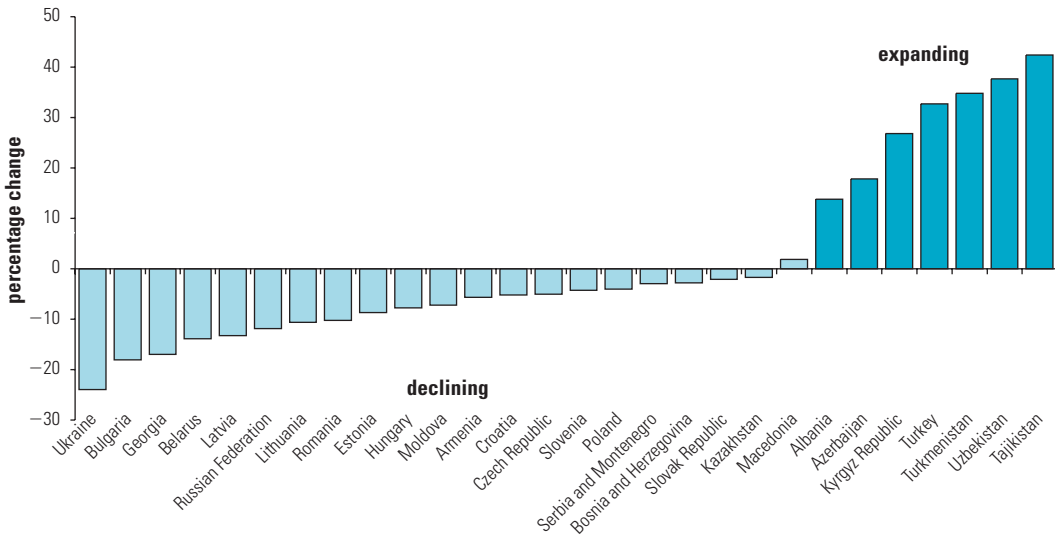


Demographic Change

The transition countries face a major demographic challenge to their growth prospects. The limited rate of labor use, reflected in a fairly low employment rate (figure 1.2), assumes greater significance against the background of an aging population and of a projected decline in the share of the working age population in the total population in many transition countries, mostly in the western part of the region. Fertility rates are below replacement in Central Europe, parts of Southeastern Europe, and such countries as Ukraine, Bulgaria, and Georgia, with their population expected to decline more than 15 percent by 2025 (figure 8.1). The picture is quite the opposite in the eastern part of the region, where the growing population is expected to be more than 30 percent larger in Turkey, Turkmenistan, Uzbekistan, and Tajikistan by 2025.

Population projections, fraught with uncertainty, particularly over long time periods, should be treated with caution. In this case the caveat is less important because such projections, if anything, underestimate aging in the population. With that proviso, the share of the working age population for the EU8, Southeastern European (SEE), and middle income CIS countries will decline rapidly after 2015 (fig-

