Guy Quaden: Ageing and welfare systems: what have we learned?

Introductory speech by Guy Quaden, Governor of the National Bank of Belgium, at a conference organised by CEPS in the framework of The European Network of Economic Policy Research Institutes (ENEPRI), in Brussels on 24-25 January 2003.

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Ladies and gentlemen,

I am very pleased to welcome you all at the National Bank of Belgium and to open this ambitious two-day conference on population ageing.

The steadily increasing life expectancy in our countries is very good news but, as you know, combined with the dramatic decline of birth rates after the baby boom in the 1950s and the 1960s it implies that populations in a large number of countries are ageing rapidly. Ultimately, the elderly dependency ratio will rise gradually but substantially. To put it more clearly: our children will have to cater for a growing number of pensioners.

Even if ageing pressures will in most cases only culminate from the second decade of the current century onwards - when the baby boom generation starts to retire from the labour market - the economics profession has a long-standing interest in population ageing. As early as the 1980s, individual authors or international bodies singled out ageing as one of the biggest economic challenges of the future.

The first task at hand for economic researchers was obviously to estimate the size of the problem: what is it that we are facing? How bad will it be? Most studies initially focused on the pensions problem and the budgetary impact of ageing. Two remarks in that respect.

– Subsequent studies revealed that, contrary to what is still often thought, pension expenditure is not the only budgetary item that will soar because of population ageing. The ageing problem is as much a health care problem, for instance, as it is a pension problem. On the other hand, one should not forget that ageing will have a beneficial effect on other spending categories like child allowances and education expenditure. Hence, the net budgetary cost of ageing can be somewhat lower than the projected increase in pension and health care spending. All in all, even taking into account the large degree of uncertainty inherent in this kind of exercise, ageing will undoubtedly weigh substantially on future governments' budgets.

– One should refrain, however, from simplifying a problem as complex as population ageing into a kind of bill for the governments to pay. Ageing will have a substantial impact on a wide range of economic variables -without speaking of other serious aspects of the social life-, from activity growth to unemployment, from national saving to the composition of private consumption and -yes, I am a central banker- from asset prices to inflation. Hence, it goes without saying that ageing requires a holistic approach on our behalf.

From the very beginning central bankers have always been keen observers of, if not active contributors to the research on ageing. Any shock that has a sizeable impact on the macroeconomic environment should be taken into account when setting monetary policy and, as we have seen, the potential consequences of population ageing, for the government accounts, for instance, can hardly be underestimated. Considering the impact that the combination, in a number of European countries, of sizeable tax cuts and an, altogether, limited slump in activity growth currently has on public finances, it is quite unsettling to imagine what kind of havoc can be wreaked in government budgets by inappropriate policy responses to population ageing. If what we are currently witnessing is the budgetary fall out of a mild economic storm, then, surely, the ageing problem should be compared to a genuine earthquake.

All in all, it is a problem that can only be countered by a well-balanced and consistent strategy that should be put into action as soon and as determinedly as possible. The lines along which action should be taken have been clearly identified. First, governments should get their fiscal houses in order before ageing really starts to kick in; excessive deficits should be avoided and countries that still face a high public debt ought to continue and, if necessary, intensify debt reduction. Second, economic policy has to be geared towards increasing productivity growth and the employment rate - especially of older workers - so as to broaden the tax base as much as possible. Third, the buoyant growth of health care spending needs to be analysed and the individual pension entitlements, both in the private and in the public sector, need to be thoroughly assessed taking into account also the development of second- and third-pillar schemes. In addition, governments of some countries should consider in what way the latter schemes can be encouraged further, either by tax abatement or by regulation. Considering present market returns, it's probably needless to add, however, that second and third pillars based on capitalisation in the stock market, can not by themselves provide a miracle solution, contrary to what some people advocated previously.

Any viable solution to the ageing crisis is bound to be a blend of those three ingredients: it would be very easy, for instance, to offset the upward pressure on government spending coming from the rising number of elderly by simply reducing the average pension to a basic-needs level and to turn the health care system into a two-tier one, where public insurance is very limited and only the richest part of the population has access to new technologies via private schemes, but that would simply amount to a hollowing out of the welfare state, which our fellow citizens and myself do not wish.

Taking stock of the policy response to the ongoing research on ageing, I guess it is fair to say that the results so far have been mixed.

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On the plus side, one can not deny that ageing features prominently on the political agenda and, in many countries, significant steps are being taken. Several countries are reforming or are set to reform their pension systems with a view to improving the sustainability of public finances. Considerable progress towards sound fiscal positions is also made in some countries. In a high-debt country like Belgium - and you will hopefully forgive me that I take this example - a special pension fund, the so-called Silver Fund, has been created within the government sector in order to clearly visualise the link between debt reduction and the impending costs of ageing and to enhance public support for further fiscal consolidation.

However, there are also some worrying trends. First, fiscal consolidation has not been commendable everywhere with some countries in the euro area clearly showing signs of post-Maastricht fiscal fatigue. Even worse is the fact that, following the problems that those countries are experiencing now, the credibility of the Stability and Growth Pact and the whole institutional framework is constantly undermined either by calling into question sensible rules or by resorting to creative accounting. The ECB Governing Council has recently confirmed in the strongest possible terms its support for both the Pact, which, if applied correctly, offers enough leeway to reconcile short-term flexibility and long-term sustainability of public finances, and the 3 p.c. of GDP deficit ceiling.

Second, policies geared towards market liberalisation, increased research and development and human capital formation, which could spur long-run productivity growth, have been hesitant at most in many cases.

Third, even if some initiatives have aimed at increasing the employment rate of older workers, progress has generally been slow, partly due to popular resistance. Still too often, negative temporary demand shocks, both at the macro and the micro level, crystallise into permanent institutional arrangements that put downward pressure on the effective retirement age and, hence, undermine future governments' capacity, if not to ward off the ageing crisis, then at least to soften its impact.

If we do not want the famous Lisbon objectives to become just a slightly offbeat alternative scenario in our projections, rather than realistic targets, then, clearly, more action is needed in these areas.

All in all, it is essential that policy makers fully understand that the window of opportunity that we have now, will not last forever. We should be aware of the fact that we still have a lot of convincing to do.

Earlier on I have likened the ageing problem to an earthquake. Contrary to a regular earthquake, however, we can predict almost exactly when and where it will hit us. In addition, the quake will not take the form of a big bang but will reach its full impact only very gradually: its disrupting ripples will be felt throughout the following decades.

And although it is hard to give precise estimates of the amount of damage that it will do, this is the kind of earthquake that is certain to shake the very foundations of our modern welfare states. It is our task, as economic researchers, policy advisors and, ultimately, policy makers, to make sure that, by the time ageing really starts to kick in, these foundations can withstand the blow.

I firmly believe that conferences like this one bringing together a host of distinguished researchers from both sides of the Atlantic are a crucial step in reaching this objective.