

Facing the demographic changes

A European overview

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Introduction

In the coming decades Denmark, like the rest of Europe, will be faced with the consequences of the constantly changing composition of age structure in the population – driven by low birth-rates and increasing life expectancy – as well as of a diversification in lifestyles and hence in the definition of the concept of family.

These rather profound changes in the composition of the population will have powerful impacts on the future of all European societies and economies, and will require reflection as to how trade unions can contribute to ensuring that welfare states remain financially sustainable in the future and provide adequate as well as appropriate benefits and services. Furthermore – though this is an aspect not examined in detail in this background document – trade unions will also have a major role to play in managing the challenge represented by the shrinking working-age population that will face Europe as from 2010. In other words, the demographic changes will put something of a strain on the financing of the welfare states as we know them today and will require a reassessment of the role of social protection in providing benefits and services.

The magnitude and impact of the changing demographics vary greatly across the European Union, depending on a host of different factors such as birth rates, longevity, size of baby boom, the method of financing, as well as levels of expenditure, social security and employment, and economic and productivity growth. Although choices made today will not have a major impact on population *composition* until more than a generation has passed, they *will* have a direct impact on the *wellbeing* of the population in the short, medium and long run. In a European, or even global, context Denmark appears to be well equipped to face the demographic challenges, in the sense that the birth rate is fairly high, employment levels are also high and social security expenditure is under control and geared up to face the demographic challenges. However, as is always the case, adjustments are bound to be required and to take place in future, as society evolves and moves ahead.

This report – which is a part of the joint LO and FTF project carried out by the ETUI-REHS on the “Lisbon Strategy and employment policies under revision: prospects and proposals” – sets out and discusses the main challenges for the European Union member states stemming from the demographic changes. For the trade unions the challenge in this respect is to ensure that the requisite adjustments and improvements are carried out in an integrated manner, taking a life-course approach to employment as well as social protection and thereby allowing for a more fluid interchange between education, work, family responsibilities and retirement, while guaranteeing that social cohesion is maintained and improved. Two very important issues in this whole configuration, namely migration and youth, are mentioned only in passing in this report.

The report is structured as follows. Section 1 gives a brief overview of the main changes in the demographic landscape. The challenges in terms of social cohesion are discussed in Section 2. The challenges and opportunities with regard to welfare state and labour market reforms are described in Section 3, while conclusions can be found in Section 4.

1. The changing face of demographics

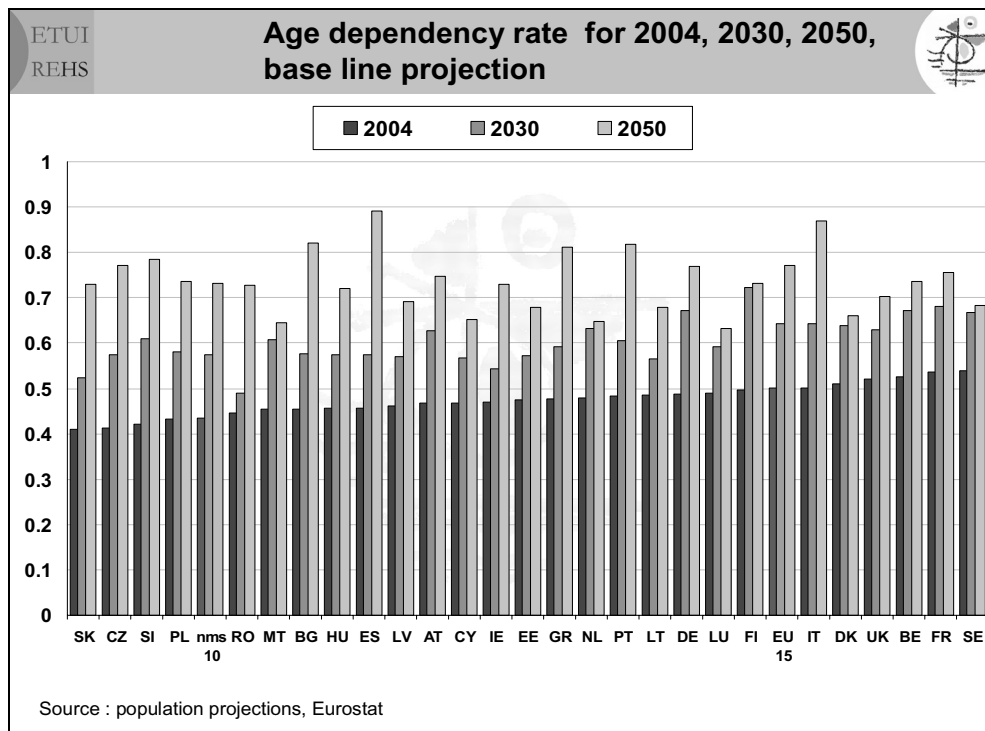
The demographic landscape in the EU, as in the rest of the world, is undergoing radical change. The changes in demography that came in the wake of socio-economic progress in income and literacy are being followed by a second demographic transition that is an outcome of further economic growth and of intellectual emancipation through education and the spread of ideas. The satisfaction of material needs and anxieties through prosperity, and – in Europe at least – the personal security offered by welfare states, have enabled the population to free themselves from subservience to traditional modes of behaviour. Under these circumstances the single state, cohabitation, lone parenthood, and the avoidance of parenthood, have all become more socially acceptable options. However, while the diversification in lifestyles can be explained by the fact that the population is able to make differentiated choices, this does not explain the drop in fertility rates, as the lowest rates in Europe are observed in precisely those countries where traditionalism in relation to sexual relationships and living arrangements can be seen to persist. Furthermore, the progress in health care and overall living standards has contributed to a continuous rise in life-expectancy, albeit with wide variations. As a result of lower fertility rates combined with increased survival rates, most countries in the world and especially the European Union are today experiencing older population structures and will, at a certain point in time, experience population decline. In Germany, Italy and Greece this trend has already started – though it is offset by immigration – and in the next 30 years the other EU countries will follow.

