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Ageing and Social Security: Ten Key Issues

A contribution by the
International Social Security Association to the
implementation of the Madrid International Plan
of Action on Ageing



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Zehn zentrale Fragen**

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International Social Security Association
Case postale 1
CH-1211 Geneva 22
www.issa.int

Tel: +41 22 799 6617
Fax: +41 22 799 8509
E-mail: issa@ilo.org

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One of the main social policy challenges of ageing societies is to secure an adequate level of income for all older persons without overstressing the capacities of younger generations. The relevance of population ageing for the coming decades has been underscored by the Second World Assembly on Ageing in Madrid and the Madrid International Plan of Action on Ageing 2002.

In view of the ageing of populations around the world, there is increasing concern as to whether social security schemes will be sustainable in the context of these challenges. Much of the discussion on old age pension reform and cost containment in health care has revolved around the issue of economic sustainability in the face of ageing populations. The future viability of ageing societies will inevitably depend on whether the provision of social security is economically sustainable. Nevertheless, this is only one side of the coin. On the other side of the coin, and of equal importance, is the social sustainability of an ageing population. If greater emphasis is increasingly placed on individual choice and responsibility, how can it be ensured that this will not lead to a more pronounced segmentation, not to mention possible destabilization, of society? How can social security systems be adapted to the challenges and opportunities of ageing societies around the world? How can the social security of the population be ensured in an efficient and equitable way? The future of ageing societies depends on the success with which economic and social sustainability can be combined in a comprehensive approach to social security.

This contribution identifies a set of ten issues relating to ageing and sustainable social security and discusses them in the light of recent policy discussions and trends.¹ In view of the complexity of the questions involved, and the diversity of problems and possible solutions around the world, this approach necessarily is selective.

The contribution starts by reviewing the effects of population ageing and the scope for political action and societal change, particularly in relation to employment promotion as the key to coping with demographic pressures on social security systems. The demographic pressures on social security systems will be manageable if accompanied by sustainable economic growth and high rates of labour market participation (1). One important supportive element would be a reversal of the trend towards early retirement (2). Addressing the close link between employment and social security from a different perspective, the third

¹ See also ILO (2001): *Social security: A new consensus*, Geneva: ILO.

issue discusses the provision of income security for workers in precarious employment and in the informal economy who are either not covered or who are only partially covered by social security (3). The fourth issue revisits this issue from a broader perspective, focusing on the question of how much risk individuals should be expected to bear in preparing for retirement (4). Recognizing the importance of striking a viable balance between individual and collective responsibilities in income security in old age, the next issue places the accent on the need for security in income maintenance in old age (5). In turn, the role of the state in social protection in an ageing society is examined (6). Closely linked to these issues is the necessity to address gender equality in old age pension schemes (7). The negative effects of ageing populations on health care provision and long-term care schemes should be mitigated by a comprehensive adjustment strategy, including appropriate policy reforms and the better use of health care resources (8). The specific challenges of ageing populations for low-income (LICs) and middle-income countries (MICs), many of which face rapid demographic change under adverse economic and social conditions, is given special attention (9). Finally, the role social security plays as a prerequisite for active ageing is addressed (10).

1. Enhancing labour market opportunities: The key to sustainability

Although the demographic changes of the coming years are inevitable, their magnitude and effects are far from clear. Despite pessimistic forecasts of a “war between generations” or the purported future bankruptcy of public budgets, it is increasingly recognized that these demographic changes will not necessarily result in ‘disaster’. Such bleak scenarios are not only inadequate but, as the following three points illustrate, they also underestimate the scope that societies have to adapt to change.

1. Although the general trend towards the ageing of the population is evident, projections of demographic changes are subject to various limitations. Short-term variations in the determinants of demographic change, such as fertility rates or migration, can require substantial adjustments to projections.² Many projections use alternative scenarios to illustrate the scope of uncertainty. However, it is not uncommon for these alternative scenarios to be ignored in political discussions. Recognizing that projections are based on strong assumptions, it is important for policies to take into account the limitations of projections and the scope of uncertainty involved.
2. Descriptions of demographic change and the resulting pressure on social security schemes are often based on the old-age dependency ratio or its reciprocal value, the potential support ratio, which reflect the relationship between the size of the working age population and the number of older persons. These measures are very coarse indicators of the processes involved, as they do not take into account the actual distribution of active and non-active groups of the population.
3. International variations in fertility rates, retirement ages and labour market performance suggest that there is considerable leeway for political intervention and societal change. The labour market, in particular, offers important opportunities for proactive policies. The sustainability of old age pension schemes, both public and private, will essentially depend on the future development of employment.

² See e.g. Pierre Concialdi (1999): *Demography, employment and the future of social protection financing*, Paper presented at the Conference on Financing Social Protection in Europe, Helsinki, November 22-23, 1999; Colin Gillion (2000): “The development and reform of social security pensions: The approach of the International Labour Office”, in *International Social Security Review* 53 (1), pp. 35-64.

Employment promotion, together with economic growth, is the key to sustainable social protection. The empirical evidence presented in a recent study suggests that the decrease in labour supply caused by demographic changes could be partly compensated by an improvement in labour market participation rates, at least over the next 25 years.³ European countries, in particular, would require a pronounced adjustment in order to offset the effects of demographic changes on their labour supply. The study shows that future declines in labour supply in France, Germany, Italy, Netherlands, Spain and the United Kingdom could be avoided, or at least attenuated, if labour force participation rates were substantially increased and supported by slightly higher levels of immigration. In the case of Sweden, the already high level of labour force participation provides limited scope for a further increase, and it would therefore be necessary to double immigration or to raise the retirement age to offset the decline in labour supply. Japan's massive fall in labour supply could be offset only by a marked increase in the labour force participation of women (which would have to be supported by appropriate family policies), combined with a rise in fertility rates and higher immigration. In the same vein, OECD chief economist Ignazio Visco recently presented projections on annual GDP growth until 2030 that foresee markedly higher economic growth, provided that older workers do not retire early and that the labour force participation of women rises. In this way, the increase in spending on pension schemes can be contained.⁴ Employment promotion can therefore significantly relieve the economic burdens of an ageing population and contribute to overall welfare.

