Population ageing and government revenue: It is not all bad news

Population ageing should increase government revenue, but not enough to outweigh the higher public spending. Cutting spending and raising taxes would be needed to keep debt stable.

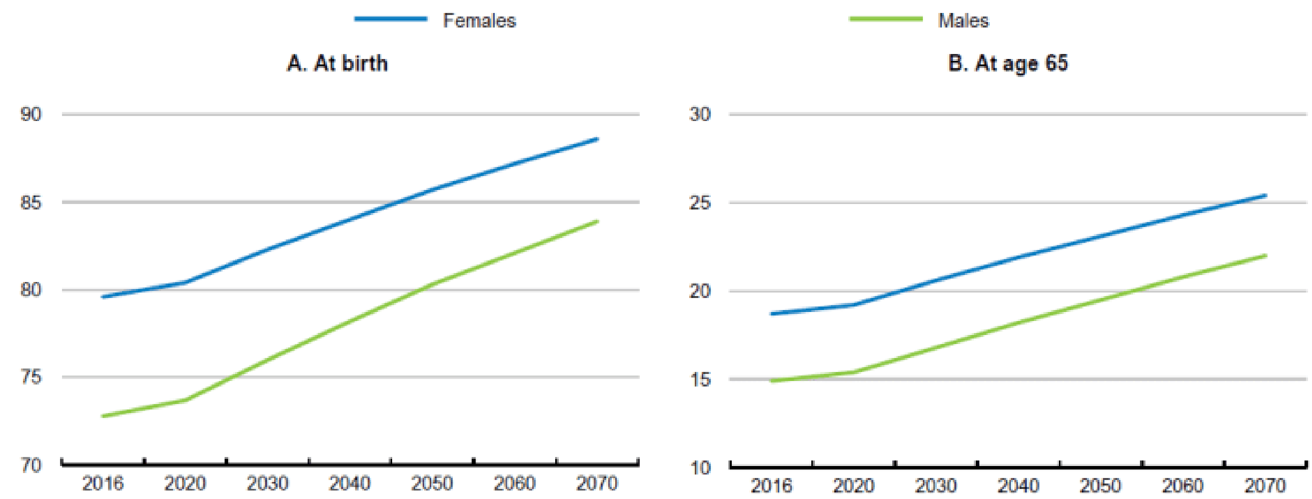
The pension system in Hungary is under pressure from demographic changes

by Ania Thiemann, Hungary Desk, OECD Economics Department

Over the next 50 years, the old-age dependency ratio will double, and public spending on pensions and health-care is set to increase. People will also spend more time in retirement. The *2019 Economic Survey of Hungary* is assessing the demands on public finances arising from this population-ageing challenge.

Life expectancy is rising, including for pensioners

In years



Source: European Commission (2018), "The 2018 Ageing Report - Economic & Budgetary Projections for the 28 EU Member States (2016-2070)", Directorate-General for Economic and Financial Affairs, Institutional Paper 079, May, Luxembourg.