While the Old EU Member States (OMS) and the New EU Member States (NMS) face similar changes in their demographic structures, there are certain important differences. The NMS, unlike the OMS, did not experience a baby-boom during the 1960s and therefore do not have this particular cyclical effect to deal with. Furthermore, it is only recently (1980s) that fertility rates have declined in these countries, while death rates remain fairly high. Accordingly, while the natural decline in population has already started, it is currently less of a problem. Life expectancy has decreased during the past 15 years in the NMS, as a result of the enormous transition undergone by these countries. Currently, though the decrease has stabilised and even been reversed, this improvement is certainly not benefiting the population evenly. For the lower socio-economic groups life expectancy is actually continuing to decrease, while for the better-off it is increasing. In the OMS, though life expectancy also differs between these two population groups, the trends are not divergent.

Demographic projections are based on a host of assumptions. As these have often proved wrong in the past, one should be careful not to paint the devil on the wall and give way to panic solutions. One thing is pretty certain, namely, that there will be an increase in older people, for these people have already been born. However, the remaining trends concerning productivity, employment rates, fertility, etc. can and probably will vary from the various projections, though projections 20-30 years into the future can be taken more or less at face value and the age dependency rate will certainly increase¹.

¹ Age dependency rate = the ratio between the economically dependent and the economically active population = $(\text{pop (0-14)} + \text{pop (65-)}) / \text{pop (15-64)}$