FIGURE 8.1
Population Change in Europe and Central Asia, 2000–25

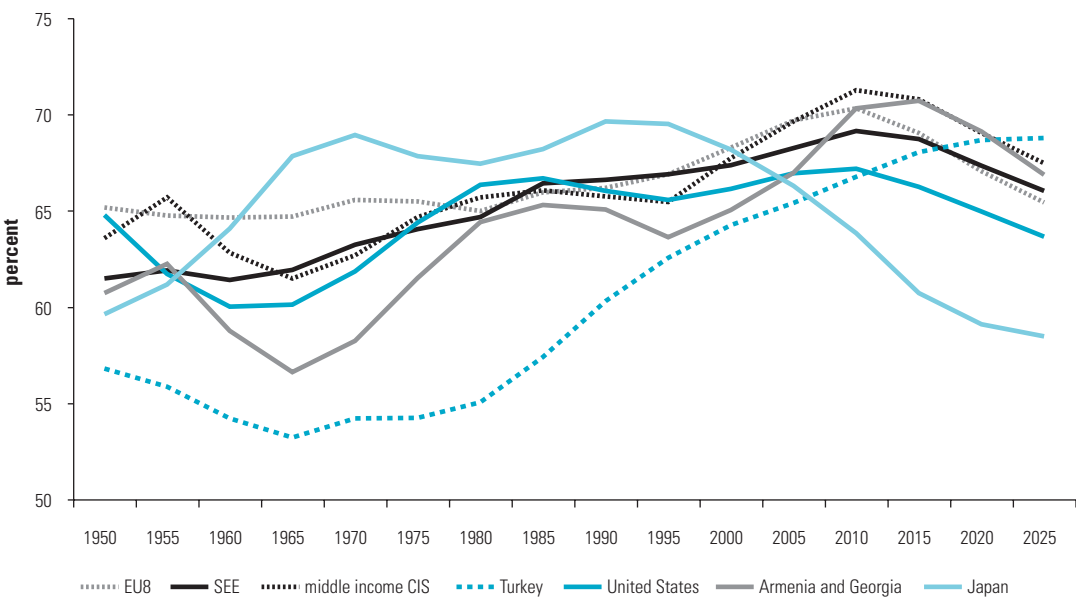


Source: UN Population Prospects.

ure 8.2), similar to the change in the EU15, deeper than in the United States, shallower than in Japan. What challenges is this demographic transition likely to pose?

A decline in the share of the working age population on the scale projected, other things being equal, has the potential to lower per

FIGURE 8.2
Working Age Population to Total Population, 1950–2025



Source: UN Population Prospects.

capita GDP growth sharply and thus delay convergence to EU15 income levels.¹

Productivity

First, there is no unambiguous evidence that aging cuts individual productivity. The impact varies depending on job-skill requirements and individual capacities. A broader issue for convergence to EU15 living standards is to improve the responsiveness of education systems to the needs of the global economy across the region, reflected in scores on the Program for International Student Assessment (PISA). PISA tests 15-year-old students' mastery of higher order skills such as synthesizing knowledge across disciplinary boundaries, integrating uncertainty into analysis, monitoring their own learning progress, and knowing where to access relevant information—precisely the skills needed for most of the fastest growing jobs in the global economy.²

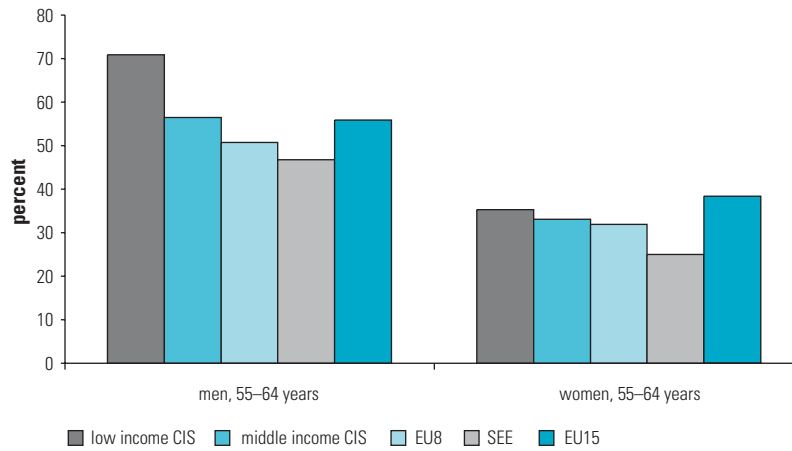
The focus of the 2006 PISA was on student abilities in comprehending and tackling scientific problems. Scores in science and mathematics were at or higher than the OECD average in the EU8, Bulgaria, Croatia, and Romania, but lower in the other countries of the region.³ These findings relate to the performance of students at the compulsory education level, where the transition countries have essentially the same coverage as the OECD countries. The comparison is likely to be less favorable for secondary and higher education. Coverage is much lower, and quality and relevance, based on limited evidence from the mid-1990s, are likely lower as well. Furthermore, lifelong learning, which can arrest a deterioration of functional literacy skills, is largely nonexistent in the transition countries; for example, only 5 percent of adults in the new member states of the European Union participate in such learning.

