Nout Wellink: The labour market in 2040 – greyer but full of vitality

Speech by Dr Nout Wellink, President of the Netherlands Bank and Chairman of the Basel Committee on Banking Supervision, at the symposium "Demographic ageing: a broader view", Science center NEMO, Amsterdam, 11 October 2007.

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Imagine: it is the year 2040. Those who turn 32 this year will then be 65 and so are now half-way there. Demographic ageing will have reached its pinnacle in 2040. More than 4 million Dutch people will then be older than 65, working out at a quarter of the population, whereas that age group now makes up less than 15%. For every person over-65, there will be just two compatriots aged between 20 and 65[1].

In such a greying society, our cities and towns will look quite different to now. Amsterdam city centre is likely to be a largely pedestrian zone, allowing for wider footpaths. Political pressure will have forced the monument conservation authority to relax its rules. Large groups of older people in the city will have been obliged to remove thresholds, install stair lifts and knock through walls. The two universities in the capital will have been forced to merge because of the smaller inflow of new students. Only a handful of the many places of entertainment around Rembrant Square will still remain, but the classical performances at the Concertgebouw and the Muziektheater aan 't IJ will be sold out every night. Subsidies for museums may even have been scrapped owing to the overwhelming increase in visitor numbers. And here, in NEMO, where today's children make their first discoveries in the area of science and technology, there may be a shopping mall with stores full of books, golfing equipment, spectacles, hobby accessories, fine chocolates and garden tools.

Of course this is mere speculation. Time will tell what life will really be like in 2040. But it's a sure thing that the older people of the future will have a major influence. Today we are looking at the economic consequences of population ageing. I want to talk to you about the impact of ageing on the labour market and how we can prepare ourselves for it.

Labour force in 2040

For a start, the average worker in 2040 will be older than at present and so have more work experience. Owing to the rise in the number of pensioners, he will have fewer competitors in the labour market, unless there is a spectacular rise in birth or immigration rates. Because work will become scarcer, but also because of the trend rise in labour productivity, his disposable income is likely to be far higher than it is now.

But population ageing will absorb a huge share of the employees' rise in income if the current schemes continue unchanged. To illustrate, if we assume that income in 2040 has risen by 60% [at, say, 1.4% per year], more than a quarter of this rise in income will be "eaten-up" by higher contributions and taxes for the state old age pension[2].

Some sectors will be faced by bigger changes in the labour market than others. At present, older workers are overrepresented in education and health care. Shortages could arise in these sectors if there is no increase in the inflow of young employees. In education, this is

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1 These figures were derived from the population forecast 2006-2050 published by Statistics Netherlands.

2 If the grey pressure doubled, and all other circumstances remained unchanged, the burden of contributions and taxes related to the state old age pensions would also double, from 9% at present to 18% in 2040. That means that net disposable income would not rise by 60%, but by 44%.

already expected to lead to problems in the short term[3]. In the longer run, the effects will be mitigated by the decline in the number of schoolgoing children. An added problem for health care is that population ageing will generate greater demand. Working conditions in the health care sector merit extra attention if we are to avert staff shortages in the future.

Retirement age

Looking at the labour market in 2040, we cannot skirt problematic pension issues. The number of pensioners will increase, because the group of people reaching retirement age is expanding while life expectancy has risen too. The latter is a great achievement, of course. In 1960, 40-year-old men had an average life expectancy of more than 74 years, compared to just above 78 in 2008. The life expectancy for 40-year-old women has risen by five years, to something over 82. And there has also been a significant gain in the number of years lived without the need for intensive health care[4].