However, many countries have a long track record of persistent unemployment and underemployment, and it is difficult to see how these countries can increase their levels of employment after years of failed attempts to reduce unemployment. It has been argued that incomplete individual employment records and relatively low national employment levels in many European countries create an additional obstacle to coping with population ageing. If a large proportion of the working age population is not employed, those who are in work have to support a greater number of inactive fellow citizens. That said, more optimistic observers have argued that this could also turn into an advantage,

³ Peter McDonald and Rebecca Kippen (2001): "Labour supply prospects in 16 developed countries, 2000-2050", in *Population and Development Review* 27 (1), pp. 1-32.

⁴ Ignazio Visco (2001): *Paying for pensions: How important is economic growth?*, Paper presented at the Center for Strategic and International Studies Conference on Managing the Global Ageing Transition: A Policy Summit for the Global Ageing Initiative, Zurich, January 22-24, 2001, p. 23.

since these employment reserves could be transformed into a source of further employment growth.⁵

Moreover, high levels of unemployment are paralleled by a shortage of skilled labour in some sectors of the economy in many European countries – a problem that will become much more severe once the large cohorts of the baby boom generation reach retirement age. The success of employment promotion will depend on the degree to which the unemployed can be (re-)integrated into the labour market. This will involve increased efforts to improve education and vocational training, and to achieve a better match between the capacities and knowledge of jobseekers and the requirements of employers.

Women's labour market participation is often cited as a main source of relief for the demographic challenges. The Nordic example shows that relatively high fertility rates can be combined with high employment rates among women, provided that families are able to rely on the support of social security benefits, social services and a work environment that is favourable to combining work and family life, for both men and women.⁶ It has to be acknowledged, nevertheless, that the effects of increased labour market participation not only relate to the proportion of the population who are in gainful employment, but also have an impact in terms of the volume of work performed. If the increase in the labour market participation of women is channelled mainly into part-time or marginal employment,⁷ the beneficial effects of increased employment rates may be limited, despite high nominal employment rates.

The participation of women in the labour force not only constitutes an effective protection from poverty for working age families, in both single-parent

⁵ See Constantinos Fotakis (2000): *Demographic ageing, employment growth and pensions sustainability in the EU: The option of migration*, Paper presented at an expert group meeting on policy responses to population ageing and population decline, New York, October 16-18, 2000, United Nations.

⁶ For a cross-national account of the importance of child care policies in the employment of mothers, see Janet C. Gornick, Marcia Meyers and Katherin Ross (1997): "Supporting the employment of mothers: Policy variation across fourteen welfare states", in *Journal of European Social Policy* 7 (1), pp. 45-70.

⁷ This is the case, for example, in the Netherlands, where the employment rate of women, adjusted for working time (full-time equivalents), is lower than, for example, in France, Germany or Ireland, although a smaller proportion of women work in these countries (lower unadjusted employment rate). See European Commission (2000): *Employment in Europe 2000*, Brussels, pp. 86-100; Karl Hinrichs (2002): "Combating unemployment: What can be learned from whom?", in Roland Sigg and Christina Behrendt (eds.): *Social security in the global village*, New Brunswick: Transaction, pp. 247-272.

and two-parent households,⁸ but also contributes to women's economic security in old age. Typically, because of lower wages, interrupted employment histories and the unequal distribution of unpaid labour, women are less likely to receive a contributory pension or, if they do, their pensions are on average significantly lower than those of men.⁹ Increasing the labour market participation of women would therefore have the double effect of rebalancing the relationship between active and inactive members of society and of improving women's income security in old age.

Together with economic growth, employment promotion is probably the single most important factor in securing the future of an ageing society. The sustainability of social security schemes, as well as the effectiveness of individual savings schemes, essentially depends on whether societies can successfully rebalance the relationship between the economically active and inactive groups of the population in an efficient and fair manner.

⁸ See Katja Forssén and Mia Harkovita (2002): "Family policy, work incentives and the employment of mothers", in Sigg and Behrendt (2002) *op. cit.*, pp. 297-311.

⁹ For a review of the driving forces and rich empirical evidence on women's pensions, see Jay Ginn, Debra Street and Sara Arber (eds.) (2001): *Women, work and pensions: International prospects*, Milton Keynes: Open University Press.

2. Reversing the trend towards early retirement

Another important component of an employment promotion strategy is the reversal of the trend towards early retirement.¹⁰ It is something of a paradox that despite increased life expectancy and the improved overall health of older persons that statutory retirement ages have not been adjusted to reflect this reality in full. Moreover, this paradox is compounded by the increasing trend towards earlier effective retirement ages.

In many countries the employment rates of older persons, especially older men, have dropped sharply in recent years, with the result that the average retirement age is in practice much lower than the statutory retirement age. If the productive capacity of older persons were used to a fuller extent this would have a three-fold effect on the sustainability of pension schemes: the goods and services produced by a larger workforce would contribute to economic growth; the provision of pensions (and related cash benefits such as unemployment benefits or disability pensions) would be deferred; and the additional tax revenue and contributions would contribute to the financing of pensions and other benefits. Bringing the actual age of retirement closer to the statutory retirement age is a much more promising policy option than that of raising the statutory retirement age.

