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Population ageing: Facing the challenge

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Ageing will make it hard for governments to deal with mounting financial pressures. It may be time to rethink our policies towards work.

Population ageing is set to affect all OECD countries over coming decades. Demographic projections are uncertain, but on middle-of-the-road assumptions, the ratio of people over 65 to those between 20 and 64 could double between now and the middle of the century. And in some countries, such as Japan, Italy and Spain, this ageing will be much stronger.

These developments will be challenging for public budgets and pension systems. Indeed, the falling share of the population at traditionally productive ages means relatively fewer people will pay taxes and social contributions at a time when the rising share of older persons implies that more people will receive pensions and costly health services, etc.

To cope with mounting financial pressures, governments have to make hard choices. In particular, to avoid increasing the tax burden or impoverishing pensioners, they are now looking at ways of inducing more people to enter or stay in work. As is often the case, these testing times may be a blessing in disguise because they provide OECD countries with a golden opportunity to break away from the mistaken policies of the past – policies that sought unsuccessfully to reduce unemployment by withdrawing workers from the labour force through a variety of misguided incentives and restrictions.

Across the OECD, the share of the population over the age of 15 that is active in the labour market varies tremendously – from around 50% in Italy to more than 70% in some Nordic countries in 2000 (see graph). There is also a strong presumption that those countries which achieved high labour force participation also had the best policy framework. The time has come for many OECD countries to implement a new set of policies conducive to stronger growth, higher employment and sounder pension systems.

These policies will have to be tailored to meet the specific needs of the various groups that make up the active population. One group in the labour market almost fully employed in all OECD countries is that of prime-age males (25-54), whose labour-force participation rate generally exceeds 90%. By contrast, there is wide variation in the extent to which women, as well as young and older persons, participate in the labour market. Those groups are most likely to be influenced by government policies, for better or worse.

As for women, their participation has been rising in all countries for several decades. Each new generation of women has had a stronger attachment to the labour market than the previous one. There are probably important cultural reasons for this, but the increase has also been enabled by technical progress, allowing housework to be done more easily, while higher educational attainment has also played a role in luring women into the job market.

Policies have also affected this trend and appear to play an important role in explaining cross-country differences in female participation. Taxation is one such policy. Married women are widely considered as the second earner in a couple and when their income is taxed jointly with that of their husband, the marginal tax rate can be very high. This is unfortunate since women's participation reacts more to tax changes than that of men. Most countries have moved towards taxing each earner in the couple separately, but joint taxation still exists in a number of countries, including France and Germany.

Better participation can also be achieved by subsidising childcare, either directly or through the tax system. Most Nordic countries have gone pretty far in this respect and also have high female labour force participation. Childcare support may be seen more as a subsidy to female full-time work than to part-time work, and indeed, the share of part-time work in Nordic countries has declined. But the money to pay for childcare subsidies obviously has to come

Economic data

GDP: +0.39% Q1 2016

Employment rate: 66.5% Q4 2015

Annual inflation: 0.8% Mar 2016

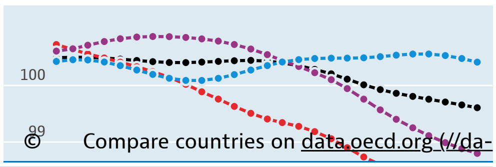
Trade: -1.6% exp, -1.9% imp, Q4 2015

Unemployment: 6.436% Mar 2016

LOOKING AHEAD: The outlook, to judge by factory order books, building permits, long-term interest rates and other "leading" indicators that point to future activity remains modest at best. Click curve to find out more country trends.

Composite leading indicator (CLI) (//data.oecd.org/leadind/composite-leading-indicator-cli.htm)

Amplitude adjusted, Long-term average = 100, Jan 2014 – Mar 2016



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from taxes, and higher taxes in general reduce people's desire to work, so there are limits to how far this policy can go. Other countries, such as the United States, manage however to achieve high female participation without large-scale subsidisation of childcare. In this case, because of a wide dispersion of wages, many households can afford to meet the costs of childcare by themselves.

