Nicholas C Garganas: The ageing of Europe's population: consequences and reforms – with particular reference to Greece

Address by Mr Nicholas C Garganas, Governor of the Bank of Greece, at the conference "The ageing of Europe's population – consequences and reforms", organized by the Bank of Greece, Athens, 17 January 2008.

* * *

I am very pleased to welcome to the Bank of Greece two distinguished colleagues from the Governing Council of the European Central Bank and good friends – Yves Mersch, Governor of the Central Bank of Luxembourg, and Erkki Liikanen, Governor of the Bank of Finland – to participate in a Public Discussion on the subject "The Ageing of Europe's Population: Consequences and Reforms".

We chose this subject in part because it is widely recognised that the ageing of Europe's population in the coming decades will have serious economic, budgetary and social implications for all European countries. Nevertheless, there is often strong opposition to policy changes aimed at addressing those implications. In part, this situation reflects the fact that the costs of inaction are not borne immediately, making it easy to postpone the necessary adjustment. At the same time, the longer that adjustment is postponed, the greater the costs of failing to act today will be. An open discussion, especially a discussion that compares the reform experiences of various countries, can therefore help improve understanding of these matters. As such, it is a prerequisite to reaching a broad social consensus on the needed reforms.

I would now like to introduce our distinguished guests:

Yves Mersch became the first Governor of the Central Bank of Luxembourg, upon its creation in 1998. He began his professional career as a lawyer, following postgraduate studies in law and political science at the University of Paris. After joining the civil service in 1975, he was seconded to the International Monetary Fund and the United Nations. In 1989, he became "Director of the Treasury" in Luxembourg. In that capacity, he was the personal representative of the Finance Minister in the negotiations that led to the Maastricht Treaty. He has also served on the boards of major private and public companies.

Erkki Liikanen's distinguished record of public service predates his becoming Governor of the Bank of Finland in 2004. He was a member of the Finnish parliament for almost 20 years (1972-90), Finland's Minister of Finance between 1987 and 90, and a Member of the European Commission for almost 10 years (1995-2004). During his service at the Commission, he was initially responsible for "budget and personnel administration" and, in his second term, for "enterprise and information society".

I will open the discussion by outlining, in broad terms, the key projected demographic developments in the coming decades in the EU, with particular reference to Greece; the economic and budgetary implications of these developments; the related policy challenges; and the extent to which progress has been made in addressing these challenges. Governor Mersch, drawing on the experience of other European countries, will discuss the ways demographic, social and political factors have influenced the implementation of pension reforms in various countries as well as the key features of these reforms. Governor Liikanen will share with us Finland's experience in dealing with the challenges posed by population ageing.

Issues related to population ageing have been studied in recent years both at the national and the EU levels by the Economic Policy Committee at the request of the Council of Economics and Finance Ministers, or ECOFIN Council. An effort has been made to produce results that are comparable across countries by relying, to the extent possible, on common assumptions, data definitions and methodologies. Building on demographic, labour market and GDP projections for each country in the EU25, in 2006 the EPC published long-term projections of age-related spending – covering pensions, health care, long-term care, education and unemployment transfers – as a basis for assessing the risks to the sustainability of public finances. The projections are based on the assumption of "no-policy change" – i.e., they reflect only enacted legislation. They also take into account the current behaviour of economic agents – for example, participation rates in the labour market are based on the most recently observed trends by age and sex. It is important to note that the projections do not constitute forecasts. Rather, they indicate the potential timing and scale of economic and budgetary challenges that would result from ageing populations if present trends continue.

Demographic projections

As I noted earlier, the age structure of the population in the EU25 is expected to change dramatically between now and 2050. Increasing life expectancy will tend to raise the elderly population (ages 65+) by about 77% in the EU25; and by 80% in Greece.[1] At the same time, the low fertility rates – i.e., fertility rates below natural replacement levels – will contribute to a decline in the working age population (ages 15-64) by 16% in the EU25, and by 21%, in Greece.[2] As a result, the old-age dependency ratio – defined as the ratio of the elderly population to the working age population – is projected to double to 51% in 2050 in the EU25 and to more-than-double, to 61%, in Greece.

