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EUROPE'S DEMOGRAPHIC FUTURE: FACTS AND FIGURES

EXECUTIVE SUMMARY

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EUROPE'S DEMOGRAPHIC FUTURE: FACTS AND FIGURES

1. INTRODUCTION AND EXECUTIVE SUMMARY

1.1. Background

Demographic change is high on the European policy agenda and, indeed, Europe has to brace itself for profound changes in its population structure. During the coming decade, the baby boom cohorts will start retiring from the labour market. Young cohorts entering the labour market will be much smaller as a result of low fertility. In about ten years, total employment in the EU could start to fall, in spite of rising employment rates. Europe's potential growth rate could decline at a time when significant additional resources will be required to meet the needs of an increasing number of elderly people for whom adequate pensions and health and long-term care provision will have to be secured.

In October 2006, the Commission presented its views on the demographic challenge and the best ways for tackling it in the communication "*The demographic future of Europe — from challenge to opportunity*"¹. This communication followed a major public debate launched by the Green Paper '*Confronting demographic change: a new solidarity between the generations*' of March 2005² as well as discussions at the level of heads of state and government at the Hampton Court informal summit of October 2005. The Commission expressed confidence in Europe's ability to cope with the demographic challenge and presented five key areas in which there are major opportunities for constructive policy responses:

- Promoting demographic renewal in Europe;
- Promoting employment in Europe: more jobs and longer working lives of better quality;
- A more productive and dynamic Europe;
- Receiving and integrating migrants in Europe;
- Sustainable public finances to guarantee adequate social protection and equity between the generations.

As was announced in the Communication, a European report will present an assessment of the demographic situation every two years, reflecting the ongoing debate and research in the EU, in conjunction with the European Demographic Forum. This first Demographic report summarises the extensive analytical work carried out prior to the adoption of the communication on Europe's demographic future. It draws extensively on the work carried out by the Economic Policy Committee and the Commission (Directorate-General for Economic and Financial Affairs) on future public expenditure trends. Furthermore, it reviews on a series of demographic impact studies and a

1 COM(2006) 571, adopted on 12 October 2006.

2 COM(2005) 94, adopted on 16 March 2005.

Eurobarometer survey commissioned under a special budget appropriation approved by the European Parliament (the ‘Walter’ Pilot Action of 2004 and 2005, i.e. named after its initiator, MEP Ralf Walter). These studies looked at a variety of relevant issues including the link between population decline/ageing and economic growth, the impact of demographic change on the skills and qualifications demanded by the labour market, as well as issues related to innovation and productivity growth in Europe. Finally, the report also reflects the hearings of leading experts in January and March 2006 as well as the first European Forum on demography held on 30-31 October 2006 in Brussels.

The aim of this report is to present the main facts and figures that underpin the debate on Europe’s demographic future and appropriate policy responses. It starts by presenting the main drivers of demographic change — fertility, life expectancy and migration — and puts these into a long-term and global perspective. Another chapter discusses the economic impact of ageing and the effect this will have on future living conditions in Europe.

A major ambition of this report is to provide facts and figures to illustrate the potential of each of the five key policy areas in which constructive responses to the demographic challenge can be developed. Thus, one chapter also reviews to what extent Member States have already started unlocking this potential. Although it covers a wide range of different areas, the material presented is certainly still incomplete and the analysis must be regarded as very preliminary. However, the chapter should provide a useful starting point for a realistic assessment of the European Union’s preparedness for demographic change. Country summaries based on a set of traditional demographic indicators complete the picture.

In the communication of October 2006 the Commission announced its intention to hold a major European Forum on Demography every two years. In connection with each Forum, a report like the present one is to be published to support an informed and constructive debate both at European level and in the Member States. The reactions to this first report received from the various stakeholders who participated in the debate initiated by the Green Paper and from the high-level group of governmental demographic experts will serve to further improve the presentations of the biennial Demographic Situation Report.

