2 DEMOGRAPHIC CHANGES AND CURRENT ECONOMIC CRISES: SOME LESSONS FOR INDIA

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ABSTRACT

World across we are witnessing rapid increase in the elderly population. Most of the developed world at present is facing enormous fiscal strain due to the ageing demographic profile of their population. The high current fiscal deficits in most developed countries appear unsustainable because most elder people are living longer. At the same time, these countries do not have enough young working population to generate sufficient tax revenues for the government to provide old age support to increasing number in the form of liberal pensions and medical facilities. The root cause of the current economic crises in most of the developed world appears to be the rapid ageing demographic profile of their population. This phenomenon of demographic ageing is going to present enormous fiscal challenges for most countries in the twenty first century. What are the various economic and social implications of population ageing? What measures have been undertaken in the developed world to tackle the problems arising due to their population ageing? At present, India has a young demographic profile. But due to its huge population base, senior citizen component is already significant and is growing at the fastest rate. Is India prepared for this coming old age population burden? What measures have already been to manage population aging? What still needs to be done to successfully face this slowly emerging demographic challenge? This paper is an attempt to answer the above questions.

Keywords: Population ageing, Demography, Fiscal burden, Economic growth, Pension.

Demography works in strange ways. Few decades back every one was worried about high birth rates in India and population explosion was considered to be the main cause of poverty, hyper inflation and unemployment. Now as the baby's born during that phase of very high fertility growth have grown young and are adding to labour force in large numbers, this development is being seen as a highly positive factor leading to long periods of demographic dividend. India has suddenly become a focus of attention for investors worldwide due to its young population base that is likely to lead to high income tax collections, savings, investment, consumption and growth. Despite many negatives in the current fiscal, India is still expected to achieve close to 7% GDP growth, which is one of the highest in the world. This in itself lends credibility to the often repeated argument that India is insulated somewhat from the effects of global pressures as its growth is primarily driven by strong domestic fundamentals. With right policy initiatives to exploit the present favourable window of demographic dividend, India could achieve a still high GDP growth rates for many years to come.

The opposite of this happened in the developed world. Some decades ago their low birth rate was considered a boon which led to a low population base. This helped in spreading the benefits of economic growth to a low population base resulting in a high per capital income and thus higher standard of living. Now with fertility rate down below replacement rates and increase in life expectancies in most of the developed world, the young working age population is decreasing and old age population is increasing fast. The focus has now

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shifted to the continuous increase in fiscal strain put by the promised liberal old age benefits to the rapidly growing number of retirees. The economic growth rates are already down in most of the developed world with little hope of recovery in near future.

Due to higher life expectancy and reduced fertility, most of the developed economies are today confronted with the problem of aging population. The trend of higher life expectancy emerged faster and earlier than the trend of declining fertility in most countries. More than the decrease in birth rates, it is the substantial and fast increase in life expectancies that is responsible for fast growth in the aged people. Even with fertility rates down below replacement rates in most of Europe, USA and some developed countries of Asia, population is still growing because of significant increase in life expectancy. But if this trend continues for long, we could see a declining population in most of these countries. The trend has already started in Japan and in some countries of Europe.

One important reason for decline in birth rates is growing urbanization. More than half the world's population now lives in cities, where children become an expensive economic liability and not an additional pair of hands to support in agricultural operations. Also with women joining the work force in large numbers in urban areas, it becomes difficult to combine carrier with large family size.

Another significant reason for the current spurt in aged people in developed world is the ongoing ageing of baby boomers. United States and Western Europe saw particularly dramatic increases in birth rates during first few decades after World War II. As these global baby boomers have started ageing, they too are adding to the population explosion of seniors.

In the western world, during 20th century many of the state funded social security systems like old age pension and health care became very generous. Now the aging population is undermining the current and future sustainability of their universal and liberal old age social and income security programmes (CRIISP, 2011). The decline in their young population is reducing the growth rate and tax base and increase in the old aged population is putting pressure on public expenditure leading to high deficit financing and government debt. Currently most of the Europe and U.S. is reeling under the fiscal pressure generated by their liberal old age social and income security programmes. The government debt has increased to such an extent that many countries in Europe will find it difficult to honour fully their pension and health care commitments. Attempt at social security reforms in some countries of Europe in the form of increasing the retirement age, eligibility age for full pension benefits and cutting back on some other liberal entitlements is meeting with stiff public resistance. We have seen this recently in France and England.