The population of the EU25 in 2050, projected at roughly 454 million, will be only slightly (less than 1 percent) below that of 2004 as the negative influence of the low fertility rates in all countries will be largely offset by the positive influences of the continuous increase in life expectancy and net inward migration. By comparison, the Greek population is projected to decline by 3% notwithstanding continued net inward migration.[3]

Employment projections

With the working-age population projected to decline significantly between now and 2050, it is clear that the level of employment can be sustained only if the *employment rate* – i.e., the proportion of population of working age that is employed – were to rise sufficiently to offset the fall in the working-age population. The following two factors are expected to contribute to a rise in the employment rate. First, the female employment rate will rise as older women with low employment rates retire and are gradually replaced by younger women, who have higher employment rates – the so called "cohort effect". Second, the employment rate of older people is likely to increase, in part because of already adopted pension reforms. However, the projected increase in the employment rate in the EU25 will not be sufficient to prevent a 5% decline in the level of employment between 2004 and 2050. In Greece, the projected decline in employment is even larger, 13% over the same period, reflecting both demographic developments and a more modest increase in the employment rate.

---

1 The projections of life expectancy are based on extrapolations observed over the previous 17 years.

2 The fertility rate is assumed to rise gradually during the projection period from 1.5% to 1.6% in the EU25 and from 1.3% to 1.5% in Greece

3 Non-nationals reached 7.3% of the population of Greece according to the 2001 Census and more than 8% of the population in 2004 (Eurostat estimates); on average during 2006, 15% of workers who paid contributions to the main employee social security fund (IKA) were foreigners and accounted for more than 10% of IKA's contribution revenues.

GDP projections

As a result of these employment trends, and on the basis of consistent-across-countries assumptions on productivity growth, potential GDP growth is projected to decline in the decades to come. For the EU15, the annual average potential GDP growth rate will fall from 2.2% in the period 2004-2010 to 1.3% between 2031 and 2050. An even steeper decline is foreseen in the new member states (EU10), because of both demographic developments and the underlying assumption that productivity growth rates in these countries will converge to those of the EU15. In Greece, that convergence is also expected to lead to a fall in productivity growth, contributing to a decline in potential GDP growth from an annual average rate at 2.2% in the period 2004-2010 to below 1% per year in the 2030s and 2040s.

Public spending projections

Population ageing is projected to lead to increases in public spending in most EU member states by 2050 on the basis of current policies although there is wide disparity in those increases across countries. In more than one third of the Member States, the long-term budgetary impact of the projected increases will be at least 5% of GDP. These countries have so far made only limited progress in reforming their pension systems or are experiencing maturing pension systems.

For the new member states (EU10) as a whole, the increase is projected to be much smaller, but this situation reflects mainly institutional changes. A switch to private pensions scheme in Poland is expected to make a substantial contribution to a decline in public pension spending in the new member states.[4] Excluding Poland, age-related spending is subject to increase by more than 5% of GDP. Most of the projected increase in public spending will be on pensions, health care and long-term care. Offsetting savings in areas as education and unemployment benefits are likely to be limited.

With respect to Greece, data on public spending projections are not available as such projections have not yet been submitted. However, according to projections prepared in 2002, pension expenditures will rise from 12.4% of GDP in 2005 to 22.6% of GDP in 2050.[5] The net increase in total old age-related expenditure (excluding spending on long-term care, for which no official figures are available) is projected to be 11.5 percentage points of GDP, reaching 32.7% of GDP in 2050. This compares with rises in pension expenditures by slightly more than 2 percentage points of GDP in both the EU-25 and the EU15 over the same period, reflecting the implementation of important pension reforms in many of these countries

---

[4] According to ESA95, defined-contribution funded pension schemes are not considered as part of the general government sector.

[5] These projections were first published in the *Greek Report on Pension Strategy* (Ministry of Economy and Finance-Ministry of Labour and Social Security, September 2002) and reproduced in the *2004 Update of the Hellenic Stability and Growth Programme 2004-2007 – Revised* (March 2005). Initially, pension expenditure had been projected to reach 24.8% of GDP in 2050 (see: Ministry of Labour and Social Security, *Actuarial Report on the Greek social security system – Report of the Government Actuary Department* UK, 19 April 2001; also: European Commission, Economic Policy Committee, *Budgetary Challenges Posed by Ageing Populations*, EPC/ECFIN/655/01, Brussels, 24 October 2001). The downward revision in 2002 reflected the more favourable demographic data obtained from the 2001 census, estimates and assumptions of a faster decrease in rural population, assumptions of a faster reduction in unemployment, more conservative assumptions with regard to annual increases in pensions, and the parametric changes introduced by Law 3029/2002. The new data affected the projection in more than one way. For instance, the presence of immigrant workers and the migration of rural populations to urban centers imply higher *current* IKA *revenues*, but also higher *future expenditure*.

since the 1990s. Total old age-related expenditures are projected to rise by about 3½ percentage points of GDP in both the EU-25 and the EU15.[6]

Long-term fiscal sustainability

Population ageing will have a significant impact on economic growth and lead to pressures to increase public spending. In order to gauge the magnitude of this challenge, the assessment of long-term sustainability of public finances has become part of the regular EU budgetary surveillance.

