

Aurelio Peccei Lecture



*The Future of Work and Old-Age
Security: Opportunities Squandered*

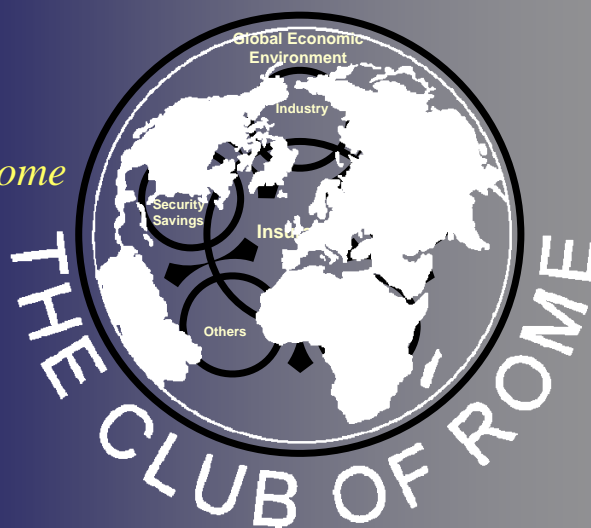
Brussels, 1 March 2007

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*The Geneva
Association*

Club of Rome



ASEC

Applied Services Economic Centre

Overview

Introduction

A few demographic facts

Part I

The future of work

Part II

Systemic challenges

Part III

Longevity Risk Management

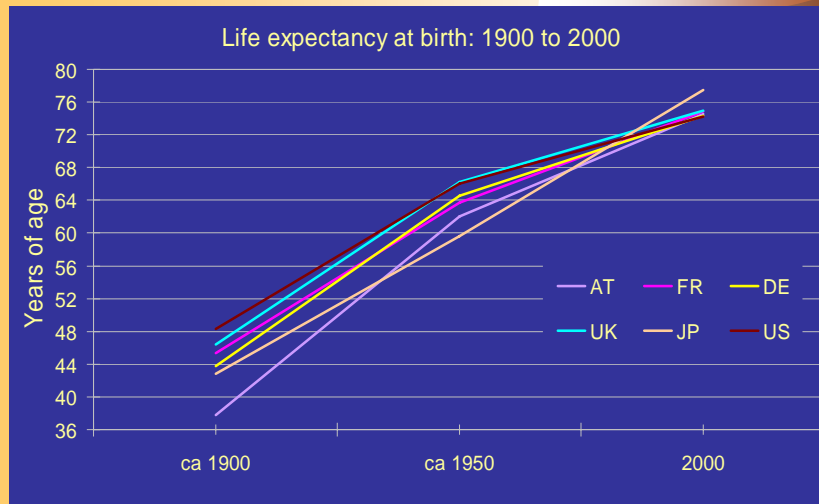


Introduction:

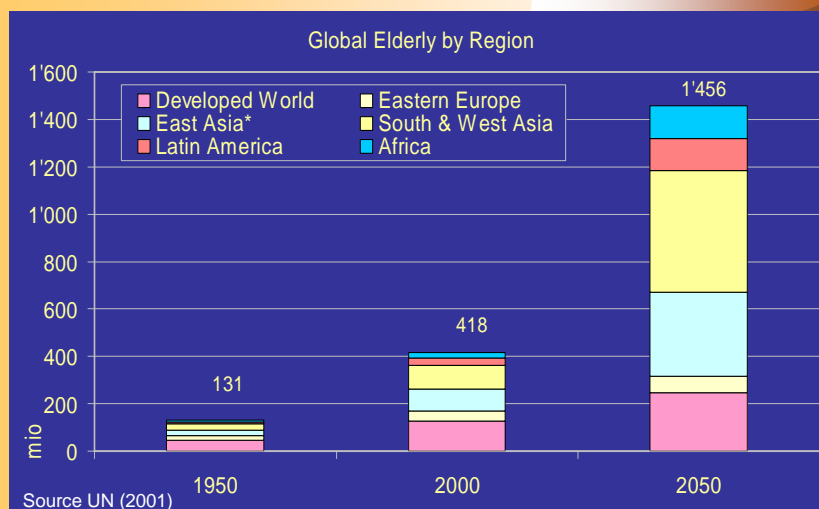
A Few Demographic Facts



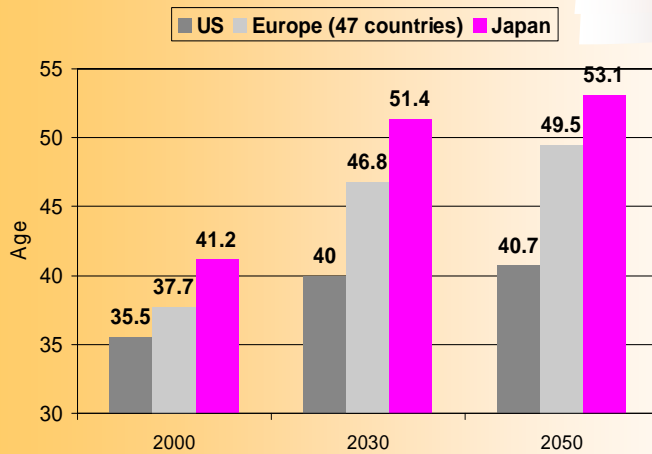
Unprecedented Increases in Life Expectancy



