

Population Aging, Public Expenditures and Financial/Economic Crises: (Re-)establishing priorities?

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Topics

- I. Aging and public expenditure: From projections to policy simulations**
- II. Aging, economic crisis and the future of multi-pillar pension schemes**

I. Aging and public expenditure: Beyond projections ...

- Kudos to AWG: Very impressive process, approach and results; international best practice
- Population aging is a world-wide phenomenon but the “North” is subject to two effects: Increasing share of elderly and low or negative labor force growth, with consequences for expenditure shares as well as benefit levels (through internal rate of return, i.e. employment plus productivity growth)
- For EU-wide policy actions important to move beyond projections to policy simulations about key triggers to avoid expenditure crisis while delivering expected social benefits

Old-age dependency ratio (ratio of people aged 65 or above relative to the working-age population)

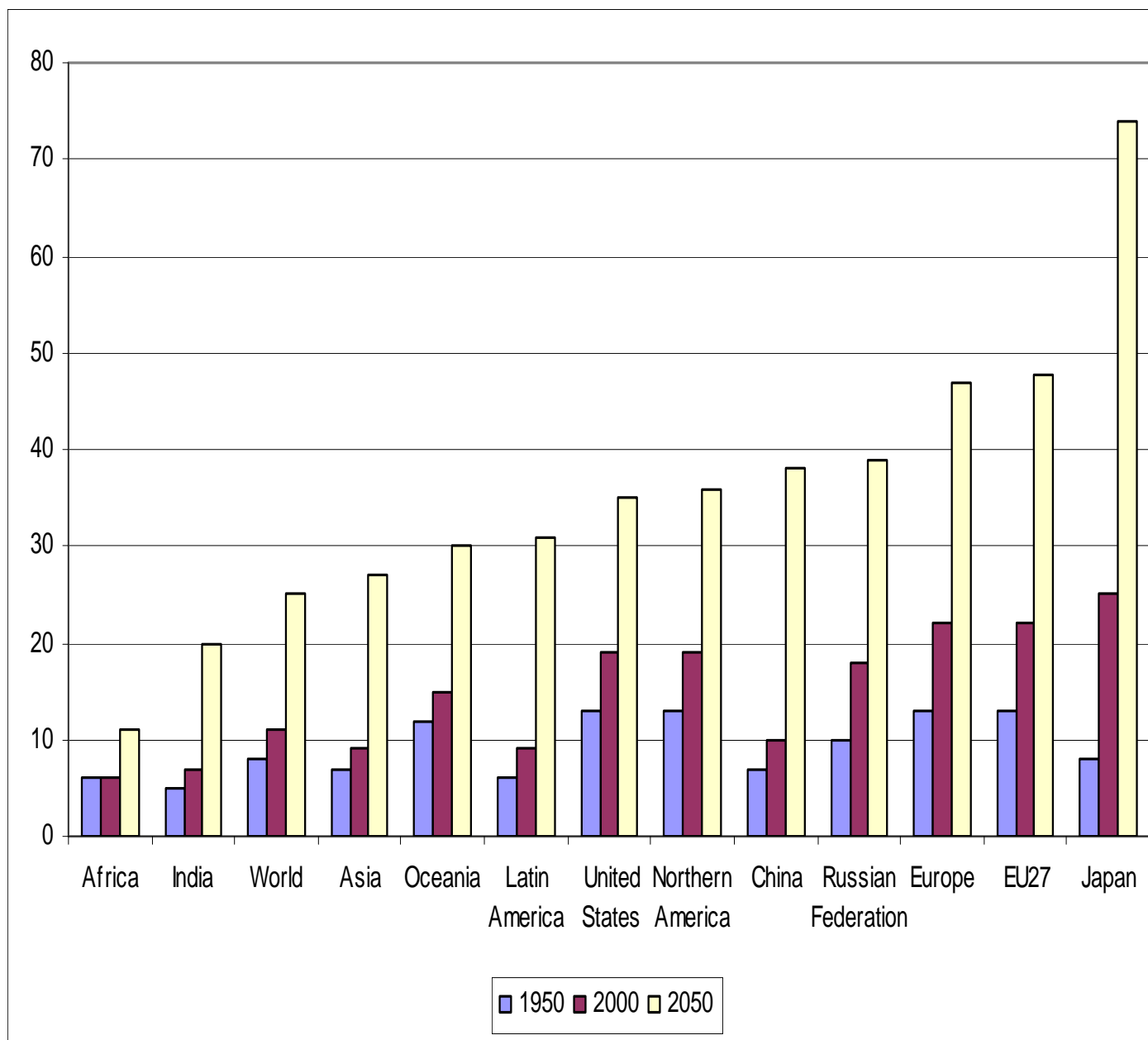


Table 3. Annual Growth Rates of the Labor Force, 2005–50

Percent

<i>Country</i>	<i>Medium variant</i>	<i>Zero migration</i>	<i>Difference</i>
China	-0.28	-0.25	0.03
Europe and Russia	-0.68	-0.85	-0.17
High Income East Asia and Pacific	-0.56	-0.75	-0.19
North America	0.44	-0.12	-0.56
Latin America and Caribbean	0.83	0.95	0.12
Low and Middle Income East Asia and Pacific	0.79	0.86	0.07
Middle East, North Africa, and Turkey	1.36	1.38	0.02
South and Central Asia	1.25	1.29	0.04
Sub-Saharan Africa	2.32	2.34	0.02
Total	0.77	0.77	0.00

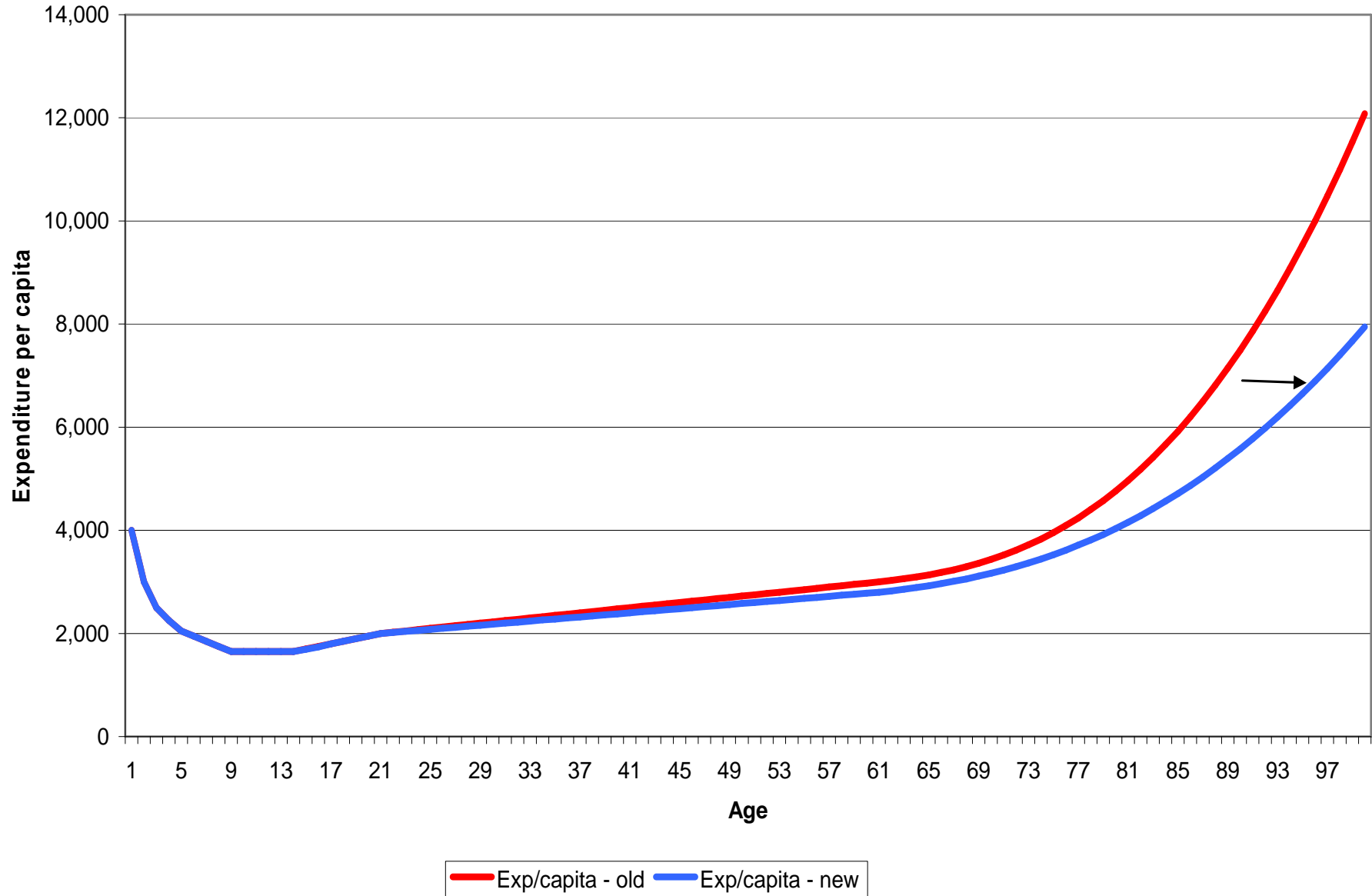
Sources: United Nations (2005); author's calculations.

