

V. HOW WILL AGEING AFFECT EAST ASIA'S GROWTH?

East Asia's rapid growth benefitted substantially from its young population. The demographic dividend that the region enjoyed accounted for as much as one-third of economic growth over the last several decades in some countries. The decline in fertility rates and the ageing population in some of the large economies now however have brought an end to this demographic dividend. But the effects on economic growth are likely to be asymmetrical and much smaller than during the previous decades. It will adversely affect growth, but only modestly due to offsetting factors, including increased labor force participation of those in working age and longer working lives than in the past. While ageing will increase fiscal and health costs, the impact will vary based on the size and role of government and will also be mitigated by behavioral changes and corrective policies.

Rapidly shifting demographics will become increasingly important in shaping economic developments in East Asia and the Pacific. Under current projections, dependency ratios across East Asia are likely to increase sharply over the next thirty-four years.¹⁶ These shifts are likely to completely reverse the favorable demographics over the last half a century, when dependency ratios in East Asia fell by one-third to as much as half while the share of the working age population grew (Figure 54 through Figure 57). While behavioral changes, policies and increased saving will likely offset part of the negative demographics, it appears that growth rates for the larger economies in the region will be affected negatively over the long term.

Ageing impacts growth

The end of declining dependency ratios is likely to have a negative impact on growth. Favorable demographics are estimated to have contributed about 15–44 percent to the rise in per capita incomes over the last decades in East Asia, with the average for developing East Asia close to 25 percent.¹⁷ And working-age population and per capita incomes were strongly correlated throughout East Asia over the last several decades.

Over the next 30-40 years, the share of working age population to total population in East Asia will fall by 10 to 20 percentage points or more. Capital per worker will rise substantially, however, helping—together with changing personal attitudes and policies—limit the declines in per capita incomes. In the absence of such offsetting factors per-capita incomes would fall by nearly one-third.¹⁸

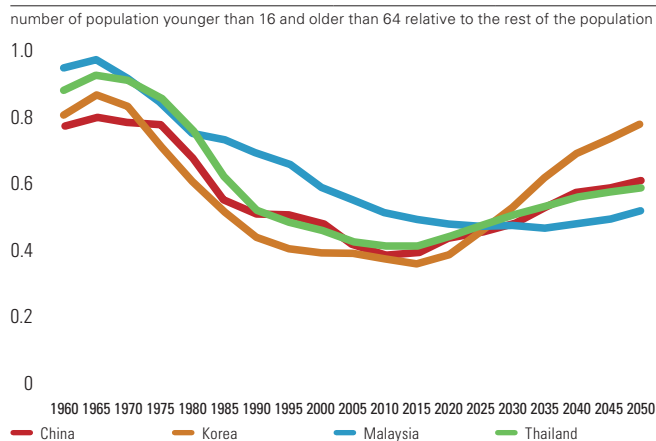
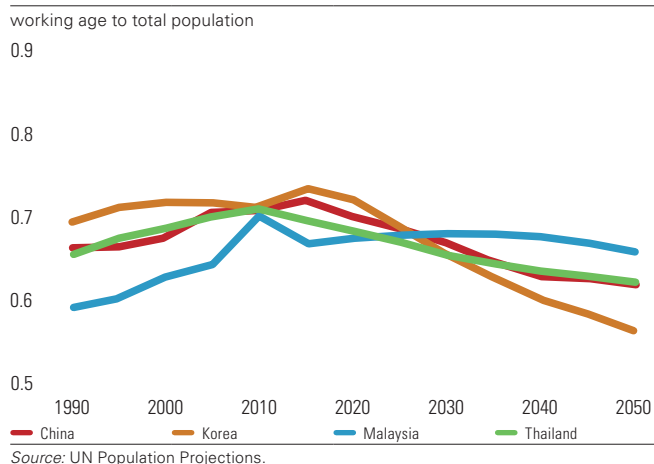
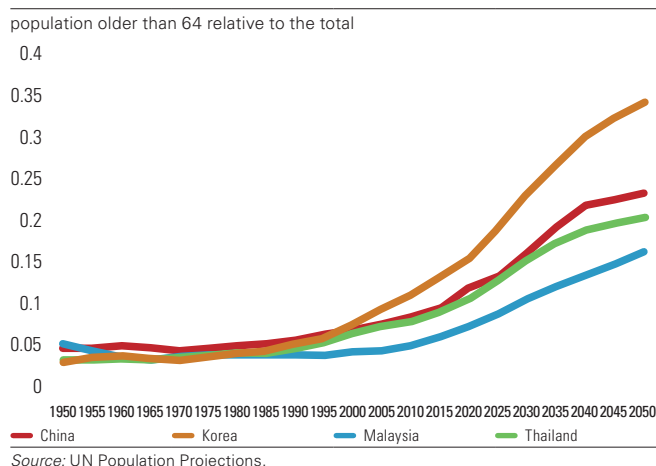
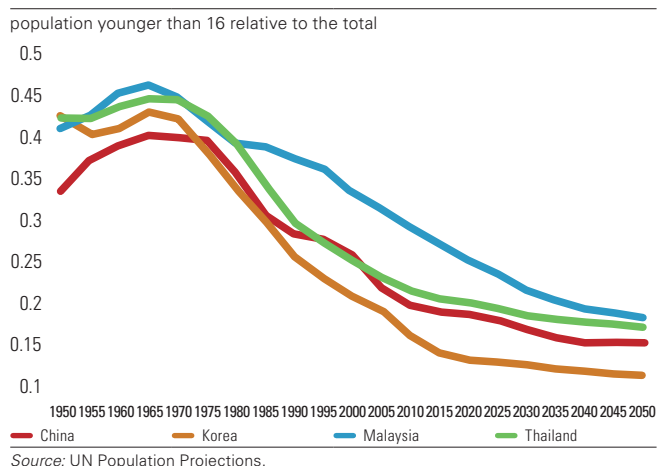
Ageing is not all: countervailing factors, behavioral changes, and policies