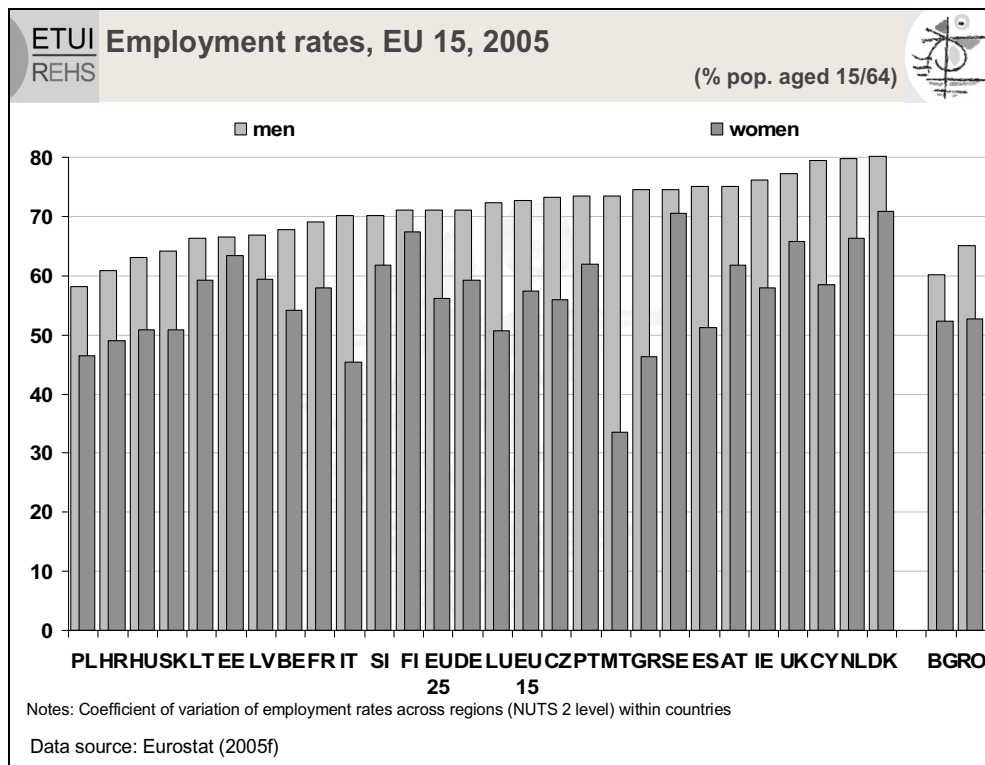
Figure 1



Notwithstanding the differences between regions and problems, it remains true that throughout the EU relatively fewer babies are being born, the population is growing older, and choices with regard to lifestyles are diversifying. The question is whether or not this situation constitutes a crisis. The latter two developments, which are positive results of prosperity, are posing challenges to the welfare states as we know them today, but for different reasons. The ageing poses problems in the sense that it is expected that relatively fewer people will have to support more people; diversified lifestyles, meanwhile, are such that welfare states need to adapt in order to provide the right support to a host of different types of family unit, and not only to the standard two-adult-two-child nuclear family. Hence welfare provision can be expected to require adaptation and reorientation, but this does not necessarily imply downsizing. The magnitude of the problem differs across the European Union and the hardest-hit countries will be those, like Italy and Spain, with very low fertility rates and high life-expectancy. Denmark will be relatively little influenced by the demographic challenges to the extent that the fertility rate has not dropped dramatically and is actually increasing, while life expectancy in Denmark is lower than in many other countries so that, in a European setting, the growth in the dependency ratio is relatively low and, in particular, the evolution from 2030 to 2050 is likely to be minor.

However, the impact of the dependency ratio on society depends not only on the ratio of the working age to non-working-age population but also, and possibly more importantly, on the employment rate among those of working age. Insofar as Denmark has a relatively high employment rate for both men and women in all age groups, what was a minor problem in the first place becomes even less significant. Denmark has the highest employment rate for men and with regard to the female employment rate is surpassed only by Sweden. However, this does not mean that there are no areas requiring improvement, one such being the full integration of immigrants into the labour market.

Figure 2



Accordingly, it is important to clarify to what extent demography is being used as a pretext for cost-cutting when discussing welfare state reforms, rather than adapting the welfare state to the new situation and needs.

2. Facing the changes in terms of social cohesion

Against this backdrop it is important to realise that the point of departure for facing these changes in demography is not the same across the European Union. The social protection systems play a key role in assuring social cohesion by providing income replacement during labour market transitions as well as providing for the alleviation of poverty, supply of health care, etc. Though the importance and scope of these income replacement schemes – in terms of service provision as well as financing – vary greatly across the European Union, the relatively high level of social protection in most EU member states is one of the main factors distinguishing the EU from the rest of the developed and developing world. A factor common to all the member states is that the social protection system is intricately interlinked with the whole employment system, and changes affecting either one of these systems will have repercussions on the other. Hence the increasing economic dependency rates, as well as the changing demographic landscape in a broader sense, are bound to have major implications for the welfare states in terms of both provision of benefits and services *and* financial sustainability.

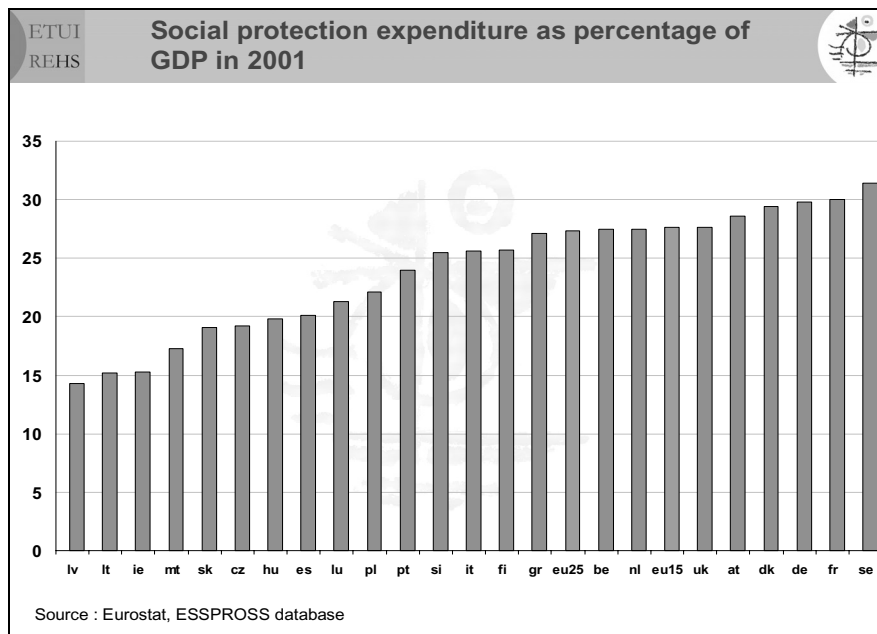
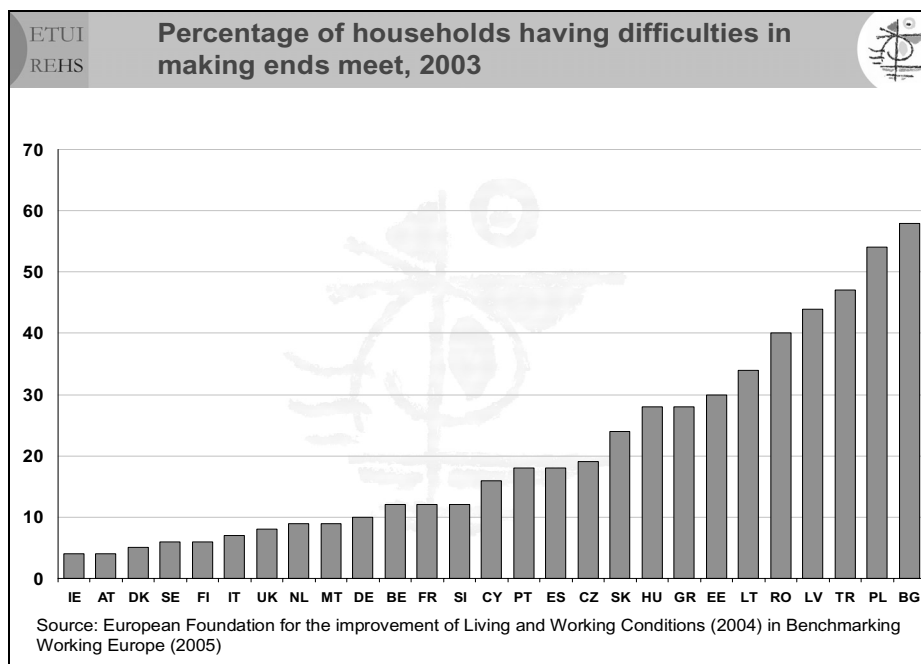
Figure 3