Moreover, the resulting benefits for the sustainability of pension schemes are only one facet of reversing the trend towards early retirement. For many people, employment is not only a way of earning a living but it is also a means of being a productive member of society. For many of those who take early retirement, withdrawal from the labour force may not be consistent with their individual preferences, even when early retirement is taken voluntarily as a second-best alternative to unemployment. Many companies use early retirement as a relatively inexpensive and socially acceptable instrument for reducing the size of their workforce. From a societal perspective, however, this policy involves a high cost in terms of the financing of social benefits and the loss of human capital and productive capacities.

The reversal of the trend towards early retirement would also require an important shift in socio-cultural patterns and individual preferences. In many societies, early exit from employment has become a desirable and acceptable

¹⁰ See James H. Schulz (2002): "The evolving concept of "retirement": Looking forward to the year 2050", in *International Social Security Review* 55 (1), pp. 85-106.

objective, even in the absence of disability or health problems.¹¹ These attitudes are related to various forms of dissatisfaction at the workplace, as well as to negative attitudes towards older workers and discrimination in the labour market.

Reversing the trend towards early retirement therefore goes hand in hand with tackling age discrimination in the labour market.¹² It is often claimed that older workers are less productive than younger workers, but this view tends to overlook the fact that mature workers can draw on a rich pool of experience accumulated over their working life. The widespread policy of disengaging mature workers is a waste of human capital that will not be sustainable in a situation of shortages of skilled labour in coming years. Companies and governments are increasingly acknowledging the potential benefits of employing or retaining mature workers and have taken action to facilitate the employment of older workers.¹³ The promotion of life-long learning can help in the constant adaptation and updating of the capacities and knowledge of the workforce, including mature workers.

The employment of older workers is not only an economic necessity, but is also desirable from the broader perspective of well-being in old age. Together with other forms of activity, work is considered as being one of the major means of social integration in modern societies. At its best, it can contribute to integration into larger social networks, improved self-esteem and fulfilment, and physical and mental well-being.¹⁴ It should not be overlooked, however, that many forms of work can have a negative effect on individual health and well-being, not least because of bad working conditions and work-place stress. The improvement of working conditions for all age groups, as promoted by the ILO and other actors, is therefore a closely related issue.

It also has to be recognized that disability and ill health constitute a severe problem for some older workers. The promotion of longer working lives should be sensitive to individual capacities and offer adequate treatment and rehabilitation

¹¹ This is for example shown in a recent survey in the United Kingdom, see BUPA (2002): *Fit, willing and able? Is Britain ready for 2020? New MORI research says not*, www.bupa.co.uk.

¹² See Ali Taqi (2002): "Older people, work and equal opportunity", in *International Social Security Review* 55 (1), pp. 107-120.

¹³ Alan Walker (1999): *Managing an ageing workforce: A guide to good practice*, Luxembourg: Office for the Official Publications of the European Communities.

¹⁴ Robert N. Butler, Mia Oberlink and Mal Schechter (eds.) (1990): *The promise of productive aging*, New York: Springer.

at all ages, as well as income security when participation in paid work cannot be continued.¹⁵

There are nevertheless grounds for believing that future cohorts of older workers in many industrialized countries will be particularly well-equipped to work longer than previous cohorts. Although public policies, as yet, have been slow to adapt to this new context, the higher skills levels and improved levels of general health place future cohorts in a better position than their predecessors to lead a more active life well into old age.¹⁶ A comprehensive strategy of promoting and supporting participation in employment would offer more opportunities for older workers and contribute to overall economic and societal welfare.

¹⁵ See Frank S., Bloch and Rienk Prins (eds.) (2001): *Who returns to work and why? A six-country study on work incapacity & reintegration*, New Brunswick: Transaction.

¹⁶ See Alan Walker (2002): "A strategy for active ageing", in *International Social Security Review* 55 (1), pp. 121-140.

3. Meeting the challenges of insecure employment

Employment plays not only a crucial role for coping with the challenges of demographic changes for social security systems on a societal level, but has also important implications for the social security of individuals.¹⁷ Precarious employment, part-time and temporary work, interrupted careers, unemployment and low wages increase the risk of an inadequate income in old age and contribute to perpetuating income insecurity into retirement. This is increasingly relevant given that many recent pension reforms have strengthened the link between contributions and benefits and, by the same token, have reinforced the link between employment records and the level of income in old age, both in public and private pension schemes alike.

Income security in old age is a particular concern for workers in precarious employment, in subsistence agriculture and in the informal economy. These issues are particularly salient for low-income and middle-income countries. Workers in the informal economy usually lack basic social rights and are poorly protected against major contingencies such as illness, invalidity, maternity, unemployment and old age. Extending the coverage of social protection to these groups of the population would significantly improve overall societal welfare. This would not only imply a significant improvement in social security from the perspective of the individual worker, but would also entail a broadening of the tax base ensuring that the financing of social expenditure was shared more equitably between larger groups of the population. The extension of coverage is made all the more crucial - yet all the more difficult - in view of the fact that informal sector employment has expanded in many countries during the course of the last two decades.

The provision of adequate social protection for workers in precarious employment and the informal sector is a core factor in improving the social sustainability of income maintenance in old age. One important element in this respect is a basic pension that provides an adequate income for those who have not had the opportunity to build up sufficient entitlements during their working life, as recognized in the Madrid International Plan of Action of Ageing and the Regional Implementation Strategy for the UNECE region. Such a pension has to be carefully designed, either as part of a broader pension scheme, or as stand-

¹⁷ For a more extensive discussion of these aspects, see the contributions in Hedva Sarfati and Giuliano Bonoli (eds.) (2002): *Labour market and social protection reforms in international perspective*, Aldershot: Ashgate.

alone scheme. It is essential that the level of the pension cash benefit provided is effective to protect all individuals from poverty and if possible to secure an adequate standard of living for older persons in the long run.