Most European Union members have a weak fiscal position depicted by huge public debt, large budget deficits on account of mainly enormous expenditure for healthcare and pension expenses. The root cause of the current economic crises in Europe, US and most of the developed world is, rapidly ageing demographic profile of their population. The current Greece crisis should be considered as an advance warning to most of the developed world that temporary economic rescue packages may not be enough and that they need to take some drastic long term measures on the demographic front to pick up the growth momentum. When the IMF recently calculated the impact of the recent financial crisis, it found that the costs will indeed be huge. But it also noted that in the longer term these costs will be dwarfed by age-related spending. Looking ahead to the period between now and 2050, it predicted that "for advanced countries, the fiscal burden of the crisis will be about 10% of the ageing-related costs". The other 90% will be extra spending on pensions, health and long-term care.

The rich world's population is ageing fast, and the poor world is only a few decades behind. According to the UN's latest biennial population forecast, the median age for all countries is due to rise from 29 now to 38 by 2050. At present just under 11% of the world's 6.9 billion people are over 60. Taking the UN's central forecast, by 2050 that share will have risen to 22% (of a population of over 9 billion), and in the developed countries to 33%. This phenomenon of ageing is going to present enormous fiscal, economic, political and social challenges for most countries in the twenty first century. In coming years age-related spending around the world, will be more than any other expense. Yet very few countries have taken serious note of this, particular many developing countries with a young demographic profile.

IMPLICATIONS OF POPULATION AGEING

As is being experienced by developed world, population ageing has serious economic, social and political implications. These are in the form of:

1. **Problem of labour supply:** With growing aging of population, the number of people of a working, taxable age will shrink. This could have a negative impact on the GDP growth rate unless productivity rises faster. This could result in gaps in the jobs market, with businesses and public services lacking the workforce required.
2. **Fiscal pressures:** With the elderly being the fastest growing age group, increasing pressure is put on the government budget for increased provisioning for old age social and income security. In countries where public pensions are generous, these will take up a much larger share of the budget. Spending on health, in most rich countries has been going up relentlessly. Expensive advances in medical research, combined with greater longevity is putting double pressure on the fiscal. On one hand government has to make increasing budgetary allocation for medical research and then allocate higher resources for the old age health care over longer periods necessitated by increase in life expectancy. Maintaining generous pension and health care promises require either substantial tax increases, which could adversely affect economic growth or worse, ever increasing budget deficits.
3. **Adverse effect on economic growth:** For sustained economic growth, societies must save to be able to allocate funds for investment for the future, in such things as education, factories, offices, infrastructure, energy and hospitals. If older people don't save or run down their savings, then a shortage of savings could seriously affect economic performance. With more of old people, there would be lack of demand, lack of investment, lack of entrepreneurship, and a decline in prices of all local assets.
4. **Societies becoming more risk averse:** Countries dominated by older citizens may also become more risk-averse. Fewer young adults mean fewer people needing to purchase new homes, new furniture, and the like, as well as fewer people likely to take entrepreneurial risks. Older societies are therefore likely to be less innovative and more risk averse so that there is less technological progress.
5. **Decline in equity and property values:** As population age, savings in the economy as a whole will be run down and assets sold off. This is likely to lead to decline in equity and property values. It has been observed that the relative abundance of young people coincide with high property prices and a relative abundance of old people with lower property prices (Nishimura, 2010).
6. **Political fallout:** With the ageing demographic profile, there will be significant number of senior citizen voters. It will become increasingly difficult for the government of the day to implement any austerity measure meant at cutting back on liberal entitlements to them at that stage. In times to come, aged people are more likely to use their number strength at the ballot box to push for policies that specifically benefit them.
7. **Impact on intergenerational relations:** Ageing results in significant increase in dependency ratio, wherein a small number of young working people will have to support a large number of retirees. This could have an adverse effect on inter-generational relations with young working people looking upon old people as more of a burden than as the respectful citizens.

RESPONSE TO AGEING CRISES

Developed world has responded to ageing crises in a number of ways:

1. **Immigration:** To make good shortfalls in their working age population some countries have over a long period followed an easy migration policy (especially USA). The young migrant contribute to taxes and thus raise government revenues. While immigration has these benefits, large migration

from countries with different cultures and social background could have adverse consequences in the form of social unrest at some stage. Many countries therefore avoid mass migration as a method of reducing the age related fiscal stress. It creates problem of integration and assimilation.

2. **Increasing the family size:** To tackle the problem of ageing, developed economies would have to think of the ways to increase their fertility rates. A number of countries have tried this by offering financial incentives. But it has little impact. The problem is that modern urban life in rich countries is not well adapted to large families. Women find it hard to combine family and career. They often compromise by having just one child. Excessive individualism in western culture is also responsible for low fertility.

