COMMENT

Geert Langenus*

Fiscal analysts are used to narrowing down the ageing problem to the question of what it will cost for the budget. A large number of the participants in this workshop worry in their daytime jobs about the government balance being 0.1 p.c. of GDP higher or lower than anticipated. If one thing is clear then it must be that the ageing problem is really of a different nature. It is not a decimal-point problem. Estimates tend to vary quite considerable but it is commonly accepted that the budgetary impact of ageing will be huge. We just do not know how huge.

The reason for this uncertainty is that estimates of the budgetary cost of ageing crucially depend on a large number of assumptions. The first group of these assumptions pertain to the evolution of the macroeconomic environment (including demography). In the comprehensive Fredriksen paper given in Session 1 it was clearly demonstrated that a relatively minor change in the macroeconomic or demographic assumptions can modify the estimate of the budgetary cost of ageing considerably. In estimating this cost, however, one also needs to make hypotheses concerning future policies.

Usually we buy our way out by resorting to a constant policy-type assumption. My impression is that this is quite problematic in the case of ageing. To illustrate this point, I would like to refer to the excellent Bogaert paper which presents the Federal Planning Bureau's

* Nationale Bank van België – Banque Nationale du Belgique.
The views expressed here are those of the author and do not necessarily reflect the views of the National Bank of Belgium.

view on the cost of ageing in Belgium, although a similar argument could be made for the equally insightful Miners paper which does the same for the UK. The basic conclusion of the Planning Bureau is that the ageing problem in Belgium is manageable. If the Belgian government brings down the deficit to zero - which is foreseen in the stability programme (submitted in December 1999) from 2002 onwards, but which would, in all likelihood, be reached sooner - and sticks to a small surplus thereafter, the subsequent reduction in the interest burden and therefore the reduction in the primary surplus would be large enough to cover the ageing-related spending increases.

This conclusion is, however, conditional. One of the conditions pertains to the generosity of the pension and health care systems. A crucial parameter in this respect is the welfare adjustment of pensions. To what extent will the retired benefit from economic growth? In Belgium pensions are automatically indexed to inflation but any real increase requires a discretionary decision. The Planning Bureau's projections are based upon a yearly welfare adjustment which is considerably lower than the growth of wages[1]. This obviously implies that the average replacement ratio, the ratio of the average pension to the average wage, will drop over time, but also that older retired will typically have smaller pensions than the younger ones.

Even if the scenario proposed by the Federal Planning Bureau is better than constant policy or, for that matter, past policy, one can hardly call it extremely generous. For different reasons, looking at the past in order to predict the future might actually not be appropriate in the case of the real increase in pensions. First of all, it is obvious that the past few years have been marked by a period of very strict fiscal consolidation where the availability of budgetary means for an increase in pension entitlements was very limited. Secondly, average pension levels might have been too high with respect to average wages in the past, requiring an adjustment process in which the real growth of pensions was curbed. There is no evidence, however, that this adjustment process should continue until the second half of the 21st century. Finally, there is the

---

1 In both scenarios (average economic growth of 2.25 or 1.75 p.c.) the difference between the growth of private-sector wages and the welfare adjustment of pensions is 1.75 percentage points.

well-known political economy argument: if an increasing share of the voting population is retired, it will be particularly difficult for governments to control the growth of pension entitlements.

Performing the same exercise as Bogaert and Miners have done, but taking into account a complete indexation of pensions to wages would undoubtedly produce very different, i.e. more worrying results.

Returning to the general point, I would argue that looking at ageing as some kind of bill for the government to pay is particularly problematic. The least that one can say is that it is a very peculiar kind of bill since the government is in a position to influence its amount. It all depends on which part of the growing welfare will be attributed to pensioners. As a discussant, I can probably be somewhat more provocative than the authors of the papers in this and other sessions. Maybe this whole question of calculating the exact budgetary cost of ageing has really had its day. It has served and still serves the purpose of convincing policy makers of the need for need for unrelenting fiscal consolidation. However, the ageing problem should be assessed in a broader context.

From a very broad macroeconomic point of view, the budgetary cost of ageing is merely a distribution problem: what proportion of the cake will future pensioners receive? As governments basically cut the cake themselves, the more relevant question is probably how big the cake will be in the future. What impact will the ageing problem have on the trend growth rate of output?

A crucial issue is undoubtedly what will happen to employment. In this respect, the views are quite divergent. I would like to make a comparison of the papers by Röger and Bogaert. According to the latter, employment will remain constant in Belgium. This implies that the considerable fall in the population of working age should be offset by a significant reduction in unemployment or a higher participation. My impression is that, even if one takes into account the cohort effect for the female population where the employment rates are higher for younger females than for older ones, this assumption is somewhat optimistic. It is quite revealing, for instance, that, despite the high unemployment rate, the Belgian labour market is already characterized by different kinds of bottlenecks (of a geographical or sectoral nature). This seems to support the assessment that existing unemployment is largely of a structural nature. Against this background, the increase in the employment rate implied by the constant employment assumption seems to be rather ambitious and would, in all likelihood, require clear policy action such as a significant clampdown in the area of early retirement or a further fight against employment traps.

The Roeger view is much gloomier. The simulations in this paper show that ageing could have a potentially large impact on the growth rate of GDP. Firstly, the fall in the population of working age would not be offset. Secondly, the impact of ageing on employment would even be exacerbated by distortionary taxation. As ageing will exert upward pressure on public spending, governments might be tempted to compensate this by increasing taxes and, as is witnessed by the empirical results in the Martinez-Mongai paper, labour taxation is usually called upon to finance a spending increase.

I do not know which view is the correct one (although I do rather fear that the Roeger view is not that unrealistic). What I do know, however, is that the impact of ageing on growth is the crucial issue on which we shall have to focus more of our attention.