While a basic safety net is certainly an important element of a comprehensive social protection strategy, it is necessary to bear in mind that this type of programme is typically associated with certain drawbacks. Generally, programmes that are targeted at the poor are particularly vulnerable to retrenchment and the decline of benefit levels in the long run. This may foster a deep division in society between those who must rely on the state and those who can choose to turn to the market for their income maintenance in old age, giving rise to “two nations in old age”. Programmes that incorporate the middle classes are much more stable in the long run. Moreover, the use of means-testing to better target benefits, and especially when this is applied in a strict and intrusive manner, may deter eligible claimants from claiming benefits because of fears of stigmatisation. Complex administrative procedures may further aggravate low take-up rates. Even though basic safety-net schemes may be targeted deliberately on the poorest strata of the population, delivery problems often remain a serious stumbling block in the path of poverty alleviation strategies.¹⁸

¹⁸ See also Alicia Munnell (2001): “Individual accounts versus social insurance: A United States perspective”, in Xenia Scheil-Adlung (ed.): *Building social security: The challenge of privatization*, New Brunswick: Transaction Publishers, pp. 78-79.

4. Limiting individual risks in preparing for retirement

Concerns about the ageing of the population have been accompanied by a vigorous debate about the financial sustainability of public pension schemes, and have contributed to numerous pension reforms throughout the world. Many recent reforms of pension systems have sought to strengthen the choice and responsibility of individuals in providing for their retirement.¹⁹ It has often been neglected, however, that this policy shift has broader implications for individuals' income maintenance in old age.

Any provision for old age is associated with different types of risks, which are dealt with in different ways by the various pension schemes. When planning their income maintenance in old age, individuals face three main areas of risk:

- labour market risks;
- investment risks; and
- the risk of inflation.

Labour market risks encompass all the contingencies that may limit the career of an individual. For example, adequate provision for old age is difficult to attain in the case of precarious employment, interrupted work histories or outright unemployment. Similarly, disability, ill health or caring for children and frail elderly relatives may constrain an individual's capacity to accumulate adequate entitlements. These labour market risks may therefore significantly limit an individual's capacity to prepare for old age.

Investment risks include partial or full loss of savings or investments, either as a function of financial market volatility, or as a consequence of the bankruptcy of a pension plan or its sponsor. By their very nature, and even for relatively

¹⁹ See e.g. Monika Queisser (2001): "Privatization: More individual choice in social protection", in Xenia Scheil-Adlung (ed.): *Building social security: The challenge of privatization*, New Brunswick: Transaction Publishers, pp. 19-30.

conservative investment strategies, equity market returns are highly volatile.²⁰ Model calculations based on the development of financial markets in the past show that the immense variation of average returns on private pensions schemes implied that some pensioner cohorts have found it very hard to make ends meet, even though they had saved the same amount of capital and followed the same investment strategy as their fellow cohorts, who have enjoyed a comfortable standard of living in old age.²¹ Future investment returns remain unknown, but the effects of demographic change on equity markets, problems of corporate governance and macroeconomic developments render it highly improbable that exceptionally high returns are sustainable.

Inflation poses a further threat to the reliability of retirees' incomes. While many public pension schemes provide benefits that are indexed to prices or wages, the risk of inflation in many private pension schemes is borne fully by the individual, as most annuities are not indexed to inflation.²² Model calculations for the United States demonstrate the magnitude of losses in purchasing power that occurred over the last decades, even though this period was not characterised by extraordinarily high inflation rates. The real value of a fixed annuity bought in 1966 by a 62 year-old worker upon his retirement with an initial value of 100 per cent of previous earnings dropped to 31 per cent of at the age of 80, and only slightly more than 20 per cent at the age of 90.²³ In countries with even higher average inflation rates, the value of fixed income would decline even further.²⁴ It is clear that, where the risk of inflation falls on the individual, increases in life expectancy are likely to be accompanied by a marked decline in the economic well-being of the elderly. Older people, in particular the oldest old, will face higher

²⁰ Gary T. Burtless (2000): *Social security privatization and financial market risk: Lessons from U.S. financial history*, Center on Social and Economic Dynamics Working Paper, Washington D.C.: Brookings Institution. See also Max Alier and Dimitri Vittas (2001): "Personal pension plans and stock market volatility", in Robert Holzmann and Joseph Stiglitz (eds.): *New ideas about old age security: Towards sustainable pension systems in the 21st century*, Washington D. C.: World Bank, pp. 391-423. For an international comparison including Germany, Japan and the United Kingdom for the period 1935-1995, see Lawrence Thompson (1998): *Older and wiser: The economics of public pensions*, Aldershot: Avebury, pp. 135-141.

²¹ Burtless (2000): *op. cit.*

²² As the level of inflation cannot be anticipated to a sufficient degree and does not affect individuals independently, efficient insurance against inflation is not feasible. See Nicholas Barr (2000): *Reforming pensions: Myths, truths, and policy choices*, IMF Working Paper, Washington D.C.: International Monetary Fund, p. 22.

²³ Burtless (2000): *op. cit.*

²⁴ For a comparative outlook on the impact of inflation rates on the value of retirement benefits, see Thompson (1998): *op. cit.*, pp. 152-167.

risks of poverty and destitution, and this may imply fundamental repercussions upon society.

