

60 Is the New 55: How the G6 Can Mitigate the Burden of Aging

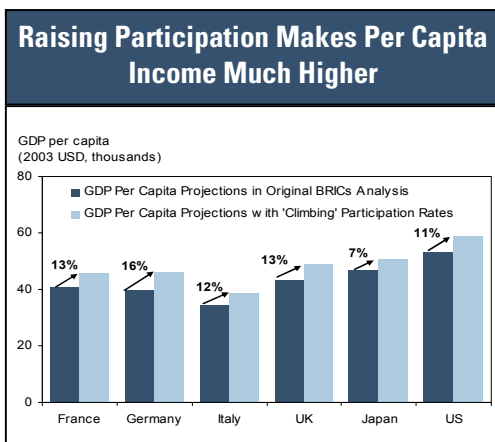
Population aging is a well-known story, and, on the surface, a rather depressing one. But we think much of the gloom about the impact of demographics on economic growth may be undone. Higher workforce participation by older workers could have a significant impact on trend GDP growth and income per capita across the G6 over the next two decades.

As is well known, G6 populations are aging rapidly. The working-age share of the population is either already declining (in Japan, Germany and Italy) or will peak by 2010 (in the US, the UK and France). A falling working-age share is likely to constrain real GDP growth and growth in income per capita across the G6 in coming decades.

Most demographic analysis presents this gloomy outlook for the G6 as a fixed picture of inevitable decline. But a fairly straightforward solution to the challenge of aging is to ‘make 60 the new 55,’ by boosting participation rates among older workers and extending the working lifespan to age 70. Although this would certainly entail some political and social pain, the payoff would be significantly higher trend growth and higher income per capita over the next 20 years.

This analysis yields the best results in the EU-4 (France, Germany, Italy and the UK combined). EU-4 trend growth could be 0.6ppt higher (at 2.2%) than otherwise over the next 20 years. In the US, trend growth could increase to 2.8% from 2.3%; in Japan, to 1.5% from 1.2%. As a result, by 2025, living standards would rise significantly, with income per capita 12% or more higher than otherwise in Europe, 11% higher in the US and 7% higher in Japan.

‘Making 60 the new 55’ is, to some extent, likely to occur naturally, as individuals recognize and respond to the economic case for working longer. Indeed, this shift may already be underway in the US and the UK. Governments can help by adjusting their pension and tax systems, and by changing expectations about retirement. If the trend of working longer does take hold across the G6, then much of the consensus gloom about demographics could turn out to be overblown.



Source: GS calculations

The Sorry State of Demographics in (Most of) the G6

Over the past half-century, the G6 has seen a significant jump in life expectancies and an even more dramatic decline in fertility rates. As a result, the working-age share of the population (traditionally defined as those aged 15-64) has already peaked in Japan, Germany and Italy, and it will peak in the US, the UK and France by 2010. In absolute terms, the working-age population is forecast to shrink more than

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twice as fast as the overall population in the next 20 years in Japan, Germany and Italy; in France, it is projected to decline despite overall population growth. Even in the US and the UK, which have the best demographics among the G6, overall population growth will significantly outpace growth in the working-age share over the next 20 years.

Thus, in less than 30 years, Japan and much of Western Europe will have just two ‘workers’ (who may or may not be working) for each person 65 or older. Even in the US, the ratio will be three to one—an enormous jump on today’s ratio of five to one. For the G6, the ‘demographic window’, in which demographics provide the most support for economic growth, is closing.

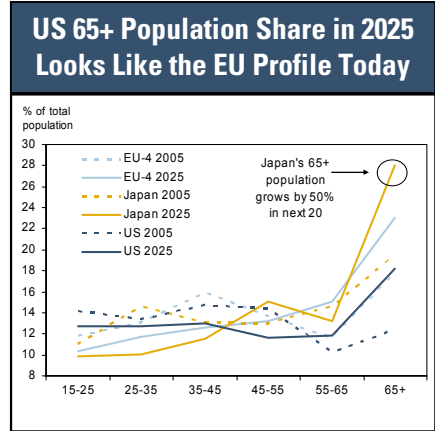
A Bleak Picture—But Not a Fixed One

These projections highlight the need for an effective policy response. It is hard to imagine that G6 governments will not respond in some way as these demographic forces take their toll on economic growth; harder still to imagine

that individuals will not recognize the strains that demographics will place on public pensions and living standards.

