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REFORM BAROMETER

REFORM TO PERFORM - ANNEX II

DEMOGRAPHIC CHANGE : IS THE EU SUFFICIENTLY PREPARED ?

2012 2013 2014 2015 **2016**

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DEMOGRAPHIC CHANGE : IS THE EU SUFFICIENTLY PREPARED ?

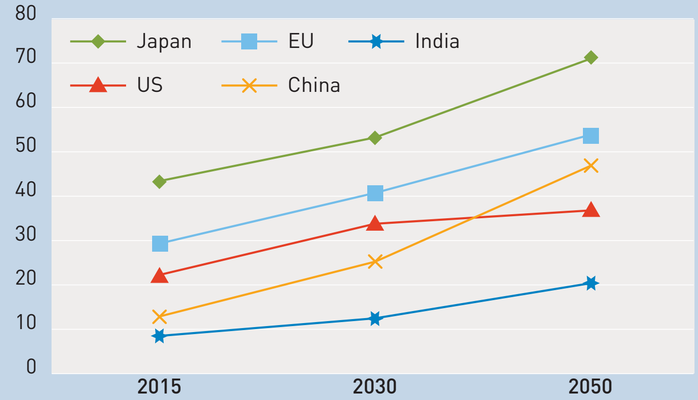
With life expectancy increasing and, fertility falling, the EU's population has started to age and this trend is expected to increase in the coming years. In this section we examine the implications of population ageing on the EU economy, and in particular on growth, the labour market and public finances. We analyse how prepared the EU and its Member States are to deal with the impacts of ageing, particularly in comparison to our international competitors. And we consider the policy responses necessary for the EU to address the challenges of population ageing.

Population ageing will be more dramatic in the EU than the US

Whilst population ageing will be common to all major economies globally, the extent and nature of it will differ. Population ageing will in particular lead to a rise in the ratio of people aged 65 years or above compared to the working-age population. The so-called dependency ratio will increase from 29% at present in the EU to 54% in 2050, a change which is much more dramatic than that forecast for the US (which already has a lower dependency ratio) (fig 1). Linked to this, the share of people 65 years and over will increase from today's 19% to 30% in 2050, in contrast to the much more moderate rise expected in the US, from just 15% at present to 22% in 2050.

Figure 1 **Strong increases in the old-age dependency ratio in the EU, Japan and China**

Old-age dependency ratio 65+/(15-64) in major economies in 2015, 2030, 2050

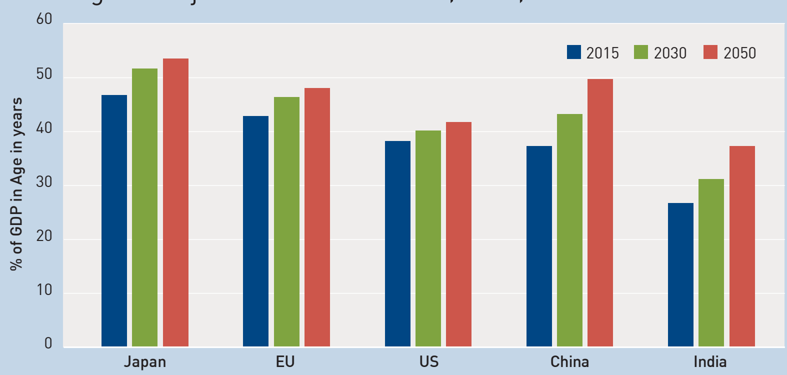


Source: UN World Population Prospects: The 2015 Revision

Similarly, the median age in the EU is also projected to increase in the coming years, from 43 years at present to 48 in 2050 (Fig 2).