Projected Demographic Dependency Ratios: Revisited and redefined

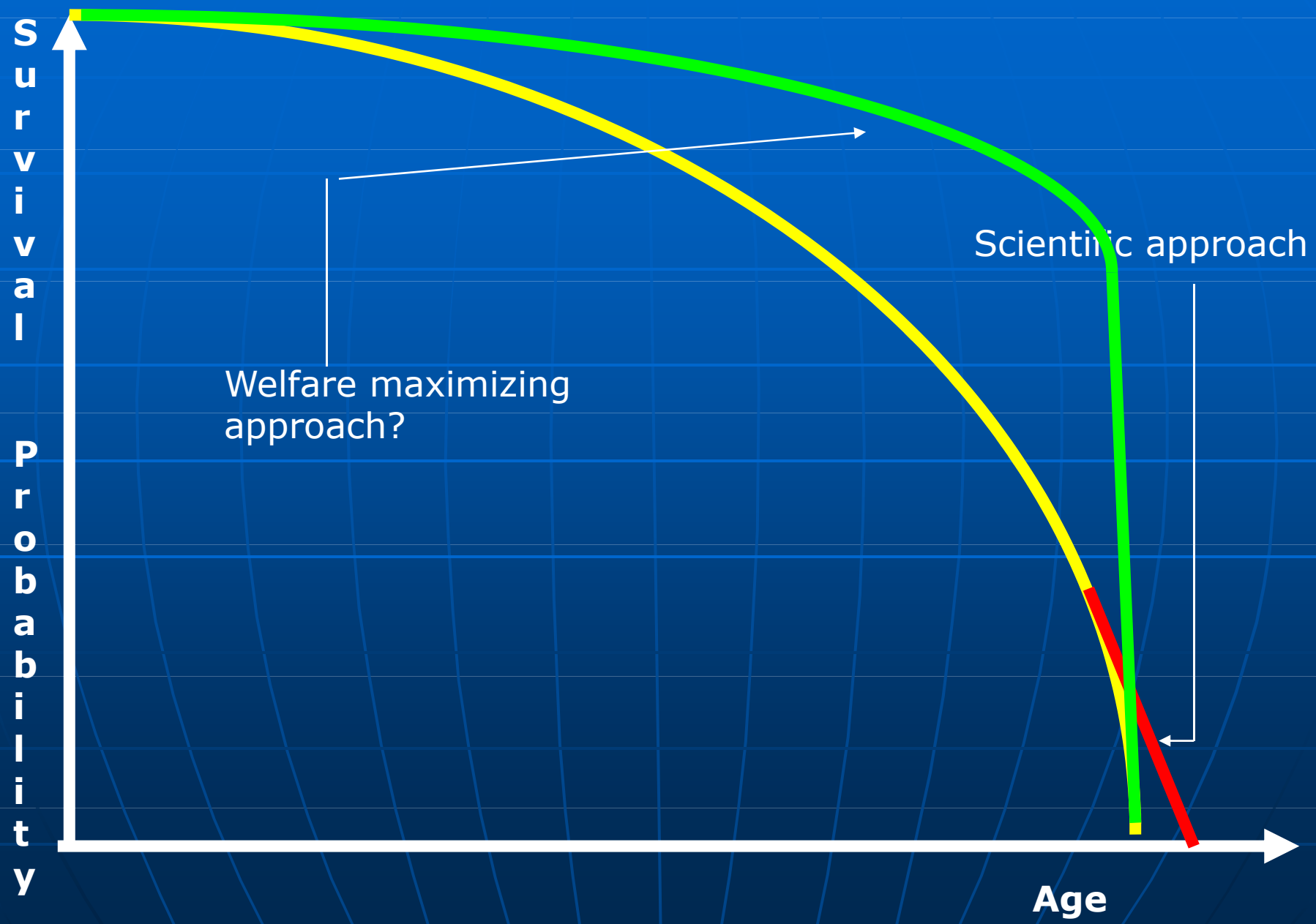
	2004	2025	2050
Ratio 60+ /20-59	39%	58%	80%
Ratio 65+ /20-64	27%	39%	58%
Ratio 70+ /20-69	18%	25%	40%