Participation

Second, aging can be expected to lower labor force participation, which among workers 55–64 in the EU8 and Southeastern Europe is already lower than in the EU15 (figure 8.3). This is due mainly to workers exiting earlier from the labor force. More generally in the region, participation rates for older men have been falling, particularly steeply for those under 60, in part due to restructuring in the early years of transition. Participation for older women, though lower, has

FIGURE 8.3

Labor Force Participation in the EU15 and Transition Country Groups for People Ages 55–64, by Gender, 2006



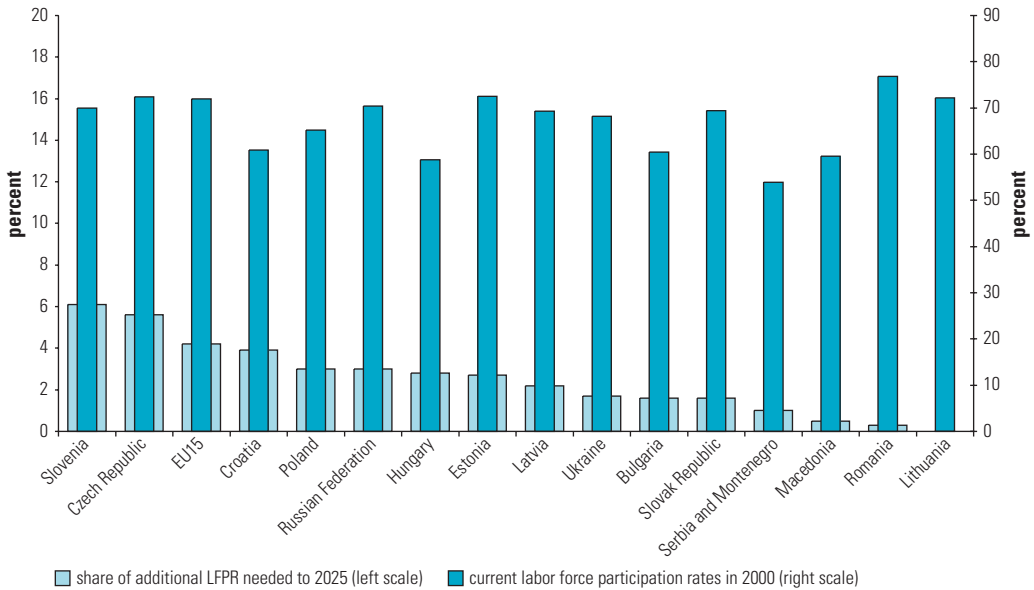
Source: ILO Key Indicators of the Labor Market (KILM) Database.

been more stable. A more detailed analysis for Albania, Bulgaria, the Russian Federation, and Turkey, only the first three of which are transition countries, shows that the effect of aging on participation rates is indeed negative, controlling for other factors that influence participation, such as the number of children in the family, number of adults, marital status, and level of education (World Bank 2007a).

What increase in labor force participation would be needed to maintain the ratio of the labor force to total population in 2025 at its 2000 level? The needed increase in the across-the-board labor force participation rate, if that were the sole policy response, ranges from 3 to 6 percentage points in Central Europe, Croatia, and the Russian Federation, comparable to and in some cases greater than that for the EU15 (figure 8.4) and provides another indication of the magnitude of the aging problem. This increase would be more difficult in the Czech Republic, Estonia, and the Russian Federation—with participation rates already close to 70 percent, comparable to those in the EU15—than in Croatia and Hungary. The full increase in this simulation may not be socially or politically feasible, but some increase in participation rates across the board, and not just for older workers, will need to be part of a broader package of measures to offset the consequences of aging for the labor supply. Increases in retirement ages, for the most part below that in the OECD countries, and their equalization for men and women will be an element of that package. That will call for reforms in labor markets, pensions, and, in some countries, the generosity of social expenditures.

FIGURE 8.4

Change in Labor Force Participation Rates Required to Maintain the Share of the Labor Force in Total Population in 2025 at 2000 Levels



Source: World Bank staff estimates drawing on data from UN Population Prospects, Labor Force Survey (LABORSTA).