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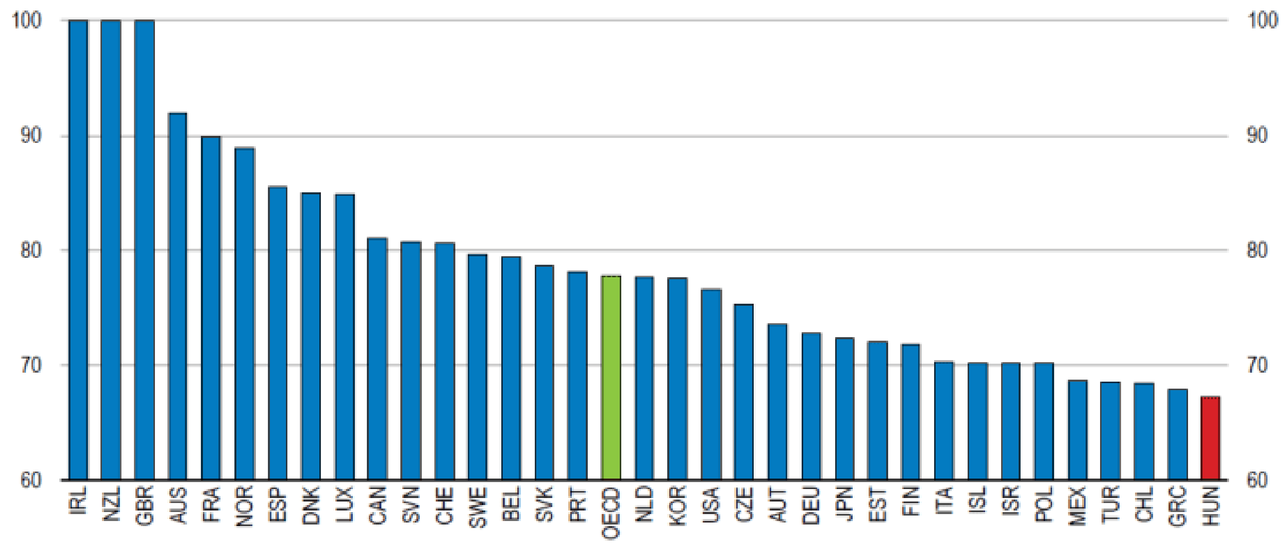
At present, public spending on public pensions is among the lowest in the OECD, but it is expected to increase by some 3 percentage points of GDP by 2070. This estimate may be on the low side. OECD work suggests that ageing-related costs could rise by as much as 4 percentage points more of GDP, for instance, if expected economic growth fails to materialise, or if people live longer than projected.

An additional concern is a high risk of old-age poverty. Already today, some 20% of pensioners receive pensions below the poverty line. Looking ahead, the earnings-related pension system will secure good pensions for individuals with full careers. Improved employment prospects will therefore address a part of the poverty issues. For others, with interruptions in their careers, for instance because of unemployment, there is a risk of low pensions, or even old-age poverty. This because the impact of career breaks on pension entitlements is larger than elsewhere in the OECD.

Workers with career interruptions have low pensions in Hungary[1]

Gross pension entitlements as a percentage of full-career entitlements, mandatory pensions only[2]



1. Pension entitlements are calculated for male average earners who enter the labour market at 25 years old (rather than the standard 20) and spend ten years unemployed between the ages of 35 and 45. What they would receive is measured against the OECD baseline pension, corresponding to a full career from the age of 20.

2. In Luxembourg and Slovenia labour-market latecomers with career gaps must work 5 years more than workers with unbroken careers to qualify for a full pension. The same figure is 4 years for France and 2 years for Germany and Spain.

Source: OECD (2017), Preventing Ageing Unequally, OECD Publishing, Paris.

