

CAN SCOTLAND AFFORD TO GROW OLD?

Robert E. Wright

Over the next few decades the population of Scotland will 'age' rapidly. In its simplest interpretation, population ageing is the process by which an increasing share of the population accumulates in the older age groups. One indicative measure of population ageing is the ratio of the population aged 16 to 60 relative to that aged 60 and older (P_{16-60}/P_{60+}). According to the UK Government Actuary's Office, this ratio is currently about 3, and is expected to fall to around 1.6 by the year 2040 - a reduction of nearly 50 per cent. Likewise, the share of the population aged 60 and older will increase from the current level of around 21 per cent to over 33 percent in the same period, which represents nearly a 60 per cent increase in the number of individuals aged 60 and older.

This dramatic ageing of the Scottish population will translate into a huge increase in the number of pensioners and a substantial decrease in the number of people of working age. More importantly, this process will present the people of Scotland and their Government with serious challenges. If these challenges are not met through sensible public policy action, then we can expect a considerable reduction in overall living standards in the not-too-distant future.

There is a large and growing academic literature concerned with the economic consequences of population ageing. For example, research has considered the impact that population ageing has on key labour market variables such as productivity, earnings, employment, unemployment, labour mobility, migration, retirement and educational activity. Likewise, serious

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attention has been directed towards its effect on savings behaviour, consumption, housing and intergenerational transfers (e.g. the flow of time, money and other resources between parents and their children). With population ageing there is an increase in the demand for public services such as health and residential care. There is a great deal of debate surrounding the mechanisms that governments are going to have to put in place in order to pay for these expected increases in demand. In fact, when it comes to state-provided pensions and other universal social security benefits targeted at the elderly, there is serious doubt about whether many governments will be able to afford to continue with such programmes. Finally with population ageing, political influence will become more concentrated in the older age groups. As their share of the population grows, their share of the vote also grows, and democratically elected governments will be increasingly forced to meet their demands or suffer the consequences at the ballot box.

Unfortunately, space does not allow for a detailed discussion of the specifics of these arguments. However it is safe to say that population ageing is viewed generally as a process that is not desirable. It will generate a series of problems that will prove to be very expensive - if not impossibly expensive - to address unless it is carefully understood and planned for. It is only through the analysis of the complex interactions between economic and demographic variables that we can develop a clear understanding of the economic consequences of population ageing. With respect to Scotland, such research has not been carried out with the degree of rigour that is required to confidently contribute to many aspects of the public policy debate surrounding how population ageing is to be accommodated.

The main cause of population ageing is low fertility. It follows that a sustained increase in fertility would help counteract population ageing. However, the amount by which fertility would have to increase in order to have a sizeable impact seems unlikely to be realised. The total fertility rate in Scotland is currently around 1.5 live births per women, which is well below the so-called 'replacement' level of fertility of 2.1 live births. In other words, fertility would have to increase by at least about 40 per cent before it would start to have any significant breaking effect on population ageing. Such a large increase is possible but improbable given that the fertility rate has declined in every year since 1960 and a drastic reversal of this forty-year trend seems (to say the least) unlikely. It is my view that the ageing of the Scottish population is irreversible. Policies aimed at increasing fertility (such as 'generous' child allowances and 'free' day care) would not only be

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unacceptably expensive but would also not be effective given the scale of the problem to be confronted.

As mentioned above, there are many economic consequences of population ageing. Some are more important than others. In my view, there are four areas that are going to be particularly problematic.

The *first* is changes in the demand for health services. It is clear that there is a positive relationship between age and health. It is an unfortunate fact of life that older people, relative to younger people (on average), are less healthy. Population ageing will increase the demand for health services. There is a growing consensus that the National Health Service in its current form will not be able to accommodate the pressure that population ageing will impose, without a severe drop in the quality of services delivered.

The *second* is changes in the demand for housing and residential services. It is clear that the demand for housing differs by age. As the population ages there will be an increase in the demand for housing more suitable to older people, which includes sheltered accommodation, nursing homes and other forms of residential care. The importance of this issue was recently illustrated by the Scottish Executive's commitment to provide state-supplied residential care for all Scots who require it. There is considerable doubt surrounding the Government's ability to deliver on this commitment given the expected costs of such a programme.

The *third* is changes in the demand for state-supplied pensions and other universal benefits. The ageing of the population will not only increase the number of people eligible for such pensions, it will also reduce the number of people who are making contributions to the pension fund. There is growing view that the current system will be unable to meet future demand without large increases in contribution rates and/or large decreases in the size of the pension the retired are entitled to. Since pensions are a 'reserved matter', analysis in this area will have implications for the UK as a whole, and is likely going to be a further point of 'tension' between the Scottish and Westminster parliaments.

The *fourth* concerns the impact of population ageing on the labour market. Population ageing not only means more older people as a fraction of the population, but it also means more older workers as a fraction of the labour force. To the extent that older and younger workers differ in the inputs they supply, the wages and earnings they receive, the jobs they occupy, their

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respective probabilities of unemployment, etc., population ageing can be expected to have effects in the labour market. More specifically, most production processes use a mix of younger and older workers and population ageing changes the relative supply of workers of different ages. If the optimal age mix cannot be obtained, productivity will be lower which in turn will lead to lower economic growth.

The above discussion suggests that there are going to be serious 'costs' associated with the ageing of the Scottish population. One view is that the Government will be expected by its 'greying' electorate to meet these costs. Although this may in fact be what happens, it will not occur without large increases in tax rates. At this time, how much tax rates will have to increase is virtually a complete unknown. It is however important to point out that there are a variety of public policy initiatives beyond simple 'tax-and-spend' that could be used to reduce the expected negative consequences of population ageing. Evaluating the potential effectiveness of such policy initiatives depends critically on understanding the scale of the problem faced. In this respect, Scotland lags well behind in its understanding of a process that could lead to a substantial and enduring reduction in the standard of living of its people.

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