Figure 2 **All major economies are affected by population ageing but to a different degree**

Median Age in major economies in 2015, 2030, 2050

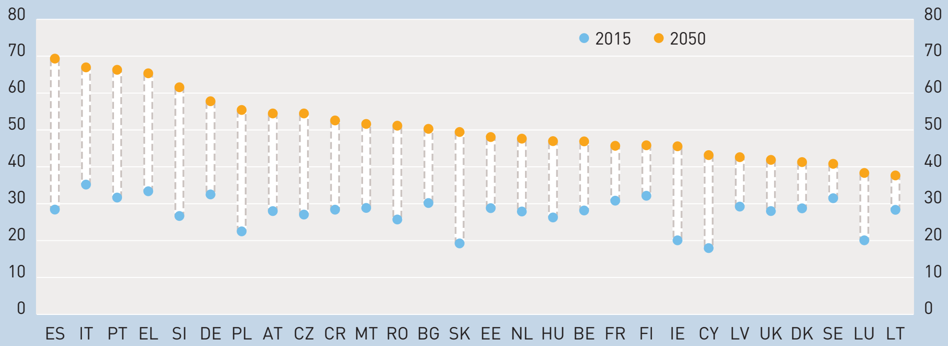


Source: UN World Population Prospects: The 2015 Revision

There will also be significant country differences in the EU with Italy, Portugal and Greece in particular, all expected to see dependency rations rise by more than 20 percentage points to over 65% by 2050 (Fig 3).

Figure 3 **Increase in old-age dependency ratio differs significantly between EU Member States**

Old-age dependency ratio in EU Member States in 2015 and 2050



Source: UN World Population Prospects: The 2015 Revision

Rising dependency rates will put a downward force on growth

An increasing dependency ratio will tend to mathematically reduce per capita economic output as, in the absence of behavioural changes, including as a result of policy reform, a smaller proportion of people will be working. However, there may be additional implications of changes in the age structure of the workforce on economic growth.

Research is inconclusive regarding the overall impact of an ageing workforce on productivity, and will depend to a large extent on the industrial and occupational structure of the economy. On the one hand it is clear that raw brain power peaks in the 20s[6], and physical strength and dexterity will also decline with age[7], with particular implications for older manual workers. But older workers, particularly in non-manual work, also benefit from increased experience, with a number of studies suggesting workers around a 40 years age range may have particularly strong productivity.[8]

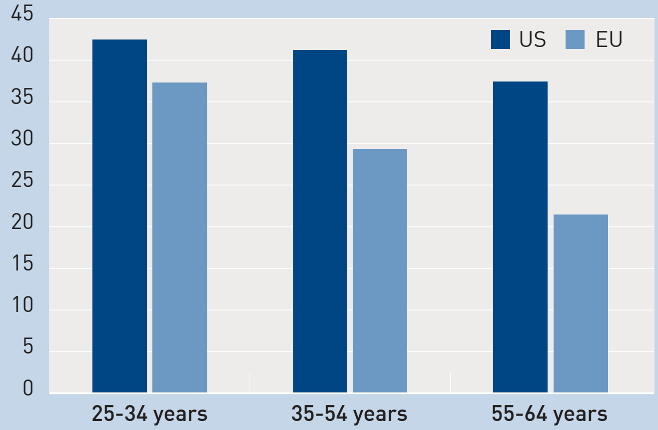
Finally, there will also be implications for productivity as the actual people in the labour force change over time (the so-called cohort effect). In particular, given that people have in general stayed in education for longer and to higher levels over time, the future workforce should be more educated than the present.

[6] For example, researchers at Canada's Simon Fraser University have found that that raw brain powerpeaks at the age of 24 after which a measurable declines in cognitive performance begins to occur.
[7] E.g. Dayanidhi S, Valero-Cuevas F J. (2014), "Dexterous manipulation is poorer at older ages and is dissociated from decline of hand strength". Oxford University Press. No 69
[8] E.g. Prskawetz P, et al. (2004). "The Impact of Population Ageing on Innovation and Productivity Growth in Europe", Vienna Institute of Demography, Austrian Academy of Sciences & Institute for Futures Studies, Stockholm, Sweden; or Skirbekk V. (2003). "Age and Individual Productivity: A Literature Survey." Max Planck Institute for Demographic Research. In addition, a case study – Boersch-Supan A. and Weiss M. (2011), "Productivity and age: Evidence from work teams at the assembly line", Munich Center for the Economics of Aging – about a German car manufacturing company shows that while the number of small errors is larger among older workers, major errors are more common among younger ones.