Population Explosion of the Elderly



Most Developed Countries are Aging Rapidly



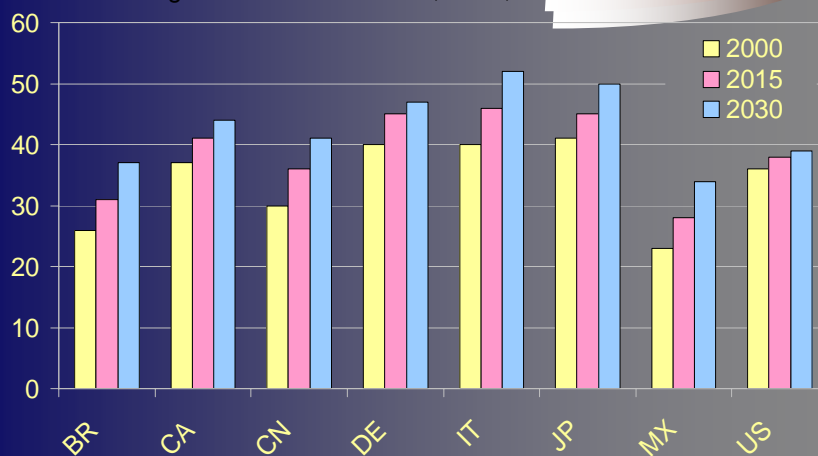
(Projected Median Ages for US, Japan, and Europe)



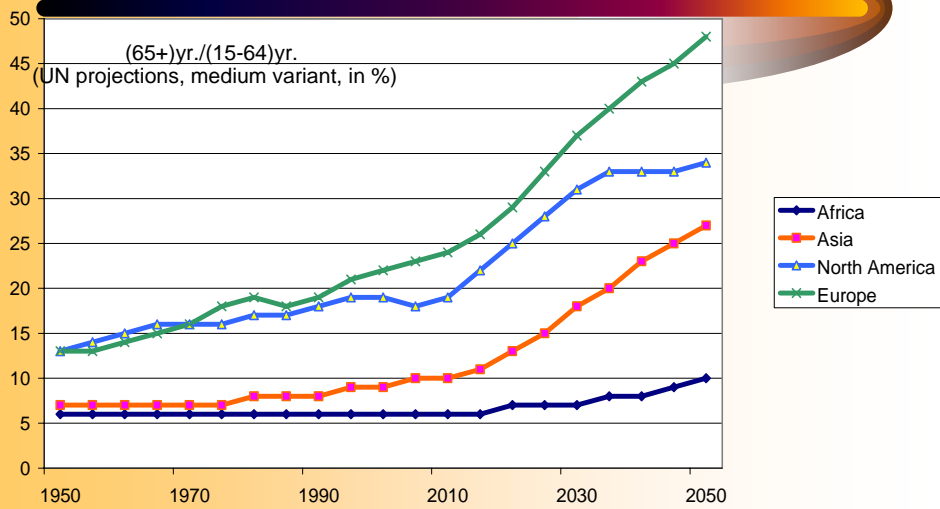
Source: UN.

Societies of Increasing Age

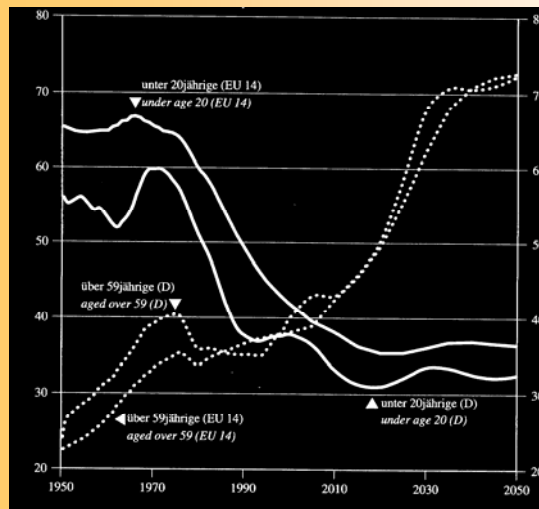
Median Age in 8 Countries: 2000, 2015, and 2030



