The Fiscal Consequences of Aging

SANJEEV GUPTA
Deputy Director
Fiscal Affairs Department
International Monetary Fund

July 15, 2016
Colombo

Outline

► Motivation
► Long-term trends, demographic uncertainty and fiscal sustainability
  ► Fertility
  ► Longevity
► Policy options to address fiscal challenges of aging populations
  ► Policies that affect demographics and labor markets
  ► Reforms to age-related spending programs
► Conclusions
Why focus on long-term trends?

- Population is already shrinking in many countries and populations are aging.
- Shrinking populations pose a formidable fiscal challenge.
  - Age-related spending projected to reach levels incompatible with fiscal sustainability.
- Reforms should start now so that they will be gradual and lasting.

[Graph showing percent of countries with negative population growth from 2015 to 2100, differentiated by world, more developed, and less developed regions.]

[Graph showing old-age dependency ratio from 2015 to 2100 for various countries, including Japan, China, India, and others.]
Why focus on long-term trends?

This presentation makes three major contributions to the debate:

1. Uses July 2015 UN population projections to help project health and pension spending for over 100 countries
2. It presents spending projections to 2100
3. Reviews potential options to address these fiscal pressures, including migration

Demographic Uncertainty, and Fiscal Sustainability
Long-term trends
The prospect of aging, shrinking populations, and higher age-related expenditure

- Population aging will have a large direct impact on public spending
- Demographic changes will also affect fiscal sustainability through their impact on growth

The impact of demographic uncertainty on fiscal sustainability

- Demographic projections are surrounded by substantial uncertainty
- Past projections have been subject to large errors
Fertility

- After declining for over 100 years, fertility rates are projected to increase slightly in the more developed economies over 2015–2100.
- For the less developed economies, the projections assume a continued but gradual decline in fertility rates.

![Graphs showing fertility trends for different regions](image)

Lower fertility scenario

- The impact of lower fertility rates on fiscal variables is significant.

![Graph showing impact of lower fertility rates on fiscal variables](image)
Longevity

- Longevity improvement is expected to slow down in the more developed economies.
- For the less developed economies, the projections suggest continued improvements in longevity.

Higher longevity scenario

- Improvements in longevity can also have an important fiscal impact.
Overview of policy options

Categories of potential policy responses to the fiscal challenges posed by population trends:

1. Policies to raise fertility rates?
2. Labor market policies
   - Allowing greater migration
   - Raising labor force participation
3. Reforms to age-related spending programs
   - Increasing retirement ages
   - Addressing the growth of age-related costs
Fertility rates?

Increase fertility rates
(change from baseline, percentage points of GDP)

-4
-2
0
2
4
-10
-8
-6
4
2
0
-1
-3
-5
-7
-9
-11
-13
-15
2050 2100 2050 2100 2050 2100 2050 2100 2050 2100
More developed Less developed Japan China India

Allowing greater migration

Allow higher migration
(change from baseline, percentage points of GDP)

-2
-1
0
1
-1
-2
-3
-4
-5
-6
2050 2100 2050 2100
More developed Less developed

Pensions (left axis) Health (left axis) Old-age dependency ratio (right axis)
Raising labor force participation I

Increase labor force participation of women
(change from baseline, percentage points of GDP)

Raising labor force participation II

Increase labor force participation of older workers
(change from baseline, percentage points of GDP)
Addressing the growth of age-related costs I

Increase retirement age by 5 years over 2015-2020 (change from baseline, percentage points of GDP)

2050 2100
More developed
Less developed
Japan
China
India

Pensions

Addressing the growth of age-related costs II

Lower excess cost growth (change from baseline, percentage points of GDP)

2050 2100
More developed
Less developed
Japan
China
India

Health
Implications

► The fall in fertility and eventual decline in world population are part of the transition to a sustainable growth path
► Nevertheless, shrinking populations pose a grave fiscal threat
► Demographic and age-related spending projections are surrounded by substantial uncertainty
► There is no escape from reforming entitlements
► Migration and labor market policies can ameliorate the impact of aging in the more developed economies
► Given the magnitude of the fiscal challenge, reforms should start now but be gradual