COMMENTS ON SESSION III:
PUBLIC DEBT, AGEING AND FISCAL SUSTAINABILITY

*Karine Hervé**

Let me start by thanking Franco Daniele and the Banca d'Italia for inviting me to this conference. I also would like to congratulate the contributors for their excellent and interesting papers. I have learnt lots of things. But I need to apologise because the time frame given to me is too short to provide an in-depth analysis of each individual paper. Indeed, these papers are quite heterogeneous and they deal with various problems related to ageing.

Moreover I want to mention that I joined the Banque de France only four months ago. Before I used to deal with international topics that are remote from these ones. Thus far, I am not very familiar with these issues and especially ageing problems. Therefore, my comments and remarks, particularly the focus on the impact of ageing on overall economies, will probably appear to be very naive for most participants. I will first consider demographic evolutions. Then, I will turn to the impact of ageing on public expenditures, labour market and saving ratios. Finally, I will try to open the debate giving some proposals.

1. Demographic evolutions

Demographers have more certainty than economists when it comes to forecasting. Relying on age pyramids and a stable trend of the life-expectancy lengthening, the part of risk is reduced to one element: the fertility rate. Of course, the latter is unknown: demographers did not forecast either the "baby boom" or the decrease of the fertility rate around the Seventies.

Nevertheless, important changes in the size and composition of the population will occur in most industrialised countries. For the main industrialised countries, we can retain five major changes that will be very significant over the period 2000-25:

- the size of the population will fall. Across the EU Member States, Italy, Spain and Germany are particularly concerned with respectively a change of –17 per cent, –11 per cent and –8 per cent by 2050,
- the number of young persons will also diminish,
- the number of elderly persons (aged 65 and over) will rise significantly,
- the working age population will fall by some 20 per cent,
- the life expectancy will be higher especially for males.

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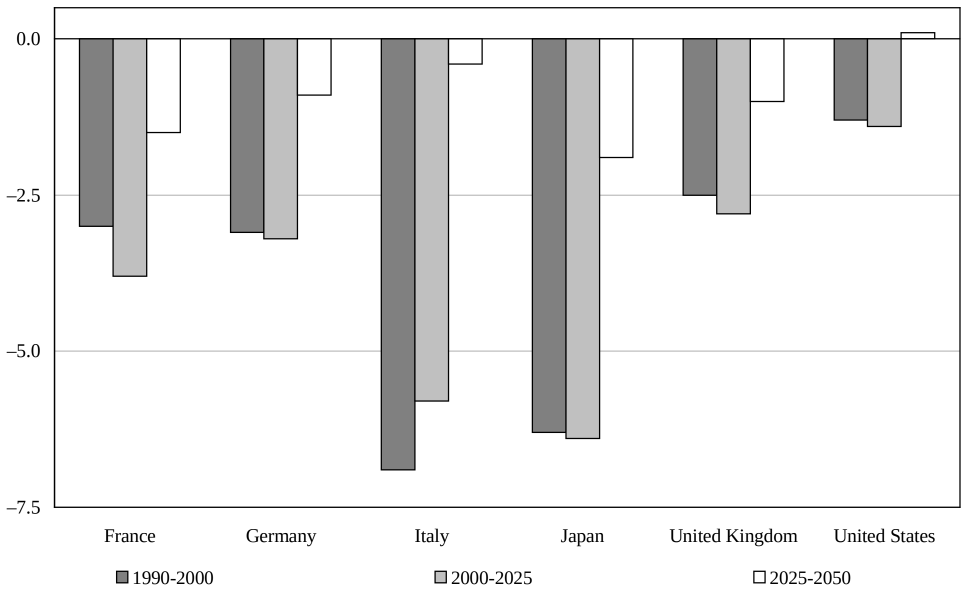
* Banque de France.