This is illustrated in fig 4 where we see that both in the US and the EU, a greater proportion of younger people than older people have completed tertiary education. But it is important to emphasise that despite the fact that the relative number of people with tertiary education in the EU and US has narrowed over time, it remains the case that even younger workers in the EU are less likely than their counterparts in the US to have completed tertiary education[9].

Figure 4 **The EU's skills gap with the US is smaller for young people than older worker**

Population with tertiary education by age, %



Source: Eurostat, US Census Bureau, BUSINESSEUROPE's own calculation

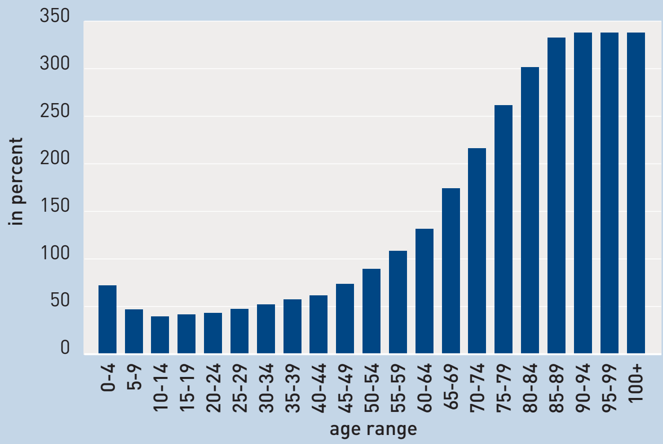
Ageing will strongly increase pressure on public finances

The strong shift in the distribution of the population will also have significant fiscal implications for EU Member States, with increases in age-related expenditure such as pensions, healthcare spending and long-term care likely to place significant additional pressures on public finances.

Healthcare spending in particular, increases substantially with age, with fig 5 illustrating that average spending is more than 3 times higher than the average for a person above 80 years of age.

Figure 5 **Public healthcare spending increases strongly with higher age**

Per capita healthcare spending for different age groups as a share of average spending



Source: Commission 2015 Ageing Report, UN 2015, BUSINESSEUROPE's own calculation

[9] We should note that completing tertiary education is not the only way to become equipped with relevant skills for the labour market, and that relatively low tertiary education levels in some EU Member States may to some extent reflect the strength of vocational education and training (VET) programmes.

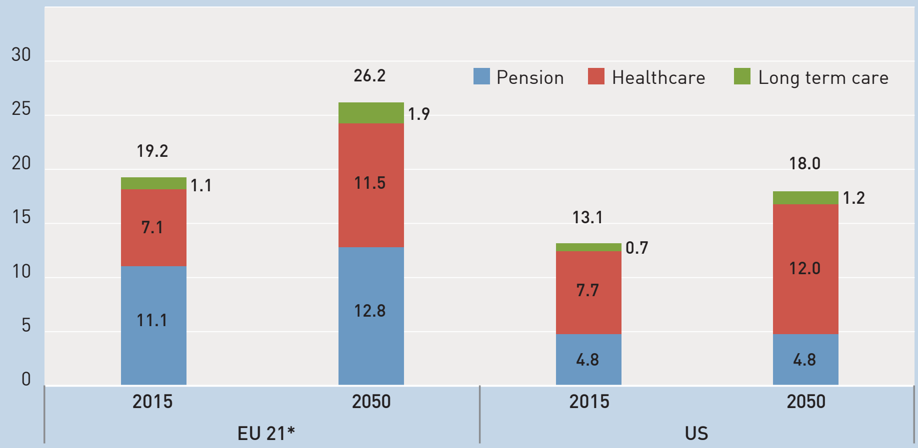
As a consequence, the share of public healthcare spending on people above 65+ years of age is expected to increase from 46% today to almost 62% in 2050 in the EU.

