclusions of the Lisbon and Stockholm European Councils, the Council should apply the open method of co-ordination to draw up the following, based on the joint report of the Social Protection and Economic Policy Committees:

- a progress report for the Laeken European Council on how the spring 2002 European Council will prepare resolutions on pension matters. The progress report should take into account the Commission communication setting out the objectives and working methods in the area of pensions.
- a preliminary study of guidelines for health care and care for the elderly for the spring 2002 European Council.

The Commission has issued its own communication on pension systems (Appendix 1), in which it expresses a wish that decisions on common objectives and working methods in the area of pensions could be decided as far as possible already at the Laeken European Council. The Commission proposes that the Member States should present their national reports on pension reform strategies in July 2002. The reports should focus particularly on the Member States' ability to contribute to the attainment of common objectives by e.g. using common indicators. Based on these reports, the Commission would then draw up its evaluation report, which would, in turn, form the basis for a joint pension report from the Commission and the Council, to be submitted to the spring 2003 European Council.

2. Demographic and workforce trends in the European Union

The ageing of populations is a global phenomenon. The increasing proportion of older people in a population may be caused by a total fertility rate below the population regeneration level[1], emigration of young people, increased life expectancy or unusually large age groups in the older generations. Increased life expectancy as such is a desirable aim. In fact, life expectancy is a key factor in the calculation of the Human Development Index.

According to the latest UN projection, the proportion of elderly people will grow in the longer term even in areas where birth rates are well above the regeneration level. The ageing of the population is particularly marked in Japan and Europe, however. According to the UN, the population is ageing at about the same rate in the countries which have applied for EU Membership as in the present Member States. Even though ageing is a global phenomenon, the working-age population will increase numerically over the next 50 years, except in Japan and Europe.

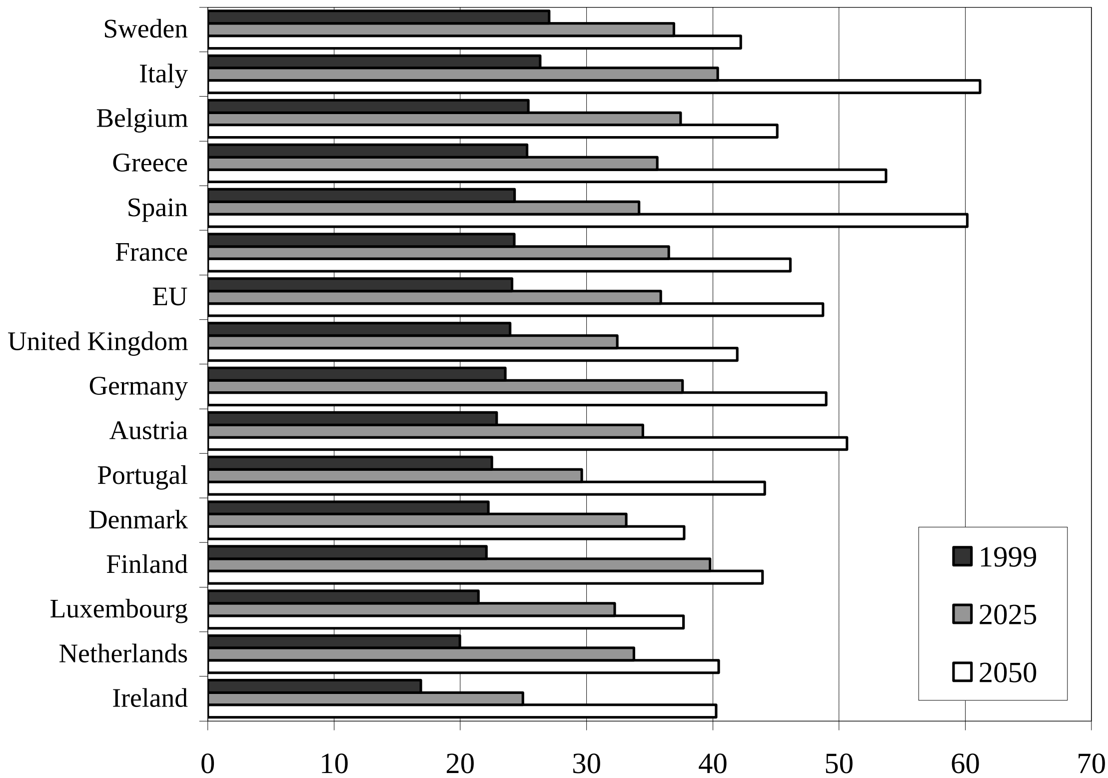
Changes in the size of the working-age population provide an approximation of the potential labour input. On this basis, the economic growth potential in Europe and Japan will fall. A long-term decline in the working-age population is a new phenomenon in developed economies, so there is little empirical knowledge of the types of economic and social policy strategies necessary to cope with the situation.

[1] The population regeneration level is achieved when each woman has an average of 2.1 children.

In the EU Member States, the working-age population will start to decline at different times[2]. The process has already begun in Germany and Italy, whereas in Denmark, Austria, Finland and Spain the turning point will be reached during 2004–2008, in Sweden in 2016 and in Ireland in 2037 (Preparing for the future: Demographic ageing & knowledge-based society, European Commission and National Labour Institute, 2001).

The **old age dependency ratio**, i.e. the proportion of elderly people (over 65) per hundred people of working age (15–64 years), now averages 23 in the whole EU area (Figure 1). Differences between Member States are not significant, with the exception of Ireland whose dependency ratio is considerably more favourable than that of other Member States. In the long term, the relative number of elderly people in all countries will grow significantly and differences between Member States will also become more distinct. The old-age dependency ratio will double within the EU as a whole. It is predicted that in 2050, Italy, Spain, Greece and Austria will have dependency ratios higher than average. Considerably lower ratios will be reached in Denmark, Ireland and the Netherlands. Because even the lowest old-age dependency ratio (Denmark) in 2050 will be considerably greater than the highest one today (Sweden), it is not likely that migration between Member States could level out differences in the dependency ratio. The same also applies to EU Candidates countries.

Figure 1. Old-age dependency ratio (population aged 65 and over per hundred 15–64 -year-olds) in the Member States in 1999, 2025 and 2050.



Source: Eurostat 2000, Demographic Projections, baseline scenario.