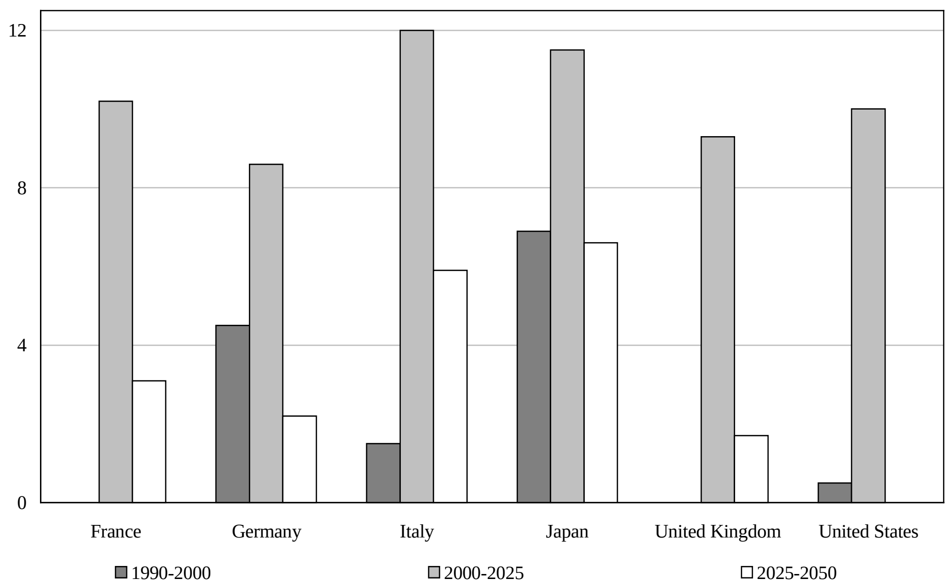
Demographic Evolutions of Youths (0-24)

(percentage-point change of share in total population over the period considered)



Demographic Evolutions of Olders (55 and over)

(percentage-point change of share in total population over the period considered)



These evolutions pose two separate problems. The first one is that the absolute reduction of population will result in a lower population of countries affected relative to the world population. The second concerns the structure by age of population which will lead to a higher part of elderly population. There is a growing recognition that ageing populations will pose major economic and budgetary challenges in coming decades. More precisely different issues come to the fare: future public expenditures, labour market and saving rates.

2. Impact of ageing on future public expenditures…

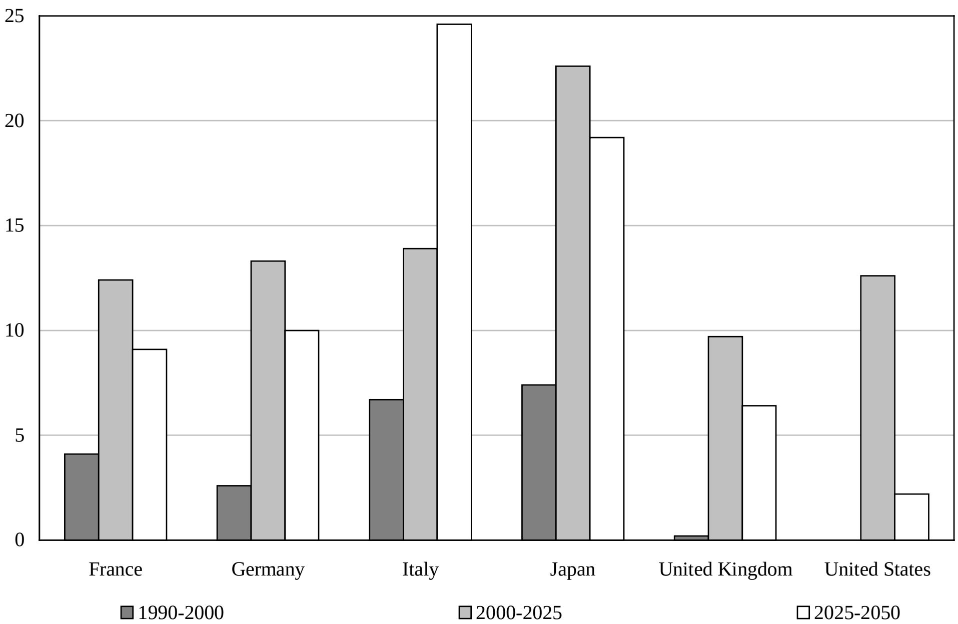
…on pension expenditures

The old age dependency ratio will more than double between 2000 and 2050. In other words and on average, the ratio of the working age population to the retired age population will continue to decline from 4 to only 2 by 2050.