Note: Data for Bulgaria are for 2003.

Savings

The effects of aging go beyond its impact on productivity and labor force participation. It can lead to a significant decline in the household savings rate, even controlling for levels and growth of income per capita, urbanization, and foreign and government savings. The declines in household savings rates would be greatest in Bulgaria, the Czech Republic, and Poland, with large projected increases in old age dependency. But household savings are less important as a source of funds for investment in the transition countries, ranging from negligible in Kazakhstan to 40 percent in Poland, than in France and Germany, for example, where they account for more than half of investment. Corporate savings, government savings, and foreign savings are more important in financing investment.

Pensions

But growing pensions and health care expenditures associated with an aging population can reduce government savings as well. Indeed, without reforms, aging can put pension systems under acute pres-

sure. Compared with OECD countries, transition countries on average have pension dependency ratios (the ratio of beneficiaries to contributors) much higher than their population dependency ratios (the ratio of individuals above 64 years of age to those in the working age population). This is due to early retirement, encouraged in the early years of transition in the wake of enterprise restructuring, to high rates of unemployment among certain age groups, and to a large informal sector that does not make pension contributions.

Some transition countries have even more generous pension provisions than the OECD. Ukraine, one of the more rapidly aging transition countries, spends 15.4 percent of its GDP on pensions, more than the 14.2 percent in Italy, the highest spending OECD country, four times as rich. But Georgia, Lithuania, Romania, Serbia, and the Slovak Republic have already enacted pension reforms more far-reaching than have OECD countries—reforms that will substantially mitigate the impact of aging on pension spending. There are two important parameters in such reforms. First is the retirement age for men and women, which even in some reforming countries continues to be lower than the 65 years usually prevailing in the OECD countries. Second is indexing pensions post-retirement to inflation, to maintain their purchasing power, rather than to wage growth. Note that pension benefits after comprehensive reforms will be inadequate to prevent old age poverty in some countries. They will need to be supplemented by social assistance.

Health

Public expenditures on health, ranging from 0.9 percent of GDP in Georgia to 6.6 percent of GDP in Serbia and Montenegro, have been growing faster than GDP in most transition countries. The growth in health spending owes less to aging and more to advances in medical technology, productivity, and societal preferences. But spending on long-term care, expected to increase substantially with aging, could be contained only through the design of delivery arrangements—introducing a category of care that is part medical and part social, located between home care and primary care. Perhaps the longest term policy strategy is promoting a healthier elderly population.

A Policy Package

What is needed to meet the demographic challenge? Raising labor force participation for men and women through delaying retirement

or reducing the tax wedge on labor—social security contributions plus personal income tax as a proportion of gross labor costs—where less distortionary taxation or coordinated expenditure cuts are an option. Generating public savings through pension and health sector reform. Building a training and education framework conducive to lifelong learning.

These reforms do not look overly ambitious. Indeed, they are similar to those under way in the aging societies of Western Europe and Japan. But the aging transition countries are much poorer and have generally less mature institutions for economic policy making. Aging will thus pose a serious challenge to growth prospects in the transition countries.