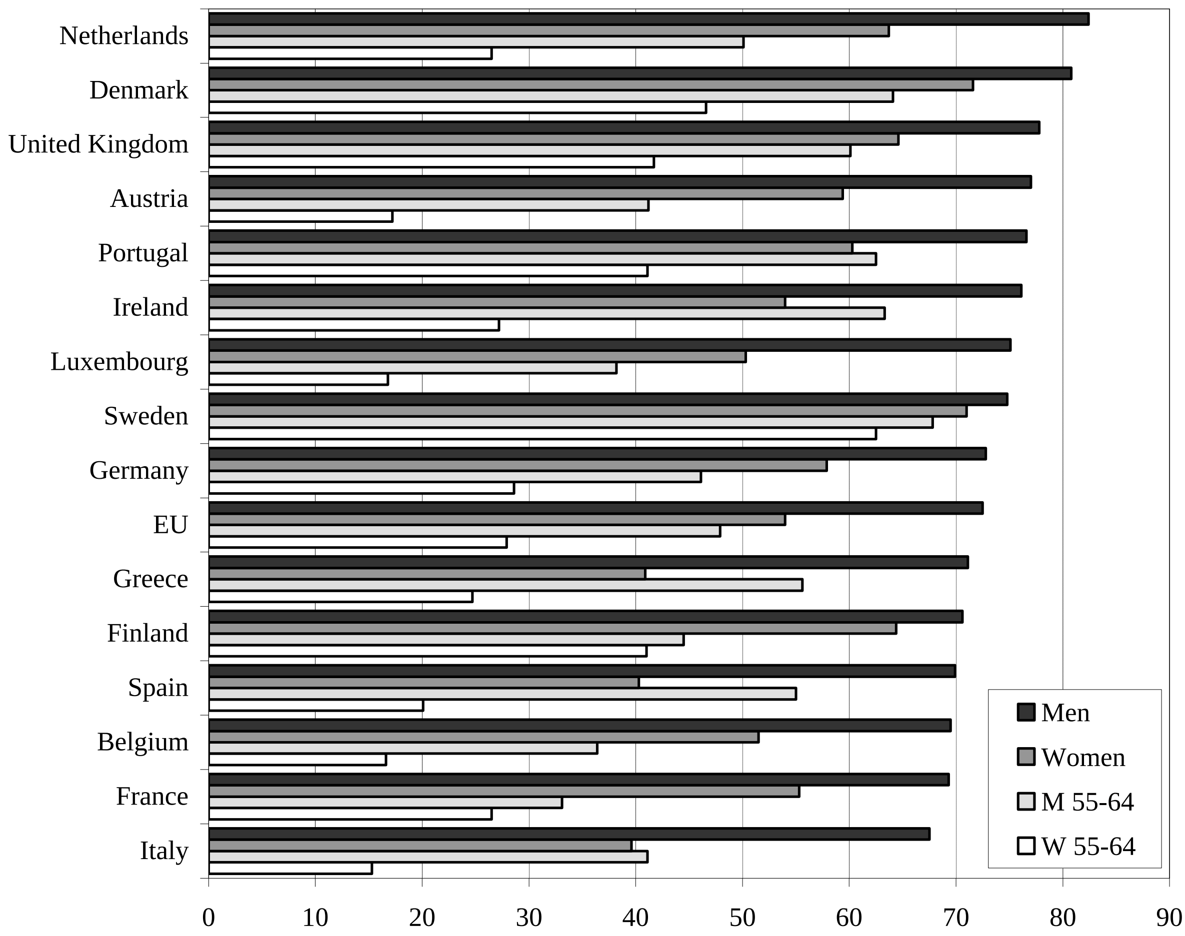
[2] The following estimates are based on the baseline scenario of the Eurostat 2000 Demographic Projections. The demographic projections extend to the end of 2050. They are based on the assumption that a degree of harmonization will be achieved in the birth rates. Specifically, it is assumed that birth rates will increase slightly in countries which have very low rates at present. Life expectancy is also expected to continue to grow.

In addition to the age structure, **the employment rate and labour force participation rate** also have an effect on the burden of dependency (Figure 2). In 2000, employment rates (i.e. the proportion of employed persons in the total population) varied quite significantly between Member States. Employment rates of working age men range from 67 per cent (Italy) to 82 per cent (the Netherlands). Women's employment rates vary between 40 per cent (Spain and Italy) and 72 per cent (Denmark).

Employment rates of older men (55–64) vary a great deal between different countries. In France the rate is 33 and in Sweden 68 per cent. Employment rates of older women vary even more: the figure for Italy is 15 and for Sweden 62 per cent.

The picture changes quite significantly if employment rates are calculated for people in full-time employment only (Appendix 2). Calculated in this way, the highest employment rates in 2000 are found in Denmark, Portugal, Finland and Sweden.

Figure 2. Employment rates in the 15–64 and 55–64 age cohorts in EU countries in 2000 by gender, per cent.

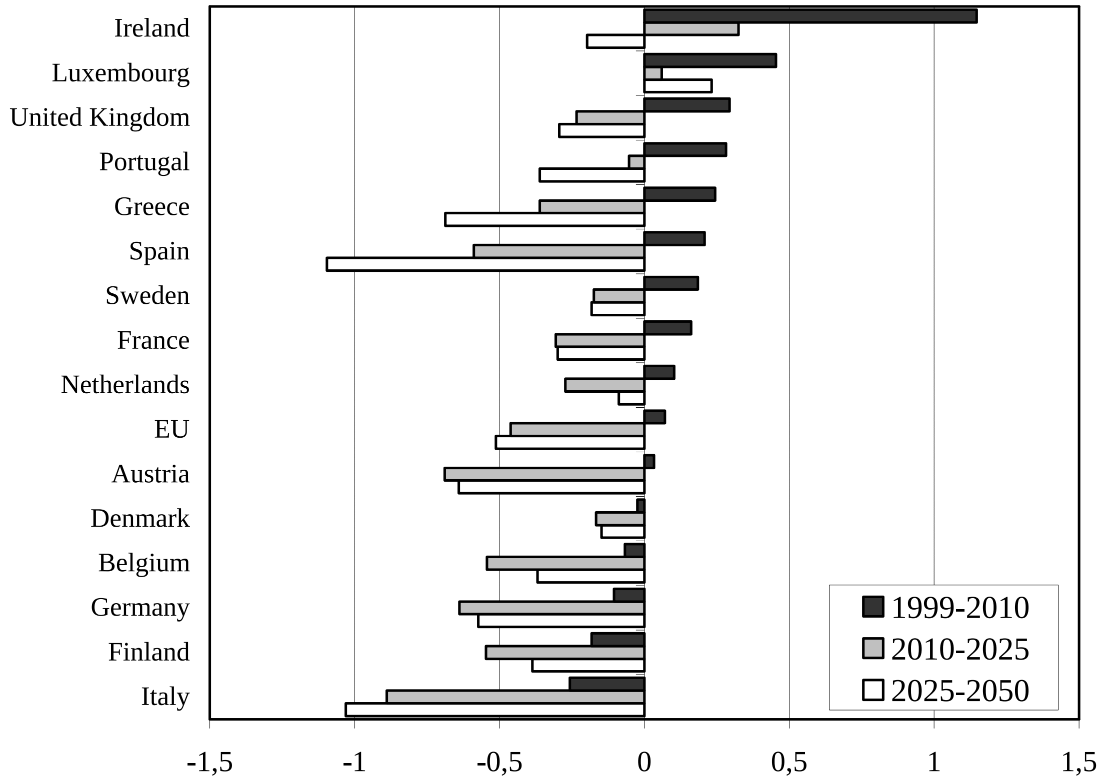


Source: Employment in Europe 2001, European Commission

Based on demographic scenarios, we can predict future labour input on the assumption that there is no change in labour-market participation rates, unemployment rates or annual average working hours of employed persons. The average change (in percentage terms) in **labour input** thus calculated is presented in Figure 3.