Several factors at least partly offset the impact of ageing on growth and make the impact of demographic changes asymmetrical. While favorable demographics of a young population fifty years ago had a significant positive impact on growth, unfavorable demographics of an ageing population will have a much less important negative impact. Among the most important countervailing factors, are behavioral changes in the population in response to ageing. These can partly offset the rise in dependency ratios by increasing labor force participation rates for working

¹⁶ The dependency ratio is the ratio of those ages 15 and below and those older than 64 relative to the rest of the population.

¹⁷ Bloom and Williamson (1998), Kelley and Schmidt (2005).

¹⁸ The analysis uses the following equation: $(GDP/Population) = (GDP/Labor) \times (Labor/Working-age-population) \times (Working-age-population/Population)$.

Figure 54. Dependency ratios are on the rise after half a century of decline...**Figure 55.** ...reflecting a reduction in the working age population, ...**Figure 56.** ...and the increase in the share of the elderly**Figure 57.** ...as the share of the young is bottoming out

age and older ages, the latter extending working lives, increasing productivity through education and urbanization and capital deepening if households increase their savings rates in anticipation of longer life expectancy. In fact, some empirical estimates of the impact of ageing on growth in high-income economies suggest that ageing has a negative but statistically insignificant effect on growth.¹⁹

In the NIEs, for example, employment rates averaged 75 percent of the working age population over the last decade. Countries in developing East Asia have lower employment rates, and thus have scope for further increases. Another offsetting factor will be the continuation or even the increase of the high rates of labor productivity growth seen in the past decade. Assuming the offsetting factors of employment rates of 75 percent throughout East Asia, and productivity growth on par with that observed in the past decades (9 percent in China and 4 percent in Thailand, Malaysia, and for the region as a whole), ageing will reduce per capita income growth rates by at most 0.5 percentage points a year on average in these countries. Relative to a scenario of no demographic change, incomes will be

¹⁹ Bloom, et al. (2008).

10 percent lower on average in 2030 and about 17 percent lower than in 2050. In the event, that productivity growth rates and employment rates are lower than envisaged; the slowdown in per capita growth rates will be greater.

Negative growth impact from rising fiscal and health costs of aging

There is however another set of factors that will increase the impact of ageing on growth. These arise from ageing-related fiscal and health costs that can crowd out productive investments. Their actual impact will depend on the level of development and the pension and health care systems prevalent in the country.

At present, countries in developing East Asia have relatively moderate pension penetration and replacement ratios. However many have already begun the process of increasing access to social insurance systems and can be expected to experience a rapidly increasing share of the population eligible to receive a pension compared to current levels over the next two-three decades. Increases of as much as five times for the middle-income countries and more than ten times for the lower-income ones are possible.

As societies age, health care costs are likely to rise substantially due to several factors. Firstly, per capita expenditures for healthcare are strongly correlated with age. Secondly, access to services and coverage through social insurance financing tends to rise with income growth. Thirdly, the rapid development of medical technology creates an autonomous cost-push factor as health providers aim to provide improved diagnostics and cures.