3. **Pension and Social Security Reforms:** Governments in rich countries have now understood that their pension and health-care promises will soon become unaffordable. Many of them have embarked on reforms, but so far only timidly. These reforms are taking place gradually in the form of cutting back on many liberal entitlements, increase in retirement age and eligibility age for entitlement of full pension.

4. **New financial products:** New financial products are being introduced to promote voluntary efforts by individuals to provide for their own retirement security. In most developed countries pension systems have been shifted from defined benefits to defined contribution in which, what a subscriber gets on retirement is based on his mandatory contribution during his working life and not funded by state. We are witnessing a growth in annuity market with new products like variable annuities, guaranteed annuities and inflation adjusted annuities which are tailor made to meet the special requirements of senior citizens. The government in many developed countries is also promoting reverse mortgage loan facility, which is an innovative financial arrangement that provides liquidity to the illiquid housing wealth in possession of the aged people.

LESSONS FOR INDIA

Significant demographic changes are taking place in India too. Due to high birth rates in the last few decades, India has a young demographic profile. At present the median age is 25 years. This has presented India with an opportunity of long period of demographic dividend. Demographic dividend refers to an acceleration of economic growth associated with a rise in the share of working-age population in total population. Other things equal, an economy's output will be larger if a larger share of the population is working. The demographic dividend is not an automatic consequence of favourable demographic changes but depends on the ability of the economy to productively use the additional workers. Unless we can provide gainful employment to most of them, the perceived demographic dividend may become a demographic burden. Over time, this large workforce will also retire and add to number of seniors.

Due to huge population base of India, senior citizen component is already significant and is growing at the fastest pace. At present, India is the second largest global hub of senior citizens next only to China. Slowly declining fertility and fast increase in life expectancy is leading to fastest increase in senior citizen component. According to the Census 2001, the number of older persons in India was 77 million, or 7.5% of the total population. It is projected that the number of older persons will be 96 million in 2011 (or 8.2%), 133 million by 2021(or 9.9%) and 301 million (or 17.3%) in 2051 (Rajan, 2006). The old age dependency ratio (number of old persons 60+ years) to the working age group (15-59 years) has increased from 9.8 per cent in 1981 to about 12.6 per cent in 2001 (Census of India, 2001). It is projected to increase to 16.0 in 2021, 19.0 in 2031and 28.2 in 2051. With these kind of projections, population ageing is going to emerge as the biggest challenge of this century for policymakers.

A large number of old and retired people with long retired lives, gradual collapse of joint family system, high inflation, steep rise in medical costs and limited pension coverage could pose a danger to the old age social security in the country (Asher, 2008). Unless the current demographic dividend is realised and high economic growth rates achieved in recent years, it will grow old before it get rich and the economy could be in real financial trouble in times to come.

STEPS TAKEN IN INDIA TO ADDRESS POPULATION AGEING CHALLENGE

1. **Change in pension system:** In the past, the pension system in the formal sector (for government employees) was defined benefit pension scheme. Taking a cue from the developed countries which were facing enormous fiscal pressure due to increasing burden of pension liabilities, Indian Government too felt that defined benefit pension scheme may not be fiscally sustainable in the long run. Therefore it shifted all its new recruits who joined service on or after 1st January 2004 to New Pension System (NPS), which is a defined contribution pension scheme. In this the regular contribution is governed by rules but what the subscriber gets on retirement depends on the performance of fund manager that is selected by him to manage his fund. From 1st May 2009, NPS is made applicable to large number of those in the informal sector (outside the government) like self-employed, wage earners etc (CRIISP, 2011).

2. **Launch of reverse mortgage loan scheme:** Most senior citizens living in urban areas have most of their wealth in the form of residential house property whose value has increased significantly in recent years. But most of these aged people have very little monthly income. They are house rich but cash poor. To provide a retirement solution for such people the government introduced a reverse mortgage loan facility in 2007. In this facility a house owning senior citizen can mortgage his house property with the bank and receive a monthly annuity much like pension for a fixed term or life time. This was attempt by the government to promote voluntary efforts by house owning middle class senior citizens to provide for their own old age security (NHB, 2008)

3. **New financial products:** The long retired lives have created demand for new financial products and arrangements that could help stretch out the available savings, provide liquidity to illiquid assets and make life easier for retired people (Rajagopalan, 2006). We are witnessing the launch of many new financial products that could provide retirement solution for aged people. There are many offerings of innovative pension plans from insurance companies. These new products provide fixed annuity, variable annuity or guaranteed annuity keeping in mind the specific needs of the retirees

4. **Changes proposed in the new direct tax code:** In the new direct tax code, tax incentives shall be available only for approved long term savings, which are geared towards retirement like the new pension scheme (NPS), provident fund (PF) and PPF. This could help in accumulating good corpus for the retired people.