Labour forces in the EU will start declining within the next 10 years. If employment rates remain unchanged, Italy, Finland and Germany will be the first Member States to experience a decline in their labour forces.

Figure 3. Average change in the numbers of employed persons within the EU and in individual Member States during the periods 1999 - 2010, 2010 - 2025 and 2025 – 2050, % per annum.



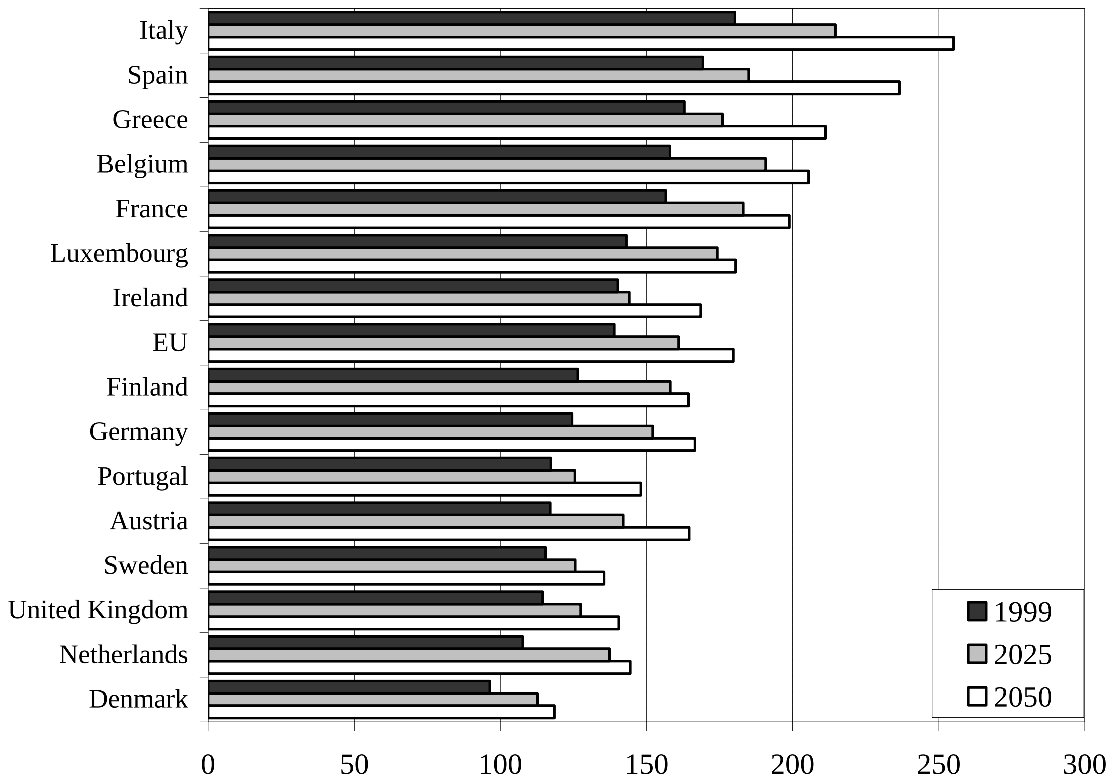
Sources: Eurostat 2000 Demographic Projections, baseline scenario, OECD Employment Outlook, 2001

During the period 2010–2050, the number of people in employment within the EU will decline at an annual rate of 0.5 per cent, according to the projections. Only in Luxembourg would the size of the labour force increase throughout the period. In Ireland the labour force would continue to grow during 2010–2025, but in the other Member States, labour force numbers would decline during this period.

The **economic dependency ratio** gives a good indication of the burden imposed by ageing on the working population. The economic dependency ratio is the ratio of non-working to working persons. The projection assumes that people of 65 and over are no longer in employment. The size of the labour force has been estimated on the basis of 1999 employment rates by age group and gender.

The economic dependency ratio is weakening in all Member States (Figure 4). Those countries that currently have a relatively low ratio will continue to be below the average in the future. The best ratios should be achieved by Member States with high employment rates, such as Denmark.

Figure 4. Economic dependency ratio (non-working persons per hundred employed persons) in 1999, 2025 and 2050 in the EU and in individual Member States.



Sources: Eurostat 2000 Demographic Projections, baseline scenario, OECD Employment Outlook, 2001

It is estimated that the population of the EU Member States will rise from the present 376 million to about 386 million in 2020. The population will then decline over the next 30 years, to about 364 million in 2050. The working-age population (15-64) will remain at about 245 million until 2015, after which it will start to decline, falling to 203 million by 2050. It should also be remembered that in the period 2001-2020, there will be a major shift in the age structure of the working-age population. The proportion of people in the 50-64 age group will increase significantly, while the proportion of 20-30-year olds will decline correspondingly. In the coming decades, ageing will create pressures for change in the EU labour market on a magnitude hitherto unseen in peacetime.

3. Main trends in pension systems in EU Member States

Existing systems

The pension systems in different countries have been built up over a period of decades and are based on the institutional conditions of each country. The basics of the pension systems are, however, funded on common insurance principles. Public pension schemes in Member States are primarily based on employment (labour-market activity), and most old-age pensions are provided by the public sector (‘first pillar pensions’, Table 1). In only three Member States - the Netherlands, UK and Denmark - is the proportion of private employer-based pension systems, i.e. second pillar pensions, significant. The financing system of the public schemes is usually pay-as-you-go (PAYG), which means that annual pension contributions and taxes are determined so as cover current pension expenses. Only Sweden and Finland have long applied a financing system for public first pillar pensions where they are partly pre-funded (Table 2). Ireland introduced a pension buffer fund in 1999.

In a defined benefit pension system, pension contributions are determined on the basis of promised benefits, whereas in a defined contribution system the benefits are based on the pension contributions made and on the investment yield of pension funds. The reformed Swedish pension system focuses on individual solutions, i.e. the size of the pension depends partly on contributions and on returns yielded by pension funds. Finland's pension system is based on defined benefit, funding is collective and does not have a direct correlation to pension benefits paid.

Table 1. Main characteristics of public pension schemes (first pillar pensions) in EU Member States

	A. Residence-based pension		B. Employment-based pension
	Universal	Means-tested	
Belgium	no	-	yes
Denmark	yes	yes	no
Germany	no	-	yes
Greece	no	-	yes
Spain	yes	yes	yes
France	yes	no	yes
Ireland	yes	yes	yes
Italy	no	-	yes
Luxembourg	no	-	yes
Netherlands	yes	no	no
Austria	no	yes	yes
Portugal	yes	yes	yes
Sweden	yes	yes	yes
Finland	yes	yes	yes
United Kingdom	yes	yes	yes

Source: EU.

In most cases, eligibility requirements for obtaining a pension include either a minimum age and/or a minimum period of contributions. Within the EU, the most common minimum age requirement for both men and women is 65 years. However, many Member States are shifting from a fixed retirement age to a flexible one. In the Netherlands, Italy, Luxembourg and France a worker may retire even before the age of 60 if he or she has contributed to a pension for a required number of years. As of 2002, it will be possible to retire at 57 in Italy if pension contributions have been made for a minimum of 35 years; if the contributions have been made for at least 37 years, it will be possible to retire at an even earlier age (no age restrictions). In France, it is also possible to retire after 40 years of employment without any age restriction. Under the new pension system in Sweden, there are different retirement options as of the age of 61, although the ‘guaranteed pension’ begins to be paid out only after the person is 65 years old.