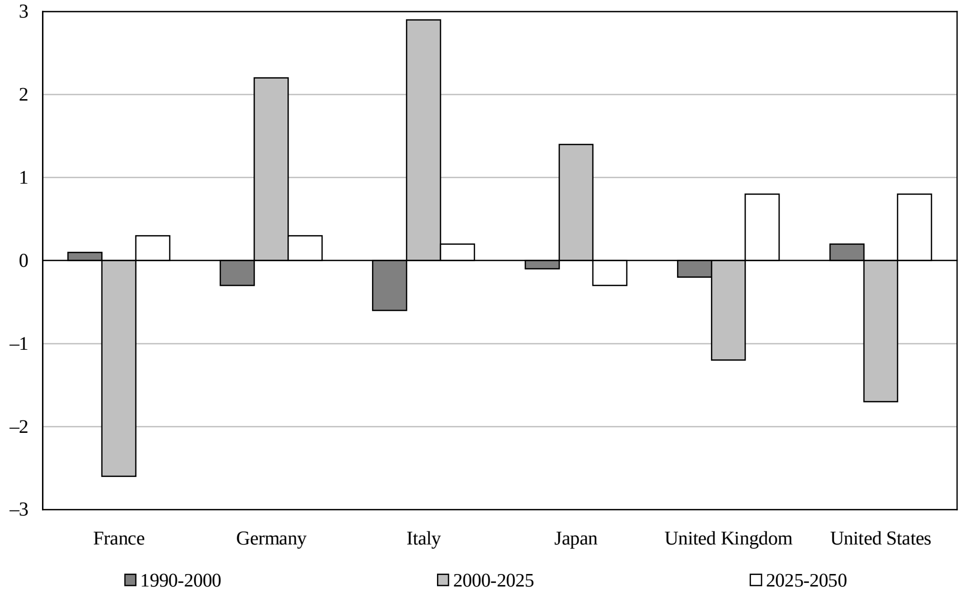
The rising old-age ratio is the main force behind increasing levels of public pensions. But, when considering pension expenditures, the key variable is not so much the old-age dependency ratio as the balance between active and inactive persons. Other variables such as employment, eligibility, *i.e.*, elderly persons allowed to receive pensions and benefits, might be taken into account. Old-age ratio

Old-age Dependency Ratio

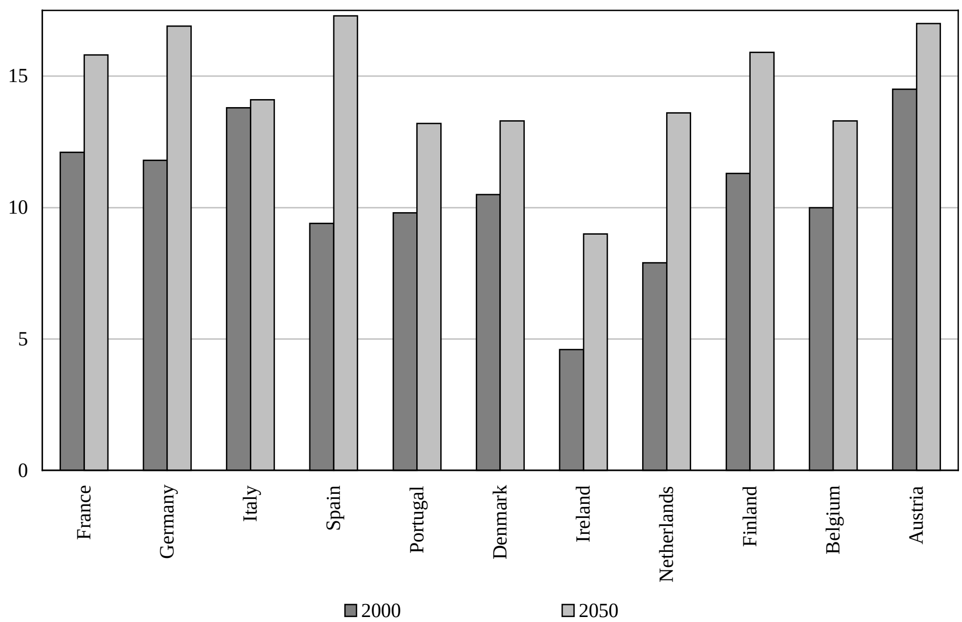
(ratio of the population aged 65 and over to the population aged 15 to 64)