Overall age-related public expenditure is expected to increase from 19.2% of GDP in 2015 to 26.2% in 2050 in the EU (fig 6). While increasing public healthcare costs, from around 7% of GDP to over 11% of GDP are the main driver, increasing pensions and long-term care expenditure are expected to increase by about 1.7 pp and 0.8 pp, respectively. But once more, the comparison with the US is unfavourable for the EU; while also increasing in the US, age-related expenditure is expected to increase to only 18% of GDP in the US (from 13.1% in 2015).

At the same time, the falling dependency ratio will tend to shrink the tax base with fewer workers paying income tax. Thus both via increasing expenditure and a shrinking tax base, population ageing will place further press on public finances.

One should also note that current data on public pensions does not reflect all public pension liabilities. As noted by the OECD[10] "differences in the set-up and the recording of government sponsored pension schemes can have a substantial impact on the reported levels of government debt". In particular, a number of countries do not fully report the liability incurred through unfunded pension commitments for civil servants. It is therefore important that EU Member States ensure they meet the target for full reporting of public pension liabilities on a harmonised basis by the end of 2017.

Figure 6 **Share of age-related spending expected to strongly increase in particular in the EU**
Age-related government expenditure for EU and US as % of GDP in 2015 and 2050



*Source: OECD and BUSINESSEUROPE's own calculation (*EU weighted average)*[11]

[10] OECD (2014), "Growth Prospects and Fiscal Requirements Over the Long Term", in OECD Economic Outlook, Vol. 2014 Issue 1, OECD Publishing.
[11] Note, these are the OECD's "cost pressure" scenarios, i.e. not assuming implicit policy action.

How to ensure that the EU economy is better equipped to address the challenge of ageing?

The above analysis has illustrated the strong pressures that population ageing will place on EU growth, public finances and living standards. Moreover, whilst the US, like other global economies will also experience population ageing, the phenomenon will be less acute, raising the spectre of the EU losing further ground in terms of competitiveness.

The following policy actions need to be taken in order to enable the EU to address the challenge of population aging whilst maintaining rising living standards for all. Many of these actions need to be introduced by governments. But the social partners may also have an important role to contribute to the solutions needed in accordance with national practices.

At European level, BUSINESSEUROPE and the other European cross-industry employers CEEP and UEAPME have started to negociate an autonomous framework agreement on "fostering active ageing and an inter-generational approach" with the European Trade Union Confederation -(ETUC).

- Promoting better and higher quality education and skills throughout people's working lives will be essential in light of the declining working population.

Life-long learning, can play an important role in helping to offset some of the challenges presented by demographic change. Improved coordination between governments, employers and workers is necessary for providing good access to, and take-up of, training on a cost and management sharing basis across all age groups (particularly the 55-64 age group who are less likely to take part in further training). Efforts are also needed to raise workers' awareness of the benefits of training to improve their career opportunities, particularly with regards to low-skilled workers.

Efforts by companies and/or social partners to assess the age composition of the workforce and future skills needs in order to devise effective strategies to address the impact of demographic change should be encouraged.

Finally, skills assessments and professional career guidance can play an important role in helping those who have been out of the labour market some time (e.g. long-term unemployed, people taking career break) to return to work.