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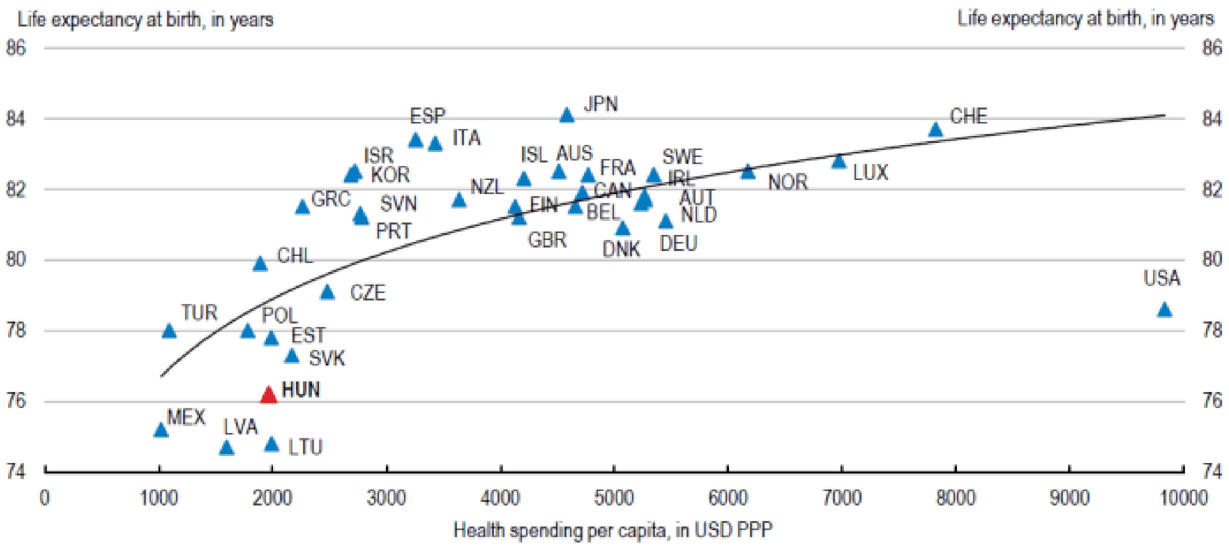
OECD work suggests that the way forward to address these problems includes a longer working life, improved predictability of pension outcomes, and the introduction of a basic safety-net pension for all. Reforms in this area also have to take into account the need for securing more actuarial neutrality and fairness in the Hungarian pension system.

Hungary spends relatively little on its public health-care system and outcomes are below the OECD average. Mortality rates are high and Hungarians spend less time in good health in old age.

Better resource utilisation could boost life expectancy significantly

2016 or nearest year available[1]



1. 2015 for life expectancy at birth for Canada, Chile and France. PPP: purchasing power parity.
Source: OECD (2018), "Health Expenditure and Financing", *OECD Health Statistics* (database), July; and OECD (2018), "Health Status", *OECD Health Statistics* (database).

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The system is not efficient, but problems are also related to life-style factors, such as smoking and high alcohol consumption. Additional concerns include uneven access to health care, particularly in rural areas. The 2019 Economic Survey of Hungary points out that addressing these problems is likely to require a significant increase in public spending. That said, there is also scope to improve the use of current resources to achieve better outcomes. This includes a larger role for the family doctor (GPs) as a gate-keeper to provide guidance for patients in the system. In addition, larger, more specialised and more independents hospitals can lead to a better use of resources and better quality treatments.

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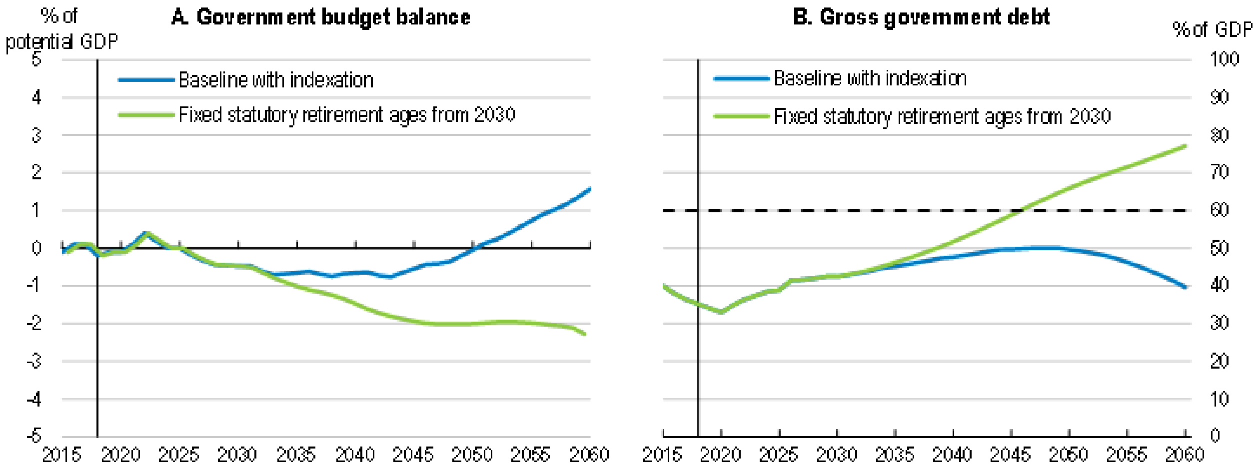
Ambitious retirement age indexation ensures sustainable public finances in Denmark