Participation Rate
(rate of the active to the total population aged 15 to 64)



Ratio of Public Pension Expenditure to People Aged Over 55
(percent of GDP)



and eligibility will increase pension expenditures but should be partly offset by changes in the employment rate (for instance: female participation) and the decline in the benefit ratio (average pension as a ratio of output per worker).

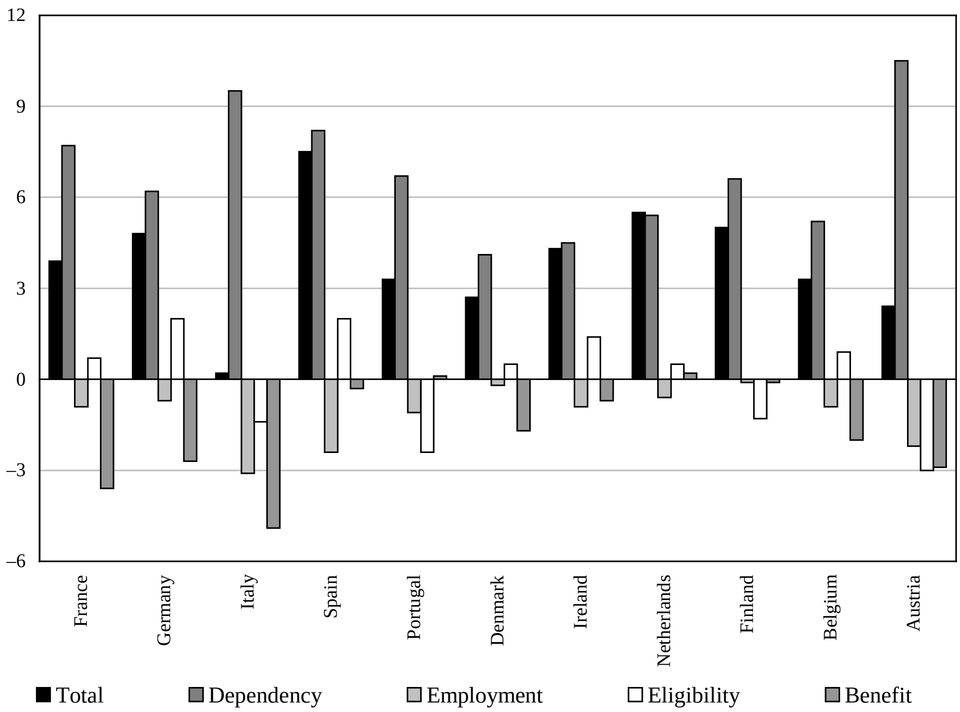
Nevertheless, most of the projections (OECD, INSEE etc.) show a substantial increase in public pension expenditures. Overall, the results of the OECD indicate that spending on public pensions will increase by between 3 and 5 per cent of GDP in most EU Member States. However, there are very large differences in the timing and scale of changes across countries.

But even assuming a stabilisation of the participation rate ratio (due to the improvement in female participation for instance) and a decrease in unemployment, the problem of future retirement pensions would not be solved since these two latest factors would not offset the wide impact of dependency.