If the investment risk and the risk of inflation are borne by individuals alone, the most probable result is a high level of inequality between cohorts of pensioners and considerable insecurity with regard to economic well-being in old age. The risk associated with such savings strategies may be acceptable if the returns are expected to provide an "add-on" income during old age, with an adequate standard of living already being secured by less volatile forms of retirement income. However, if these savings are expected to cover primary necessities in old age, the volatility and uncertainty of returns renders such strategies very questionable.²⁵

²⁵ Munnell (2001): *op.cit.*, pp. 63-82.

5. The public-private mix: Securing adequate income for old age

The promotion of an expanded role for private pension provision rests largely on the claim that private pension schemes produce higher rates of return than public schemes. Notwithstanding other problems, this discussion tends to overlook that return on investment constitutes only one element of the quality of a pension scheme. Of equal importance is security of income in old age. Individuals are not only interested in high returns on their investment. They also require protection against the risk of being left without sufficient means in their retirement. In the trade-off between yield and security, many people, especially those on moderate and low incomes, tend to opt for the latter.

There is strong evidence that the level of security provided by collective forms of insurance, with their ability to pool risks in larger groups, is highly valued. In many countries, the majority of the population supports a major role for social insurance in providing income security in old age. For example, a recent survey conducted in France, Germany, Italy and Spain reveals that public support for a strong role by the state in the provision of income maintenance in old age is unremittably high.²⁶ Although redistribution always implies that some individuals will be worse off in financial terms than they would have been in the absence of such a scheme, the level of security is valued highly, even among groups of the population that tend to be net contributors. This can be explained in two ways. On the one hand, this seemingly irrational attitude may indicate that individuals do not strictly pursue their economic interests, but value social cohesion, solidarity and income security higher than their expected individual financial return. On the other hand, support for existing pension schemes may also be related to the fact that individual life courses do not follow a straight line, but tend to be characterized by upward and downward social mobility, which manifests itself in uncertainty about the future. The preference for well-established and familiar pension systems that incorporate only a limited level of risk, in comparison with private schemes, can be understood as an entirely rational risk-containment strategy.

The most important component of any pension system is an adequate role for social insurance. Benefits are more stable and equitable if the risks can be

²⁶ Tito Boeri, Axel Börsch-Supan and Guido Tabellini (2001): "Would you like to shrink the welfare state? A survey of European citizens", in *Economic Policy* 16 (32), pp. 8-44.

pooled within a larger group, backed up by the fiscal capacity of the state.²⁷ It is now well accepted the sustainability of pension schemes is, on aggregate, not dependent upon the funding mechanism. Both pay-as-you-go (PAYG) and funded pensions have to be paid out of current national income; it is impossible to “save” funds for future generations on a macro-economic level.²⁸ In the distribution of resources between active and non-active groups of the population, social insurance has an important role to play in guaranteeing adequate protection for individuals who have experienced precarious employment or whose careers have been interrupted due to caring responsibilities, disability or illness.

While risks are borne by individuals or single cohorts in private systems, in the case of public schemes the effects of financial, labour market and demographic risks can be spread over a large number of cohorts, including both contributors and beneficiaries, and are backed by the tax and borrowing power of the state. The pooling of risks can therefore balance the uncertainties of pension provision and smooth the distribution of income in old age.²⁹

²⁷ Nicholas Barr (1998): *The economics of the welfare state*, New York: Oxford University Press; Barr (2000), *op. cit.*; see also Peter Orszag and Joseph Stiglitz (2001): "Rethinking pension reform: Ten myths about social security systems", in Robert Holzmann and Joseph Stiglitz (eds.): *New ideas about old age security: Towards sustainable pension systems in the 21st century*, *op. cit.*, pp. 17-56.

²⁸ Thompson (1998): *op. cit.*

²⁹ Burtless (2000): *op. cit.*

6. *The evolving role of the state in an ageing society*

One of the main motivations for “radical” pension reform in many countries is to reduce the role of government in the provision of income maintenance in old age. Nevertheless, the privatization of pension schemes does not bring an end to the responsibility and liability of the state for income maintenance in old age. Four aspects are of particular importance in this respect:

1. Even where the administration and funding of pension schemes is partly transferred to the private sector, public institutions fulfil an important role in the regulation and supervision of private pension schemes. Assuming this responsibility not only requires high administrative capacities but also involves considerable cost for the taxpayer.
2. In many countries, legislation requires the government or government-sponsored institutions to step in if pension funds or their sponsors go bankrupt, or to provide guarantee payments if the fund's returns do not meet specified benchmarks. These guarantees have been introduced in some countries as safeguards to protect individuals from the vagaries of the market, and to enhance popular confidence in the schemes. Even if these legal safeguards do not exist, political pressure would often oblige governments to bail out private pension schemes in case of financial collapse.
3. Most countries provide tax incentives for voluntary or mandatory saving for old age. Even though it is much less visible as direct expenditure on pensions, the volume of these tax concessions often reach a sizeable proportion of public spending in terms of revenue forgone. Moreover, tax concessions tend to benefit those on high incomes much more than low-income earners.
4. In addition, social assistance schemes generally step in if individual retirement income is inadequate for any reason. In this respect, the high volatility of returns in market-based pension schemes and the uneven distribution of risks has important consequences for public social expenditure since, in the last resort, public social assistance schemes need to intervene in order to guarantee at least a minimum standard of living in old age for those with an insufficient pension.

Contrary to the claims of proponents of 'pension privatisation', the reduction in the level of public expenditure dedicated to pensions is much less than is often

inferred. Empirical studies on these issues are still sparse, but there is some evidence that a substantial degree of public spending, including revenue forgone, is added to direct expenditure on pensions.³⁰

The desire to empower individuals by giving them greater personal responsibility for providing for their retirement is matched by the need to ensure that the myopic behaviour of individuals does not impose an excessive burden on society. Leaving aside the important issue regarding those who are unable to make provisions for themselves, this question is relatively uncontroversial with regard to the failure of individuals to save for retirement. What is less clear is the issue of how much risk individuals can and should bear in their investment strategy, since the state ultimately acts as the 'banker' of last resort in the event of failure.