Increase of Old-age Dependency



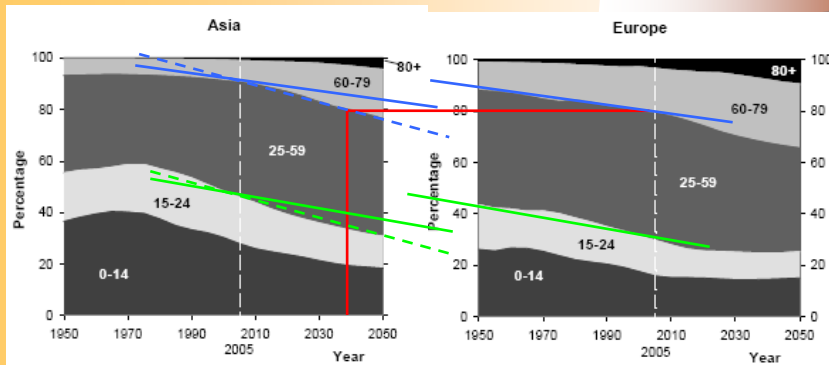
A Time of Low Dependency “Stress“ on the Systems



Youth- and
Old-age ratios
per 100 persons
aged 20-59



Asia versus Europe: Population Development



- *Asia will be in 2040 where Europe was in 2005...*
- *...but the old population will increase faster...*
- *...and the younger will shrink faster*

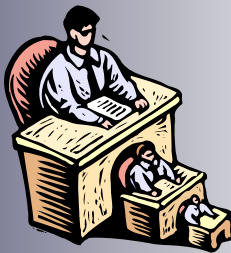


Delimiting Uncertainty

1. Certain: The imminent baby-boom effect is unavoidable
 2. Certain: Fertility levels only impact in the very long run
 3. Uncertain: Two schools of thought on mortality trends:
 - Past demographic projections have underestimated mortality improvements. This leads some specialists to predict that life expectancies will go on increasing at a sustained rate.
 - However, some factors point in the opposite direction: decreasing returns on medical progress, new pathologies, quicker/ more wide-spread transmission, delayed impact of decreasing selection at birth...
 4. Uncertain: The impact of technological break-throughs in medicine (and related fields) on mortality and morbidity is notoriously difficult to predict
- ⇒ Although there is no apparent inflexion for western developed countries, things remain open



Part I: The Future of Work

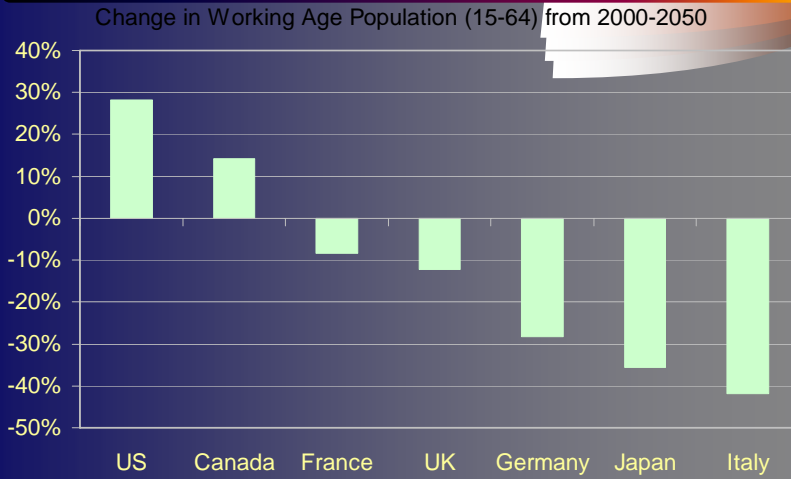


4 Key Transformational Drivers of Our Societies:

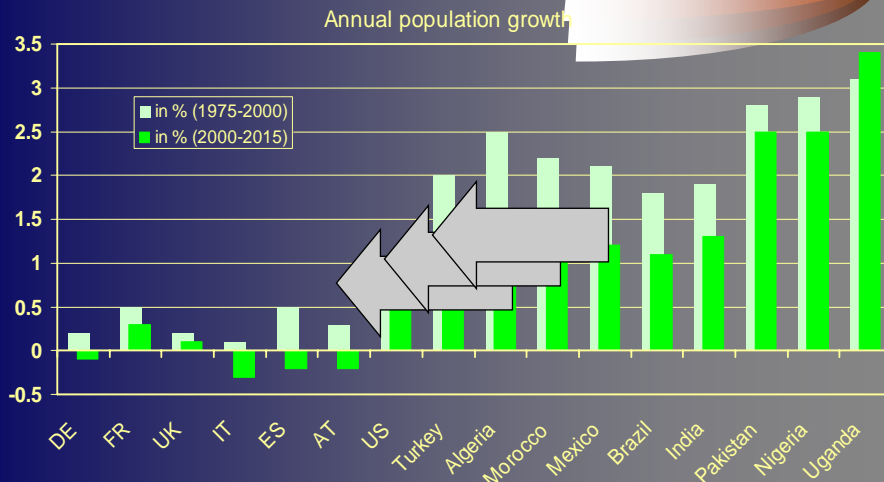
- Structural transformation from Industrial to Service Economies
- Globalisation
- Technical progress
- Demographic development



