AGING POPULATION AND ITS ECONOMIC IMPACT + IMMIGRATION

Supporting Sustainable and Effective Social Security System Development in Aging Developing Countries

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Abstract

Population aging progresses in developing countries as well and is likely to become a more serious policy issue in the near future. Because of the faster rate of aging, developing countries tend to be less prepared for a large elderly population, especially since their fast expanding social security system may neither be adequate nor sustainable. In an effort to promote Sustainable Development Goals, G20 member countries' systematic support will be necessary for the development of effective and sustainable social security systems in developing countries. In this regard, G20 members need to (i) support the establishment of a framework for developing countries to assess the effectiveness and efficiency of their systems, and (ii) provide technical support to developing countries in developing and implementing their own medium- to long-term frameworks.

Challenge

By 2050, the world's population aged 60 years and older is expected to reach approximately 2 billion, more than doubling in number from 900 million in 2015. The increasing number of aged people at the global level reflects aging demographic structures at the country level; and the economic implications of this demographic change have become a topic of global interest. The challenges from population dynamics seem more imminent in certain advanced economies, and these countries have been leading the discussion on population aging and related policy issues thus far. However, population aging is not an issue confined to advanced economies. In fact, by 2050, approximately 80 percent of people aged 60 or older are projected to be living in what are now low- or middle-income countries, and the impacts of population aging could be more detrimental in these developing countries. Most developing countries are not adequately prepared for the rapid aging of their populations, and more importantly, appropriate policy responses have yet to be widely explored.

- **Why is it more serious?** Population aging can pose a bigger risk to developing countries. First, the rate of population aging is often much faster in developing countries. With better medical services playing a key role, longer life expectancy and lower fertility rate are the two main drivers of population aging. The benefits of better medical services spread quickly nowadays, substantially increasing life expectancy and decreasing infant mortality, especially in low- and middle-income countries. Combined with the fall in fertility rate, some developing countries are facing an unprecedented rate of population aging. Second, social security in developing economies is either non-existent or at an early stage. With many grand plans to expand these systems, they are often designed unsustainably, given the magnitude of the demographic challenges. Third, economic and financial institutions are less developed so that individuals are less prepared for the effects of increasing life expectancy.[1] With slow progress in financial development, old age poverty will become a serious policy issue, reinforcing the need for the quick expansion of social security systems. In particular, resorting to the traditional way of family support is quickly losing ground as industrialization progresses in these countries (Martin & Kinsella 1994).

- **How are they different?** In advanced economies, population aging and related policy issues are mostly linked to the potential growth slowdown with smaller working age populations and unsustainable social security systems, with increasing number of retirees. In developing countries, on the other hand, the impact on potential growth can be less significant, considering that still the favourable labour force structure often outweighs the negative demographic effect. However, the financial sustainability of expanding social security systems is a major concern. In most developing countries, social security systems tend to expand faster, and a decision to expand these systems is often made without proper consideration of the their effectiveness and long-term financial sustainability, which can exacerbate the country's long-term stability risk.

[1] In many developing countries, the financial market is less developed, so that proper long-term investment and saving tools to prepare for the retirements are not available. As the fast-changing economic environment quickly depreciates the value of their human capital, the majority have to depend largely on the traditional way of family support for their retirement, except for a small part of the population with formal sector pensions.

Proposal

These days, the social security system[2] is one of the key institutional elements in many advanced economies to promote the welfare of the public. In developing economies, it is considered an important policy instrument to promote economic development and growth by reducing poverty, fostering social cohesion and improving human capital (Bender et al. 2013, World Bank 2012, ILO 2012, European Commission 2012). Therefore, more countries are implementing and expanding their social security systems as an essential component of sound economic development, in line with the 2030 Agenda for Sustainable Development, but designing an effective and sustainable system remains one of the most serious policy challenges for these less experienced countries. In particular, a rapid expansion of the system without proper sustainability considerations can significantly damage a country's long-term macroeconomic stability and growth potential.

As evidenced by many country experiences, policies enacted, even if found inappropriate afterward, are very hard to correct, especially when many stakeholders are involved. Therefore, it is highly critical for developing countries to look to establish adequate and affordable social security systems from the very start.

Given limited capacity and institutional constraints in most developing countries, we suggest that G20 members provide support to facilitate the development of sustainable and effective social security systems in developing countries in which populations are rapidly aging.

[2] To simplify the discussion, this proposal uses the term 'social security system' in a broad sense, inclusive of 'social protection systems' with means-testing.

Recommendation 1: Support the establishment of a framework for developing countries to assess the effectiveness and efficiency of their social security systems

Although the number has improved substantially in recent years, only 45 percent of the world's population is effectively covered by at least one social protection benefit, and only 29 percent has access to a comprehensive social security system (ILO 2017). Given current trends and global initiatives such as SDGs, policy efforts to expand the social security system is expected to continue, especially in low- and middle-income countries. In addition, countries with aging population will face higher pressure to expand the system from growing social issues such as old age poverty, inequality, etc.