There are probably numerous ways in which future reports could be improved over the present one. Comments and suggestions would therefore be gratefully received and should be sent to:

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1.2. Highlights of this report

This Report on the Demographic Situation in Europe 2006 consists of three main sections corresponding to the main subjects covered by the Communication on the Demographic future of the EU: an overview of the drivers of demographic change, an analysis of the main impacts of this change and a description of the potential for responding to the challenges posed by demographic change within five key policy areas. This summary highlights the main themes of the report, each of which is discussed more extensively in the respective chapters.

Chapter 2: Demographic transition: a common feature of social and economic development

The main drivers of demographic change are fertility, mortality (life expectancy) and migration. In addition, the passage of age cohorts of different sizes through the life cycle can have significant impacts.

Regarding **fertility**, there are roughly two groups of countries within the EU: those with a moderately low fertility in the range of 1.6-1.9 births per woman and those with very low fertility in the range of 1.5 births or less. The average for the EU-25 is 1.5 (2005). The fertility rate needed for a full replacement of generations is estimated by demographers at 2.1, but given current levels of migration and rising life expectancy, the population size will decline only at fertility rates significantly below this replacement rate. Currently observed fertility rates may also underestimate long-term trends.

The indicator is constructed in such a way that postponement of childbearing will initially lead to a lower fertility rate until the mothers' new, higher average age at birth is reached. This 'tempo' effect may be affecting countries with the lowest birth rates, notably in Central and Eastern Europe. The Eurostat population projections up to 2050 assume an increase in fertility rates, particularly in countries with the lowest rates: for the EU-25, a slight recovery from 1.5 to 1.6 is assumed. A Eurobarometer survey carried out in 2006 revealed a generally positive attitude of Europeans towards childbearing. Women would like to have more children than they actually have. Moreover, they would also prefer to have their children somewhat later in life than they actually do.

Since the 19th century, gains in **life expectancy** have above all been the result of reduced **mortality in early life**, due to general socio-economic progress and public health measures. More recently, mortality in mid-life has also been reduced. While socio-economic factors such as income and education remain important for gains in life expectancy, the availability of modern medical treatment is playing an increasing role, as are lifestyle changes. Life expectancy is generally higher in the old (EU-15) Member States (82.4 and 76.7 for women and men respectively) than in the new (EU-10) Member States (78.7 and 70.4 for women and men). The Eurostat population projections expect further increases in life expectancy by about six years for men and five years for women (EU-25) between 2004 and 2050. These will have to be brought about mainly by declining mortality at higher ages, thus contributing to the increasing share of older and very old people in the total population. Such progress in life expectancy will, however, be contingent on the avoidance of unhealthy lifestyles, including smoking, poor diet, lack of physical exercise and excessive alcohol consumption.

Migration has become a major determinant of demographic change in the EU. In the second half of the 20th century, large parts of Europe witnessed a historical change from emigration to immigration. Net migration into the EU reached a peak of almost 2 million in 2003/2004.

However, two thirds of this observed flow concerned Italy and Spain where large numbers of illegal migrants, the majority of whom had arrived in these countries in previous years, were regularised and thus suddenly appeared in the migration statistics. If immigration is maintained at this very high level, the EU's working age population would continue to grow until around 2030 rather than already starting to decline by the end of the present decade, as is currently assumed in the Eurostat population projection. However, such a perspective would raise growing concerns about the integration of these immigrants. Indeed, the degree of integration of populations of immigrant origin already present in many Member States is often seen as highly problematic.

The **baby boom cohorts**, born between 1945 and 1965, currently still boost the working age population. They will start retiring soon, thereby bringing about a major shift in the balance between the active and the retired. About 15 to 20 years later, these cohorts will start relying heavily on health and long-term care systems.

The combination of these trends will leave the total population size roughly unchanged by 2050, but will transform Europe's population structure. According to Eurostat's baseline **population projection**, the median age of the EU will increase between 2004 and 2050 from 39 to 49 years. The number of young people (aged 0-14) in the EU will continue to decline in absolute terms from around 100 million in 1975 to some 66 million by the year 2050. The population of working age (15-64) will be most numerous around the year 2010 (331 million) but will subsequently decline to about 268 million by 2050. While ageing will affect all Member States of the EU, it will do so to varying degrees. The old-age dependency ratio (number of people over 65 divided by the number of people aged 15-64) will reach around 53% in 2050 for the EU-25 (up from 25% today), with the highest rates projected for Italy and Spain (66-67%) and the lowest for Denmark, Luxembourg, Malta, the Netherlands and Sweden (around 40%).