The price we pay for this progress is that bottlenecks may arise in the funding of the state old age pensions and supplementary pension schemes. We can of course absorb these by either raising contributions, or by letting benefits fall behind them. But such measures hit people directly in their pockets, and I think that better solutions are available to improve the sustainability of the pension system. One of these is to widen the contribution base through greater labour participation. There is still scope for widening participation in the Netherlands, notably among women, youths from ethnic minorities, people with occupational disabilities and, most definitely, among older workers themselves. Population ageing apart, higher participation is a good thing in itself. Our prosperity will benefit from the optimum deployment of available workers. Moreover, older people are staying active for longer, thanks to the higher life expectancy and good health care. They look after their grandchildren, perform voluntary work and play a full part in society. An obvious path is to stimulate older people to use their active attitude to life to stay on longer in the workplace. This would also reinforce the solidarity between working and non-working people.

But let’s not go too far. Employees in sectors such as construction, the fire brigade and the army have often started working at a very young age. It would not be reasonable to expect these groups to work for more than 50 years of their lives, whereas people in less demanding positions are hard pressed to work for 40 years. Especially as these jobs are physically taxing. The collective labour agreements for such physically-taxing occupations generally arrange for pension funding that enables employees to stop work before reaching the statutory retirement age. That is understandable, and may continue on broadly the same lines as far as I am concerned.

It is difficult to exactly determine what percentage of the labour force hold physically-taxing jobs, but in all likelihood, it would be reasonable and possible for the greater part of the labour force to prolong their careers. An additional factor is the structural decline in the share of physically-taxing jobs owing to the diminishing share of industry in our economy. This employment shift to services set in many years ago, but is still ongoing. In 1980, industry still accounted for 15% of employment, but this share has now dwindled to less than 10%[5]. The share of construction in our economy remained stable over this period at around 5.5%.

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3 In education, the percentage of employees aged 55-64 is 19.2%, whereas the average rate is 11.8%. In addition, in its report Vergrijzing en vervanging (Ageing and Replacement), the Council for Work and Income expects bottlenecks in education in the short term.

4 The Rapportage Ouderen 2006 (Report on Older People 2006) by the Ministry of Health, Welfare and Sport, shows that in 2003 the so-termed life expectancy without physical impairments of a 65-year-old man was 77.3 years, compared to 75 in 1989. For 65-year-old women, these figures were 77.4 and 74.1 respectively.

5 “Less welfare growth in the service economy”, DNB Quarterly Bulletin, September 2005.

Will staying on in the workplace alleviate the impact of ageing on the labour market? Yes, most definitely! For employers, it means that labour supply will not decrease as rapidly, making it easier for them to fill vacancies. And the bigger the working section of the population, the better the labour market for both employers and employees because of the lighter marginal tax burden. If more people continue working, not just until they turn 65 but afterwards too, and delay drawing the state old age pension, there would be less state old age pension claimants and more potential contributors. The level of contribution for the working part of the population would then be lower. So it works both ways. Older people themselves benefit from prolonging their working lives as a means of safeguarding the sustainability of the pension system. For they enjoy higher disposable income.

Retaining older workers

The reality is that labour participation among those aged between 55 and 64 is relatively low[6]. And participation among the over-65s is negligible, the reason being the various legal and socio-cultural impediments discouraging older people from working for longer than they generally do now.

A major obstacle is that many collective labour agreements provide for termination of employment on reaching 65. It is subsequently quite unappealing – for both employer and employee – to enter into a new contract. Having reached retirement age, the employee has much less financial incentive to work, because he is then entitled to a state old age pension as well as his supplementary pension benefits. For the employer, entering into an employment contract with someone over 65 represents a risk, seeing as he is obliged to offer all his employees occupational disability insurance. The employer may choose to place this risk with the Employee Insurance Administration Agency or to run it himself, possibly by taking out private insurance. If cheaper in their case, employers generally choose the latter option. This choice applies for their entire payroll. But a problem is that insurers do not provide occupational disability insurance for employees over 65. So it is up to employers to carry the risk of occupational disability for these employees. Moreover, the risk of an employee becoming sick increases as he gets older. Since the Sickness Benefits Act obliges employers to continue paying sick employees for two years, this could be very costly for employers.