The minimum contribution period entitling a retiree to a full pension varies considerably between Member States, and no major changes are expected in the near future.

Table 2. Funding methods for first pillar occupational pensions

	Private sector employees	Public sector employees	Self-employed
Belgium	PAYG/SF	SF	PAYG/SF
Denmark	-	-	-
Germany	PAYG/SF	SF	PAYG/SF
Greece	PAYG/SF	SF	PAYG/SF
Spain	PAYG/SF	PAYG/SF	PAYG/SF
France	PAYG/SF	PAYG/SF	PAYG/SF
Ireland	PAYG	PAYG	PAYG
Italy	PAYG/SF	PAYG/SF	PAYG/SF
Luxembourg	PAYG/SF	PAYG/SF	PAYG/SF
Netherlands	-	-	-
Austria	PAYG/SF	PAYG/SF	PAYG/SF
Portugal	PAYG/SF	PAYG/SF	PAYG/SF
Sweden	PAYG/FF/SF	PAYG/FF/SF	PAYG/FF/SF
Finland	PAYG/FF	PAYG/FF	PAYG/SF
United Kingdom	PAYG	PAYG	PAYG

PAYG = Pay-as-you-go
SF = Financed by state budget
FF = Fully funded

Source: EU.

Even though the most common old-age pension retirement age is 65 years, a variety of early retirement schemes and a shift to a flexible retirement age have meant that the effective retirement age is actually considerably lower - even below 60 in many countries. Employment rates in the 55–64 age group are very low in many Member States (see Figure 2).

Because public and employer-based pension schemes (first and second pillar pensions) provide a fairly high level of pension provision in most Member States, voluntary pensions have so far been relatively unimportant. In the future, however, voluntary pension schemes will probably account for an increasingly significant share of total pension provision at least in some countries.

Main principles of pension reforms in EU countries

Pension policies took a new direction in the EU during the second half of the 1980s. Subsequent reforms have curbed the growth of future pension expenditure, and reduced the disincentive effect of pension systems on the supply of labour. Pension systems have been significantly reformed in Italy, France, Germany, Sweden, Austria, Greece, Portugal, the United Kingdom and Finland.

The purpose of the reforms has been to reduce the pressures on pension expenditure, and to improve the sustainability of the funding of pension systems and central government finances as a whole. In addition to cost savings, the reforms have attempted to increase both the employment rate and the GDP, thereby securing the funding of pensions.

Measures that encourage people to take early retirement might have been considered justifiable in the past, when unemployment was high, but such policies are now being questioned. Instead, the reforms of the last decade have aimed to encourage later retirement and gradual transition from working life to retirement. These measures vary between Member States. Some countries have limited the possibilities for early retirement and eliminated disincentives to work. Other countries have adopted positive subsidies that offer an incentive to stay in employment for longer. The effects of these reforms can only be assessed in a few years' time. Their final effects also depend on labour market reactions to economic changes and changes in the age structure.

Sustainability of pension schemes has been improved the most by changes in **indexation systems**. In France and Italy, for example, pensions under the old system are now indexed to prices rather than wages. In Finland, indexation has also been shifted clearly towards prices (CPI). In Austria, there has been a switch to net indexation of pensions, whereby they are indexed to an earnings index from which social security contributions and taxes have been deducted. Net indexation aims to retain unchanged the income distribution between pensioners and wage-earners.

Since the index reforms in most countries have tied pensions to either the cost-of-living index or a combined index based on the cost of living and productivity, the rising average age may cause the position of long-time pensioners to deteriorate in the future, perhaps even significantly, compared with people who are still in work. This is because the income level of people still in work tends to follow productivity trends.

In addition to indexation reforms, pension expenditure has also been reduced by changing the definition of **pensionable earnings** (earnings that determine the size of pension). There has been a transition in the calculation of pensionable earnings to using longer work histories than before. The general trend is towards taking into account all earnings over the entire working life of the individual. Italy and the UK have already adopted a calculation method in which pensionable earnings are based on earnings over the entire career of individuals. In France, pensionable earnings are based on the 25 highest annual incomes of the individual. Finland has also changed the basis of pensionable earnings from the last 4 to the last 10 years of an individual's employment, and there is now discussion about transferring to a system where pensionable salary would be calculated on all earnings over an individual’s working life. The extension of the earnings period relevant to the calculation of pensionable earnings reinforces the principle that pensions are based on contributions made. The number of years in employment required for a full pension has also been increased in order to improve the balance of contributions and entitlements. In France, for example, the number of years in employment entitling a person to a full pension is being gradually increased from 37 to 42 years. The balance between contributions and entitlements in a variety of early retirement schemes has been made more actuarial and many special retirement entitlements, usually available for public sector employees, have been cut. In the countries which have transferred to a contribution-based system – Sweden and Italy – pensions are determined on the basis of pension contributions made during the person’s entire working life.

An increase in the statutory **retirement age** was also designed to slow down exit from working life. Such increases in the retirement age will be implemented over long transition periods. Statutory retirement ages have either been raised or there have been attempts to raise them in Germany, Italy, Greece, Portugal and the UK in the last few years. In Finland, the retirement age of public sector employees has been raised from 63 to 65 years. In Italy, the raising of the statutory retirement age (to 65 years) was accompanied by the possibility of early retirement at the age of 57–64, in which case the size of the early retirement pension depends on the time of retirement. Sweden has adopted an actuarial old age pension system in which the retirement age is flexible and pensions are determined on the basis of contributions and life expectancy. The trend seems to be to relinquish a fixed retirement age in favour of a flexible, actuarially-based old age pension and retirement age, with the pension system allowing retirees to choose their retirement age and, consequently, the size of their pension. The earlier the retirement age, the smaller the pension, and vice versa.

According to the projections drawn up by the EU Commission and the OECD Secretariat, increases in the retirement age provide the most efficient means to curb pressures to increase public expenditure.

Pension expenditure in EU countries up to 2050

In autumn 2001, a sub-group of the EU Economic Policy Committee on ageing populations drew up pension expenditure scenarios that cover the period until 2050. The scenarios are based on the Eurostat population projection and common computational assumptions were used. The scenarios are based on ‘current policies’, taking into consideration pension reforms implemented before 2000.

Despite the reforms, pension expenditure is expected to increase in EU Member States by 2050. Pension expenditure for the baseline projection shows (Table 3) that, with the exception of the UK, pension expenditure as a percentage of GDP will grow considerably by 2050, by an average of 3 percentage points. The sharpest increase in pension expenditure will be in Greece, Spain, the Netherlands and Portugal. Pension reforms in Sweden and Italy, applying an actuarial principle for contributions and benefits and taking life expectancy into account in fixing benefits, would seem to be effective in slowing down the growth of pension expenditures. In Luxembourg, too, the rate of increase of pension expenditure will be slow.