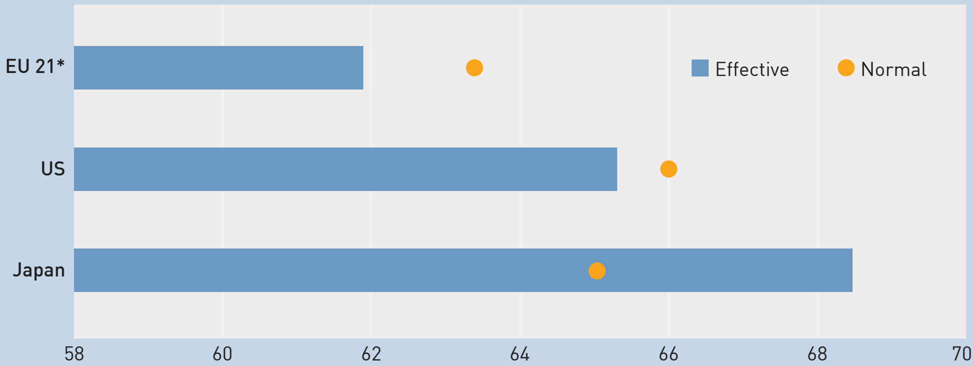
- Member States must also do more to encourage older workers to stay in the workforce.

Providing adequate pensions for future generations and fairness between the generations will not be possible without further reform of pension systems. Increasing the pension contributions from employers and workers would place too large a burden on companies and existing workers, particularly younger generations. The best way to increase pension contributions is to make sure more people are working, including through people working longer.

Both the statutory retirement age and the effective age at which men and women retire in the EU are currently below that of the US and Japan (Fig 7). In particular, while workers in the US on average retire at slightly above 65, less than a year before the statutory retirement age kicks in, and Japanese workers retire on average at above 68, more than 3 years after the statutory retirement age, workers in the EU on average retire at 62, 1.5 years before the statutory retirement age.

Figure 7 **Both the statutory and the de-facto age of retirement lower in EU than in US and Japan**

Average effective age of labour-market exit and normal pensionable age in 2014



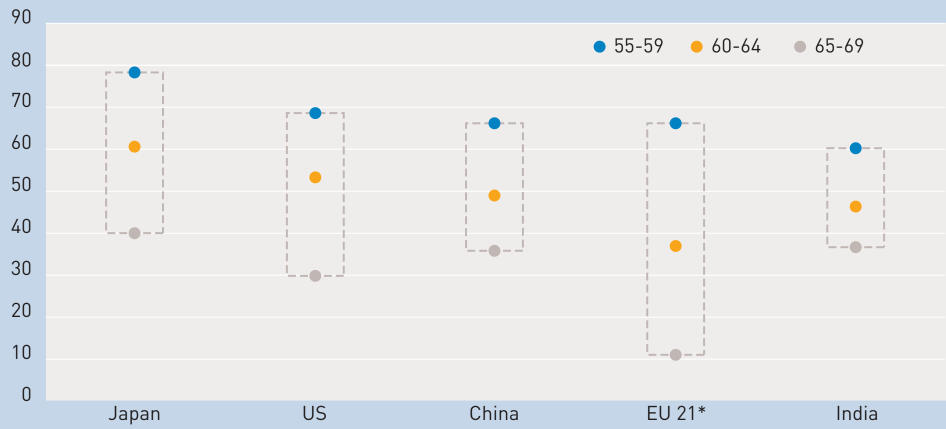
*Source: OECD, Pension at a Glance 2015 and BUSINESSEUROPE calculation, (*EU weighted average)*

As a consequence, the EU significantly lags behind other major economies in terms of employment rates for older workers (Fig 8). This illustrates that alongside increasing statutory pensionable ages and/or extending contribution periods, many EU countries could do much more to encourage older workers to remain active in the labour market, for example creating automatic adjustment mechanisms linked to life expectancy.

The EU and Member States should ensure that the legislative framework and labour costs do not hinder companies in recruiting and employing workers, including older workers, with tax and benefit systems encouraging people to re-enter and stay on the labour market. In particular, Member States should ensure pensions schemes incentivise people to stay in work longer by reducing pensions if workers leave early and supplementing them if they stay longer.

Figure 8 **Significant room to increase EU employment for older workers**

Employment rates of workers aged 55-59, 60-64 and 65-69 in 2014



*Source: OECD, Pension at a Glance 2015, (*EU weighted average)*

- **Immigration, when properly managed, can also play an important role in addressing the increasing dependency ratio.**

To foster growth and employment, the EU needs to attract qualified people from outside its borders. In particular, migration has the potential to mitigate the ageing of the native population if migrants are younger than the average.