Figure 3 shows the difference in social security spending as a percentage of GDP. The variation across Europe is tremendous, with some countries spending twice as much as certain others and the NMS a far lower percentage than the OMS. As such, the problems to be addressed also vary considerably, from being a question of general sustainability to one of finding ways to provide more appropriate benefits and services to the population.

Figure 4

This difference in spending on social protection is reflected in household hardship levels. While in financial terms there is not a big difference in relative poverty levels

between the NMS and the OMS, there are huge differences if one looks at the percentage of households that have difficulty in making ends meet. Hence the NMS face the enormous challenge of simultaneously building up a welfare state that can ensure more social cohesion, and coping with the change in demography.

3. Facing the changes in terms of reforming the welfare state and creating a more inclusive labour market.

The main challenges for the welfare state may be presumed to lie in the financing and cost containment of adequate pension and health care systems, as well as reforming the entire social security system so as to provide support for all groups and family types in society.

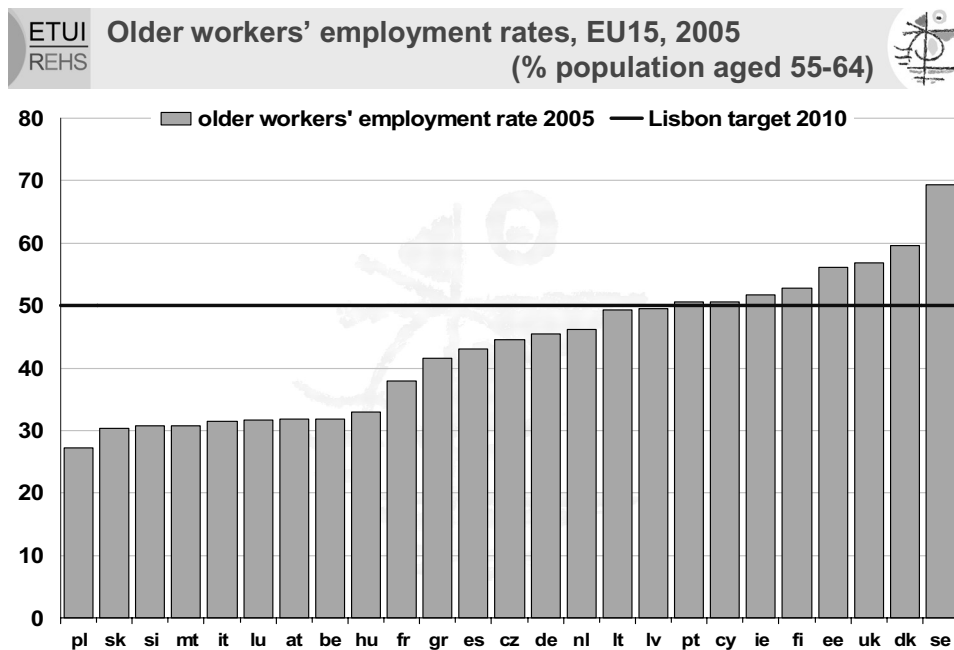
The ageing of the population has implications for the pension system via three channels:

- people tend to work fewer years (late entry and early exit) and hence to contribute less;
- they live longer;
- relatively more people will be dependent on pensions than is the case today.