By Mikkel Hermansen, Denmark desk, OECD Economics Department

Denmark has a long tradition of reforms delivering sound public finances and strengthening economic growth. One foundation of long-term fiscal sustainability was the decision taken in 2006 to index statutory and early retirement ages to life expectancy. Projections of public finances suggest that in this case (the baseline scenario) the government budget will remain close to balance and debt stay well below 60% of GDP (Figure 1). However, if indexation where to be stopped from 2030, persistent deficits and fast rising debt are projected.

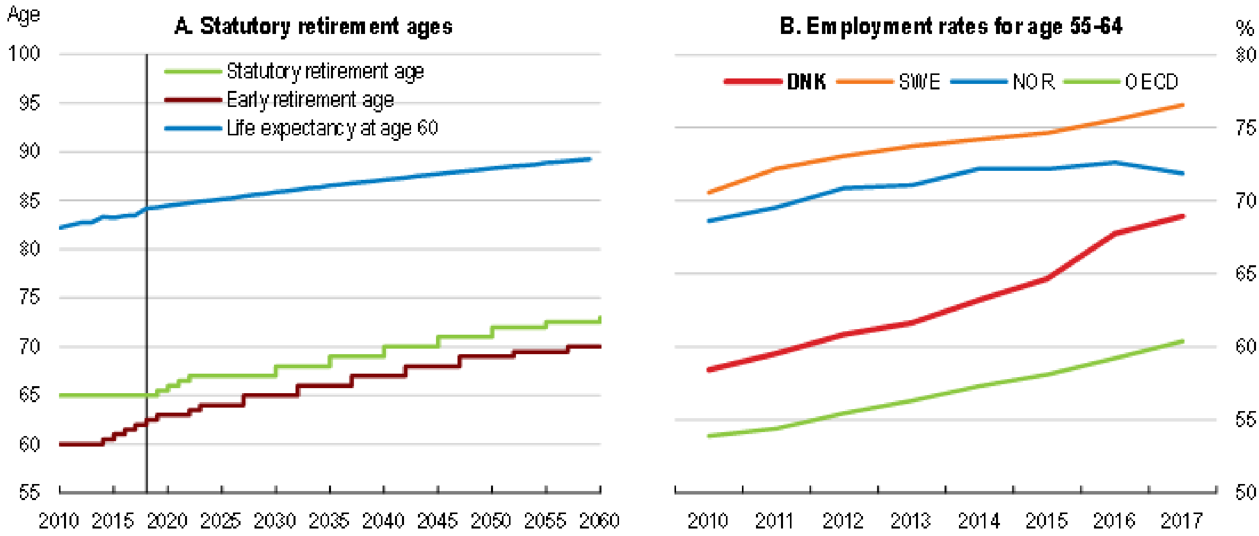
Figure 1. Retirement age indexation will ensure sustainable public finances



Source: OECD calculations based on Danish Ministry of Finance (2018).

The indexation mechanism works by raising the statutory retirement age by up to one year every five years to keep the expected number of years in retirement constant (Figure 2, Panel A). Experience from the first adjustment of the early retirement age starting in 2014 has been encouraging. Many seniors have chosen to stay in their job, which has supported a significant rise in the employment rate among 55-64 year olds (Figure 2, Panel B). There is still scope for improvement as the senior employment rate in Denmark remains below those of Norway and Sweden.

Figure 2. The statutory retirement age is set to increase to 73 by 2060



Source: Danish Government (2018); OECD Labour Force Statistics.