³⁰ See e.g. Gerard Hughes (2000): The cost and distribution of tax expenditure on occupational pensions in Ireland, in: The Economic and Social Research Institute: *Economic Problems of Ireland in Europe, The Thirty-First Geary Lecture*, 2000, Dublin: ESRI, pp. 19-57.

7. Ensuring gender equality in pension provision

Although the issue of gender equality has been on the political agenda for earnings-related pay-as-you-go (PAYG) pension schemes for some time, as yet this issue has failed to gain much attention in respect of funded schemes.³¹

Most funded pension schemes are defined contribution schemes (DC) and do not take into account specific circumstances associated with child-bearing, child care and the care of frail elderly persons; roles which are either fully or predominantly assumed by women. Interrupted employment careers and lower lifetime wages, as well as long vesting periods in many occupational pension schemes, also result in women having a lower probability of participating in a funded pension scheme during their working life and of receiving benefits in retirement. For those women who do, the average level of benefits is often significantly lower than those of men.

In the case of earnings-related PAYG schemes, some countries have chosen to introduce credits to cover periods of childcare by both mothers and fathers, or informal carers engaged in the provision of long-term care. In the latter case, some countries (such as Germany) pay pension contributions for informal carers out of long-term care insurance. Could this also be a viable strategy for private sector funded schemes?

A further complication pertains to the question of equity and fairness in the pricing of annuities and the level of contributions in pension plans. Many pension plans and insurance companies use gender-specific mortality tables for the calculation of contributions and benefits. As women are expected to live longer, they are required to pay higher contributions to receive the same level of monthly benefits, and they receive lower annuities for the same amount of capital invested. This practice tends to be defended on the grounds of gender differences in average life expectancy, yet this argument is seriously flawed. A broad variety of factors have been found to determine the life expectancy of an individual, including current and past health problems, exposure to harmful substances, occupation and life-style. Of all the possible factors, gender is probably the easiest to observe, but this does not justify its use as the only factor in discriminating between different groups of the population. A truly fair calculation would need to take a much more complex view of the life expectancy of an individual. It may well be that female blue-collar workers have lower life

³¹ A notable exception is Ginn, Street and Arber (2001): *op. cit.*

expectancies than male executives, or that male non-smokers live longer than female smokers. So the use of unisex mortality tables is not only hard to defend on technical grounds, but should also, and above all, be questioned on the basis of social justice. Some countries have already enacted legislation to ensure equality of treatment, instead of continuing the discriminatory practice of sex-based mortality tables. However, this practice is still widespread in many countries.³²

³² Thompson (1998): *op. cit.*, p. 164.

8. Providing sustainable health and long-term care to an ageing population

The ageing of the population is expected to place an increasing burden on the financing of health care and long-term care systems, in both the public and private health care sectors. Nevertheless, when debating population ageing there are a number of positive factors to be taken into account that suggest that it may be far from appropriate to invoke disaster scenarios envisaging the breakdown of all health care systems.³³ These factors include:

1. There is broad recognition that the need for health services and long-term care is highest during the last one or two years of life, and that this need is relatively independent of the age of the person.³⁴ However, many projections of health care expenditure are based on current average expenditure per cohort and therefore do not adequately reflect the fact that increases in longevity tend to be associated with the extension of a healthy life span. Accordingly, it may be expected that the ageing of the population will be associated with a less dramatic increase in health care costs than is often feared.
2. The continued trend towards improvements in health status and disability rates, together with changes in the structure of long-term care (in particular the extent to which institutionalization can be avoided through the provision of home-based services), may lead to much less pronounced increases in expenditure on health and long-term care in many countries.³⁵ A more effective and efficient organization of long-term care, through the introduction of specific social insurance schemes or social services, could also have a positive effect.

³³ For some recent projections of expenditure on health care and long-term care, see Stephane Jacobzone and Howard Oxley (2002): "Ageing and health care costs", in *Internationale Politik und Gesellschaft Online/International Politics and Society* 1/2002; Thai-Thanh Dang, Pablo Antolin and Howard Oxley (2001): *Fiscal implications of ageing: Projections of age-related spending*, OECD Economics Department Working Papers, Paris: OECD.

³⁴ OECD (1998): *Maintaining prosperity in an ageing society*, Paris, pp. 91-99.

³⁵ Stephane E. Jacobzone, Emmanuelle Cambois and Jean-Marie Robine (2000): "Is the health of the population increasing fast enough to compensate for population ageing?", in *OECD Economic Studies* 30, 2000/1.

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3. There is strong evidence that demographic changes have only a relatively small impact on health care expenditure, and that a large part of the increase in health care spending is associated with technological change, the cost of pharmaceuticals and medical equipment and the inefficient provision of health care. As the organization of health care systems and their modes of financing are closely related to costs, it is important to examine and, if necessary, reform them as an important element in ensuring their sustainability. Some experiences with health care reforms, including systems of managed care, have produced very positive results that possibly can provide valuable guidance for reforms in other countries.³⁶

In view of the above, the impact of the ageing of the population on health care systems may therefore be less dramatic than is often assumed. Careful monitoring of the performance of the systems is essential to secure their future economic and social sustainability. Evaluations of health care systems should adopt a comprehensive approach, covering both the public and private sector, so as to identify how an equitable and affordable provision of health care can best be achieved. Improving efficiency in the provision of health care can be achieved while maintaining or even enhancing the quality of the care provided. As a result, carefully designed reforms that have the dual aim of economic and social sustainability can be instrumental in mitigating demographic pressures on health care systems.