In anticipation of the impact of the ageing population, most European Union countries have reformed their pension systems over the past ten years. In some countries, however, major reforms are still to come. By now it is commonly acknowledged that switching from pay-as-you-go financing to funded pensions will not solve the problem of sustainable pensions and that other solutions – or rather combinations of solution – must be found, along the lines of a state-guaranteed pension (1st pillar), topped up by an occupational pension system (2nd pillar) and private savings (3rd pillar). This is the type of model – known as the cappuccino model – found in the Scandinavian countries, Great Britain and the Netherlands. In general there is a trend towards more developed 2nd pillar pensions, and in some cases a downsizing of 1st pillar pensions. The major pension reforms in the EU during the past 10 years, though varying widely from country to country, have in common the fact that pension benefits are becoming more closely tied to individuals' employment and wage records. Furthermore, in more general terms, the social protection system is also undergoing reforms to convert universal-type benefits into targeted and means-tested measures. Another trend of reforms related to the sustainability of pension systems is that of retaining older workers on the labour market and moving towards more gradual retirement solutions, thereby ensuring that workers both contribute to the pension system for a longer period and draw on the social protection system for a shorter period.

The employment rate for older workers (aged between 55 and 64 years of age) varies greatly across the European Union, from below 30 percent in Poland to nearly 70 percent in Sweden. In Denmark the employment rate of this category is 60 percent, well above the Lisbon target of 50 percent.

Figure 5



Data source: Eurostat (2005)

Workers leave the labour market before the statutory retirement age for a host of different reasons. A part of the variation in the employment rates can be ascribed to the incentives stemming from the various forms of pre-retirement and early retirement systems across Europe. However, according to Duval (2003), these incentives can account for only about a third of the trend in the labour market participation of older male workers. Hence closing the early-exit paths might increase labour market participation somewhat but it will not solve the main problems underlying the early withdrawal of the workers from the labour market, and might lead to “unemployed ageing” rather than “active ageing”.

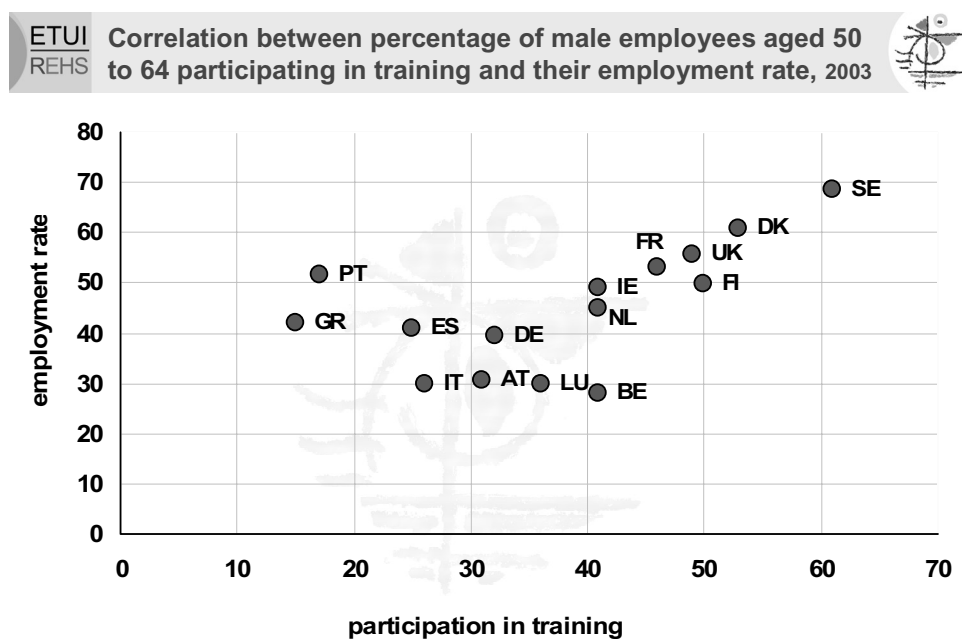
In countries where early-exit paths have been restricted or closed, the employment rate has increased, but so also has the unemployment rate. Early withdrawal from the labour market is far from being a free and unconstrained “choice”. It is well known that older workers encounter discrimination on the labour market, so that if one is over 50 or even 40 years of age, the probability of finding a job after leaving or losing one is unlikely, if not impossible, a reality to which the long-term unemployment rates of older workers pay ample testimony. Furthermore, many workers leave the labour market due to ill health and difficulties in maintaining the pace demanded by the job, the most well-known examples here being nurses and construction workers. As such, far from being solely a matter of personal preference, early retirement is frequently the only available option under the circumstances. It is obvious that, for older workers, remaining on the labour market may be perceived as positive to the extent that the job in which they remain or to which they move provides them with positive rewards and is fulfilling. On

the other hand, remaining on the labour market simply because there is no other option may be perceived as negative. The danger in pursuing a one-sided policy of closing and downsizing early-exit routes is the risk of adverse selection, whereby workers unable to retire for economic reasons are forcibly retained on the labour market. These, inevitably, tend to be low-skilled workers, while those that have the individual economic possibility to retire earlier than the statutory age do so and these are generally highly skilled workers. A more productive approach would be to provide the right conditions and incentives for workers to remain on the labour market, rather than simply closing exit paths.