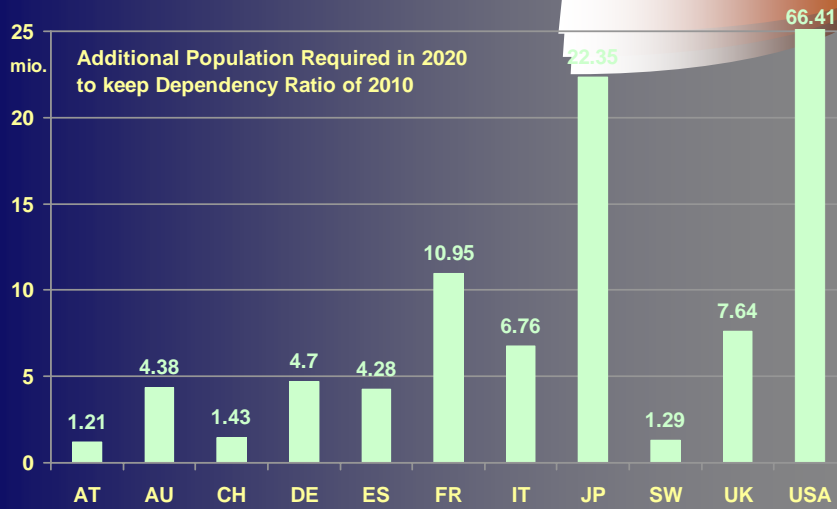
Future Labour Potential



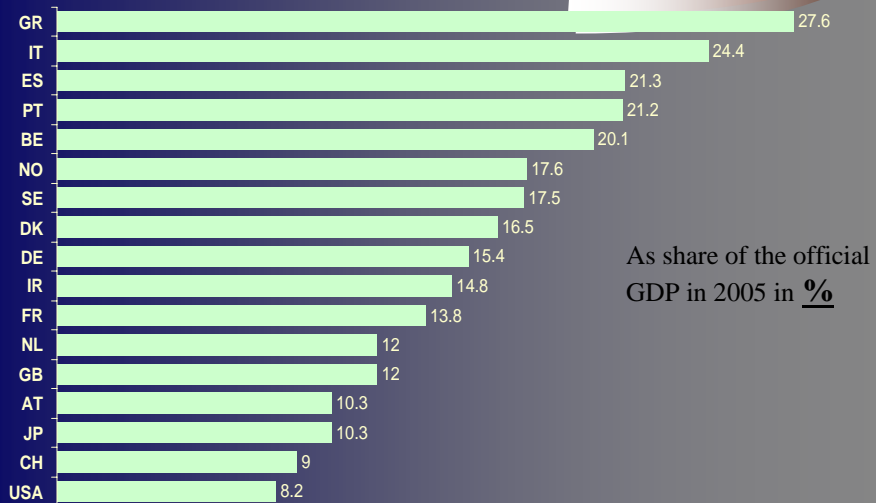
Migration Pressures: Shrinking West versus Growing South and East



