

# Editorial: Back to Bismarck? The Public Policy Implications of Living Longer

In the current issue of *CJA*, Frank Denton and Byron Spencer urge us to take account of the significant gains in longevity achieved over the past half-century and adjust our now conventional chronological markers of “old age”. We are living longer and living healthier. In the future, they argue, we might reasonably expect people to retire as late as age 70, the age of eligibility famously established by Bismarck for German public pensions in the 1880s and, less famously, by Louis St. Laurent in 1951 for Canada’s Old Age Security (OAS) program. The fact that we are living healthier lives at more advanced ages should also enable many of us to live independently longer without institutional supports, thus offsetting expected increases in the costs now associated with an aging population.

This will be a welcome message in public policy circles. For policy makers (see Organization for Economic Cooperation and Development [OECD], 2001), though not necessarily their publics, keeping current and future generations in the labour force longer (i.e., later retirement) is widely seen as the most painless and cost-effective cure for the expected impact of population aging on the public budget. For example, OECD estimates (2001, p. 69) show that the effect of *small* increases in the average retirement age can have a greater impact on retirement costs than *large* cuts in retirement benefits. Simulations for a typical OECD country indicate that a 5 per cent reduction in the number of beneficiaries – equivalent to an effective rise in the retirement age of 10 months – is equivalent to a 10 per cent cut in average retirement benefits. The reason for the difference is that a higher retirement age has a double impact on retirement costs: It not only reduces benefits paid out but also increases national output and government revenues, since more workers contribute for a longer period of time.

Few policy makers are as ambitious as Denton and Spencer, however. In most OECD countries, the average retirement age is now closer to 60 and most of the people who worry about these things would probably be delighted to see it creeping back toward 65. To get back to an *average* of 65, of course, many of us would have to work beyond that age since some workers will always retire before 65. Is this likely to happen?

The three main reasons older workers exit from the labour market are health, wealth, and labour market redundancy. Trends for two of the three – health and labour market redundancy – suggest considerable

optimism that future cohorts could retire later. The good news about growing old in the twenty-first century includes

- *Increased longevity*: People are living longer, which adds to the cost of retirement pensions, but, as Denton and Spencer highlight, also means that later retirement will not reduce the number of years the average person will have to enjoy retirement.
- *Improved health status*: In general, the health of persons in their sixties has been rising. There is greater reported prevalence of some chronic illnesses (heart disease, hypertension) in older cohorts, since these diseases are less likely to lead to early death than in the past, but the number reporting significant activity limitation has declined substantially (Pransky, 2001).
- *Changing work conditions*: New technologies and post-industrial job structures have reduced the number of jobs requiring strenuous physical effort.
- *Rising educational and literacy levels*: Among younger cohorts, these changes should reduce one of the major barriers to continued employment as they age and improve the likelihood of successful retraining at advanced ages.
- *Changes in labour demand*: Perhaps the strongest force working in favour of later retirement ages in the coming decades is the effect of population aging on labour demand. Slower labour force growth drives up capital–labour ratios so that real wages tend to rise and interest rates to fall. Higher real wages create incentives to remain in employment. Under these conditions, healthier and more skilled workers faced with an age-neutral pension regime might increasingly choose to remain at work longer and employers to adapt employment conditions to be more “friendly” for older workers.

If the labour market is able to generate sufficient employment to absorb older workers and raise total employment levels, a potential payoff is greater economic growth and higher living standards for all.

The paradox, of course, is that actual retirement ages have been falling over the past few decades *despite* these positive trends in health status, longevity, education, etc. Why would one think the trend might now be reversed? The answer largely has to do with retirement wealth accumulated over a lifetime and stored up in public and private pensions and other forms of savings.

As Burtless and Quinn (2001, 385) conclude, the “simplest and probably most powerful explanation for earlier retirement is rising wealth.” Today’s elderly

adults are able to enjoy a relatively prosperous retirement because they enjoyed prosperous working lives, unlike their parents, who spent many of their working years in depression and war. National GDP in the affluent democracies has grown dramatically in the last half-century and some of this increase has been used to purchase more years of retirement. Moreover, while working years and working hours have declined for individual workers, they have risen for families, a result of women's higher labour force participation. The increase in family years and hours worked helps pay for more years of retirement.

There is considerable evidence that recent cohorts – those who entered the labour market in the eighties and nineties – have been faring less well. They have been earning lower wages (Heisz, Jackson, & Picot, 2001) and accumulating less wealth (Morissette, Zhang, & Drolet, 2002) early in their working lives than previous cohorts, implying that they may have to work longer to reach their retirement goals. However, this change is likely to be temporary because of future productivity gains, especially if, as many anticipate, population aging raises labour demand for young workers in the future. In the longer term, the rules and incentives that govern the age at which retirement wealth is accessed are likely to prove more salient.