…and on health and long term care expenditures

Ageing populations could have a two-pronged impact on health and long-term care systems. Some OECD simulations on EU Member States show that

Factors Behind the Change in Public Pension Spending
(variation between 2000 and 2050)

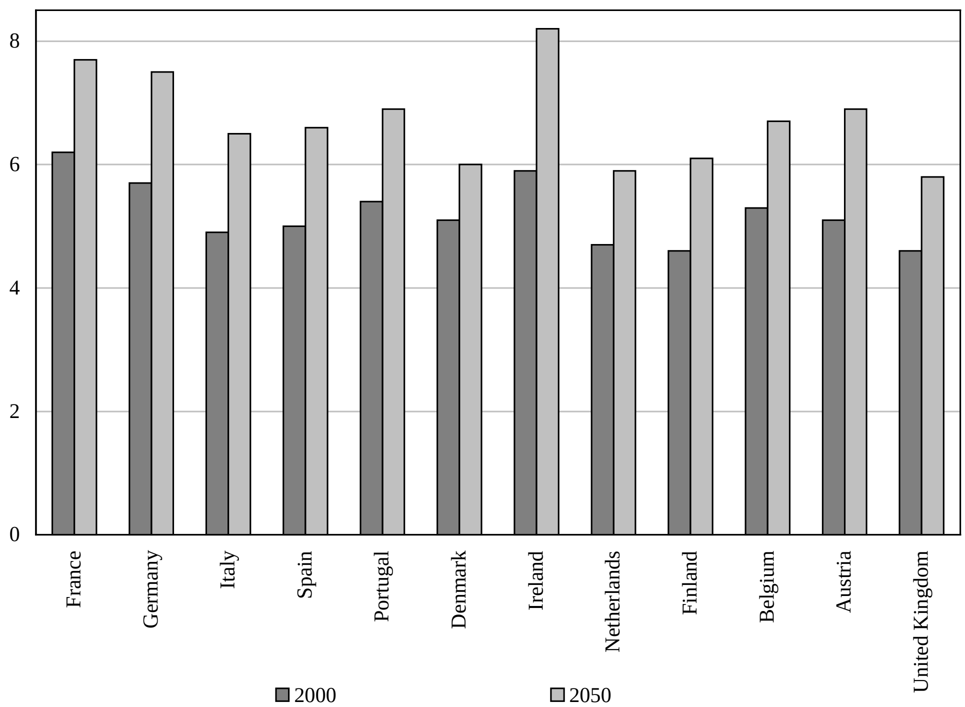


by 2050, public spending on health and long-term care is projected to increase by 1.7 and 3.9 percentage points of GDP in countries reporting results for both expenditure components.

According the OECD projections, demographic changes would lead to increased public spending in the range of 0.7 to 2.3 percentage points of GDP over the next fifty years.

For long term care, ageing would increase expenditure ranging from 0.2 to 2.5 percentage points of GDP. The increase is especially high in Denmark, Sweden and Netherlands with respectively 3, 2.8 and 2.5 per cent.

Impact of Demographic Changes on the Future Expenditure Level of the Health System



...all in all

Always according to the OECD projections, the total of public spending (pensions, health and long term care) could rise by between 4 and 8 per cent of GDP in most EU Member States in coming decades.

3. Impact of ageing on labour market

Ageing populations would theoretically lead to a decrease in unemployment because active population will fall. All things being equal, this evolution of unemployment would ease the burden on public spending. This prognostication is based on the idea that unemployment stems from an unfavourable trends in growth. Nevertheless, if we believe that unemployment is due to structural problems as the discrepancy between labour supply and demand (labour cost, rigidities…), the decreasing size of the labour market (on account of a fall in the active population) would not resolve the structural problems and the unemployment would hover at the same level.

Empirically, this prognostication is no more validated in the past periods. Indeed, in many countries unemployment rose during the Seventies while the active population started to increase a long time before. Given the absence of relationship between employment and demographic developments, the slowdown or the reversion of active population growth could not be interpreted as a reduction of unemployment.

In this context, it is not because the size of the labour market will decrease that structural problems, which lie at the roots of unemployment, would disappear. It should even be the opposite if the diminution of active population will be accompanied by transfers on favour of retirement and an increase in social contributions.

Moreover, as wages grow with seniority, ageing in companies could lead to an higher unemployment of elderly persons. This is a real contradiction with the fact that in an ageing society in order to balance the pension systems, old people would have to work more and more while for demographic or economic reasons the companies would try to exclude them sooner and sooner.