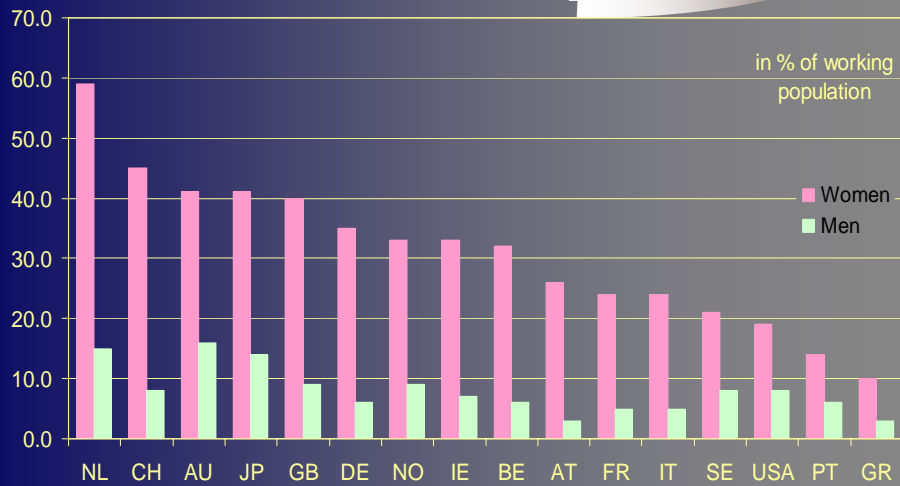
Additional Population Required



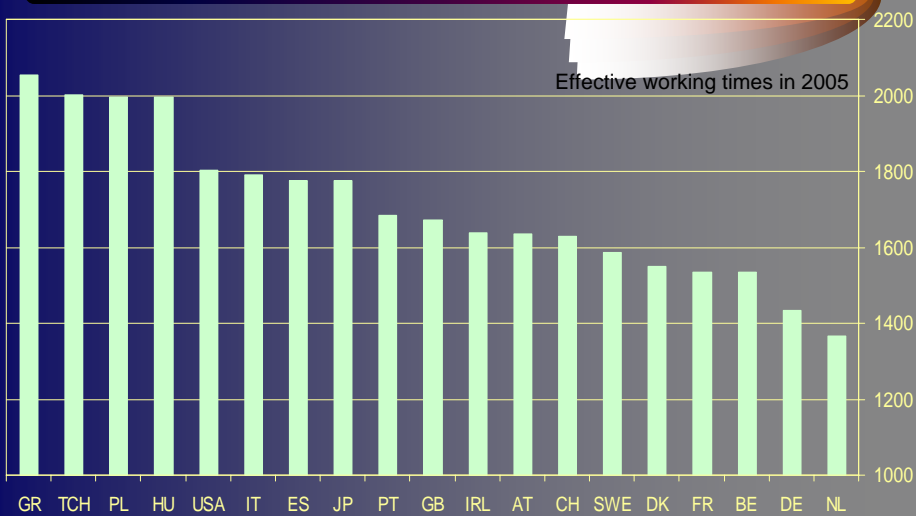
Dynamic Shadow Economies



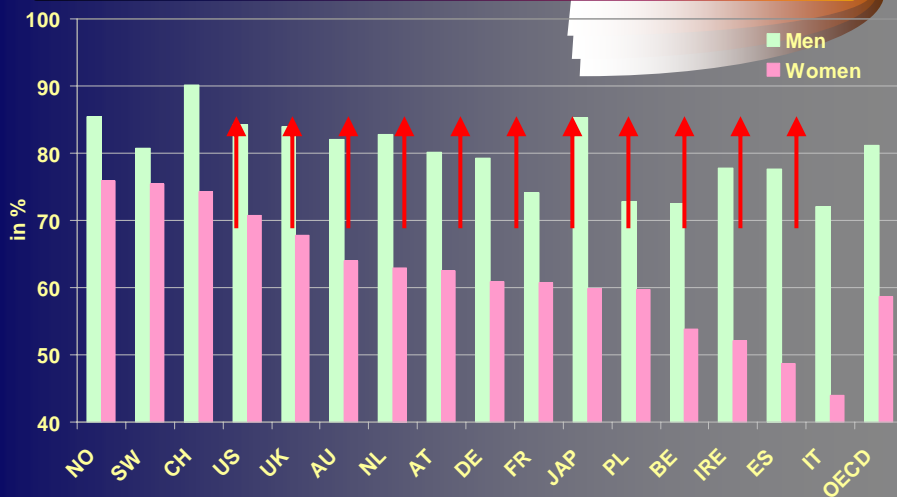
Part-time Work: Good but not good enough....



Ever Shorter Working Times?



Participation in Labour Markets: The Female Potential



Work and the Private Sphere: Work – Life – Balance ?

When and
where is
„work“?



When and
where is
„life“?

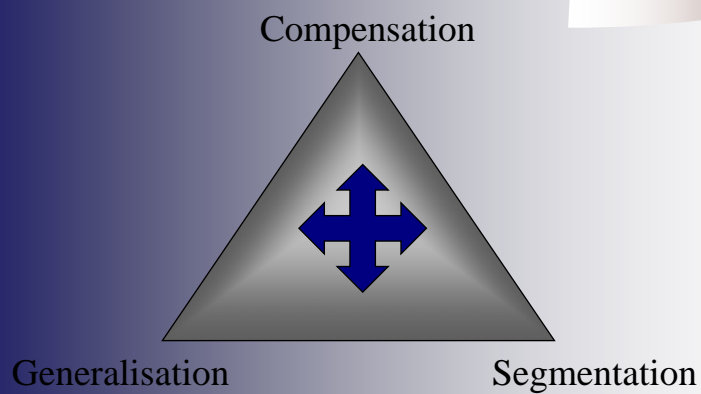


The Quality of Work is Changing

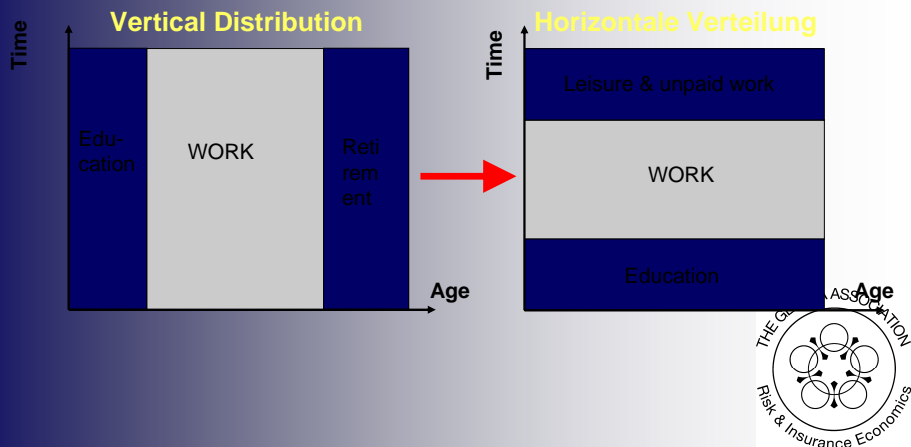
Physical	⇒	Intellectual
Standardised	⇒	Individualised
Local	⇒	Virtual
Time-fixed	⇒	Intertemporal
Directed	⇒	Autonomous
Process-oriented		Results-driven