However, that a system has been implemented does not necessarily imply that it is properly designed to provide the necessary protection in a financially sustainable way (Asher 2010). With the progress seen in social security system development, the effectiveness of the system is an important point that needs careful examining. Despite a noticeable improvement globally, its impact on poverty (measured in terms of inequality, poverty headcount and poverty gap) reductions is found to be considerably less significant in low-income countries (World Bank 2018).[3]

The efficiency of the system is another important aspect to be considered in policy design. Despite being implemented more recently, social security systems in low-income countries are found to be relatively more costly, covering a substantially smaller part of the population and providing less

[3] They explain this result is partly due to insufficient data in low-income countries.

significant benefits than those in high-income countries.[4] According to the World Bank (2018), high-income countries spend 1.9 percent of GDP on average to provide social protection to 81 percent of the population, while low-income countries already spend 1.5 percent of GDP on average to cover only 18 percent of the population. Improving this low coverage and still relatively low benefit levels is a key policy direction to enhance the social security system in many developing countries. The biggest policy challenge in this aspect is maintaining the long-term financial sustainability of the system, which can be more serious in countries with aging populations.

Although the need for better social protection is still high in many low- and middle-income countries, there also exists doubt about those countries' capacity to implement social security systems properly. Indeed, recent statistics show that the social security systems in low- and middle-income countries have been developing in a less efficient and less effective way, and the continued expansion of the current system could pose serious risks to the long-term sustainability of economic development. Therefore, before this risk emanating from the continued expansion of the social security system materializes in some countries, coordinated efforts are necessary to complement the promotion of SDG implementation toward more efficient and effective social security system development.

In particular, G20 members need to take a lead in establishing an assessment

[4] The efficiency of social protection is closely linked to cost containment while maintaining an adequate level of benefits distributed to people. In developing countries, however, the distribution of benefits can be relatively costly because the benefit distribution network is often still at an early stage of development so that it is hard to expect. In addition, owing to a relatively large informal sector and informal income sources, the social security system usually covers only a small portion of the population and a small portion of their whole incomes.

framework readily available for low- and middle-income countries to assess the effectiveness and efficiency of their systems, and promote more informed policy decision-making to ensure the system's long-term sustainability. Additionally, advanced economies should promote more technical assistance in the system design, tailored to individual countries.

Challenges of a fast aging population also need to be properly assessed in this framework. Noting that unfavourable demographic changes have not yet received an adequate level of public attention in most developing countries, such assessment framework needs to provide credible groundwork to facilitate system adjustments in a proper way with greater public support.

Recommendation 2: Encourage technical support to developing countries in developing and implementing long-term policy frameworks

Sustainable Development Goal 1.3 instructs countries to 'implement nationally appropriate social protection systems and measures for all, including floors, and by 2030 achieve substantial coverage of the poor and the vulnerable'.[5] As discussed, social security systems have been expanding fast in recent decades, and establishing an effective and affordable system has become of key importance to more policy makers, especially in countries with aging populations. Obviously, a proper design of the system is a crucial element in ensuring efficiency and sustainability. However, this requires a careful analysis of long-term dynamics of the system together with the progress in economic development, which can be particularly challenging in low- and middle-income

[5] The Sustainable Development Goal 1 commits all countries to ending poverty, protecting the planet and ensuring prosperity for all. Key to achieving this is the pledge to 'Leave No One Behind', which includes people of all ages. The SDGs will only be successful if older people's rights and needs are taken fully into account.

countries. Additionally, there are many practical constraints – such as the lack of appropriate data for reliable long-term projections and actuarial calculations, hard-to-predict structural changes along the development path and labour market projections.

In addition, public resource management in low- and middle-income countries is usually carried out in an annual framework and often seriously lacks longer-term perspective. Although many development plans and strategies are available covering longer-terms, corresponding plans on the fiscal side are often neglected or set unrealistically. Extending the fiscal policy time horizon is a key first step, but human resource constraints and institutional constraints have to be resolved first to make meaningful progress on this front.

Public support is a key ingredient in policymaking and a myopic policy discussion framework is a problem related to the public as well. Often, without any proper analysis of possible impacts on the system's long-term sustainability, expanding the social security system remains a very attractive option for many politicians. Such expansion of the system will continue as long as the public provides strong support, and this often renders the system even more unsustainable. On the contrary, reform toward a sustainable and effective social security system can also leverage strong public support. The challenge for developing countries is that the public in general is less informed and sometimes even less concerned about the system's sustainability. Even if the sustainability of social security systems is not a popular issue of discussion in country with an aging population, proper information and reliable analyses are indispensable basic elements to gaining more public support for sustainable and affordable social security system.

In developing countries, diverse practical constraints often lead to a 'gradual' approach in the implementation of a poorly designed system. The gradual implementation of social security can reduce the risk of damage from policy mistakes, but may also slow down progress in social issues that the system is intended to address. On the other hand, a poorly designed system without proper analysis may not be as effective and may jeopardize the long-term sustainability of the system. In either case, institutional arrangements for well-informed decision-making can substantially improve the development path of the country. However, such institutions are not easy to establish.

Advanced countries have decades of experience with social security systems, while developing countries need to establish the underlying analysis framework for their own systems. Although policy focus may be different across countries, advanced countries' support will likely greatly improve developing countries' institutional capacity to properly approach the issue from a long-term perspective. In addition, G20 member countries' support can help the authorities' reform initiatives to promote public awareness on the importance of not only the adequacy of the social security system but also the financial sustainability of the system, so that policy discussions are properly guided with appropriate public pressure.

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