While it may still be one or two decades before the impact of ageing becomes clearly visible at the level of an entire country, the impact can already be observed at **regional level**. In some regions, 'natural change' (difference between births and deaths) has already become negative. Migration may either aggravate or alleviate these trends. Regions will increasingly have to include the effects of long-term population trends in their regional medium-term strategies. A number of regions have already been active and are at the forefront of strategic thinking and actions to tackle the demographic challenge.

A century ago some 15% of the world population lived in the area of the current EU-25; nowadays this share is 7% and by the year 2050 the **share of the EU-25 in the total world population** is projected to be around 5%, according to the UN population projections (2004). While all world regions — except sub-Saharan Africa — will experience significant ageing of their populations, the EU is the only major world region where the total population is projected to decline in the coming four decades. Although declining fertility can be observed in many developing countries, the demographic and socio-economic contrasts between Europe and its Southern neighbours suggest that strong migratory pressures will persist over the coming decades.

Chapter 3: The economic and social impacts of demographic change.

Demographic change will gradually limit the scope for future **employment** growth. Although the population of working age (aged 15-64) is already expected to decline from around 2011 onwards, total employment in the EU-25 is expected to continue growing up to around 2017

due to rising labour force participation. Thanks to higher education levels and greater labour force attachment of younger cohorts of women, female employment rates are projected to rise from just over 55% in 2004 to almost 65% by 2025. The employment rates of older workers are also projected to increase, from 40% in 2004 for the EU-25 to 47% by 2010 and 59% in 2025. From around 2017 onwards, however, the shrinking working age population will lead to stagnation and, subsequently, reduction of total employment. Projections show that, as employment decreases and productivity becomes the only source of future economic growth, the annual average **potential GDP growth** rate in the EU-25 will decline from 2.4% in the period 2004 to 2010 to only 1.2% in the period 2031-2050.

Declining employment at a time when the number of older people in need of adequate pensions and health and long-term care is rising will make it a challenge to provide **sufficient resources for social protection** in a sustainable way. The projected increase in these expenditure categories by 2050 is about 4.5 percentage points of GDP in the EU-25. Public and private spending on pensions, which averaged 13% of GDP in the EU (in 2003), has ensured that being old is no longer associated with being poor or being dependent on one's children. However, Europe's future ability to provide the ageing population with adequate pensions will crucially depend on whether the effective retirement age can be raised and the pension systems adapted to increasing life expectancy, thereby making the relationship between contributions and benefits transparent. The main consumers of health and long-term care today are elderly people, whose projected increasing numbers will result in greater demand for these services. According to Eurostat projections, the share of the total population over 80 will rise from 4.1% in 2005 to 6.3% in 2025 and to 11.4% in 2050. Although age in itself is not the only factor influencing healthcare spending (though it does serve as a proxy for a person's health status), projections illustrate that an ageing population will bring about pressure for increased public spending on health and long-term care.

Chapter 4: Opportunities for tackling demographic change.

The Commission's Communication on 'The demographic future of Europe — from challenge to opportunity' identified five key policy areas in which constructive responses to the demographic challenge can be developed. These include birth rates, employment levels, productivity growth, migration and the sustainability of public finances. If policies in these areas are formulated in an integrated manner, synergies may be reached. For example, policies that promote the labour market participation of older workers will also have a positive impact on public finances. In addition, more competitive markets will increase the return on investment in older workers.

Promoting demographic renewal in Europe through greater gender equality

While the choice to have or not to have (more) children is and must remain a private one, there appears to be scope for policies to enable families to make their choices. Indeed, survey evidence suggests that Europeans generally would like to have more children than they actually have. International comparisons show that policies supportive of those who wish to have children can have some effect in raising birth rates. Even small changes in fertility rates will have a strong impact on the population size and age structure in the long run. However, an increase in fertility rates will only translate into a larger working age population and increased employment after 20 or more years. Therefore, it could at best make a small contribution to tackling the challenge of providing for the ageing baby boom cohorts. Furthermore, the number of women of childbearing age is also projected to fall in the coming decades.