In the coming years the statutory retirement age will be increased from 65 to 67 years. Assessing whether the affected workers remain active will provide another indication of whether the long-term fiscal strategy is on track. Current projections indicate that the statutory retirement age will reach 73 by 2060. This is an ambitious path and the highest planned retirement age across OECD countries. Still, since additional years lived are generally in good health such a rise is achievable, but requires policies to retain seniors in the labour market.

The recent *OECD Economic Survey of Denmark* commends Denmark for its impressive reform track record and sound public finances. The indexation of retirement ages to life expectancy should become a pillar of the economic policy framework and useful guide for other countries undertaking their own reforms. Nonetheless, successful reform requires full implementation and more could be done to ensure the functioning of the labour market does not discriminate against seniors as well as helping those with reduced work capacities to remain in employment (OECD, 2015).

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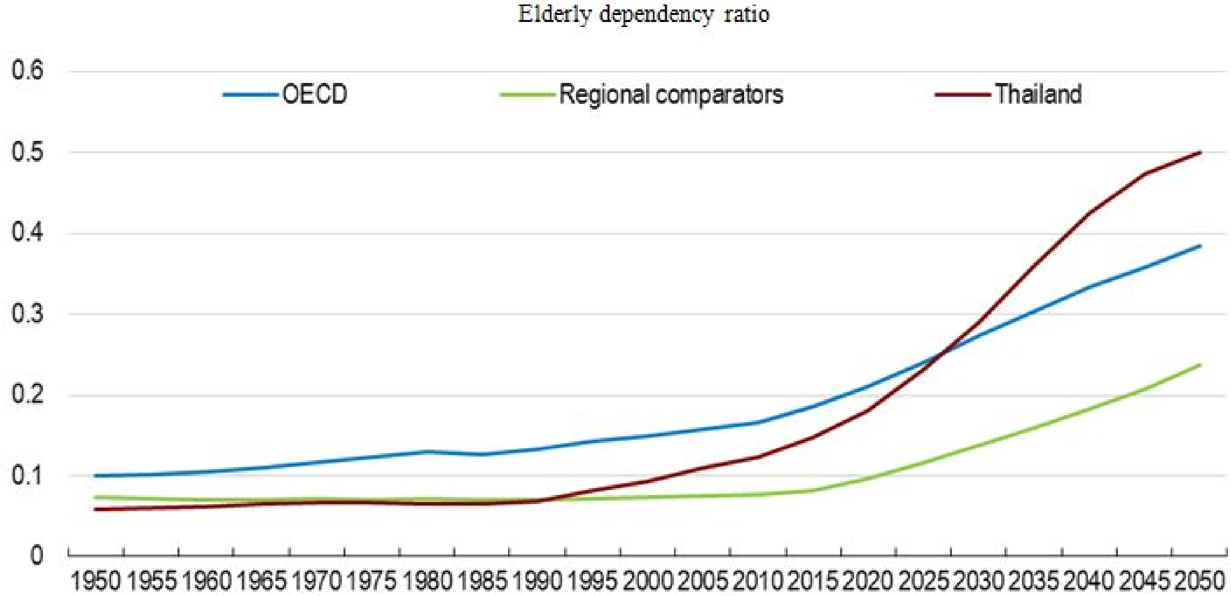
Sustainably financing pensions and healthcare in Thailand

By Adam Bogiatzis, Economist, South East Asia Desk, Economics Department.

Thailand has made remarkable socio-economic progress over the past several decades. Poverty has plummeted and access to education and health services has become near universal. As is commonly the case, improved health outcomes and expanded opportunities – particularly for women – have led to higher life expectancy, a declining fertility rate and ultimately an ageing population. However, the rate of Thailand's ageing is exceptional, particularly given its stage of development. Indeed, Thailand's elderly dependency ratio far exceeds that of other emerging economies in the region (including Indonesia, the Philippines, Malaysia and Viet Nam) and is expected to surpass the OECD average by 2030 (Figure 1).

