

The Economics of an Ageing Society

How many of us are anxiously considering our prospects as more of us contemplate surviving to a ripe old age, without perhaps having done quite enough ourselves to contribute to a workforce large enough or generous enough to keep us in comfort?

The relevance of the discussion of population ageing to all generations was illustrated from the outset by our platform party. Jeremy Peat flourished grey hair and senior citizens status while Lucy O'Carroll, senior economist from HBOS and our chair for the evening highlighted as well as her professional interests, her own personal concerns as the mother of young children who would take on the burden of an ageing population.

Professor Ermisch has an unparalleled enthusiasm for the topic and the ability to present both trends and likely responses in a field fraught with uncertainty. He gave us a thorough and engaging analysis of the challenges and opportunities, referring to the key themes of his paper "Population Ageing: Crisis or Opportunity?".

Stressing that the consideration of declining population was not a new topic, he noted that it exercised the members of the Royal Commission on Population even during the Second World War when declining fertility was a worrying trend - only shortly before what became the baby boom. Since society would certainly change in ways we could not predict, the one sure element in our approach must be flexibility.

John Ermisch traced the declining mortality of the population from 1980 to 2006 showing that women still live longer than men on average, and, although men have in recent years made the most marked gains in chances of survival, by 2004-6 they had just equalled the survival rates of women in 1980-82. For both sexes the gains in expectation of surviving are especially high amongst the older age groups, so contributing to the increase of the older population as a proportion of the whole.

Turning to fertility and patterns of family formation, Professor Ermisch illustrated the trend towards later development of live-in partnerships, most beginning as informal unions, and of which half dissolve and half turn into marriage. While more educated women were pioneers as cohabiting partners, by the 1970's cohabiting was equally common across groups of different educational attainment. After a stable rate of child birth outside marriage for some 130 years, there has been since the 1970's an "explosion of non-marital childbearing" - from 9% to 44% in England and Wales and up to 48% in Scotland by 2006.

Given the high dissolution rate of cohabiting unions and the increasing rates of divorce, births tend increasingly to be within unstable unions. And over one third of births outside marriage are to parents not living together. Both

have implications for investment in children's human capital and the composition of households.

Population projection to the 2030's, based on fluctuating patterns in the past and recent trends of rising fertility since 2001, suggests family size of 1.85 per woman in England and Wales and 1.65 in Scotland. With immigration, this is projected to increase the working population by 3 million from 2006 to 2031 from which, with matching figures for people aged over 65, John Ermisch calculates an "aged support ratio". In UK this is anticipated to fall from 3.7 workers per pensioner in 2006 to 2.5 in 2031. Similar or greater declines are predicted throughout Europe. For Japan the ratio is expected to fall below 2.

Leading then to the central question of how to support an ageing population, Professor Ermisch examined the range of transfer models: within the family; by private claims on the production of others (such as funded pensions); and government transfers (unfunded pensions).

While providing some evidence that we had no clear tradition of people assuming responsibility for their elderly parents, he did examine Hume's convention of a social contract whereby middle aged family members pay for the young and gain repayment when the young become middle aged and they themselves are old. However the incentive to provide financially for older family members appears to be diminished, perhaps by the Poor Laws or the Welfare State, and in 2008 only 5% of British parents received financial help from their children.

To explore how the market and the state adjust to the new demographics John Ermisch considered patterns of private savings. He showed that not all possible scenarios were problematic. In an economy with slower population growth and lower aged support ratio, far sighted people would save more and therefore supply more capital per worker which would represent opportunity, not problems. A 1/3 drop in the aged support ratio would be offset by real wage growth of 1/3 over 25 years, maintaining real pension benefits.

Given that prospective pensioners actually anticipate a widening differential with weekly earnings they might be assumed to save more to compensate. But they don't. Figures show one in two of people aged 55-59 with less than £17,000, and one in five with no net wealth.

Uncertainty about the value of their wealth or of their private pensions at the time of retirement is especially prevalent now. With four fifths of private pensions schemes already in deficit and to be further challenged by the ageing population, reliance on state pension is bound to increase.

Seeking to maintain state pensions in line with earnings might entail an increase in National Insurance from 19% to 25% as well as immediate and permanent increase in income tax of 2p. But because of uncertainty we cannot be sure that such high contributions can be sustained or that they

are equitable across generations. Generational accounts which seek to address these issues and to inform self-correcting policies, have pensions liabilities as a huge element within those accounts.

John Ermisch described a simulation model considering the effects of increasing tax to cover pensions and healthcare in different countries. This stimulated considerable comment and question in later discussion as it highlighted the variation in our prospects depending on different ranges of international interdependence. When EU, USA and Japan were included the effect was to depress capital accumulation so real wages stagnate. However when China - with a high saving ratio - was also included, there was continued capital deepening and real wage growth such that all the regions would continue to grow.

In his final section Professor Ermisch returned to the theme of investing in children and the significance of parents splitting up. Transfers from a divorced father to support children become less efficient than when living as a family, and this encourages him to spend less. Spending less money and parental time on children whose families have broken up makes for lower achievements. John Ermisch therefore argued that the children born in recent years are suffering a range of effects diminishing their future earnings, and their inclination to support their parents. But they are the ones who will need to support the growing retired population.

The wide ranging discussion following this thorough analysis also drew on the complementary paper provided by Professor Robert Wright focusing on the Scottish profiles of ageing (also on DHI website). Robert Wright highlighted the competition for jobs between old and young that was likely to arise, and the essentially political nature of the challenge.

Among the points considered were the following:

- In considering the balance to be struck between the standard of living sought and the level of intergenerational equity, the democratic impact of an increasing older share of the voting population would have influence.
- On pensions, it was suggested that current issues of perceived inequity between public and private provision should be tackled in preference to an intergenerational shift.
- A policy of increasing retirement age was thought likely to make only a limited contribution. Although incentives to work longer might be effective, especially since people are tending to become incapable of work as little as three years before death, there was a need to be consistent with the expectations that workers had been given earlier.
- Investment in people to increase earning potential would be a key element in offsetting consequences of family formation trends highlighted in the presentation

- On migration, and with likely declining immigration, it was noted that family is not the draw for returners, rather it is economic prospects. So we should not look to returning children to support ageing parents. There might be increase in emigration of older people, although the fall in housing equity was likely to slow recent trends, and in any case many living abroad still drew state pension.

Summing up Jeremy Peat noted the value of this demographic analysis to set the foundations for consideration of many aspects of policy on ageing. The macro challenge was to determine and deliver an acceptable standard of living for the elderly. It would inevitably provide a brake on economic growth but, as John Kay had highlighted in an earlier seminar, what we need to look for was "better, not more" growth. At the micro level there were major impacts to consider further, particularly in relation to health, housing, availability of labour and demand for goods and services.

Discussion over dinner focused on how best to progress thinking on the issues arising. Although consideration was not yet very evident, the ageing agenda was of direct relevance to the Scottish Parliament in relation to health, education and social care. And across much policy development the role of older people as carers, spenders, even as sources of wisdom, required greater attention.

Some saw a disconnect between the tax payer and government. A desire for real evidence of wise spending by Government ("they can bail out banks but not spend on schools") was balanced by recognition of taxpayers' limited willingness to spend more for the longer term.

Among the action points for us to take forward are: more discussion on specific aspects of policy challenges from ageing; and direct engagement with politicians and policy makers.

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