In comparing different countries, their prevailing institutional differences should be taken into account. The size of the public sector in different countries varies considerably. Countries with an extensive public sector will strive to limit growth in that sector. In countries with a high level of agricultural production and entrepreneurship, public pensions expenditure will probably be lower than average.

A Member State’s ability to cope with the challenge of an ageing population will depend on how well the public finance arrangements are able to meet the extra spending demands. Countries with sound public finances (showing a surplus and having low debts) whose public spending in relation to GDP is at a tolerable level will stand the best chance of success.

Table 3. Pension expenditure as a percentage of GDP (current policy scenario), before tax

	2000	2010	2020	2030	2040	2050	Change from 2000 to peak year
Belgium	10.0	9.9	11.4	13.3	13.7	13.3	3.7
Denmark	10.5	12.5	13.8	14.5	14.0	13.3	4.1
Germany	11.8	11.2	12.6	15.5	16.6	16.9	5.0
Greece	12.6	12.6	15.4	19.6	23.8	24.8	12.2
Spain	9.4	9.2	10.0	12.7	16.1	17.4	8.0
France	12.1	13.1	15.0	16.0	15.8	NA	4.0
Ireland	4.6	5.0	6.7	7.6	8.3	9.0	4.4
Italy	13.8	13.9	14.8	15.7	15.7	14.1	2.1
Luxembourg	7.4	7.5	8.2	9.2	9.5	9.3	2.2
Netherlands	7.9	9.1	11.1	13.1	14.1	13.6	6.2
Austria	14.5	14.9	16.0	18.1	18.3	17.0	4.2
Portugal	9.8	12.0	14.4	16.0	15.8	14.2	6.2
Finland	11.3	11.6	12.9	14.9	16.0	15.9	4.7
Sweden	9.7	10.2	11.3	11.9	12.0	11.2	2.4
United Kingdom	5.5	5.1	4.9	5.2	5.0	4.4	-1.1
EU-15	10.4	10.4	11.5	13.0	13.6	12.8	3.2

Source: EU.

4. Health care expenditure and anticipated future trends

The health of the population in the EU Member States is better now than it has ever been. The state of public health has been improved through increased health care resources, new advances in medical science, changes in working methods and working conditions brought about by technology, and changes in lifestyle. Over a short space of time, life expectancy has grown by several years. The downside of all this is that public spending on health care is also growing rapidly, and it is funded chiefly from public finances. Health care expenditure as a percentage of GDP doubled in the EU Member States between 1960 and 1990, and public health care expenditure has gone up even faster. This increase in expenditure is related to both demand and supply factors. The general increase in wealth and income has allowed an increase in demand for health care services and also in the supply of these services. On the providers' side, expenditure has been boosted by the introduction of new and more expensive technology and by the rise in medicine costs, which has been considerably in excess of inflation.

The major trend of the future, i.e. the ageing of the population, will significantly increase the demand for health care services and public spending on health care, because elderly people require considerably more health care services than the young or middle-aged. The role of other factors influencing the supply and demand for health care services is less clear. It is clear, however, that even if the effects of the ageing population are excluded, the demand for health care services will continue to outpace the growth in GDP. Thus the health care sector will probably be the fastest growing market sector in future, alongside the information technology sector.

The demand for health care services and the cost of the services begin to rise steeply after the age of 65. The growth in expenditure on long-term care begins to increase steeply after the age of 80. The Eurostat population projection shows that while the number of citizens over 80 was about 14 million in 2000, it is predicted to nearly triple to 38 million by 2050. As life expectancy grows, increasing numbers of people will attain an age where health care expenses are very high. The highest health care expenditure in a person's lifetime occurs during the last year of life. On the other hand, as life expectancy increases, so the health of elderly people can be expected to improve, something which may shift the peak of health care expenditure to increasingly older generations, thus slowing the rate of growth in this expenditure.

Alongside the ageing of the population, changes in family structures will also increase the demand for health care services. The increased number of one-person households will cause an increase in the need for public health care services. Women's increasing participation in the workforce has the same effect. The system of arranging care also has an impact on the expenditure level, i.e. whether care is provided in institutions or as outpatient care. Shifting the emphasis toward outpatient care is one way of reducing the growth pressure on expenditure.

Calculations made by the sub-group of the Economic Policy Committee on ageing populations in October 2001 show that the ageing of the population would appear to increase public spending on health care as a percentage of GDP by 1-2 percentage points up to 2050, measured per capita (Table 4). If public spending on long-term care for the elderly[3] is added to this, the development trend changes significantly. Between 2000 and 2050, public health care and long-term care expenditure as a percentage of GDP will grow most rapidly in the Netherlands (3.2 percentage points). The lowest growth will be in France at 1.7 percentage points. Expenditure on long-term care for the elderly as a percentage of GDP will nearly double in the EU Member States by 2050. If this is calculated per worker, the increase is naturally even higher.

The baseline scenario is based on the assumption that public per capita spending on health care for each age group will grow at the same rate as the GDP per capita. The calculation only takes into account the impact of the changed age structure on public spending and service needs. However, the demand for health care services and the provision of services are also increased by other, non-demographic factors, for instance the introduction of more expensive technology and the high income elasticity of demand. It is, in fact, entirely possible that health care resources in relation to GDP will increase more than the estimates in Table 4 indicate. Since the ageing of the population also causes a considerable increase in other types of public spending, especially pensions, the pressure for shifting the responsibility for funding health care from the public sector to the service users will grow. A rising income level and general prosperity will also create opportunities for this. The crucial question is where can the much-needed additional resources for the health care sector be found and at what price, in a situation where the labour supply is dwindling.

[3] Public spending on long-term care has only been calculated for ten Member States.

Table 4. Total public spending on health care and long-term care

Central demographic variant
Expressed as a share of GDP

	TOTAL HEALTH AND LONG-TERM CARE			HEALTH CARE			LONG-TERM CARE		
	Expenditure as a share of GDP in 2000 %	Increase in expenditure in per cent of GDP between 2000 and 2050		Expenditure as a share of GDP in 2000 %	Increase in expenditure in per cent of GDP between 2000 and 2050		Expenditure as a share of GDP in 2000 %	Increase in expenditure in per cent of GDP between 2000 and 2050	
		per capita	per worker		per capita	per worker		per capita	per worker
Belgium	6.1	+2.1	+2.4	5.3	+1.3	+1.5	0.8	+0.8	+0.8
Denmark	8.0	+2.7	+3.5	5.1	+0.7	+1.1	3.0	+2.1	+2.5
Germany[1]				5.7	+1.4	+2.1			
Greece[1]				3.7	+1.4	+1.2			
Spain[1]				5.0	+1.7	+1.5			
France	6.9	+1.7	+2.5	6.2	+1.2	+1.9	0.7	+0.5	+0.6
Ireland	6.6		+2.5	5.9		+2.3	0.7		+0.2
Italy	5.5	+1.9	+2.1	4.9	+1.5	+1.7	0.6	+0.4	+0.4
Netherlands	7.2	+3.2	+3.8	4.7	+1.0	+1.3	2.5	+2.2	+2.5
Austria	6.0	+3.1	+3.4	5.4	+2.0	+2.3	0.7	+1.0	+1.1
Portugal[1]				5.4	+0.8	+1.3			
Finland	6.2	+2.8	+3.9	4.6	+1.2	+1.8	1.6	+1.7	+2.1
Sweden	8.8	+3.0	+3.3	6.0	+1.0	+1.2	2.8	+2.0	+2.1
United Kingdom	6.3	+1.8	+2.5	4.6	+1.0	+1.4	1.7	+0.8	+1.0
EU (weighted average)	6.5	+2.2	+2.7	5.3	+1.3	+1.7	1.2	+0.9	+1.0