4. Impact of ageing on saving rates…

…on private saving rates

Ageing populations would be expected to result in a lowering of the private savings ratio if the saving pattern of consumers were to comply with the traditional "life cycle" hypothesis. This type of model suggests that saving propensities and the overall dependency ratio are expected to be negatively correlated.

Unfortunately, the empirical supporting evidence is more heterogeneous. On the one hand, most econometric studies, especially Meredith (1995), show that:

- Data source used impacts significantly on the results obtained, with studies based on microeconomic or macroeconomic time-series or cross section data, producing widely divergent estimates of the responsiveness of the saving ratio to changes in the dependency ratio.

- Changes in elderly dependency ratio have a greater effect on saving patterns compared with the youth dependency ratio. For instance, for every one percentage point increase in the elderly and youth dependency ratios respectively, the saving rate is falling by 0.86 and 0.61 of a percentage point.

On the other hand, other studies using household survey evidence suggest that any effects on the saving rate may be negligible. Some of them conclude that although demographics are important determinants of private saving rates, the size of the dependency ratio effect is lower than that found in the above series of studies. Masson *et al.* (1995) for instance find that one percentage point increase in the dependency ratio leads to a reduction of only 0.14 per cent in the private saving ratios of industrial countries.

…but also on public saving rates

Ageing would increase public expenditures and on the basis of unchanged policies public saving is likely to decrease.

…and on national saving ratios

Assessing the national saving implications is not simply a matter of aggregating the separate effects of private and public savings because that would ignore the existence of potentially important interactions between both of them such as the Ricardian equivalence.

5. What could be envisaged to address these problems

In order to address the problems of ageing, various political measures will have to be taken by governments. Nevertheless, as some of these measures are politically unpalatable, most governments fail to address the problems. Thus, as some contributors have already mentioned, in many countries increasing efforts will have to be undertaken to inform the public that the situation will be unsustainable if nothing is done. I will try now to open the debate by proposing different measures that would ease the burden of ageing.

Increasing the rate of fertility

The idea that a revival of fertility could restore the pension system is fairly obvious. In France, for instance, studies show that in order to make the system of pensions balanced by 2020, the rate of fertility would have to increase to be three children per woman. Of course, this solution seems unrealistic in so far as this rate is higher than that observed during the baby boom. Moreover, this “super baby boom” would have to be permanent.

Increasing immigration

Even if migrations could only bring a partial and limited solution to the issue of ageing, they can, particularly in the French case, revert the current trend of depopulation. On this topic, studies are missing, especially in France. The UNO simulations are only proxies and they do not deal with the issue of this migration absorption by national labour markets. But they set a very interesting discussion framework and the scale of the problem. According to the French case simulations, the stabilisation of the total population is achieved with some 100,000 immigrants per year, which is not unrealistic.

Changing labour market structures

In order to neutralise the demographic developments, labour markets needs to be reformed. By this way, several measures could be envisaged:

- Lowering structural unemployment: the reduction on the unemployment rate represents a budgetary saving due to decreased transfer spending and increased tax receipts.
- Raising labour force participation rates: two ways of acting could be considered. The first one would consist in increasing the participation rate of females. The second one is related to elderly work. Early retirement programmes and financial disincentives to remain longer in the labour force should be removed. Elderly employment would have to be promoted.
- Extending working lifetimes: with life expectancy having increased and continuing to do so, with jobs becoming less physically strenuous and with entry into the labour market occurring at a progressively later age, governments would lengthen the average working life time.

These policies, more than offset adverse demographic developments could also increase potential output and tax revenues but also decrease public expenditures on the elderly (due to the slower rate of rise in the effective dependency ratio).

Making public finances healthier

One of the problem of ageing populations is their impact on national saving. Indeed, when focusing on the current evolutions of public finances namely emergence of deficits in most countries and a growing debt ratio, the initial situation which is not optimal would worsen in the future.

A sounder fiscal position will ensure more favourable debt dynamics when the public sector spending pressures from ageing start to emerge. In that sense, respect of the Stability and Growth Pact would be a good way to protect against negative impacts of ageing populations. Moreover, as highlighted in various papers, the criteria of the debt ratio should be reinforced.