In nations like Italy, Germany and Sweden where most pension wealth is stored up inside public sector retirement schemes, policy makers have considerable discretion over the age at which individuals can gain access to it. Pension reform has been a major growth industry in most of Europe since the 1980s and initiatives to require or encourage later retirement have been widespread (Myles and Pierson, 2001). These reforms include making actuarial reductions in pension benefits for early retirees, tightening the link between contributions (i.e. years worked) and benefits, restricting access to pseudo-retirement benefits in disability and unemployment schemes, and opening pathways to partial retirement and upward harmonization of retirement ages among workers in different sectors of the economy and among men and women. The Swedish and Italian reforms of the 1990s that essentially "indexed" retirement benefits to future population trends are often considered the most dramatic. Henceforth, pension benefits in Sweden will be "indexed" to expected cohort longevity. Future gains in longevity will be offset by lower benefits unless workers choose to remain in the labour force for a somewhat longer period.

Countries where public sector benefits provide a smaller share of retirement income face a rather different situation, since it is pressure on the public budget, not total retirement costs per se, that provides the

short-term incentives for reform. In Canada, only about half of total old age income appears on the public budget and that share is likely to fall in the future as a result of future maturation of occupational pension plans (RPPs) and personal retirement accounts (RRSPs). Moreover, of that total, half again is delivered through Old Age Security and the Guaranteed Income Supplement, benefits that are already subject to the age test of 65.

The remaining benefits provided by the Canada and Quebec Pension Plans (C/QPPs) can be accessed at reduced levels as early as age 60. However, for middle and upper income earners the amounts involved are relatively modest, even when compared to the U.S. Consequently, changes to the age of eligibility for C/QPP benefits are unlikely to have large effects on retirement behaviour except among lower income earners, creating obvious equity problems.<sup>1</sup> Such a result would be perverse for macroeconomic as well as for distributive reasons. The largest gains to the economy are to be had if the most productive workers (the healthy, well educated, and presumably better paid) remain in employment longer. Reform can have a potentially perverse effect if changes to retirement incentives in public sector plans mainly produce higher retirement ages among low wage, low productivity workers.

To induce large changes in retirement ages among middle and upper income wage earners in the Canadian context would require extensive regulation of the age at which workers can access private sources of retirement wealth (RPPs, RSPs), on the one hand, and, on the other, reforms that eliminated incentives that now *bias* retirement decisions in favour of more retirement and less employment. Early retirement incentives and defined benefit formulae that discourage continued employment are examples. But there is precious little pressure on Canadian policy makers to pursue such an agenda, little analytical capacity to do so, and little likelihood of reaching the political consensus required for reform if such an agenda were chosen.

Despite all this, I suspect that images of "Freedom 55" will slowly recede for future cohorts. In the Canadian context, however, labour market conditions, not legislative reform, will be the most likely determinant of retirement trends in the foreseeable future. For a variety of reasons, I do not see large-scale reform of either the public or private components of Canada's retirement income system looming large on Canada's political agenda. As I have argued elsewhere (Myles, 2000; Myles, in press; Myles & Pierson, 2000), the major pressure for pension reform in other OECD countries is a product of high and rising payroll taxes to meet

current and future pension expenditures. By European and even U.S. standards, however, current and future payroll tax levels for pensions in Canada are quite modest, reflecting the modest scale of the C/QPP, greater reliance on general revenue financing (for OAS/GIS), and (in future) the results of increased advance funding introduced as part of the 1997 CPP reform.

Recent estimates by the OECD (Scherer, 2002) indicate that retirement ages ticked upwards in the latter half of the nineties in many countries, including Canada. Whether this jump was a result of a temporary increase in labour demand associated with the business cycle or was the beginning of a longer-term trend remains to be seen. It is hard to imagine, however, that the impact of population aging on labour demand can be postponed forever, and that impact will affect the incentives employers offer to their older workers to remain on the job. How are workers likely to respond?

Both public opinion data and the way in which older workers vote with their feet make it clear that people like retirement. Hicks (2001), however, reports that while most people are opposed to legislating later retirement, about half of Canadian retirees would prefer to have a full or part time job if it were available. Hicks (p. 15) concludes that the explanation for this apparent contradiction is that the retirees "were likely thinking of hypothetical, highly desirable, jobs that were particularly suitable for them – ones that are in limited supply for most people". If correct, these results underline the importance of changes in job quality and working conditions for determining future retirement trends.