1 Results for public expenditure on long-term care are not yet available for these Member States.

Source: EU Economic Policy Committee, working group on 'Ageing Populations'

5. How to prepare for an ageing population

The ageing of the population will pose a serious challenge to the social and economic policy of Member States in the next few decades. Member States have therefore already begun to prepare for wide-ranging reforms which will help balance the problem of income distribution between the generations and secure sustainable public finances in the long term. It has been suggested, however, that the measures needed are late in coming and politically difficult to implement and that the reforms that have already been carried out will not be enough to solve the problem of income distribution between the generations and pressures to increase public expenditure.

Preliminary calculations by the Economic Policy Committee sub-group on ageing populations show that public spending on pensions and health care as a percentage of GDP will rapidly increase in nearly every Member State (Table 5). It must be emphasized that these calculations should be viewed with some caution and that it would be unwise to use them for more detailed comparisons of individual countries. These calculations do, however, indicate strongly that in many Member States the increase in public spending brought about by the ageing of the population will create great pressure to increase taxes and/or public debt. The measures required to control these pressures for increased expenditure must therefore not be underestimated.

Table 5 Public pension expenditure and expenditure on health care as a percentage of GDP (current policy scenario)

	2000	2050	Change (in percentage points) of GDP between 2000 and 2050
Belgium	15.3	19.9	+4.6
Denmark	15.6	19.0	+3.4
Germany	17.5	24.0	+6.5
Greece	16.3	29.9	+13.6
Spain	14.9	24.6	+9.7
France	17.3	23.2	+5.9
Italy	18.7	20.6	+1.9
Netherlands	12.6	19.2	+6.6
Austria	19.9	24.4	+4.5
Portugal	15.2	20.3	+5.9
Finland	15.9	21.6	+5.7
Sweden	15.7	18.2	+2.5
United Kingdom	10.1	10.0	-0.1

Source: EU Economic Policy Committee, working group on 'Ageing Populations'

Answering the challenges of ageing requires wide-ranging measures. This was also underlined in the conclusions of the Stockholm European Council. The measures needed can be divided into the following areas:

- rapid and stable economic growth
- raising the employment rate
- securing sound public finances
- pension reforms
- health care and long-term care services
- immigration and workforce mobility.

The following will give a brief overview of each of these areas.

Rapid and stable economic growth

Rapid and stable economic growth on a sustainable basis is one of the main requirements in preparing for the challenges of an ageing population, as it makes it easier to target funds to meet the increased expenditure. The OECD Secretariat has, however, pointed out that a major boost in the level of growth would be required in order to compensate for the increased expenditure caused by ageing (OECD: Economic Outlook No 69, June 2001). Productivity will be decisive for economic growth in the future; but will labour productivity continue at the same rate as hitherto, or will it slow down? Will productivity growth actually be slower due to a more elderly workforce, and will economies in general be less dynamic than during times with a younger age structure?

European competitiveness will have to improve and economic dynamism be retained if productivity growth is to be secured. In this connection, the further development of the internal market will be very important; this in turn will require the removal of obstacles to competition in product markets and a reduction in labour market rigidities. It will also be particularly important to increase skills and knowledge through training, learning-by-doing and research and development, and to promote innovation and use of technology throughout the economy.

Raising the employment rate

In preparing to meet the challenges of an ageing population, a crucial question in the Member States is whether the employment rate can be raised over the next ten years. Increased employment will simultaneously improve the prospects for further growth, increase the inflow of revenues to the economy and expand the tax base, thus improving the ability to finance a welfare society. In most Member States, the labour market participation rate of ageing workers, in particular, has been falling. In many countries in central and southern Europe, the labour market participation rate of women is also rather low.

An important feature in almost all EU Member States is that people tend to leave working life long before the official retirement age. Thus, while the authorities would like to raise the retirement age and thereby increase the available workforce and keep pension expenditure under control, the interests of employees tend to be diametrically opposed to these endeavours. Factors such as increasing workloads, work-related diseases, working conditions felt to be considered poor, and the lack of appreciation that many employers have towards ageing workers conspire to drive workers into early retirement. The increased value that people attach to free time also makes it harder to motivate them to stay on longer in work than at present. Furthermore, in many countries university studies begin late and take many years, which, together with a low retirement age, further reduces the working life of individual workers.

In raising the employment rate, there are a number of general measures, both carrots and sticks, that can be applied. A closer connection between training and the labour market and extending training throughout people’s working lives are among the measures which could be considered. In welfare policy, more incentives could be created for unemployed people to accept offers of work, poverty traps could be eliminated and more active measures introduced to encourage participation in work. Measures to prevent exhaustion and burnout and to increase working conditions in general would help reduce occupational diseases.

Measures targeted at specific groups can also be useful in raising the employment rate. The workforce participation rate of ethnic minorities is rather low in most Member States, and so measures to integrate these groups into the labour market would improve the employment rate. Useful measures here would include training and especially language skills. As the educational level of women has risen, their participation in the workforce is rising rapidly. This does, however, require an improvement in child daycare services. Where ageing workers are concerned, the attitudes of management are important, but working conditions and tasks may also need to be adapted to ageing workers’ capacity.

Securing sound public finances

To meet the challenges of an ageing population it is essential to ensure that public finances are on a sound footing in the present decade. Public debts can be reduced if public finances are balanced or preferably showing a surplus. This, in turn, would reduce interest expenditure and thus create some latitude for increasing pensions and services for the elderly and for possibly raising the level of public debt at a future date[4].

Pension reforms

Over the next few years, the most important reforms necessary to meet the challenges of ageing will be the continued reform of pension systems. In considering the alternatives for funding statutory pensions, the key question is to what extent the funding of pensions should be a collective responsibility and to what extent it should be left to the individual. Most EU Member States use a pay-as-you-go system for funding their first pillar pensions. In this system, current annual contributions from workers are determined so as to cover the costs of current payments to pensioners. Pension payments are a form of income redistribution from one age group to another. This means that age groups or individuals do not fund their own benefits, but those of someone else's. A defined benefit pay-as-you-go pension system transfers the demographic risk to the "funder", i.e. the next generation. In a defined contribution system, each generation bears its own demographic and financial risks.

When age groups are very different in size, pay-as-you-go funding of pension benefits leads to different tax rates for different generations. Small age groups have to pay higher taxes and social security contributions than large ones. The weakening of pension indexation systems has been just about the only politically acceptable method of balancing the burden of payment between generations.