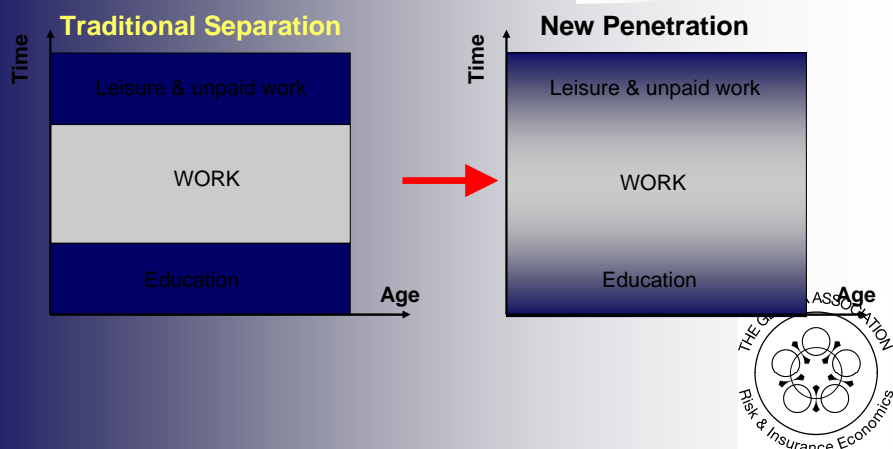
The Relationship between Work and the Private Sphere



Work, Leisure, Education: Distribution over the Life-cycle



Die Verteilung von produktiven Tätigkeiten

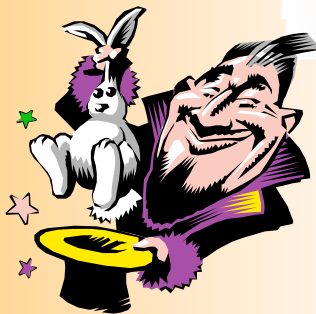


Work and the Private Sphere : Critical Questions

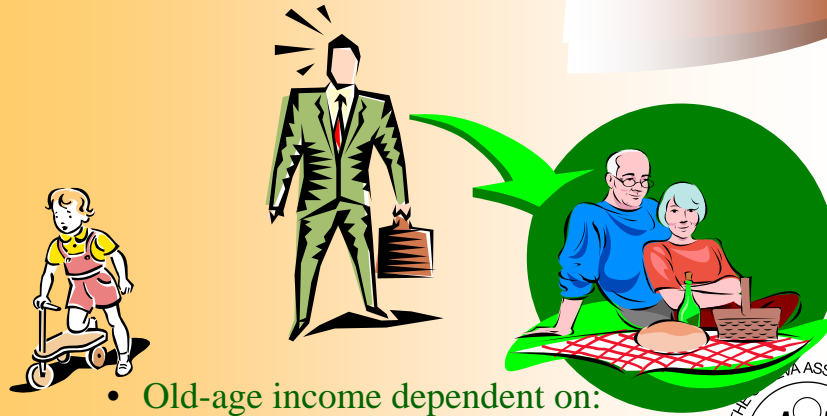
- Who defines when and how much to work?
- Who defines where to work?
- How are target results negotiated?
- What happens when they are not attained?
- Who sets and controls work safety?
- Who is responsible for what?
- Who is liable for what?
- Who will defend special interests?



Part II: Old-age Security - Systemic Challenges



The “Moral Hazard” Problem of the 2-Generations Pension Model



- Old-age income dependent on:
 - Old-age dependency ratio**=> Cohort variable**



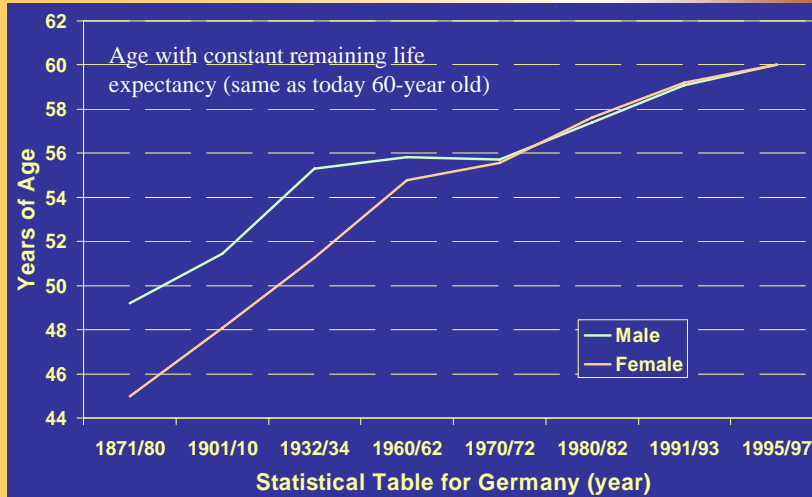
The “Moral Hazard” Problem of the 2-Generations Pension Model