There are three ways to improve a country’s demographic profile: higher fertility, higher immigration or higher labor-force participation rates. Fertility is a long-term solution at best. Moreover, because current demographic projections already include a significant boost to fertility in most of the G6, still-higher fertility does not appear to be a likely solution. Additional migration would undoubtedly be helpful, but the scale of the inflows that would be needed to offset aging is politically implausible in most of the G6.

This leaves the third option, of higher participation by older workers and longer working lives. There is ample scope for improvement on both counts. Although life expectancies have increased dramatically over the last half century, retirement ages have not risen in tandem. In fact they have generally fallen, so that retirement now typically lasts 20 years rather than the 13 that was the norm in the early 1950s. This makes little sense from a national perspective and will increasingly make less sense from an individual perspective.



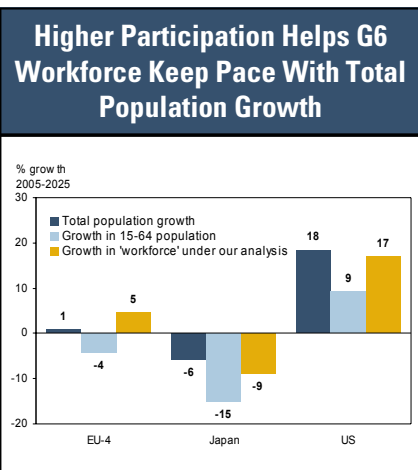
Source: US Census Bureau International Projections

This allows us to capture both the impact of demographic trends and the variations in employment rates across countries and age groups. Thus our results turn on two factors: the change in participation rates, and the change in the number of people in each age bracket.

Our baseline case holds today’s participation rates constant to evaluate the impact of broader population aging on the workforce. At current participation rates, the EU-4 workforce is projected to fall by 7% by 2025, and the Japanese workforce by 15%. The US workforce is projected to rise by 10%. Each country will see the share of the working-age population in the total continue to fall.

As an alternative, we assume that ‘60 is the new 55’ across the G6. In this ‘climbing participation’ scenario, participation rates for workers 55 and older rise gradually over the next two decades, so that by 2025 each five-year cohort is working at rates currently seen in the immediately preceding cohort. Thus, in 2025, people aged 55-59 work at rates currently seen among 50-54-year-olds. People aged 60-64 work at the rate of 55-59s today. People aged

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Source: US Census, GS Calculations

60 Is the New 55

If older people are healthier, live longer and consider themselves to ‘be’ younger, why should they not work like younger people do?

We construct two alternative scenarios for the G6 workforce over the next two decades. Each looks at the 15-70 age bracket—a working lifetime that seems more sensible than the traditional 15-64. We define ‘workforce’ as the number of people actually working, calculating it by multiplying specific population shares by the employment participation rates for those age groups.

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65-69 work at the rates of 60-64s today. We have stopped this exercise at age 70—though advances in life expectancy may well mean that people in their 70s are fit to work more by 2025. Because this shift is phased in over a full 20 years, it would not entail a dramatic shock to current expectations.

Europe: Biggest gain, hardest challenge? The EU-4 fares the best under our ‘climbing’ scenario, largely because its older population currently works the least. Although participation rates peak at slightly higher levels in the EU-4 than in the US or Japan, they fall off more sharply thereafter. Across the EU-4, participation rates for workers above 55 have averaged only 30% in recent years, against 54% for Japan and 48% for the US.

In the EU-4 as a whole, the workforce swings from a baseline fall of 7% to an increase of 5%. Germany gets the biggest boost: its workforce grows by 1% rather than declining by 11%.

France and the UK also fare well, with the workforce growing by nearly twice as much as the overall population. In Italy, the workforce will shrink by 1% even with higher participation, but this outpaces the 3% decline in the overall population.

Japan: Aging is inescapable. Even our best efforts still produce a fairly gloomy picture in Japan. Japan has the highest participation rates among older workers, and its older workers are already ‘old’, clustered in the 65+ segment. This means that our climbing scenario can make only a small dent in the country’s rapid aging trend, slowing the decline in the workforce from 15% to 9%. The workforce will still shrink more rapidly than the overall population, which is forecast to decline by 6%.