Figure 1. The elderly dependency ratio is expected to exceed the OECD average by 2030



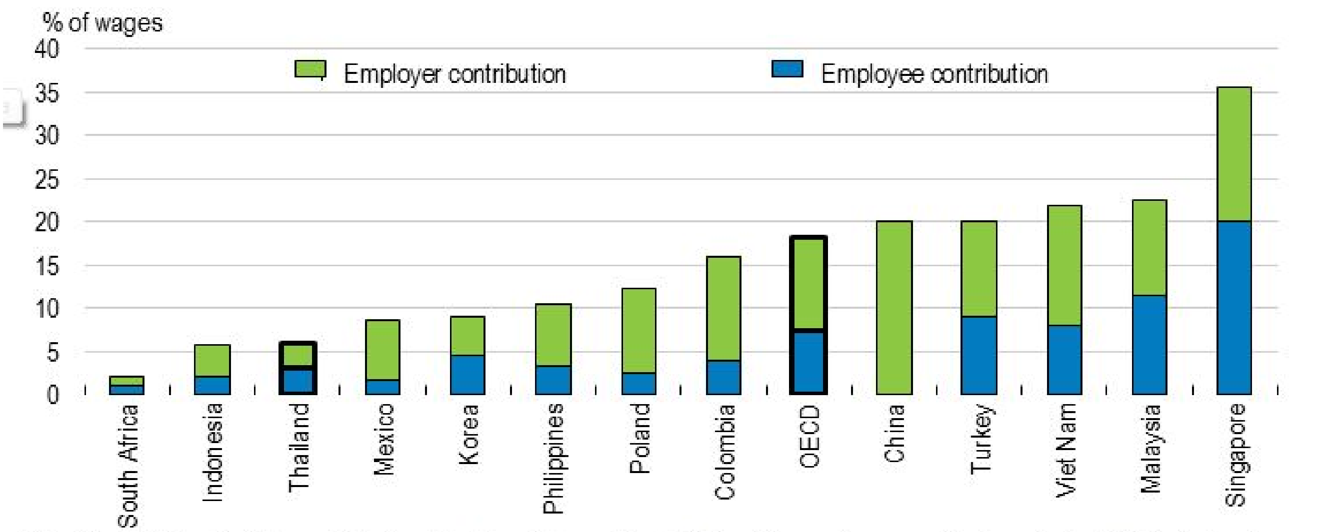
Note: The elderly dependency ratio is the number of persons aged 65 and above divided by the working age population (aged 15 to 64). Regional comparators refer to the simple average elderly dependency ratio for Malaysia, Philippines, Indonesia and Viet Nam.
Source: UN Population projections, 2017 revision.

With a rapidly ageing population, the public burden to provide social pensions (which will need to increase to improve very low replacement ratios and safeguard against elderly poverty) and healthcare will grow considerably. Indeed, the Initial Assessment Report of the Multi-dimensional Review of Thailand notes that although Thailand's current fiscal position is healthy, structural reforms to the pension and healthcare systems are needed to ensure fiscal sustainability (OECD, 2018).

On pensions, Thailand's shrinking labour force and longer retirements mean there are fewer work years available to support the burgeoning number of retirees. As a first step, the pensionable age of the private pension scheme (55 years and over) should be aligned with the public sector and the social pension scheme (60 years and over), with transitional arrangements put in place for current or imminent retirees. Moreover, consideration should be given to progressively raising the official retirement age in line with life expectancy. Indeed postponing retirement is an efficient way to both raise retirement income and improve financial sustainability (OECD, 2017). Thailand should also gradually increase the mandated private sector contribution rate (i.e. the share of wages mandatorily contributed to a pension fund). Under the national private pension fund, employers and employees combined contribute 6% of wages. This is below the contribution rates for comparator countries and the OECD average (Figure 2).