- Expenses dependent on:
 - Old-age dependency ratio
 - Number of children**=> Cohort plus individual variables**



Inverse Ageing - younger than ever



Bismarck's Static Legacy

- Middle-European Reality in 1900
 - Average life expectancy: 44 years
 - Retirement age: 65 years
 - Middle-European Reality in 2000
 - Average life expectancy : 74 years
 - Retirement age: 65 years
 - Bismarck „dynamic“ in 2000:
 - Average life expectancy: 74 years
 - **Retirement age: 95 years**
- +30 years (between 1900 and 2000)
- +30 years (between 2000 and 2000 dynamic)



The positive long trend

- Longevity (the medical aspect):
 - life expectancy at birth was never higher than today
- Educational attainment:
 - adult literacy was never better
 - primary, secondary and tertiary enrolment ratios were never higher
- Standard of living (the economic aspect):
 - real GDP per capita was never higher
- Plus inequalities between nations seem to decline



...more positive news...

- Medical:
 - medical treatment and health care were never better or more widespread
 - “We are not ageing but **counter-ageing**”
- Educational:
 - learning facilities and knowledge transfer are becoming delocalised and more accessible
- Economic:
 - the weekly and yearly working times were never shorter



...therefore...

- The active (producing) part of our life-cycle could be extended
- The impact of ageing will remain mediated by many other parameters
- The demand for healthcare would initially continue to increase but then be a relatively stable share of GDP
- The demand for additional old-age security could remain limited



However....

...for the young: Life is tough...

- Medical aspects:
 - medical expenses (in absolute terms or as share of GDP) were never higher -- and are growing
 - number of older dependent people is increasing
- Educational aspects:
 - expenses for education were never higher -- and are growing
 - longer education leaves less years for work
- Economic aspects:
 - youth unemployment is high
 - the fiscal burden has never been higher
 - poverty has shifted from old age to young age



...and getting tougher...

- Medical aspects:
 - shift from physical pathological conditions to psychological ones (increased complexity)
 - the biggest boost to life expectancy (lowering child mortality) leaves little room for further improvement
 - future morbidity might come back with a vengeance (HIV/Aids, new epidemics, tropical and rare diseases, growing resistance to treatments etc.)
- Educational aspects:
 - the working years are complemented by additional constant (re)training
 - the increasing complexity of abstract concepts could marginalize more people



...and tougher...

- Economic aspects:
 - GDP growth rates are falling
 - economic development is becoming more volatile
 - an increase in old-age life expectancy is still seen as an increase in economically inactive time -- to be financed by the younger generation
 - historically high fiscal deficits will have to be borne by the young
 - the current ratio of retirement to working (and education) years will have to fall
 - the increasing penetration of work into the private sphere will make family life more difficult to manage



...and tougher...

- Additional aspects:
 - Increasing dependency ratios have to be countered:
 - either the older generation agrees to lower pensions and/or to working later...
 - ...or the younger generation will decrease that part of the dependency ratio they control, child dependency, ...
 - ...leading to even lower fertility rates...
 - ...a vicious circle!
 - Predicted labour shortages and changing societal expectations will force especially women into increasing their participation rates...
 - ...leading to more strain on their family lives...
 - ...and to more pressure on fertility rates.



...therefore...

- The active (producing) part of the life-cycle would come under more pressure
- The impact of ageing will be felt especially by the next generation
- The costs for healthcare would increase dynamically and be accelerated by inflationary pressures and rigid supply
- The balance of the generational old-age security systems could break down
- Public contracts would be revised by governments, private contracts would be recalibrated through inflation and default



Part III: Longevity Risk Management



Specific Challenges Facing Individuals in Managing Longevity Risk

1. Health/LTC risks:
Possibility that resources prove insufficient to cover related expenses
2. Investment risk:
Possibility that actual investment returns deviate from expected
3. "Pure" longevity risk:
Possibility of outliving resources or, alternatively, dying with resources remaining