If the aim is to enable people to have the number of children they really wish, public policies that promote greater gender equality and facilitate the reconciliation of work and care seem to be most successful. It is primarily women who adjust their career ambitions to the needs of their families (including caring for elderly relatives), either by dropping out of the labour market or working part-time. Countries that have achieved the highest female labour force participation and the most progress in terms of gender equality (as reflected in differences in time use patterns between men and women) today also display relatively high fertility rates. Some 20 years ago, countries with high female labour force participation tended to display lower fertility than those with low female labour force participation. Access to services (in particular affordable day care provision of high quality), flexibility in working hours and conditions as well as gender equality (including shared family and domestic responsibility) are all important factors in reconciling work and private life. In addition to policies that promote better conditions for women and men wishing to raise a family, it may become increasingly important to address biological obstacles to fertility. As potential parents postpone the moment at which they decide to have children, infertility is becoming a more and more frequent obstacle to the realisation of their desire to have children. The availability of fertility treatments may then have some impact on birth rates.

Promoting employment in Europe: more jobs and longer working lives of better quality

The effective old-age dependency ratio, or the ratio between people over 65 and the employed persons aged 15-64, is even higher than the demographic dependency ratio and is projected to rise from 37 to 70 in the EU-25 by 2050. Despite a significant increase in employment rates, the effective old-age dependency ratio is projected to worsen significantly. Raising the EU-25 employment rate to the level of the current three best-performing Member States, however, would compensate for about two-thirds of the decline in employment expected to result from a shrinking working-age population. Such an increase in employment rates would, of course, require many changes in the labour market and in institutional arrangements. A life-cycle approach aimed at enabling people to remain much longer active and productive, including through lifelong learning and better health protection, is needed. The main potentials for increased employment rates lie with women and older workers and some other disadvantaged groups on the labour market..

In order to unlock these potentials, raising levels of educational attainment seems to be particularly important. Higher levels of education are associated with significantly higher employment rates and much lower unemployment rates. In 2005, the average employment rate among the highly-skilled in the EU was 82.5%, for the medium-skilled (those having completed upper secondary education) it was 68.7%, whereas for the lowest skilled it was only 46.4%. Both the Lisbon strategy and the European Employment Strategy aim to increase employment and growth and provide guidance on how to meet demographic challenges. A higher labour force participation of women will require better provision of affordable high-quality childcare and care of other dependents, shared family and domestic responsibilities between men and women, reduced gender pay gaps, enhanced gender equality and equal opportunities. The European Pact for Gender Equality adopted in 2006 aims at mainstreaming gender in all actions taken and will be a tool for increasing the employment of women. Prolonging working lives by providing effective incentives for later retirement is an even more important policy to unlock the potential for increased employment. This concerns not only pension schemes, but also early retirement and social security schemes (disability, unemployment, sickness) that are sometimes used as an exit-route. Older workers are nowadays in a much better health condition than the same category of workers 40/50 years ago. Moreover, as today's older workers entered the labour market at a later stage,

strengthening incentives to remain on the labour market seems appropriate. This can be further reinforced by adopting a life-cycle perspective. Active ageing needs to be prepared for by a good initial education that enables workers to participate in lifelong learning. Health promotion throughout working life, as well as effective and efficient health services are also important because a healthy workforce is more productive. Ill health is a key factor in absenteeism and early retirement. Pension reforms in the majority of Member States are already raising the labour market exit age and would be further underpinned by promoting the employability of older workers, both with regard to their skills and their health status. The labour potential of all groups must be fully used and measures taken to better integrate disadvantaged groups on the labour market, such as disabled persons, ethnic minorities and people with a migration background. A high youth unemployment rate is also a serious concern.

A more productive and dynamic Europe

Economic growth and high living standards beyond 2017, when total employment is expected to decline, will depend solely on increases in labour productivity. There is a huge potential for productivity improvements in Europe if all Member States were to catch up with the highest-performing countries whose productivity levels are above or close to that of the US. Indeed, even the productivity leaders can further accelerate their growth by removing obstacles to innovation and structural change and by boosting research and development leading to new products and more efficient production processes.