US: Picture is brighter, but aging is still a burden. The US doesn’t ‘need’ higher participation as acutely as Europe and Japan do. Higher rates of fertility and net

migration, as well as a younger population, mean that aging takes a smaller toll on the US workforce. But even our baseline 10% growth will not be enough to keep pace with the total population, which is forecast to grow by a much more robust 18%. Our ‘climbing’ scenario would instead allow the workforce to grow by 17%.

The Payoff: Higher Growth and Per Capita Income

To identify how much economic growth our ‘climbing’ scenario can generate, we return to the long-term growth model used in our earlier work on the BRICs (Brazil, Russia, India and China). In our original work, differing demographics (specifically, the growth in employment) were entirely responsible for the divergence in trend real GDP growth paths over the next two decades of 2.3% in the US, 1.5% in the EU-4 combined, and 1.2% in Japan.

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Re-running this model with the workforce growth rates from our ‘climbing scenario’, we find that:

- Trend growth over the next two decades is higher than in our original projections by 0.6ppt in Europe, 0.5ppt in the US and 0.3ppt in Japan. Trend growth is thus 2.2% (due to rounding) in the EU-4, 2.8% in the US and 1.5% in Japan.
- Within Europe, trend growth is nearly 0.75ppt higher in Germany over the next 20 years; 0.6ppt higher in both France and the UK; and more than 0.5ppt point higher in Italy.
- Higher trend growth makes G6 citizens richer. Again, the impact is felt most dramatically in Europe. Per capita income is 16% higher than under our original projections in Germany, 13% higher in the UK and France, and 12% higher in Italy. This pushes Germany slightly ahead of France. In the US, per capita income is 11% higher, and in Japan 7%.

How to Make 60 the New 55

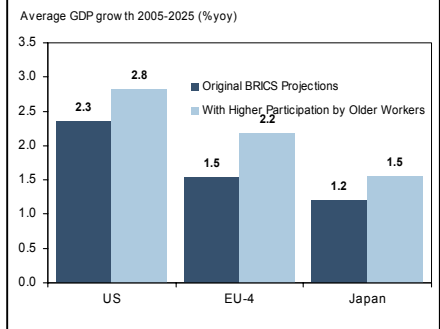
‘Making 60 the new 55’ is, to some extent, likely to happen naturally. Retirement may be enjoyable, but it can also be expensive. As asset returns fall and pension promises come under pressure, people may decide that they cannot afford to retire as early as they do now. Better physical health, desk jobs and a reluctance to become ‘old’ may also lead people to continue working well into their 60s.

In fact, participation rates among older workers have begun rising in recent years. This trend is most notable in the US and the UK, but it seems to be gaining hold in the rest of Europe as well.

G6 governments can do much to facilitate this shift by improving the financial incentives for people to work longer. This would be especially helpful in Europe, where it is difficult to imagine greater participation rates under current incentive systems. Although the EU set ambitious employment targets as part of its Lisbon Strategy in 2000, progress thus far has been limited.

Throughout the G6, the obvious step would be to raise the age of eligibility for public pensions, bringing it more in line with life expectancies. Some developed countries have raised their state-pension eligibility ages in recent years, but formal retirement rates still fall well short of where they ‘should’ be. Raising the age at which (reduced) benefits are first available would also help, as would true actuarial fairness in state pensions, and tax and benefit reforms to ensure that people are not penalized for continuing to work while receiving pensions.

G6 Trend GDP Growth Gets a Significant Boost From Higher Participation in Older Groups

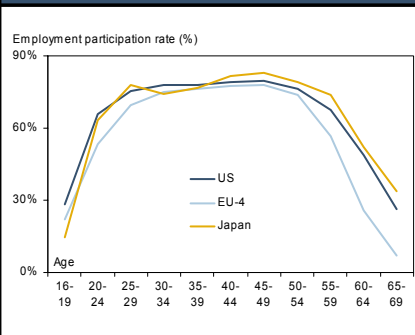


Source: GS calculations

Aging Is Inescapable, So Flexibility Is Key

Changing expectations about retirement will not be easy. Structural reform is always difficult, and voters’ appetite for painful change is limited. But the potential gains of higher living standards in the future should make trying worthwhile, and growing concern about the reliability of public pensions should help to make the case. The recent upward trend in older workers’ participation in the US and the UK is encouraging. Flexibility—in working lifetimes, pension systems and in expectations—will be essential if G6 countries are to meet the challenges of their own demographics.

Participation Rates Drop Sharply After Age 55



Source: National Sources