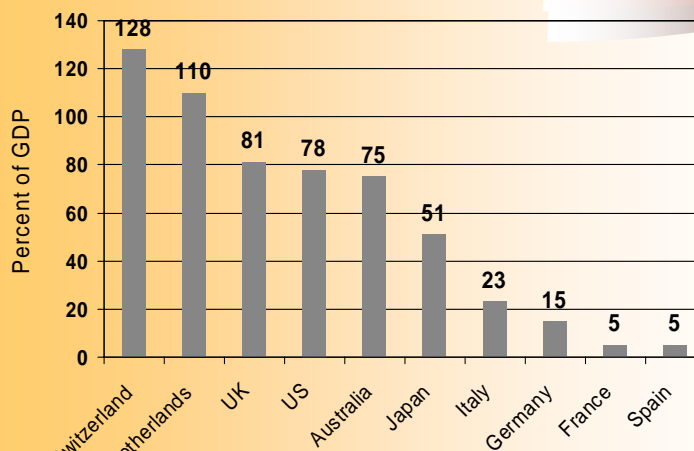


Individual longevity risk management is likely to become more important

- More responsibility is shifted to individuals
 - Employers continue substituting DC for DB pensions, shifting decisions about retirement income to individuals
 - Public pension benefit levels are declining relatively, shifting more of retirement income burden to individuals
 - The partial “privatization” of public pension systems is a further likely shift of retirement income decisions to individuals
- Individuals are living longer and retiring earlier
- Medical breakthroughs and complex tax and old-age security systems complicate its management



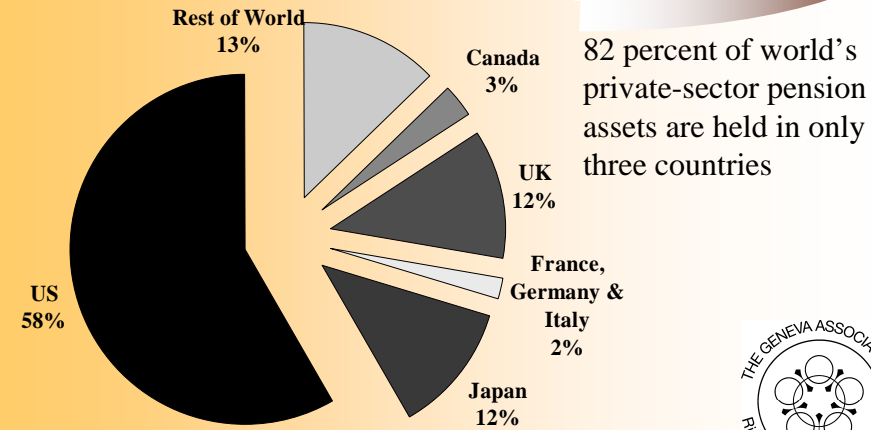
Private pension assets are important in only a few countries (assets to GDP)



Source: UBS



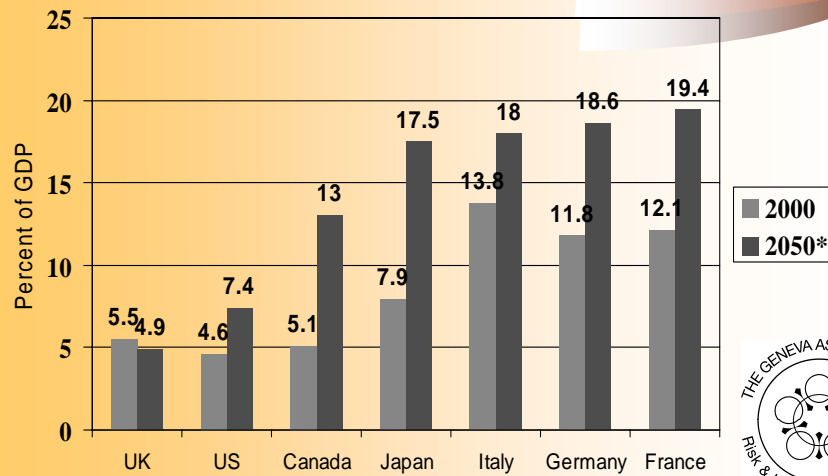
High Concentration of Global Pension Assets



Source: Goldman Sachs and CSIS.



Spending on public pensions is unsustainable in many countries



*CSIS Projection

Sources: EC/OECD and CSIS.



Policy issues

- What is the optimal distribution of retirement risks among individuals, government, and employers?
- Can we develop a deeper understanding of individual decision-making for distant cash flows?
- What is the magnitude of societal welfare loss because of low private engagement?
- What is the role of government in encouraging/forcing greater engagement?



Competitive issues

- Why have financial services providers failed to respond more positively and creatively to pension imperfections?
- How much potential profits are foregone?
- Are obstacles to risk-based pricing and to control biometric risks really insurmountable?
- How can the capital market be used to address this issue?



Challenges for the financial services industry

- Reconsider the value propositions of life, health and long-term care solutions (esp. under the "pressure scenario")
- Live up to the opportunities that the gradual exit of state systems provide for private old-age provision
 - Consider protection and savings vehicles
 - Consider distribution mechanism for risks over groups and over time
 - Insurance and banking as private contracts versus public solutions
- Speed up the development of new products, especially in
 - retirement planning
 - health and long-term care
- Help to develop financial markets for instruments that can be used to lay off additional risks



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