The statutory retirement age thus constitutes an obstacle for older workers and their employers, even though prolonging working lives would be of general benefit. Germany has opted for gradually raising the retirement age from 65 to 67 as of 2012. During the first twelve years, Germany will raise the retirement age by one month a year, and in the six following years by two months a year, completing the process by 2030. So German employees will have the opportunity to prepare for a later retirement age, and no one will have to carry on working unexpectedly. We could likewise raise the retirement age in the Netherlands step-by-step to, say, 67 too. This would make it easier and more rewarding to stay on in the workplace.

But it is vital to encourage older workers to continue working, even before the retirement age of 65. Because too many people are now taking early retirement without being prompted by the physically-taxing nature of their job. With this in mind, the government has already voiced its desire to partly fund the state old age pension by taxing older people's incomes. In itself, the idea of funding state pensions from public resources seems a good idea: older people would then help carry the collective burden of population ageing. All other things being equal, it would allow for a reduction in general tax rates, and it is also expected to boost total labour participation. Moreover, the funding of state pensions from public resources forms a direct

[6] According to Eurostat figures, average labour participation among people aged 55-64 in 2006 was 50.5%, whereas it was 77.1% for those aged 15-65.

incentive to older workers to keep working. However, the impact of this inducement will be contained, because the change in funding will mainly affect the more well-off pensioners. Research by De Nederlandsche Bank[7] has shown that when it comes to choosing their own retirement date, this group is less sensitive to changes in their pension wealth. Besides the said income effect, the move to finance state pensions from public resources also has a substitution effect: the positive effect that continuing to work would have on the level of a pension would be less if this pension were subject to tax. However, our research shows that, on balance, funding state pensions from public resources would stimulate older workers to stay on.

In addition to funding state pensions from public resources, there are conceivable measures to reward older workers for continuing to work. In part, the current system already contains such features. Owing to the fixed accrual of pensions, the years leading up to the age of 65 are relatively lucrative. And the earned income tax credit is higher for employees over 57. Nonetheless, this now gives older workers who prolong their careers no more than EUR 500 a year. One possibility would be an incentive in the form of a considerable hike in this earned income tax credit.

Helping older people find work

Besides older people who are already employed, there are of course those who have lost their job through, say, a reorganisation. Many of them would like to keep working but find it difficult to find a new job. In this respect, we need to look at older workers' salary and productivity. Older workers are often more expensive than their younger colleagues, because their salary has increased over the years. However, their expertise is often less up-to-date.

In part, the wider experience of older workers makes up for their perhaps outdated expertise. However, this experience often proves to be most useful for the organisation in which it was acquired. It is also difficult for employers to assess the precise nature of experience gained in other enterprises. To what extent do the tasks and corporate culture resemble those in their own company? How much responsibility did the job applicant actually hold? How well did he perform? All too often there is no satisfactory response to such questions, prompting employers to choose the safer option of a younger, cheaper candidate.

[This means that older job seekers have often been job hunting for some time when they file job applications. Existing prejudices about older people, generous severance payments and overestimation of their own employability make it harder to find work. The longer older people seek work, the worse their labour market position becomes.]

To enable older workers to actually stay in the workplace, it is hence not enough to gradually raise retirement age and increase financial incentives. Employers and employees will need to make a joint effort. Employees will need to continue developing their skills to strengthen their labour market position. And employers will have to be prepared to give older workers a chance. For it is in their own interest to quickly fill vacancies and to take on good employees. Importantly, employers should realise that older workers are indeed able to acquire new knowledge and skills. And that they can win commitment from a motivated employee who they are likely to retain in service for longer than a job-hopping employee in their twenties or thirties.

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[7] Bruinshoofd, Allard en Sybille Grob (2006), Do changes in pension incentives affect retirement? A stated preferences approach to Dutch retirement considerations, DNB Working Paper no. 115.