Note : EU25. Source : Eurostat 2005 demographic projections.

Changing the Health Expenditure Profile ...



Changing the approach to health policy ...



Population Aging Requires

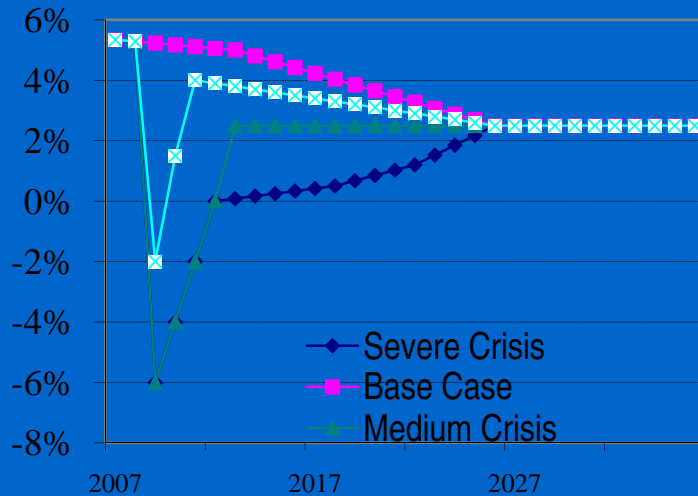
- Comprehensive rethinking of most or all institutions of society ... including quite likely its oldest one
 - Marriage
- Attitude and policy changes that make individual aging a positive experience that is economically sustainable
 - Keep them healthy and skilled
- Policy and program changes needed to make them more effective and less distortive for individual decisions across the life-cycle
 - Activation oriented (social) policies from cradle to grave

II. Aging, economic crisis and the future of multi-pillar pension schemes

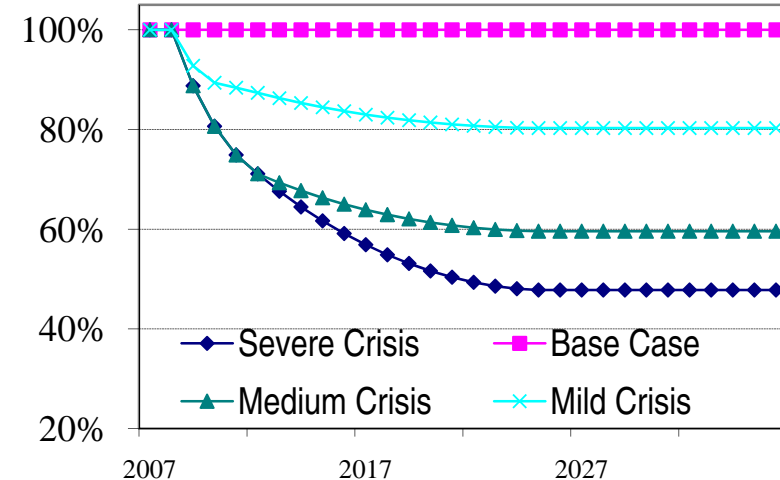
- For assessing the effects of the economic crisis on pension schemes, it is important to look at both expenditure and revenue side
 - Fiscal pressure primarily via lower revenue due to lower wages and employment
 - Expenditure same or increase via more beneficiaries (early retirement; disability)
 - If benefit levels unaffected, bound to lead to deterioration of fiscal balance of scheme
- Simulations for synthetic CEE transition economy using the World Bank's PROST model (Pension Reform Options Simulation Toolkit)