In contrast to women, older men have reduced their labour force participation in all countries over the past three decades – in some cases sharply. It may seem ironic that effective retirement ages have fallen at the same time as people are living longer and healthier lives. This fall may reflect a stronger appetite for leisure as real incomes have gone up. But it also owes a lot to policies.

Early retirement, invalidity and unemployment benefit schemes in many countries provide people in their 50s with strong incentives to retire. These often misguided policies led to a sharp drop in participation in the 1970s and 1980s. There has been some moderate roll-back since then, but most of these policies remain in place in many continental European countries, with detrimental consequences for employment.

Old-age pension schemes also stack the cards in favour of people retiring early. If people postpone their retirement by a year, this is rarely reflected in correspondingly higher pensions later on, despite their extra contributions. This is already problematic at ages between 60 and 65, but after 65 the disincentives to work become almost prohibitive in some countries. In our society where people are fitter for a lot longer, we should be free to engage in "active ageing".

Could policy reforms in some of these areas help to alleviate the problems brought about by population ageing? Probably yes, but by how much remains to be seen. Recent OECD research may provide us with some of the answers. A first step may be to consider how much policy reforms could affect participation.

Without them, the share of the population over 15 years old that would be active in the labour market could decline by perhaps some 4-5 percentage points in the OECD on average by 2025 – even taking into account that recent cohorts of women will maintain a stronger attachment to the job market than their predecessors. According to OECD estimates, radical reform in the above areas could arrest the decline, and may even produce a moderate rise in participation.

A policy package that could work would include the following steps: eliminate early retirement schemes; make old-age pension schemes actuarially neutral so that pensions fully reflect time spent at work; raise standard retirement ages; increase childcare subsidies; eliminate tax discrimination against female participation; and enhance the role of part-time work. All of this would be strengthened by measures to make the school-to-work transition more effective.

This is obviously a radical policy package, but it sends an important message: in a context of rapid population ageing, it will take very strong policy action to stabilise the share of the working age population and start reversing the trend.

These strong recommendations come, however, with a note of caution. It is obviously not enough for policy reforms to bring people out onto the labour market. Looking for a job is an important prerequisite but finding one is what ultimately matters.

Measures could well be needed to ensure the full employment of more people coming onto the job market. Indeed, many of these measures have been dealt with extensively in the OECD Jobs Strategy. But while they demand our attention, it is reassuring to note that those countries which have promoted active labour force participation also benefit from high employment. Given time, it seems that employers have been able to create the jobs needed to match a more abundant supply of labour.

Reference

OECD, *OECD Jobs Study*, 1994.

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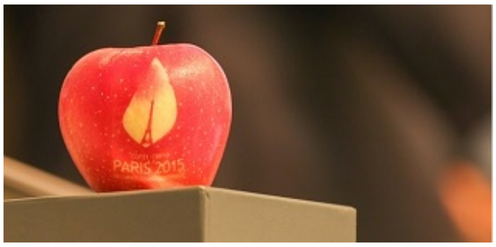

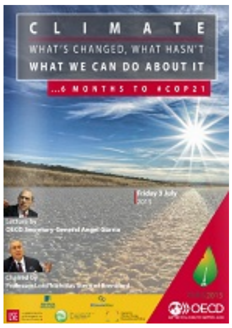

Climate: What's changed, what hasn't, what we can do about it.
Lecture by OECD Secretary-General Angel Gurría, hosted by the London School of Economics and Aviva Investors in association with ClimateWise, London, UK, 3 July 2015.

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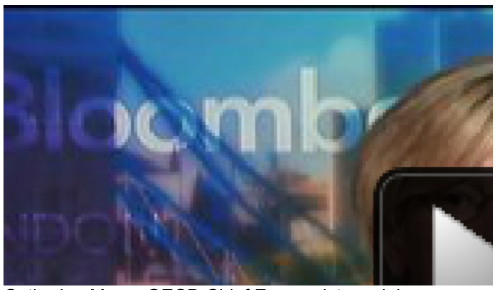

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