Figure 2. Thailand can boost mandatory contributions to pensions

Employer and employee contribution % of wages, 2014



Note: South Africa includes contributions for all social spending. In China, the employer contribution rate is 20% for the basic pension, but in the case of the Provident Fund the contribution rates vary by province. The OECD average only includes countries that have isolated contribution rates for pensions and excludes countries that have larger contribution rates for broader social security measures.

Source: OECD calculation based on World Bank Pension Data; and OECD (2015), Pensions at a Glance.

In healthcare, Thailand should avoid near-term regressive and often ineffective blanket cuts to the health budget and instead implement targeted structural reforms that will be beneficial over the longer run. For example, to prevent overburdening of hospitals, Thailand should increase health provision through preventive and primary care by boosting the number of family physicians and general practitioners, particularly in rural areas. Healthcare financing should also be reformed by reducing the exemptions on co-payments and allowing greater private contributions from those able to afford it.

Tax revenues are, and will continue to be, the dominant source of finance for Thailand's pension and healthcare systems. The government provides an old-age allowance to 82% of people aged over 60 and accounts for 78% of total healthcare expenditure – a share higher than the OECD average and regional comparator countries including Indonesia, Malaysia, the Philippines and Viet Nam. Therefore, a complementary set of reforms that boost revenue is needed. In this regard, Thailand needs to broaden the tax base whilst improving efficiency by relying more heavily on less distortive taxes such as those on consumption, property and inheritances. Moreover, the government should continue its efforts to improve collection efficiency by easing compliance through technological innovation, providing incentives that discourage tax avoidance and informality, and strengthening enforcement on tax evasion.

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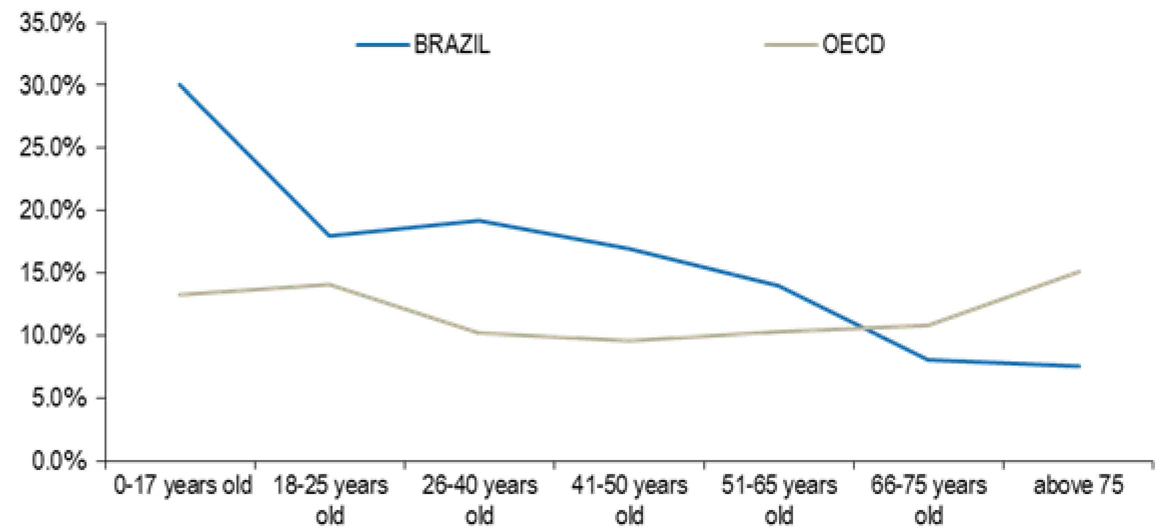
Reforming Brazil’s old-age pension system to ensure its sustainability

By Jens Arnold, Head of Brazil Desk at the OECD Economics Department and Hervé Boulhol, Head of Pensions and Population Ageing at the OECD’s Directorate for Employment, Labour and Social Affairs

Pensions have been successful in reducing old-age poverty well below the population-wide average, and below the OECD average (Figure 1). At present, all pension recipients – and this includes around 90% of those aged 65 and above – receive at least the minimum wage, which is more than 5 times as much as the poverty line of BRL 170 (equivalent to USD 55).

