Ageing Population: Its Impact and Challenges
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Keynote remarks by Paola Subacchi, March 19 2019

The G20 countries - both advanced and developing economies - are experiencing an unprecedented shift in their demographic profile. The average person now lives for longer and in better health conditions, which is indeed a cause for celebration. But the demographic transition has presented us with challenges as well; a shrinking labour force opens the door to a decline in productivity and the growing number of pensioners both threaten the sustainability of public finance and affect the impact of conventional macroeconomic policies.

The main focus of public policy in this area has been fiscal sustainability, with policies aiming to reform the pensions system - mainly from defined benefit to defined contribution - and increase the mandatory retirement age. Tax incentives have also been introduced for people willing to extend their working age and in some countries the mandatory retirement age has been outright abolished. There are limits, however, on how long the working life can be extended. Survey figures show that health conditions play a significant role in individuals' decision to stay in paid employment after they reach state pension age. Still, active individuals tend to concentrate at the 'younger' end of the over 65 age group; only a small minority (4% of men and 2% of women) are still in work past 75 years of age.

It is critical that Inter-generational inequality - and in particular that related to property ownership - is included in the policy debate. In relative terms, pensioners are the most prosperous age group in many G20 countries, especially those with advanced economies. Before chronic diseases kick in - increasingly so in later in life - pensioners rely on a guaranteed income, often in real terms. They own the houses where they live and in many countries, such as the UK, for example, they enjoy a variety of benefits including free public transport and TV licences. In the last two decades, and in particular after the global financial crisis, public policies have been skewed towards pensioners, who have gone through the post-crisis fiscal austerity almost unscathed.

Since the global crisis, the proportion of income going to the top 1 per cent has grown, while average wages are still much lower than the highs seen prior to 2008. Even in the recent years, there has been relatively strong income growth among the older households, meaning that those aged 65+ no longer form the poorest group. Incomes among households aged 25-44, however, do not yet appear to have recovered to their pre-crisis levels.

The uneven distribution of incomes means uneven distribution of savings, wealth and debt. Nowadays most debt is accumulated early in life from things such as student loans - and individuals' financial debt decreases with age. Many individuals and households live close to the breadline and struggle to save for unexpected costs - let alone for their pensions. Surveys show that around 55 per cent of people interviewed cite low income as the main reason for not contributing towards their pension.

But in a system like Britain's, which combines a basic state pension with a private one, saving towards retirement whilst working is critical. Without a private contribution, individuals and families will struggle to maintain living standards close to those that they experienced during their working life. Indeed, some will simply not have enough for their retirement and will need financial support. People's expectations vis-à-vis savings and retirement are often off the mark. The length of retirement is on average underestimated by 10 per cent, and 25 per cent of people expect to survive on an income that is inadequate.

Despite savings acquired through various pension reforms, falling relative income levels and ageing will continue to put pressure on public spending. The policy implications are that even countries that successfully manage public expenditure on pensions risk ending up with pensioners who aren't financially self-sufficient. The UK, for example, has one of the lowest rates of public spending on pensions. Currently at 7.7 per cent, it is well below the EU28 average of 11.3 per cent. Many households in the UK's low-to-medium income bracket will have to survive in retirement on roughly 20 - 25 per cent of their pre-retirement income.

As discussed, the inter-generational difference in income growth is reflected in savings - and hence the distribution of assets. The younger generations' 'constrained' saving capacity has impacted on wealth accumulation with the result that inter-generational inequality in the distribution of wealth has also widened. Home ownership can be used as a proxy for wealth. In the UK, nearly three-quarters of pensioners live in homes that they outright own, meaning that their housing costs are minimal. But for the working-age population, the rate of homeownership is roughly 1 in 5.

While ageing is widely discussed, the policy consequences of inter-generational inequality are largely unexplored. The policy debate is still grappling with the complexity of the issues linked to the ongoing demographic shift and needs to focus on, and understand better, all the inter-generational implications. Currently the focus is on raising the state pension age, but a more plausible policy option would be focusing on helping low-to-middle income households to save more into their pension pots. A simple scheme that could guarantee a retirement replacement rate of 20 per cent of the average pre-retirement earnings would, along with a state pension, ensure a higher retirement income. In addition, policy makers should work with the financial services industry to adequately manage expectations about the level of retirement income that the average (and median) pensions savings will produce. The introduction of the auto-enrolment pension schemes in the UK has helped to mitigate the problem of retirement savings, but it remains to be seen whether this will be enough to support an increasing number of old people, without significantly relying on benefits.