An improvement in the treatment of age-related diseases is another factor that could help to enhance the well-being of older persons and lead to a more focused use of health and long-term care resources. If acute or chronic conditions of ill-health, which frequently occur in the last years of life (such as Alzheimer's disease, other forms of dementia and cardiovascular diseases) could be avoided, or at least contained or postponed, this would be a major step in the right direction. Achieving this would require increased efforts in research and the development of new forms of treatment, as well as preventive measures to promote healthy nutrition, physical and mental activity, and a reduction in tobacco use and alcohol consumption.

Access to adequate health care and social services is an integral part of social security and an essential precondition for productive and active ageing.³⁷ In many low-income and middle-income countries, a large proportion of older persons do not have access to any health care provision, but there are also substantial gaps in health care coverage in some industrialized countries.

³⁶ See the contributions in Aviva Ron and Xenia Scheil-Adlung (ed.) (2001): *Recent health policy innovations in social security*, New Brunswick: Transaction Publishers.

³⁷ Walker (2002): *op. cit.*, pp. 121-140.

Extending the coverage of primary health care for all ages is one major element in improving the living conditions of older persons. In addition to the immediate effects on the health of the population, coverage of younger age groups helps to prevent disease and disability and therefore has important long-term effects on the health of future cohorts of older persons. The effective provision of health care is also a prerequisite for employment promotion and overall productivity improvements in the economy.

A further pressing issue is the improvement of long-term care for the frail elderly. Demographic changes are expected to be associated with a growing need for long-term care. Throughout the world caring is most often provided by family members. A more efficient coordination between formal and informal modes of care could help to avoid institutionalization, improve the quality of care and reduce costs. In this way, many persons in need of long-term care could stay in their homes and remain independent for longer, which is not only less cost-intensive but also more likely to correspond more closely to individual needs and preferences.

Encouraging home care does not mean that individuals should be left without support for the provision of care. Above all, it is important to evaluate carefully the amount of care needed and determine whether it can be best provided by formal or informal care providers, or a combination of both. Social services have an important role to play in this respect. Good quality home care can only be ensured if it is adapted to the needs and capacities of carers and those in need of care. Support can be given to caring relatives through an intelligent coordination of formal and informal care, training, practical assistance and psychological support. This would help improve the quality of the care provided and prevent serious tensions between carers and those in need of care.

In addition, it is important to improve the social security of carers. Informal carers, most of whom are women, often have to reduce their working time or give up gainful employment when they choose to assume the task of caring for frail relatives. It is therefore essential to ensure that carers have access to adequate social protection, both for their immediate needs (including health care) and in the long run (pensions). Taking responsibility for caring for a frail person should not be associated with social insecurity and the risk of poverty in old age.

9. Addressing the challenges of ageing in low-income and middle-income countries

The ageing of the population is often perceived as a problem of high-income countries where the populations are already relatively old. To date, low-income (LICs) and middle-income countries (MICs) have often been assumed to be relatively well protected from these changes, or at least to be benefiting from a much longer time span until demographic pressures reach their peak. However, as shown by many contributions to the Second World Assembly on Ageing, nearly all countries, including LICs and MICs, now face mounting socio-demographic pressures. Irrespective of their level of development, all countries can ill-afford to ignore the challenges presented by the rapid pace of demographic change. Whereas in OECD countries it took 150 to 200 years for old-age dependency ratio to double from some 7.5 to 15 percent, in some LICs and MICs it is projected that this ratio will double in less than 50 years. These changes will constitute a very harsh test of the capacity of these societies to adapt, especially in countries with a rapidly declining fertility rate.

Communicable and non-communicable diseases, most notably in the form of the AIDS pandemic and malaria, place further strains on the ability of many societies to cope with the ageing of the population. In cases where the working age population has been decimated the general productive capacity of society is severely reduced and it becomes much more difficult to support children and frail older persons.

In many LICs and MICs contributory social security schemes only protect a small proportion of the population, with coverage being mainly confined to civil servants and employees in the formal labour market. Workers in informal employment often do not have any access to social protection, and therefore face destitution in the event of the temporary or permanent loss of their earnings capacity. The extension of social security coverage is therefore a vital element in improving the well-being of these workers, especially in the fields of health care and old age pensions. Building effective social safety nets, for example through the institution of basic universal or means-tested tax financed old age pensions, can help to prevent destitution for those often many, many people with no means of contributing to a social security scheme.

Traditionally, a major asset of many LICs and MICs has been strong family and community networks that offer mutual support to their members. In countries where formal social security schemes are not well developed, these networks can be essential for coping with the ageing of the population, especially since they provide transfers of resources in cash and in kind from the active to the inactive members of the community. The notions of mutual support and reciprocity have

been central to functioning of these relationships. While older people may receive money, nutrition or other goods, it should be recognized that they play an important and irreplaceable role in the family and the community.

But the strength and robustness of family and community networks should not be overestimated. Increased geographical mobility, as a result of urbanization and migration, changing family patterns, diseases, natural disasters, as well as underemployment, poverty and destitution, is placing major strains on the capacity of mutual support networks. It is therefore questionable whether families and communities will continue to be strong enough to cater for all members of society and it is likely that a growing proportion of the population will be excluded from these traditional forms of support. Family and community networks are not a substitute for formal social security schemes but, together with such schemes, they constitute an important element of a comprehensive social protection strategy. Formal and informal support mechanisms can be mutually reinforcing. Formal schemes can step in when major contingencies occur that would overstretch self-help capacities, while at the same time strengthening such capacities. A combined approach can therefore provide a basis for social protection that takes into account needs and capacities. A well-balanced approach would offer social security transfers and services to those who are in need, but would take care not to disrupt existing support networks. For example, the provision of child care should not deprive older persons of their role in caring for young children, but it could integrate them in the provision of these services.³⁸ This is an example of an innovative approach to building social protection in low-income and middle-income countries that is both economically and socially sustainable.