What of Denton and Spencer's second prognosis that increases in longevity and health status mean that we may have exaggerated future need for providing services and support to the frail and mentally confused elderly? On this point I am less sanguine, not because of future changes on the demand side (a dramatic increase in the share of the "oldest old") but because of changes that are already with us on the supply side. Working-age families have been the major providers of elder care. Traditionally, informal care by family members, primarily daughters and daughters-in-law, has accounted for about three-quarters of all care provided to the frail elderly, work that generates considerable public savings in long-term care provision and related services (Wolf, 1999). Declining fertility, however, has created not only a larger pool of elders requiring care but also a diminished pool of potential care providers, and these care providers are also more likely to be employed than in the past. Increased longevity also means that the care traditionally provided by spouses to one another (typically by the wife)

occurs at an age when caregiving capacity is diminished.

Like longevity, the onset and duration of frailty in old age is unpredictable and hence an insurable risk for which at this point in time there is little or no private market, a policy challenge that few nations have begun to meet (OECD, 1996). The emergent market for long-term care insurance is beset with a variety of problems and is still modest in scope, reminiscent of the world before the spread of mandatory public pensions.

As recent historiography (Haber & Gratton, 1994) has shown, in the world before mandatory pensions, intense poverty in old age was still the exception, mainly associated with those elderly persons without working adult children able or willing to supplement the declining incomes of their aging parents. Mandatory public pensions, in this sense, were a way of sharing not only the risk of one's own longevity but also the risk of one's parent's longevity and the imperative of supporting parents financially through an extended old age. Similarly, the expansion of publicly financed long-term care and home help services in the contemporary period represents a welfare gain not only for the frail elderly who receive these services but also for their adult children and other family members, who otherwise would be called upon to provide such services directly.

## Conclusion

Conservative critics of the welfare state have often portrayed population aging as the social equivalent of Armageddon. If this were true, we would all be dead. Population aging has been a distinguishing feature of the industrial world since the nineteenth century and the end of the world has yet to arrive. Pension reform in the 1990s was not the result of a right-wing conspiracy, however. The most dramatic European reforms were adopted by parties associated with organized labour (Sweden) and/or only after labour had signed on to the reforms (Italy). It is hardly surprising that retirement systems designed under conditions of high fertility and sustained labour force growth might require some serious tweaking once those conditions have disappeared. It would be the height of imprudence to hand on to our children a policy legacy that does not take account of the fact that we are having so few of them but living longer.

Big pension reforms have been characteristic of countries where the public sector share of retirement costs is quite large. The maturation of public pension schemes since the 1970s combined with adverse economic conditions compelled these nations to address the fundamental issues of retirement costs well in

advance of the demographic shift all nations will experience in the next quarter century. As a result, however, many of the lessons to be learned have already been acquired. The trade-offs and dilemmas, both practical and normative, are known and there is some experience in addressing these problems.

For countries like Canada, the challenges of achieving social objectives related to intergenerational equity and intragenerational justice in the face of population aging are more difficult, since the public sector share of retirement costs is more modest. This is unfortunate. There are strong normative and social reasons to be concerned with how the future costs of population aging are distributed within, as well as between, generations.<sup>2</sup> And there is good reason for governments to take substantial responsibility for determining how these costs are allocated. But this cannot be done simply by reference to the share of retirement costs that appear on the public side of the national ledger. The total economic cost of supporting the retired population is simply the fraction of each year's economic activity given over to supplying the goods and services the retired consume or:

$$(1) \text{ Cost of supporting the retired} = \frac{\text{Consumption of the retired}}{\text{Total national production}}$$

In turn, this fraction can be expressed as the product of two other ratios, the retirement ratio and the retiree consumption ratio (Peter Hicks, personal communication, December, 2001):

$$(2) \text{ Cost of supporting the retired} =$$

$$\frac{\text{Number of retirees}}{\text{Number of employees}} \times \frac{\text{Average consumption of retirees}}{\text{Average production per employee}}$$

Assuming all else remains fixed, population aging raises total retirement costs. A 10 per cent increase in the ratio of retirees to workers results in a 10 per cent increase in the cost of supporting the retired. The public-private mix does not per se change this scenario. Public and private pensions are simply alternative ways for retirees to register a claim on current production (Barr, 2001). The share of total consumption of the retired rises irrespective of whether it is financed with state pensions or with investment returns from bonds and equities.<sup>3</sup>