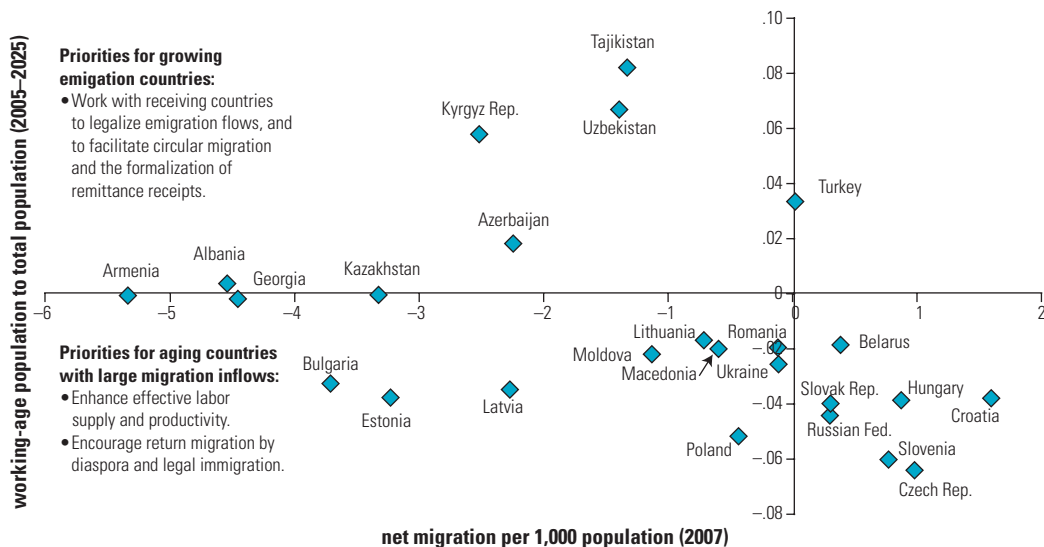
For these reasons, the deleterious effect of aging on labor supply will need to be offset through faster growth in productivity as well. But productivity growth requires attention to all the issues to do with the business environment for firms that were the subject of Chapters 2 and 3. Failing to deal with them will derail the convergence toward the EU15 living standards to which many transition countries aspire.

The Role of Migration

Migration is not a substitute for policies to offset the consequences of aging. But it can be one part of the solution. Countries can be classified by whether the share of the working age population is projected to rise or fall till 2025 and whether they were net senders or recipients of migrants in 2007 (figure 8.5). Belarus, Croatia, the Czech Republic, Hungary, the Russian Federation the Slovak Republic and Slovenia are examples of aging societies that are net receivers of migrants (in the southeast quadrant). By contrast, Albania, Azerbaijan, Turkey and all countries except Kazakhstan in Central Asia are projected to see a rising share of the working age population in total populations. With the exception of Turkey, where immigration and emigration are broadly in balance, these countries are net senders of migrants (in the northwest quadrant). Among the countries where the share of the working age population is expected to decline or stay unchanged, Armenia, Georgia, Moldova, Bulgaria, the Baltic states, Macedonia, Poland, Romania and Ukraine are net senders of migrants (in the southwest quadrant, including the horizontal axis).

As incomes per capita rise rapidly in the wealthier transition countries, it is likely that net senders among them, such as Poland and the Baltic states that currently export labor to the EU15, where growth is typically slower, will become net receiving countries. This will be

FIGURE 8.5
Migration and Demography—Policy Implications



Source: UN Population Prospects Database and national statistical authorities.

accelerated by labor market shortages that have emerged in some EU8 countries. Such receiving countries will wish to combine circular immigration from poorer sending countries with reverse migration of their own citizens from the EU15 countries. This would be consistent with the historical experience of migration flows from Southern Europe—Greece, Italy, Portugal, and Spain—as well as Ireland, which shifted from being net emigration to net immigration countries during the post-World War II period. The poorer aging countries, such as Macedonia and Moldova, will continue to be net sending countries, though possibly at a slower rate for the foreseeable future. And outflows from Armenia and Georgia, both sending countries could continue for a long time to the Russian Federation, which faces more acute aging than either of them. Hence circular migration, with the particular features highlighted in Chapter 7, could play a role in a broader policy package designed to meet the demographic challenge in the aging transition countries.

These developments will also affect the EU15 countries that rely on migrants from Poland and the Baltic states to fill labor market shortages. Since the new member states of the EU are aging faster than the EU15, the latter will need to look farther afield to countries where populations are young and growing, such as Turkey, Central Asia, and beyond.

Endnotes

1. The equation associated with figure 1.1 can be written in terms of growth rates as follows: Growth in GDP per capita = Growth in aggregate labor productivity + Growth in the employment rate + Growth in the share of the working age population in total population.
2. Countries from the region that participated in the PISA survey in 2006 were Azerbaijan, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, the Kyrgyz Republic, Latvia, Lithuania, Montenegro, Poland, Romania, the Russian Federation, Serbia, the Slovak Republic, Slovenia, and Turkey.
3. Reading scores were correlated with those in science.