Simulations of the impact of ageing on health costs suggest a sustained escalation. If observed patterns of access to health care and the levels of relative spending by age are assumed health outlays are projected to rise from the current level of 3 to 7 percent of GDP to more than 10 percent over the next decades (Table 6). Unlike pensions, however, experience with health care has shown health care consumption grows disproportionately faster than income growth. This creates the potential for expenditures to increase far beyond the impact of ageing and access. If the experience of OECD countries is taken into account (where health care spending is estimated to have increased by 1.28 percent for each 1 percent of per capita GDP growth), expenditure estimates can potentially reach extremely high levels ranging from 17 to 33 percent of GDP.

The role of government policies

Government policies will have an important bearing on the impact of ageing on growth. Policies that could help mitigate the negative effect include measures to encourage a longer working life through delays in retirement, flexible old-age pension schemes, and adjustments in the premiums and benefits in pension systems. The

Table 6. Health Spending is projected to rise sharply

in percent of GDP				
	2009/2010	2030	2050	2070
Ageing only				
Middle income maturing*/	5.0	7.4	10.3	12.7
Middle and low income, developing*/	4.0	5.7	7.2	8.4
Ageing and access				
Middle income maturing	5.0	8.0	11.6	14.5
Middle and low income, developing	4.0	6.2	9.3	12.9
Ageing, access, and cost growth				
Middle income maturing	5.0	10.1	19.7	33.6
Middle and low income, developing	4.0	7.8	15.4	28.9

Sources: UN World Population Prospects and World Bank staff calculations.

Note: The classifications refer to an assessment of health systems. Middle-income maturing includes data on China and Malaysia, middle- and low-income developing includes Thailand, Indonesia, Vietnam, and PNG.

organization of health care delivery and the financing mechanisms can have very significant effects on overall costs. An active approach to old-age and increased access to preventive health care will ameliorate the effects of ageing by compressing the years of morbidity. Other policies that encourage more labor force participation through flexible working arrangement and improvements in child care systems will also help in this regard.

Another vital policy that will help is migration. A well-managed labor migration strategy will help ameliorate the impending labor shortages in some countries arising from these demographic changes, while providing opportunities for countries with excess labor to provide migrant workers and benefit from greater remittance flows (Box 6).

Box 6. Advancing labor mobility in East Asia: One scheme at a time

East Asia and the Pacific is one of the most integrated regions in the world in terms of goods and capital flows. The integration of labor markets within the region is lagging, as the legal flows of both skilled and unskilled people remain relatively small. The ASEAN declaration on migration has sought to give this issue priority by focusing the agenda on enhancing the mobility of skilled workers through a framework of regional accreditation of skills and supporting the mobility of unskilled workers by encouraging labor-sending and receiving countries to work together. The latter is considered particularly important because of its potential to reduce joblessness and poverty. Rising pressures to attract labor provide the opportunity to explore labor mobility for East Asia's poor. Labor mobility is also one of the most contentious issues, with the popular perception often one of ill-managed illegal flows of labor accompanied by the social ills of wage depression, overstayers and anecdotes of worker abuse. If more progress is to be made in opening up labor markets to the poor, then mechanisms need to be found to address the concerns of labor-sending and receiving countries.

One such mechanism is the bilateral agreement (BLA) between countries to institute a temporary movement of persons (TMP) scheme. Such schemes have been instituted globally before but many of them failed. The failures teach valuable lessons, however, on how to design and implement such schemes. Indeed, a few best practice schemes now exist within East Asia with Singapore, Philippines and the Pacific islands demonstrating how sound policy and good institutional support can deliver results for all. Some of these lessons are:

- 1. Get the scheme design right by paying attention to the four Cs: cost, circularity, choice of workers and commercial viability.** Attention to the fixed costs of moving for the poor is paramount - the higher the costs, the longer it will take to recoup them. A circular scheme which allows multiple access opportunities to employment is likely to discourage overstaying and encourage workers to invest in skills. The appropriate choice of qualifications for the type of work selected is important. And linking access to foreign labor markets to commercial considerations rather than to inflexible quotas can reduce the social tide from turning against foreign workers.
- 2. Sending and receiving countries need to work together.** This entails attention on the sending country side to maintaining sound recruitment regulations, procedures and oversight, timely information dissemination to the workforce about foreign labor markets, their rights and obligations, pre-departure training, portability of benefits (if available) and repatriation procedures if they become necessary. Similarly, on the receiving country side, employers and support institutions need to be aware of their respective roles in recruitment, the contractual obligations of the work agreement, wages and any allowable deductions that have been negotiated in the BLAs such as airfare or other levies.
- 3. Measure the development impact of TMP schemes to gain wide support from the stakeholders involved.** This can be done through a systematic collection of data from a sample of migrants. Such efforts can be expensive and are of a long term nature, but can be justified since they generate evidence on the benefits and offer insights on which programs are working well and which ones need modifications.

Source: Manjula Luthria.