The EU should improve its legal migration policy framework to prioritise access of the people coming from third countries who possess the skills that companies find in short supply in Europe, in particular in science, engineering, mathematics, and ICT related occupations (in the ICT sector alone there are expected to be shortages of around 825,000 workers by 2020).

BUSINESSEUROPE is contributing to the Commission's preparations for a revision of the Blue Card Directive 2009/50/EC, for example, to support intra-EU mobility of Blue Card holders. Better cooperation with public employment services and universities of excellence in third countries may also help promote the EU as a destination for highly skilled third country nationals.

In the longer-term, a comprehensive EU policy framework for economic migration at all skills levels will be necessary. Existing directives in the field of EU migration policy (Intra-Corporate Transferees, seasonal workers & Blue Card) need to be better promoted and explained to third country nationals and companies inside and outside the EU.

Recent migration into the EU has been of younger people; 81% of the people applying for asylum in the EU between November 2014 and October 2015 were below 35 years of age and 54% were of young working age between 18 and 34 years. It is important that asylum seekers that are granted permission to remain in the EU are integrated into the labour market as quickly as possible. Refugees should quickly develop local language skills to improve employment possibilities, including through increasing access to education and training. Such efforts to increase migration employment need to be accompanied by renewed efforts to increase employment of the native population.

- **Population ageing makes the need to consolidate public finances now more acute.**

Both through rising expenditure and a shrinking tax base, population ageing will place further stress on public finances. Population ageing has the potential to put the long-term sustainability of public finances into question if rising expenditure is met with increases in taxation which makes investment or employment in any given Member State less attractive, potentially contributing to a downward spiral of falling output and increasing pressure on public finances. The economic crisis has delayed the time Member States have to get their fiscal houses in order before population ageing really kicks-in. Member States need to address the sustainability of public finances now by taking forward overarching public expenditure reductions which, at the same time, prioritise growth enhancing expenditure.

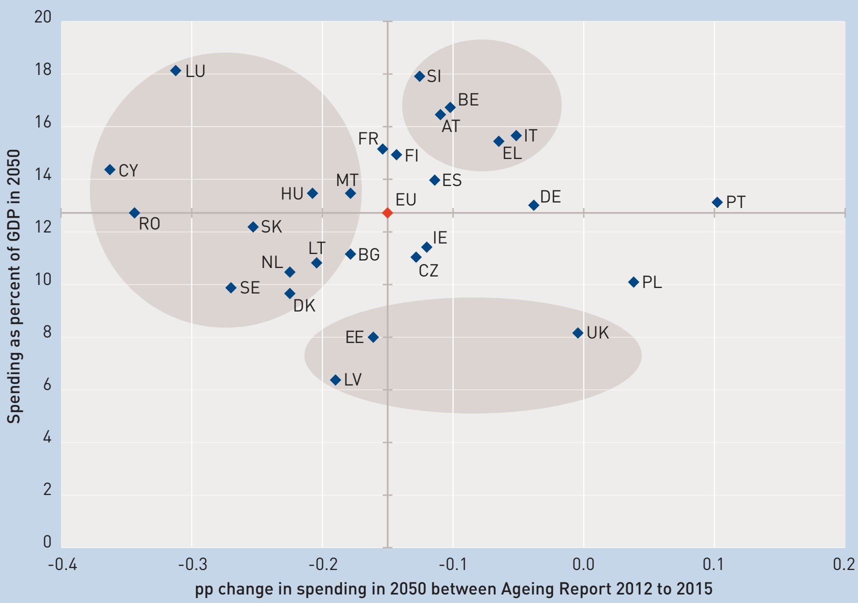
Member States need to build on recent pension reforms to make pensions more sustainable.