Concerns about the sustainability of old age pensions and health care schemes in industrialized countries should not discourage the further development of social security in low-income and middle-income countries. Using the policy experiences of other countries with similar levels of socio-economic development, LICs and MICs should develop and implement social security policies appropriate to their country specificities. Even if the possible policy options remain limited, it is increasingly accepted that successful economic development requires the development of a viable social security system.³⁹

³⁸ See Nana Araba Apt (2002): "Ageing and the changing role of the family and the community: An African perspective", in *International Social Security Review* 55 (1), pp. 39-48.

³⁹ This is the case for example in many South-East Asian countries, see Ian R. Gough (2002): "Globalization and national welfare regimes: The East Asian case", in Sigg and Behrendt (2002): *op. cit.*, pp. 47-66.

10. Social security: A prerequisite for active ageing

The ageing of the population, if it is not already, is sure to become a major global policy issue in the coming years. Societies will need to prepare viable ways of adapting to this demographic process. The concept of active ageing is often referred to as positive model for the future, as confirmed by many contributions to the Second World Assembly on Ageing. Having gained prominence in recent years, this concept acknowledges the contribution of older people to society and encourages their active participation in all sectors of society.⁴⁰ The World Health Organization has defined active ageing as follows:

Active ageing is the process of optimizing opportunities for physical, social, and mental well-being throughout the life course, in order to extend healthy life expectancy, productivity and quality of life in older age.⁴¹

One important component of active ageing is employment, although it also encompasses unpaid work, community activities, integration into social networks and leisure activities. It is closely related to physical and mental well-being, but is broader than the mere notion of health. While mainly emphasizing the integration of individuals in society, active ageing also implies individual autonomy, dignity and choice. It is important to acknowledge that the concept of active ageing concerns not only older persons, but affects all ages.

Over the coming decades, it is envisaged that societies will develop into “long-life” societies in which increased longevity is reflected in a changing balance of paid and unpaid work over the life course, involving a more active later life than for previous generations.

Social security is an integral part of an active ageing strategy, since it guarantees an adequate standard of living for those who cannot earn their living because of old age, disability, ill health or other contingencies. The adequacy and security of pension income is an important component of well-being in later life and in enabling people to live out their old age free of material worries. The absence of material deprivation for older people is a fundamental precondition for an active later life, but social integration, equal rights and access to adequate health care and long-term care are no less important.

⁴⁰ For an overview on the concept of active ageing and its implications, see Walker (2002): *op. cit.*, pp. 121-140.

⁴¹ World Health Organization (2002): *Health and ageing: A discussion paper*, Geneva, p. 17.

Just as it cares for older persons, a long-life society should also care for its younger members. In the context of an ageing population, it is more important than ever to offer families suitable opportunities for raising and educating children. These opportunities should include adequate financial means to protect families from poverty, as well as access to education, health care and child-care services. While a comprehensive family policy may or may not lead to higher fertility rates, it is evident that no improvement can be expected in the absence of such a policy. Besides, in an increasingly internationalized economy, it is being more widely recognized that expenditure on education is an essential investment in future competitiveness and productivity.

The main challenge over the coming years is to devise a comprehensive strategy to cope with socio-demographic changes. This strategy should be based on a realistic assessment of the situation that neither invokes overly pessimistic disaster scenarios, nor carries on with 'business as usual'. The ageing of the population affects a large number of policy fields, including the labour market, the economy, education, social security and health care, which all tend to be managed by different actors, separated into different policy areas and governed by different rationales. One example is the use of a policy of early retirement in many countries as a tool for employers to reduce the size of their workforce. But early retirement is at odds with policies to contain pension expenditure. A comprehensive strategy should aim to overcome these inconsistencies and promote an effective and more focused approach in the coming years.

Societies have shown a remarkable capacity for constant adaptation to changing circumstances, and there is no reason to believe that this will not be the case for the ageing of the population. The success of this adjustment process will depend on the capacity of societies to promote employment and productivity, while taking into account the needs of all the categories of the population, so as to secure a fair and just society for persons of all ages.

The International Social Security Association

The International Social Security Association (ISSA) is an international organization which brings together institutions and administrative bodies dealing with one or more aspects of social security in the various countries of the world, with particular reference to all forms of compulsory social protection which, by virtue of legislation or national practice, are an integral part of the social security systems in these countries.

The Association's objectives are to cooperate, at the international level, for the defence, promotion and development of social security throughout the world. It was founded in 1927 in close cooperation with the International Labour Office (ILO). The ISSA has over 360 member organizations in more than 140 countries.

Many of the ISSA's activities directly or indirectly address the issue of ageing, including:

- its international conferences, meetings and seminars, and particularly the ISSA General Assembly, as the principal forum for reflection on social protection throughout the world;
- its research activities, especially comparative and prospective international research projects aimed at achieving improvements in the quality of social security schemes and their adaptation to the problems that they are facing, which provide a solid knowledge base for the formulation of social policy and its long-term orientations;
- its regional activities, which play an important role in identifying the specific needs of ISSA member organizations in the various regions, with a view to developing appropriate means of action and promoting the necessary technical support to meet the needs that are identified; and
- its information services and documentation, including the database "Social Security Worldwide" and the ISSA Documentation Centre, which has a vast collection of publications and documents dealing with the various aspects of social security, including pensions and health care, throughout the world.

For more information, please consult the ISSA web page at:

www.issa.int