The public-private mix, however, does alter the public policy challenge. As I have highlighted above, altering the age of eligibility for C/QPP benefits would mainly impact the retirement ratio of lower income workers. Similarly, cutting public sector benefit levels

would disproportionately affect the consumption of the least advantaged, since low-income families are less likely to compensate with more savings than high-income families (Diamond & Hausman, 1984). The proximate challenge to policy makers faced with population aging is a public finance problem: how to keep government revenues (taxes) and expenditures (public pension benefits) in balance. The larger policy challenge, however, is to allocate the *additional* retirement costs induced by population aging across the entire retirement budget, public and private (= *total* social costs), in ways that satisfy principles of intergenerational equity and intra-generational justice. The favourable tax regime available to occupational pensions and personal retirement accounts clearly warrants that they too are charged with social goals.

John Myles

University Of Toronto

### Notes

1. Since health (life expectancy, disability) and income level tend to be correlated, raising the age of eligibility for programs like C/QPP compounds the equity problem. When retirement ages are falling, the social welfare gains in additional leisure and free time tend to go disproportionately to the least well off. An additional year of retirement, for example, represents a larger proportional gain for someone with a 7-year life expectancy than for someone with a 12-year life expectancy. But the reverse is also true: an additional year of employment represents a proportionately greater loss for those with shorter life expectancies.
2. I have outlined these normative issues and offered some possible solutions in Myles (in press).
3. Indeed, as Thompson, (1998, p. 44) observes, proposals to shift towards group or personal advanced funded accounts are often made on the grounds that retirees will receive higher returns from their contributions. If this turned out to be true, the effect of change would be to *raise* future retirement costs.

### References

- Barr, N. (2001). *The welfare state as piggy bank: Information, risk, uncertainty and the role of the state*. Oxford: Oxford University Press.
- Burtless, G., & Quinn, J. (2001). Retirement trends and policies to encourage work among older Americans. In P. Budetti, R. Burkhauser, J. Gregory, & H. A. Hunt (Eds.), *Ensuring health and income security for an aging workforce* (pp. 375–416). Kalamazoo Kalamazoo, MI: Upjohn Institute.
- Diamond, P., & Hausman, J. 1984. Individual retirement and savings behavior. *Journal of Public Economics* 23, 81–114.
- Haber, C., & Gratton, B. (1994). *Old age and the search for security: An American social history*. Bloomington: Indiana University Press.

- Heisz, A., Jackson, A., & Picot, G. (2001). Distributional outcomes in Canada. In K. Banting, A. Sharpe, & F. St-Hilaire, (Eds.), *The longest decade: Canada in the 1990s* (pp. 247–272). Montreal: Institute for Research on Public Policy.
- Hicks, P. (2001). *Public support for retirement income reform*. Paris: Organization for Economic Cooperation and Development. Retrieved August 13, 2002, from the OECD Web site: <http://www.oecd.org>
- Morissette, R., Zhang, X., & Drolet, M. (2002). The evolution of wealth inequality in Canada, 1984-1999 (Analytical Studies Branch, Research Paper No. 187). Ottawa: Statistics Canada.
- Myles, J. (2000). The maturation of Canada's retirement income system: Income levels, income inequality and low income among older persons. *Canadian Journal on Aging*, 19, 287–316.
- Myles, J. (in press). A new social contract for the elderly? In G. Esping-Andersen, D. Gallie, A. Hemerijck, & J. Myles (Eds.). *Why we need a new welfare state*. Oxford: Oxford University Press.
- Myles, J., & Pierson, P. (2001). The comparative political economy of pension reform. In P. Pierson (Ed.). *The New Politics of the Welfare State* (pp. 305–333). Oxford: Oxford University Press.
- Organization for Economic Cooperation and Development. (1996). *Caring for frail elderly people*. Paris: Author.
- Organization for Economic Cooperation and Development. (2001). *Aging and income: Financial resources and retirement in 9 OECD countries*. Paris: Author.
- Pransky, G. (2001). Living longer but able to work? In P. Budetti, R. Burkhauser, J. Gregory, & H. A. Hunt (Eds.), *Ensuring health and income support for an aging workforce* (pp. 431–438). Kalamazoo, MI: Upjohn Institute.
- Scherer, P. (2002). *Age of withdrawal from the labour force in OECD countries*. Paris: Organization for Economic Cooperation and Development Retrieved August 13, 2002, from the OECD Web site: <http://www.oecd.org>
- Thompson, L. (1998). *Older and wiser: The economics of public pensions*. Washington: The Urban Institute.
- Wolf, D. (1999). The family as provider of long-term care: efficiency, equity and externalities. *Journal of Aging and Health*, 11, 360–382.