Investing in human capital and workplaces is a strategy worthy of consideration in this context. In countries where there is a constant investment in the workforce, and an organisation of the workplace/life that allows for a certain degree of autonomy, people work longer. Denmark, Finland and Sweden have applied this strategy and its effects are visible in the employment rates for older workers.

There is evidence that a more comprehensive approach with the right policy mix can produce the right results, Finland being the paradigm case here. Training throughout working life would seem to be one factor, as can be seen from Figure 6.

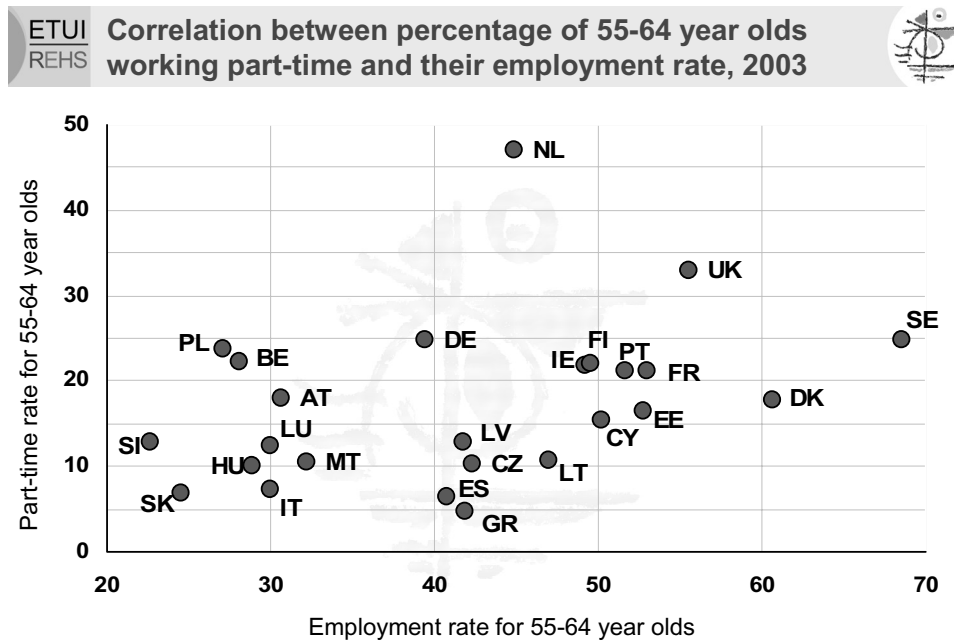
Figure 6



Source: Eurostat (2004e)

The possibility of part-time work and work autonomy is a further aspect of the measures that seem to favour a high employment rate among the 55 to 64 year-olds.

Figure 7



Source: Eurostat (2004e)

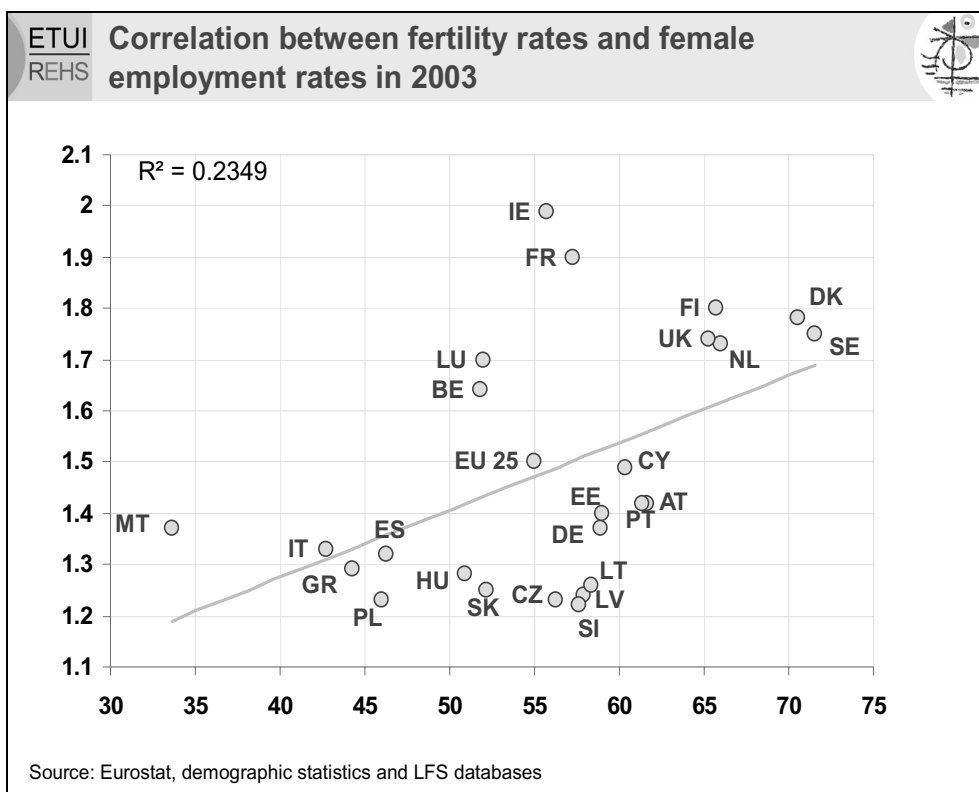
Hence, despite the fact Denmark already has one of the highest employment rates for older workers, this could be improved by further investment in human capital and by offering older workers different types of working time reduction that would enable and encourage them to remain longer in employment.