According to the Commission, in the absence of reform measures and budgetary consolidation, a considerable "sustainability gap" of about 3.5% of GDP, i.e., a gap between the structural budgetary position in 2005 and a sustainable fiscal position, emerges in both the EU and the euro area.[7] Unless measures are taken to fill this gap, the government debt/GDP ratio is projected to remain above 60% over the coming decades for the EU as a whole and, from around 2020, to start rising considerably, reaching almost 200% of GDP in 2050. The debt/GDP ratio would exceed 60% – the Maastricht debt criterion – in more than two thirds of the Member States. In about one half of the member states, the initial budgetary position illustrates that the public finances are on an unsustainable path even without considering the long-term budgetary impact of ageing populations.

With respect to the effects of ageing on the sustainability of public finances in Greece**,** European Commission projections of the general government debt-to-GDP ratio indicate that this ratio would more than triple between 2005 and 2050, reaching 346.0%, though the ratio would be somewhat lower if the recent GDP revision were taken into account.

Policy challenges for Greece

The projections presented so far highlight the fact that demographic, economic and fiscal prospects are more unfavourable for Greece than for the EU as a whole. As projections – rather than forecasts – they can be useful in identifying specific areas where Greece compares unfavourably with other EU countries and, therefore, improvement is presumably feasible with the adoption of appropriate policies. Demographic changes will have major implications for the pension and healthcare systems and, hence, for the sustainability of public finances. The implications are particularly unfavourable for Greece, in light of its *initial* fiscal position, the second highest debt/GDP ratio in the EU. This circumstance underscores the need of a comprehensive set of policies to change demographic prospects, enhance employment and its productivity through reform of the product and labour markets, reform the pension and healthcare systems, and pursue sustained fiscal consolidation.

A number of measures can help boost employment rates. These include improving child-care and introducing flexible working time and leave arrangements, implementing reforms that would attract more youth, women and older persons to the labour market (thereby also helping to raise the effective age of retirement), and facilitating the integration of immigrant workers.

---

6 Economic Policy Committee and European Commission, "The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050)", *European Economy,* special report no. 1/2006 (February).

7 To understand the challenge that policy-makes face, the Commission has estimated the size of the budgetary imbalance on the basis of the so-called "sustainability gap indicators". These indicators measure the size of a required permanent budgetary adjustment that permits one of the following conditions to be met: i) reaching a target of 60% of GDP for the Maastricht debt in 2050 or ii) fulfilling the intertemporal budget constraint over an infinite horizon.

In addition, greater labour productivity growth in the long run should be achievable through accelerated structural reforms in the product and labour markets, increased productive investment in physical capital, and the upgrading of human capital.

The projected very large increase in Greek pension expenditures over the long term – much larger than in most other EU countries – clearly suggests that, in the absence of an early and major pension reform, fiscal consolidation measures by themselves (e.g., tax increases or reductions in non-pension public spending) would not be able to eliminate the projected budgetary imbalances without jeopardising the provision of essential public services. The pension reforms should aim to ensure the long-term viability of the public pension system, which should nevertheless continue to function as an important social safety net.

Finally, the sooner the fiscal consolidation is undertaken and the reforms are implemented, the better, for both fiscal sustainability and for long-term growth. The primary fiscal balance required to stabilise public debt on a sustainable basis is significantly higher in the long run than in an early adjustment scenario. Moreover, delayed adjustment entails lower economic growth because of increasing crowding out effects and the economic disincentives stemming from rising taxes. These results are confirmed by work done at the Commission and the IMF.

In sum, population ageing will have important demographic, economic, and fiscal consequences for Europe. Moreover, these consequences will be especially pronounced in the case of Greece. Many countries in the EU have already undertaken reforms that should cushion them from population ageing and its consequences. In the case of Greece, it is essential that appropriate policies be adopted. These policies should aim at improving the fiscal position, safeguarding the viability of the pension and healthcare systems, alleviating the demographic prospects, and enhancing productivity through reform of the product and labour markets.

Table comparing the projections of the main variables for the EU25 and Greece

	Greece	**EU 25**
Elderly population (ages 65+)	Now-2050: +80%	Now-2050: +77%
Working age population (ages 15-64)	Now-2050: -21%	Now-2050: -16%
Old-age dependency ratio	2050: 61%	2050: 51%
Total population 2004-2050	-3%	-1%
Employment 2004-2050	-13%	-5%
Rise in public spending as % of GDP 2005-2050		
-- Spending on pensions	+10.2%	+2.2%
-- Total ageing-related spending	+11.5%	+3.4%
Government debt/GDP: projection 2050	346%	almost 200%

Source: Economic Policy Committee and European Commission projections.