Defined benefit pay-as-you-go pension systems also distribute income within age groups, usually to the detriment of the less well off, as life expectancy tends to be below the average in lower social groups.

In a defined benefit pay-as-you-go pension system the connection between contributions and benefits is usually quite weak at the individual level and, therefore, economic incentives for working and saving do not work in the best conceivable way. It is possible to build notional accounts within a pay-as-you-go pension scheme in order to create a firm correlation between pension contributions and benefits, which has been done in Sweden and Italy. This improves the economic incentive to work significantly. In such a system, pension contributions may not be considered as taxes but rather as savings.

Since costs cannot be transferred to someone else for payment within a defined contribution system, employees are likely to be more willing to stay on in work than they would be in a defined benefit system, where financial risk can more easily be transferred to someone else for payment. Risks such as moral hazard and political risks are greater in a defined benefit system than they are in a defined contribution system.

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[4] The difficulties in securing public finances include the following: a) in the case of expenditure not related directly to ageing, primary surpluses must remain in force for several decades, b) the public finances of several Member States are still showing a deficit on the whole, c) the surplus at present has been achieved through high taxation in many Member States, d) the high public debts at present mean that public finances are sensitive to interest rate changes, and e) if public finances show a surplus, this is difficult to preserve because of the pressures to increase spending.

The main criticism against defined contribution systems centres on the fact that the investment risks are excessively left to individuals to shoulder. Also, the advocates of defined contribution systems have been criticised for forgetting the funding and capital market risks. Such a risk may be triggered if pension liability payments fall due at the same time, causing the price of assets (e.g. shares) and thus the value of pensions to fall.

Different tax burdens associated with different age groups can also be balanced out by reducing public debt when large age groups are still in employment and adding to it when they have retired and smaller age groups are working. However, the EMU criteria impose tight restrictions on building up debt and specifically public debt. Funding problems arising from the different sizes of age groups can also be alleviated by pre-funding of future expenditure.

Health care and long-term care services

It will also be necessary to control expenditure on health care and long-term care services. As life expectancy climbs and the number of elderly people in the population increases, there is growing pressure for increasing public spending on health care and long-term care. Pressures on expenditure will grow dramatically when the number of people over 80 in the EU Member States increases to about 38 million in 2050 from 14 million in 2000. Meanwhile, the increased participation of women in the workforce and the ever smaller sizes of family units will make it difficult to care for the elderly at home.

Healthier lifestyles and improved working conditions help prevent illnesses and enable people to enjoy a healthier old age. Health education and the introduction of stricter legislation on working conditions will contribute to achieving these aims. Nevertheless, the responsibility for these issues lies ultimately with individuals themselves and with employers.

The chief method for controlling health care expenditure is usually to set a cost ceiling. Cost ceilings can lead to increased effectiveness in health care and long-term care, and this, in turn, would reduce cost pressures.

It is also important to limit the demand and supply of those health care services which are not strictly necessary from the point of view of primary health care. Expenditure can also be controlled by actively improving the matching of health care needs and service provision. This type of matching should be the aim in both regional service provision and within specific fields of health care.

Finally, it is also possible to curb public spending by shifting part of the responsibility for costs to individuals themselves. Thus, for instance, a care insurance system could be introduced, where individuals are expected to take out insurance to cover their own future health care and long-term care needs.

Immigration and workforce mobility

As the ageing workforce retires, many Member States will experience worsening recruitment problems and labour shortages. In this situation, immigrant labour and improved workforce mobility will help. An important question is what kind of labour migration we can expect from the new Member States which are to accede to the EU during this decade. However, since the working-age population is ageing at the same rate in these countries as in the rest of

Europe, it seems clear that much of the present Member States' need for additional labour will have to be covered through immigration from third countries. It has also become evident that the immigration issue will have to be discussed at EU level, although each Member State has independent responsibility for its immigration policy at present.

Questions for discussion:

1. What has the role of your Economic and Social Council been in the preparation of an ageing policy in your country in relation to other bodies involved? How does the council itself perceive its role in this respect?

2. When would you estimate that the issue of population ageing was first included on the agenda of your Economic and Social Council? Are there any observations to suggest that the emphasis on ageing-related issues has increased compared with other issues in recent years? Which aspects has your council placed special emphasis on in preparing for the challenges brought by an ageing population (increasing the employment rate, pension reforms, health care reforms, immigrant labour)? To what extent have preparations for population ageing had a practical impact on fiscal policy solutions related to public debts and the balance of public finances?

3. To what extent have there been clearly divergent opinions among members of your Economic and Social Council concerning the aims and recommended measures for policies on the ageing population? Which questions presented the greatest difficulties when striving for consensus?

4. Has your council drawn on the work of the Commission, the various EU committees and working parties and the OECD Secretariat in preparing an ageing policy? If yes, in which manner?

5. How do you perceive the role of cooperation between the Economic and Social Councils of the EU Member States and the European Economic and Social Committee on the issue of ageing?

Appendix 1

Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee (July 3, 2001)

Supporting national strategies for safe and sustainable pensions through an integrated approach

The Communication defines the pension systems of the Member States as the combination of the statutory social security, occupational and personal pensions schemes in use. The Göteborg European Council in June 2001 endorsed three broad principles for securing long-term sustainability of pension systems:

1. to safeguard the capacity of pension systems to meet their social aims of providing safe and adequate incomes to retired persons and their dependants and ensuring, in combination with health and long-term care systems, decent living conditions for all elderly persons;
2. to ensure the financial sustainability of pension systems, so that the future impact of ageing does not jeopardise the long-term sustainability of public finances or the ability to meet fundamental goals of budgetary policy (in terms of overall tax burdens or spending priorities) and does not lead to an unfair sharing of resources between generations;
3. to enhance the ability of pension systems to respond to the changing needs of society and individuals, thereby contributing to enhanced labour market flexibility, equal opportunities for men and women with regard to employment and social protection and a better adaptation of pension systems to individual needs.