The key to unlocking this potential is to invest in human capital. The example of the highest-performing Member States shows that general education levels across the EU can still be raised significantly. In this context, it is particularly important to reduce the number of early school leavers, who will face increasing difficulties in future labour markets. In 2005, 17% of men and 13% of women aged 18-24 had not reached more than lower secondary education and were not in further education or training. Further improvements are also necessary with regard to the proportion of people with an upper-secondary or tertiary education. Spending on tertiary education in the EU-25 represents only 1.2% of GDP, compared to 2.9% in the US. The gap between the EU and the US is somewhat smaller with regard to R&D spending, which is just under 2% of GDP in the EU and nearly 2.7% in the US. Europe's future capacity for innovation and productivity growth will depend on increased investment in top-level education and research. This will also be crucial for successful adaptation to the new market opportunities brought about by the 'silver economy', i.e. new goods and services adapted to the changing needs and demand patterns of an ageing society.

Receiving and integrating migrants in Europe

Europe will continue to be an attractive destination for migrants due to its prosperity and well-functioning societies. However, it should be noted that the EU is not as successful as the USA and Canada in attracting the highest-skilled migrants. The procedure adopted in 2005 for the admission of third-country researchers is a first step towards addressing this issue³. Such arrangements need not come at the cost of developing countries in the form of brain drain, but can and should be beneficial to all parties. Around 3.7% of the EU-27 population are non-EU nationals (5.1% in the EU-15). Migration is therefore already responding to the needs of

3 Directive 2005/71/EC.

European labour markets, and this need for both high- and low-skilled migrant labour will continue.

While internal mobility of workers within the EU will not change demographic trends for the EU as a whole, it does represent an enormous potential for higher rates of participation and employment as it opens up better opportunities for people living in regions where they face poor labour market prospects. Countries that have experienced rapid economic growth over recent years, like Spain and Ireland, have clearly benefited enormously from the significant inflow of workers both from outside and from within the European Union.

The main challenge to realising the potential of immigration is the integration of migrants and their descendants into European societies. The Member States of the EU have evidently had different degrees of success with labour market and social integration. The educational attainment of non-nationals is generally substantially lower than that of nationals, although in several Member States the percentage of non-nationals with tertiary level education is actually higher than that of nationals. At the same time, in several Member States, the employment rates of migrants, particularly migrant women, are very low. Linked to this insufficient integration of migrants in their host societies is a rather negative perception of immigration: Eurobarometer results indicate that on average only 4 out of 10 EU citizens feel that 'immigrants contribute a lot to their country', while a slight majority of citizens (52%) do not agree with this statement.

Sustainable public finances to guarantee adequate social protection and equity between the generations

In all Member States, the ageing of the population will increase public expenditure on pensions, health and long-term care. Projections show that most Member States where pensions are financed by specific contributions will see a growing imbalance between contributions and needs. The reserve funds established by several Member States can alleviate future financing needs but appear to be inadequate in most cases. In most Member States, public finances are not sustainable in the long run under current policies. Budgetary consolidation and further reform efforts in pension, health and long-term care systems are required. An increase in the number of years that people remain active and in good health will help to reduce the financial pressure on health and long-term care systems.

Apart from future expenditure and revenue trends, the long-term sustainability of public finances depends on the current deficit and debt situation, which if left unchanged can put public finances on an unsustainable path. Interest payments on public debt can represent more than 10% of public revenue in some Member States. Reducing current deficit and debt levels and avoiding unsustainable expenditure trends are recommended policies to ensure that Member States remain capable of meeting future spending needs, including those arising from population ageing. The potential for further consolidation of public finances differs greatly across Member States.

To consolidate public finances over the long-term, it is important to act at a time when growth prospects are still favourable. The EU has a window of opportunity of about 10 years until employment is projected to start to fall as a result of a shrinking working age population. Mobilising the full potential of older workers, including making use of the window of opportunity to reform pension and healthcare systems and prevent the early withdrawal of the baby boom cohorts from the labour market will be key to tackling the challenges of ageing. This will strengthen Member States' capacity to ensure adequate social protection of the

elderly while making sufficient investment in younger generations and hence maintain intergenerational solidarity.