However, Brazil’s old-age pension system already costs more than 10% of GDP, despite the country’s young – but rapidly ageing – population. The combined annual shortfall of the pension schemes is close to 4.5% of GDP, contributing substantially to the budget deficit. If the current parameters of the system remain unchanged, spending on pensions for private-sector workers alone would increase by almost 3% of GDP by 2030, and by almost 5% of GDP by 2040. Taking into account the public sector amplifies imbalances, which will make the system financially unsustainable. An in-depth reform is necessary and inevitable.

Figure 1. Poverty by age group

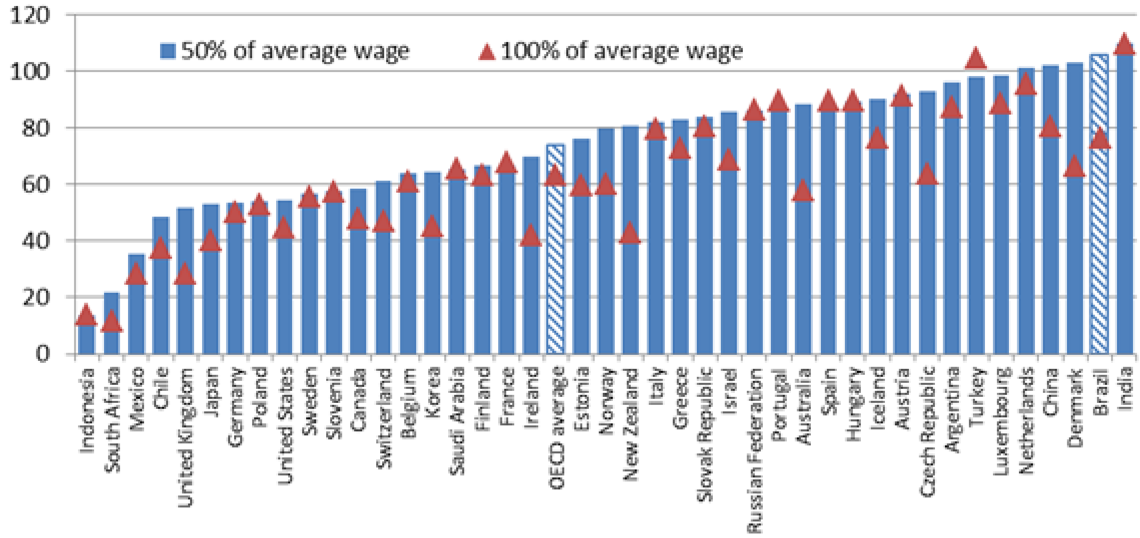


Source: OECD Income Distribution Database (IDD).

Several policy measures could contribute to containing pension expenditures. Raising Brazil's low average retirement ages of 56 years for men and 53 years for women appears urgent, by introducing a binding minimum retirement age. Many OECD countries are now gradually moving their normal retirement ages beyond 65 years for men and women. In contrast to Brazil's pension system, all public pension schemes in OECD countries include a minimum retirement age.

Brazil also stands out for high pension benefits relative to working-age incomes, in particular for low-wage earners, paid at low retirement ages (Figure 2). In the OECD, an average-wage full-career worker will get a pension paying 53% of pre-retirement earnings at the age of 65.5 years, compared to 70% for men and 53% for women in Brazil at age 55 and 50, respectively. Moreover, the minimum pension benefit is equal to the minimum wage, which has led to real increases in the minimum pension of almost 90% over the last 10 years. The minimum pension is available after 35 years of contribution or from age 65 after only 15 years of contribution.

Figure 2. Net replacement rate for full-career worker having entered the labour market in 2014



Source: OECD Pensions at a Glance (2015)

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