Even more important is the attitude of companies and company-level human resource management. Though European firms are slowly realising that older workers are indeed valuable workers, it would appear that they still predominantly hire or hold on to older workers only insofar as they have no choice. Only a few companies have taken up the challenge and fully integrated the idea of having a satisfied older workforce in the workplace. Changing policies at national or regional level will have little effect if there is no change in attitude towards, and human resource management of, older workers at company level.

Another aspect with regard to which the social protection system has a proactive role to play is the demographic landscape, not by interference in the individual choice of whether to have babies or not but rather by the provision of assistance for men and women in the task of successfully combining their private and professional lives. The main thrust of this argument pertains to the fact that not only are fertility rates at a worrisome low in the new member states, southern Europe, and some of the continental European countries, e.g. Germany, but the female participation rate is *also* very low in most of the same countries. This is to a large extent due to the fact that, although across Europe over the past 30 years married women, in particular, have increased their labour supply, the measures needed to enable families to combine work and family responsibilities have been developed to an uneven extent in the different countries. Currently gainful employment has become the norm for women, and the choice to have

children or not has become dependent on the quality of the job (in terms of employment security and income) and on whether there are possibilities to combine work and children, as well as caring for parents. In other words, the choice for women today, as can be seen from Figure 8, is whether to have jobs and careers with children or without children. The Nordic countries are a perfect illustration of this, having relatively high employment rates and fertility rates, and hence showing the right way forward. In the Nordic countries, the public provision of childcare and elderly care not only creates job opportunities for women but also enables them to enter and remain on the labour market. For decades Sweden and Denmark have had the highest rates of pre-school childcare provision. In addition, both countries have maternity and parental leave schemes that are relatively generous and flexible, allowing for a break from – while at the same time ensuring maintenance of a strong link with – the labour market when children are born. These strong and comprehensive policies have given rise to a situation where the employment rates of women are the highest in Europe and fertility rates are also among the highest.

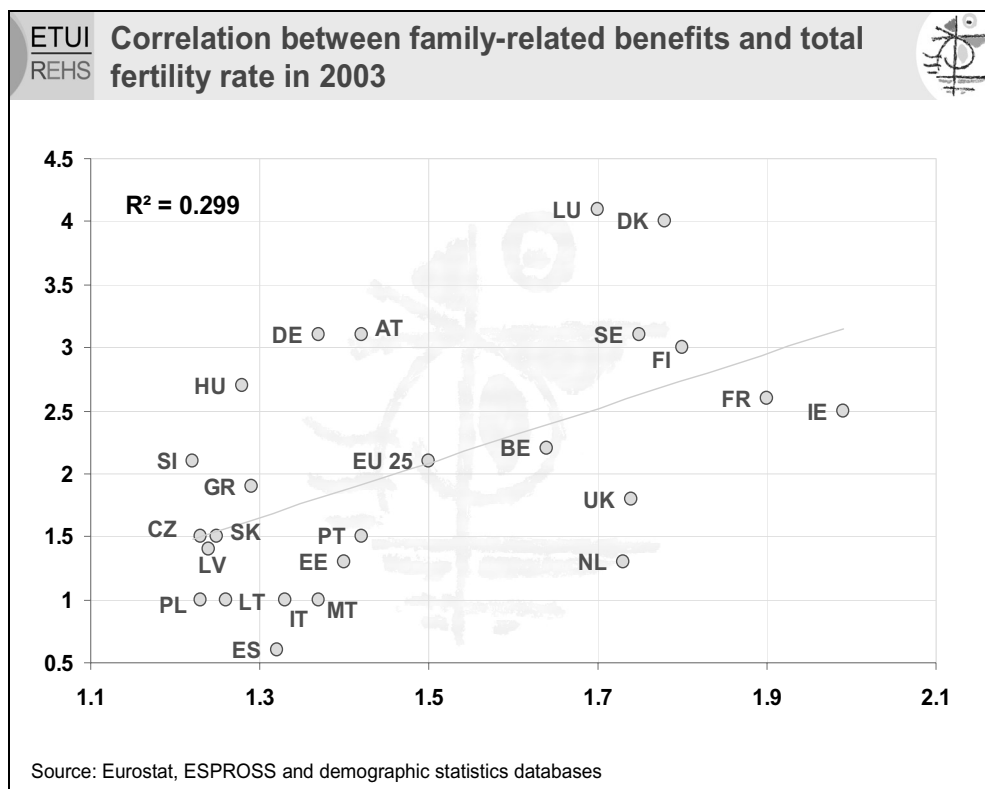
Figure 8



Accordingly, a key factor in facing demographic change is to provide women (and especially young women) with a perspective on the ability to combine family and work, and the possibility to share this responsibility with their male partners and society, by gearing welfare systems towards the changing realities of families and the labour market in combination with an emphasis on high-quality employment for women in terms of contractual relationships and wages. Women have an interest in promoting change, in order that reality should take better account of their specific situation, but also so as to encourage men to take advantage of opportunities to play a full part in family