WHAT MORE NEEDS TO BE DONE IN INDIA TO MEET AGEING CHALLENGE

1. Though the recent issues of corruption and policy paralysis have slowed down the growth rate somewhat, Indian economy is expected to continue to record sustained economic growth. The introduction of key reforms in the area of law, pension and taxation etc. will help India achieve its long term potential. In addition to high consumer spending, India also benefits from the availability of skilled manpower which provides it with an edge in the services sector. Government policies need to focus more on Infrastructure development, employment generation and addressing income inequality.

2. In India a large number of all elderly persons are illiterate, work in the unorganised sector with no regular source of income and live below poverty line. The majority of Indian elders are in potentially vulnerable situations without adequate food, clothing, or shelter. Insurance cover is virtually non-existent for them. It becomes the responsibility of the government to provide income and social security for the people at subsistence level. Providing some minimum income support to such people is likely to be a huge fiscal burden, considering their number. While the economy is growing at a good rate enjoying demographic dividend, the government of the day must provide for these future liabilities and do not leave them uncovered.

3. The level of financial literacy is very low in our country. With changes being introduced in the pension system and new annuity products being

launched, individuals increasingly have to assume more responsibility to provide for long periods of retired life. The role of financial education becomes very important in this context. More education and information is needed in the workplace to help this happen. For many employees, especially younger ones, planning for retirement seems a complex and far-away concern. Even if they are aware and informed about the need to save more, people tend to remain passive. Far too few employees understand their objectives and needs when it comes to planning for old age. So most of them fail to correctly choose, and update, their investment options.

4. To alleviate the problem of fiscal pressures, bold initiative should be taken to index the pension age to life expectancy. The retirement age of government employees in most countries was fixed at a time when life expectancy was low. The heavy public expenditure over the years on advancement in medical sciences has increased life expectancy considerably. Holding on to existing retirement ages would tantamount to negating the benefits of advancement in medical sciences. It makes perfect sense therefore to stretch the retirement age and make the old people work for some more years. It will increase tax revenues and reduces spending on pensions at the same time.
5. The new pension system and reverse mortgage loan facility have remained almost a non-starter even after number of years of their launch. Sincere efforts are required to promote their use if the government is serious about the business of reducing the old age related fiscal stress.
6. People in general need to be educated, so that they do not expect the pensions and health care benefits to become more generous. Since they now live so much longer, and mostly in good health, they will have to accept that they must also work for longer and that their pensions will be smaller.
7. Each country, depending upon the stage of its demographic transition will adopt its own strategies to deal with the problem of population ageing. Since the population ageing challenge is common to all of them, mutual learning and cooperation is essential.

CONCLUSION AND SUGGESTIONS

The Europe and US economy reeling under high fiscal deficits, rising public debts, ageing populations, deep recession, downgrading of sovereign debt, decline in asset values, stagnant consumer spending, persistent unemployment and massive slowdown in corporate investment are facing the long term prospects of slow growth. The focus of global investors' attention has shifted to India with a comparatively high youthful population and thus a very strong consumer base. The higher domestic consumption will be driven by rising income levels and a younger working population. Through proper policy measures the government must make best use of its young demographic profile.

The compulsions of coalition politics in our country make it difficult to take rational decisions that affect sizeable section of population. We have seen this in case of bill relating to new pension system (NPS). The new pension system bill is still not passed by the parliament as some political groups are insisting that it should provide guaranteed and not market based returns. But this is against the basic philosophy of new pension system that is to reduce the long term fiscal stress that population ageing creates. In India the real problem lies with the myopic view of our politicians. They simply ignore these major future liabilities, because they think that real trouble is not going to occur during their tenure. By adopting a short sighted approach, they leave an unaffordable legacy for future generations. They utilize whatever surplus is there to promote their electoral prospects.

The speed of population aging in India demands that government show a sense of urgency to the task of preparing for an older demographic structure. While the immediate priority is to fully take advantage of a demographic dividend but it should start planning for a greyer future. It should learn from the policy mistakes of the advanced economies which have fiscally unsustainable public transfers and premature retirement ages. In recent times, it has become clear how mounting government debt and deficits can lead a country to the brink of insolvency.

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