Simulation of Fiscal Impact of Financial Crisis

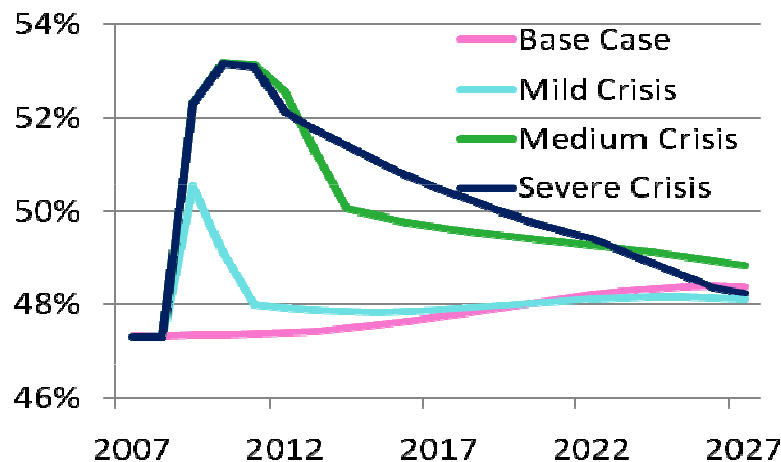
GDP growth



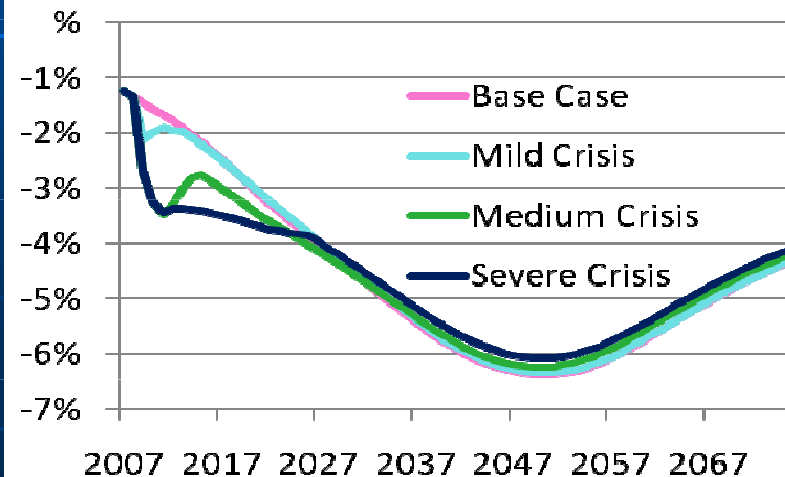
Cumulative Effect on GDP level



Replacement Rates



1st Pillar Deficits

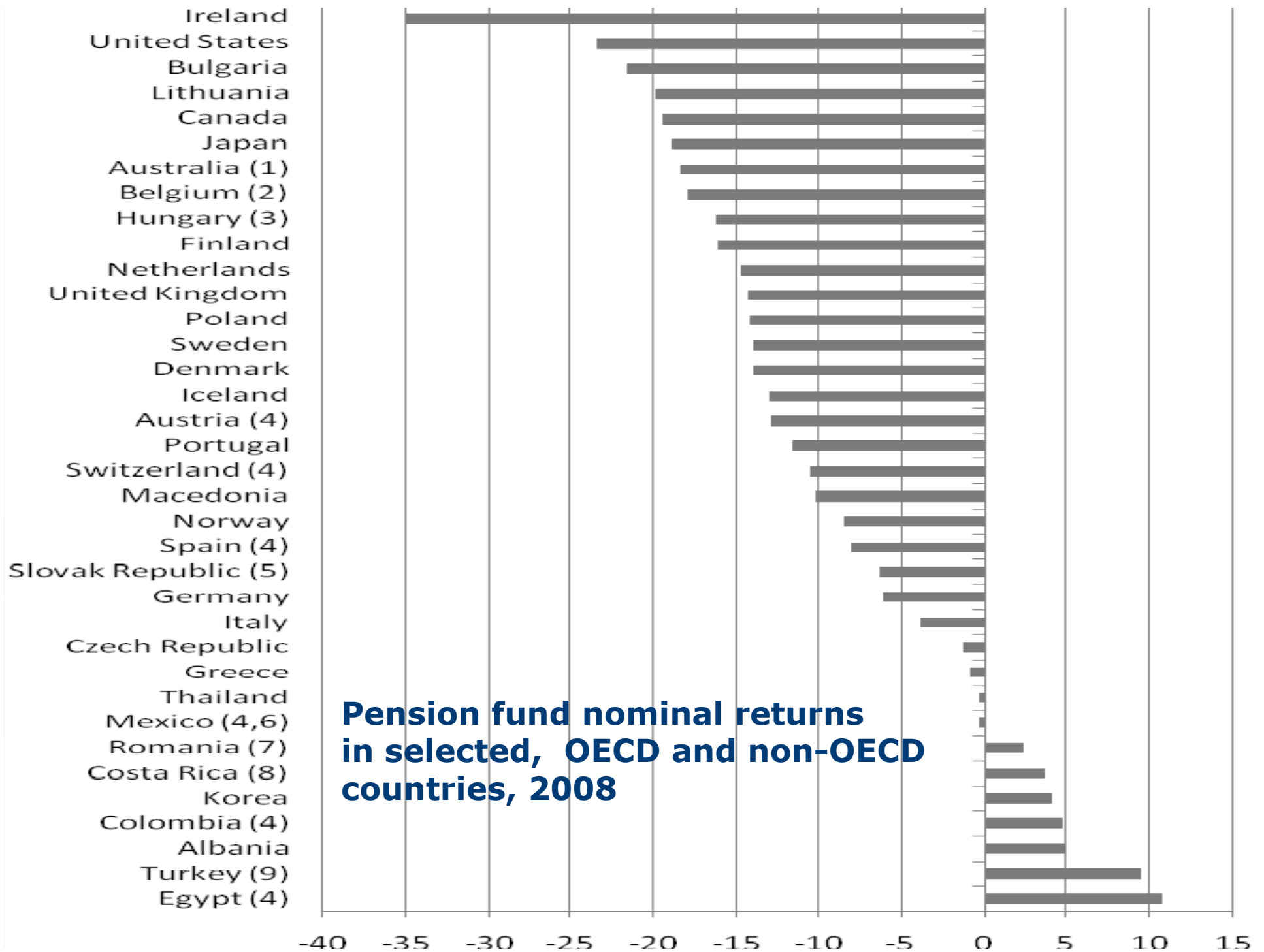


The future of multi-pillar pension systems

- Current financial and economic crisis have reduced the value of assets to finance retirement by some 20 to 25% (for OECD and emerging economies)
- Does this mean that funded pillars as have failed and should be abolished?

NO: Crisis strengthens the argument for risk diversification and multi-pillar schemes

BUT: Need to review design and improve risk management of funded pillars for beneficiaries



Assessing funded pillars

- Crises with fall in output and asset values hit unfunded and funded systems alike, but in a differentiated manner that strengthens arguments for risk diversification
- Retirement assets are for the long run and need to be managed for and judged on their long-term performance
- Funding is not a panacea against population aging but highly supportive, including to handle increasingly differentiated life courses
- Funding helps develop financial markets and intermediation beyond (foreign dominated) banking system

Improving risk exposure in funded pillars

- From single to life cycle funds with change in exposure to growth, balanced and conservative funds with age
- Flexibility in converting accumulated amounts into a (mandatory) annuity
- Probing of guarantees for contributions (and related incentive effects)
- Reviewing incentive structure for pension funds to focus on long-term results

References and Sources

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