responsibilities. The social security system must play a key role in providing universal, affordable childcare and must also ensure the provision of affordable, high-quality elderly care. Parental-leave provisions should also be strengthened and shared between the parents. Furthermore, social protection systems based on the male-breadwinner model should undergo reform so as to take full account of the role played by women in the economy. Family-derived rights in social protection and taxation systems should thus be abolished and compensatory measures for unpaid care work introduced. The Scandinavian countries have implemented these principles and have high female employment rates and relatively high fertility rates, while the southern European countries, and also Germany, which have maintained the principle that families (read women) are the main providers of care, today experience low fertility rates and low female employment rates. These measures should be viewed as an investment rather than a cost to society, as they will allow women to become fully-fledged members of the labour market, entailing also the payment of taxes on their wages. Gösta Esping-Andersen has made this computation for Denmark and found that the State receives more tax revenue when, by ensuring childcare availability, it allows women with very young children to participate in the labour market. As Figures 8 and 9 show, investing in the right social policies can trigger the sought-after results, namely high female employment rates and a fertility rate close to the population replacement rate.

Figure 9



4. Conclusions

Facing up to the demographic challenge may be an opportunity to review and adapt welfare states as we know them today, but it should by no means be used purely as an excuse for an exercise in cost-cutting. Social expenditure should be perceived as an investment in the current and future workforce, and as an instrument to redistribute the risks that occur within a society.

The countries of the European Union have, for the past 30 years, aimed to eradicate poverty among the older population and have achieved this to a large extent via comprehensive pension systems. One of the main aims in the future must accordingly be to preserve this achievement while making sure that the pension systems are sustainable. The latest projections on increases in pension spending predict a rise by 2050 in all EU15 member states except Austria, as a result of the recent reforms. In Sweden and Italy the increases will be only minor and in most other countries will be between 1.5% and 3.3%. Only four countries are forecast to experience significantly larger percentage increases, namely Ireland (6.4%), Spain (7.1%), Luxembourg (7.4%) and Portugal (9.7%) (Commission of the European Communities 2006). Bearing in mind the fact that these figures are based on a host of assumptions that are very likely to change over time (see *infra*), it may also be asked whether a percentage-point rise of around 3% can accurately be described as a crisis, or whether it is not rather a matter of political choice to perceive this as a political problem. In the Danish case, the increase is predicted to be 3.3%, a figure which makes the sustainability of the pension system appear in quite a favourable light and its financing seem quite bearable. The case with regard to ensuring adequate labour supply seems, however, to be a larger issue that needs to be handled in an appropriate manner.

Older workers who leave the labour market before the statutory retirement age do so for various reasons: financial incentives (private or policy-driven), discrimination, lack of opportunities, disability. Equally, those who remain on the labour market do so for a host of different reasons: financial need, no way out, positive incentives, whether financial or social, to remain on the labour market. Accordingly, there are many different ways of encouraging older workers to remain on the labour market. The simplistic and therefore often proposed solution is simply to do away with “early exit” from the labour market, by scrapping the early retirement provisions. However, this policy solution may not have the desired effect, firstly because in a number of countries and amongst a number of individuals, private savings are sufficient to bridge the period to old-age retirement, and secondly because it might prevent a number of individuals who are no longer suited for labour market participation from leaving in a decent manner, thereby creating distress rather than anything else.

Families should be enabled to combine professional and private life in an acceptable and fulfilling manner. Key to this is the need to provide affordable and high-quality child and elderly care, combining this with generous and flexible maternity and parental leave. Such policies can ensure that families are able to have the number of children they desire and at the same time be available on the labour market on a continuous basis. However, policy measures alone are not enough; corporate attitudes and human resource management also play a key role in enabling women and men to be in a position to start a family and retain full labour market participation.

As to the question of how to achieve sustainable social protection systems, especially pension systems, there is a general consensus today that shifting the financing from public to private systems is not going to solve the issue. What is generally advocated is enlargement of the base for financing the social protection system, key to this being the need for quality employment and economic growth that will increase the overall employment rate. Such enlargement should not, however, rely exclusively on contributions from the workforce but should include direct taxation of other production factors, and of profits, while also incorporating sources of indirect taxation. With regard to the adjustments and improvements of the welfare state, there is a need to move towards a system that allows for a life-course perspective, i.e. to break down sharp barriers between education, work, and retirement, in order to use the full potential of the working-age population and allow for negotiated and protected individual choices on the labour market.

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