

Ageing and public finances

Debt threat

Extending working lives is a better answer than making pensioners poorer

DEATH and taxes, said Benjamin Franklin in the 18th century, are the only two certainties in life. In the first half of the 21st century, the greying of many countries' populations looks equally unavoidable. Much less certain, as two new studies make clear, is governments' ability to meet the cost of supporting their ageing citizens.

The first study, published on March 18th by Standard & Poor's, a credit-rating agency, estimates the damage that increases in age-related spending will wreak on government budgets if policies remain the same. In America, Germany and France, public debt will balloon from about 65% of GDP now to over 200% by 2050; in Britain it will rise from about 40% to over 150%. This would cause credit ratings to tumble in the 2020s: solid sovereign debt would turn to junk by 2035.

Unlike the ageing of populations, the rise in public-sector debt is not a certainty, because governments can change their policies. S&P's projections are intended not as a prediction but as an indicator of the scale of the reforms that are needed to avert a drastic deterioration in governments' finances.

One priority is to cut today's budget deficits. Another is to hold down future pension costs. This is especially important in France and Germany, where age-related spending will be driven up mainly by public-pension commitments. It will also help countries such as America and Britain, where more of the pressure on government budgets will come from escalating health-care spending.

Public pensions have already been reformed in many countries, so how much scope is there to trim their costs further? The second study, forthcoming from the OECD, casts light on this question by estimating the adequacy of future pensions, including those from compulsory private schemes. This is both a social and a fiscal issue. Stingy pension benefits may be affordable, but they might not be sustainable politically, especially with so many grey-haired voters.

In the report, Monika Queisser and Edward Whitehouse, pension specialists at the OECD, calculate how much today's young workers can expect from their pensions when they retire in around 40 years' time. Among other things, they estimate the "net replacement rate"—the proportion of post-tax earnings replaced by post-tax pensions. The use of the net rate captures

the generally more favourable tax treatment of pensioners than of workers.

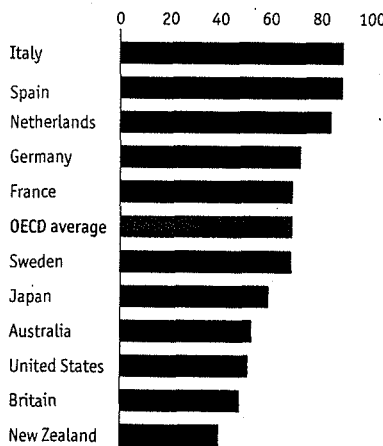
The report suggests that many countries will find it difficult to contain the costs of population ageing by making mandatory pensions less generous. Britain's Pensions Commission has used a net replacement rate of 80% for workers on average incomes as a rough guide to whether they will have enough to live on in retirement. Many developed economies have already pared future pensions to below 70% (see chart), and it may be hard to push them much further down.

The implication is that governments have to rethink how to contain pension costs. One strategy is to relieve the pressure on mandatory pensions by encouraging private, voluntary saving for old age. Such arrangements are widespread in America and Britain. For many employees covered by them, net replacement rates will be adequate. But there are worries that many will not be well provided for: half of workers are not covered and some of those who are covered are not saving enough.

The most vital reform is to extend working lives. According to Ms Queisser, the report shows that there is only limited scope to whittle away future pensions: the way forward is to raise the age at which they start to be paid. Few people like the idea of retiring later, but it may be essential to prevent the ageing of populations from wrecking public finances. ■

Look forward to that

Mandatory pension schemes
Post-tax pension as % of post-tax earnings
for average earners retiring around 2045



Source: Pensions at a glance, OECD