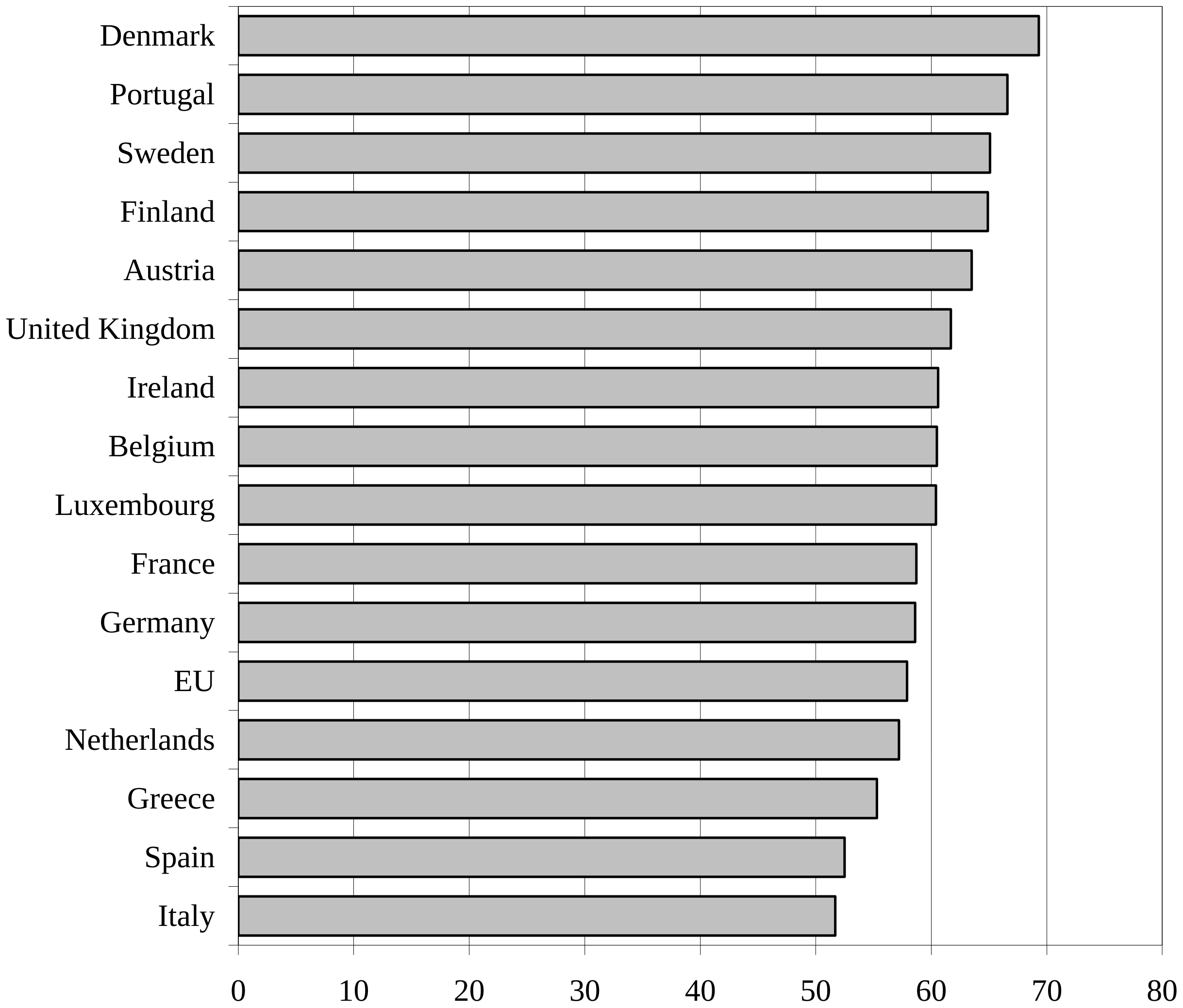
The Communication by the Commission strives to find clear and integrated strategies to cope with the challenges of an ageing society. The Commission proposes that the appropriate approach at EU level is to combine the existing policy processes that are relevant for the future of pension systems with the open method of co-ordination in a way that does not change the respective responsibilities of policy makers at European and national level.

The open method of co-ordination involves setting common objectives, translating these objectives into national policy strategies and, finally, as part of a mutual learning process, periodic monitoring on the basis inter alia of commonly agreed and defined indicators. Member States should prepare national strategy reports, presenting their national strategy for ensuring financial sustainability of pension security. The Commission will assess the national reports from the point of view of common objectives and identify good practice and innovative approaches.

The Commission proposes that a progress report setting out the objectives and working methods in the area of pensions should be presented to the European Council at its meeting in Laeken in December 2001, in preparation for the spring 2002 European Council.

National statements on the Commission’s Communication are being prepared at present.

Employment rates for full-time work in the Member States of the European Union, %, 2000



Appendix 3

SUMMARY OF VIEWS EXPRESSED AT THE MEETING OF SECRETARIES-GENERAL ON MAY 11, 2001

The following is a summary of the discussion at the meeting of the Secretaries-General of the Economic and Social Councils of the EU Member States and the European Economic and Social Committee on May 11, 2001. The meeting agreed unanimously that the ageing of the population will create considerable challenges in the EU over the next few decades for the working of the labour market, public spending and income distribution between age groups. Member States must take action to alleviate these problems immediately, as delays will inevitably make problems more difficult to solve. Corrective measures will be more expensive the later they are initiated.

The memorandum drawn up by the Secretariat of the Finnish Economic Council was considered a good background document for discussion. The narrow perspective of the memorandum and its focus on technical issues were considered a drawback, however. It was felt that ageing policy should be viewed from the broadest possible perspective, taking account of economic growth, the sustainability of public finances, employment trends, pension and health care policy and immigration policy. It should also be more closely linked with the strategy outlines which have already been presented on ageing in different EU bodies. The memorandum should also include an assessment of health care and long-term care expenditure in addition to pension issues. Finally, it was considered important to find out how the Economic and Social Councils of different Member States have dealt with the challenges of ageing policy.

The meeting emphasized the key role of economic growth and an improved employment rate in preparing for the challenges of ageing. With regard to improving the employment rate, two key issues were identified: discouraging early retirement and improving the workforce participation rate of women in countries where it is low (central and southern Europe).

Immigration policy was considered another important factor in preparing for ageing. Immigration will not, of course, solve the problems related to ageing, but will help to stabilize the situation. However, EU-level solutions are needed on immigration policy. It was also proposed that refugee and immigration issues should be examined separately.

It was emphasized during discussions that institutional and cultural differences between countries have an impact on solutions and on how well they can be compared. Caution should therefore be exercised so that comparisons are not used to draw conclusions which are too detailed. In some Member States, the size of the public sector and the scale of pensions expenditure are below the average, and, as a result, system changes may give rise to rather large increases in expenditure items. In many countries in southern Europe, women traditionally play a crucial role in caring for family members at home, unlike in northern Europe. The percentages of entrepreneurs and farmers in the population also influence the comparisons.

Discussion also dealt extensively with pensions issues, as the background memorandum focused on this subject. Pension policy overviews should be based on the overall strategies. Economic growth and high employment were considered to be important in controlling the growth of pensions expenditure. In pension policy, it would be desirable to shift from a PAYG system towards a pre-funded system. It was, however, considered problematic that the yield on investments might have too much of an influence on pension levels. Similarly, large investments by major employment pension funds may give rise to turbulence in the market. It would, furthermore, be fairer if pension levels were based on an individual's entire working history. Thus, if employees work for a long period, they should also receive a higher pension. Differences in mortality between demographic groups also influence comparisons. Low-income groups and groups with lower educational background have a shorter life expectancy than other groups, which means that they do not have the opportunity to benefit from their pension in the same way as members of high-income groups with higher education.

Coooperation between Economic and Social Councils was considered important in looking for answers to ageing, as in other matters. It is important to exchange opinions and compare best practices. The tasks of economic councils in relation to ageing policy were defined as follows:

- to seek consensus in ageing-related solutions
- to act as an advisory body for the national government in matters involving ageing policy
- to use analysis and discussion to persuade different parties to support necessary reforms
- to act as a cooperation network between the various parties involved in ageing issues.