Member States have made some progress in making public pension provision more sustainable in recent years. As illustrated in figure 9, compared to three years ago, the expected share of GDP spent on public pensions in 2050 has fallen by 1.5 percentage points to 12.7% of GDP.

But a number of Member States such as Italy and Austria with relatively large public pension commitments have made little progress in making them more sustainable in recent years, with liabilities actually rising as a share of output in Poland and Portugal. Such Member States might seek to learn from countries such as Cyprus, Romania, Luxemburg and Sweden all of whom reduced pension commitments in recent years.

Figure 9 **Several EU Member States made recent progress in reforming their pension systems**

Public pension spending in 2050 and change in estimations between 2012 & 2015 Aging Report



Source: Commission 2012 & 2015 Ageing Report and BUSINESSEUROPE calculation

The EU's role should be to support national reforms by monitoring and exchanging information on public pension systems, but due to the underlying normative questions Member States should determine the reform path.

- **Member States must improve the efficiency of health and long-term care provision including by building strong partnerships with the private sector, in order to keep healthcare costs under control.**

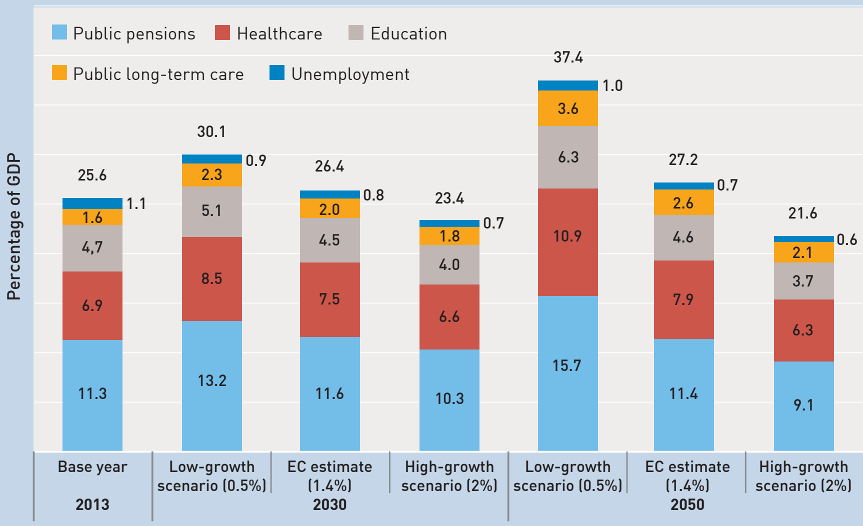
As noted above, both population ageing and improving technology which has the potential to improve the scope and quality of medical services will mean there will be strong pressures on public health expenditure to increase in the coming years; the OECD suggest that in the absence of policy reform, public expenditure on health and long-term care could reach 14% by 2060.

OECD Research suggests whilst there is no one-size-fits-all approach to public health provision, countries can improve efficiency by improving the co-ordination of care provision between different institutions, including private providers, and ensuring that financial incentive for healthcare providers properly reflect likely improvements in health benefits. In particular, appropriate investment in health promotion and disease prevention can deliver improved health outcomes at relatively low costs.

- **Strong growth is essential to pay for the additional costs of population ageing.**

One overarching means to ensure the EU is able to cope with the challenges associated with population ageing is to increase growth. As shown in fig 11, increasing the EU's potential growth is vital to keep age-related public spending relative to GDP on a sustainable path. If EU growth averages 0.5%, then by 2050 public expenditure alone on public pensions, healthcare and long-term care would account for over 30% of GDP. In contrast, growth of 2% would mean that such expenditure would account for just 17% of GDP in 2050.

Figure 10 **Sufficient economic growth vital to sustain age-related expenditure**
Age-related spending in 2013, 2030 and 2050 under different growth scenarios



Source: Commission 2015 Ageing Report

The EU and it Member States must build on the Commission's focus on investment as part of a broader strategy to increase competitiveness.

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