HSBC Insurance

Ageing Horizons Brief

Ageing emerging economies in Eastern Europe and Central Asia

September, 2008

HSBC Insurance and the Oxford Institute of Ageing have entered into a strategic alliance in order to build a cutting-edge research base on global ageing which will provide key information for policy and corporate decision makers. As part of the agreement, HSBC Insurance funds three research fellowships at the OIA, jointly runs the Future of Retirement research programme, and sponsors Ageing Horizons – a quarterly review bulletin which collates and integrates current research and analysis on the medium-term implications of population ageing.

This brief is a supplement to Ageing Horizons. The full review is available online, with regular updates reflecting new developments and ideas on the themes chosen for each issue.

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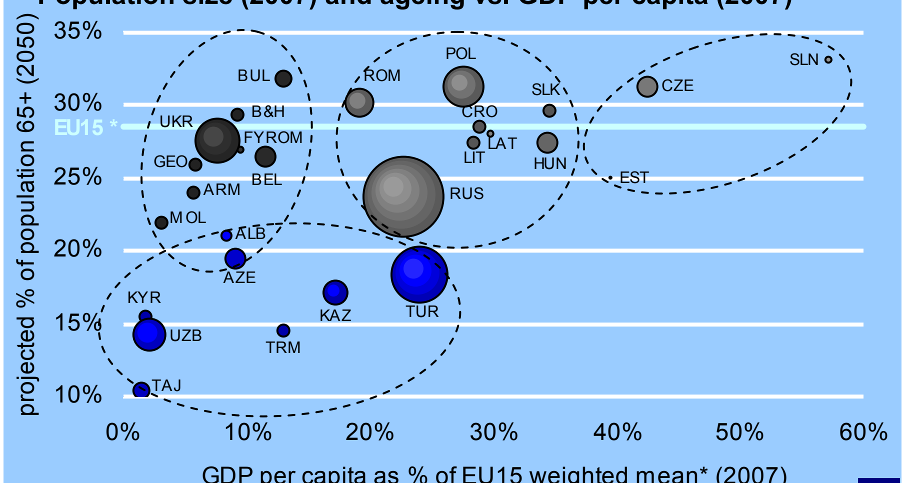
Emerging market economies in Eastern Europe and Central Asia have been growing rapidly over the last decade. Thanks to untapped natural resources, cheap labour, and the rising prosperity of a large army of consumers, some of these countries are attracting increasing international investment. As economic and corporate profits growth in advanced markets declines, the emerging markets have the potential to become an important investment destination and a significant contributor to global economic growth. The promise of the East may, however, remain unfulfilled due to demographic ageing and shrinking populations. This data brief looks at the effects of demographic ageing on the populations, workforces, healthcare, and pensions in emerging markets in the region of Eastern Europe and Central Asia, including the new EU member states, South East Europe, former Soviet Union, and Turkey. ■

► Emerging economies

Although the economy of the region is still rather small, its population is ageing fast. With a combined population of 480m – compared with 390m in the advanced European nations (EU15) – the region's GDP is just 23% of that of EU15. The countries in the region with the youngest populations, which are all predominantly Muslim, include some of the least affluent Central Asian countries as well as moderately affluent Kazakhstan and Turkey. As fig.1 shows, the rest of the region will have an age profile in 2050 similar to EU15. Even the most affluent of these nations, however, the Slovenians, Czechs and Estonians, have a long way to go before their GDP per capita catches up with the average for the EU15. In 2007 GDP per capita in these countries was around 50% of the EU15 average, which is comparable to Portugal, the EU laggard. Most of the new EU member states, along with Russia as the most populous country in the region, have GDP per capita between 1/5th and 1/3rd of the EU15 average. GDP per capita is even lower – less than 1/8th of the EU15 average – in a final cluster of nations that includes one of the two most recent EU member states, Bulgaria.

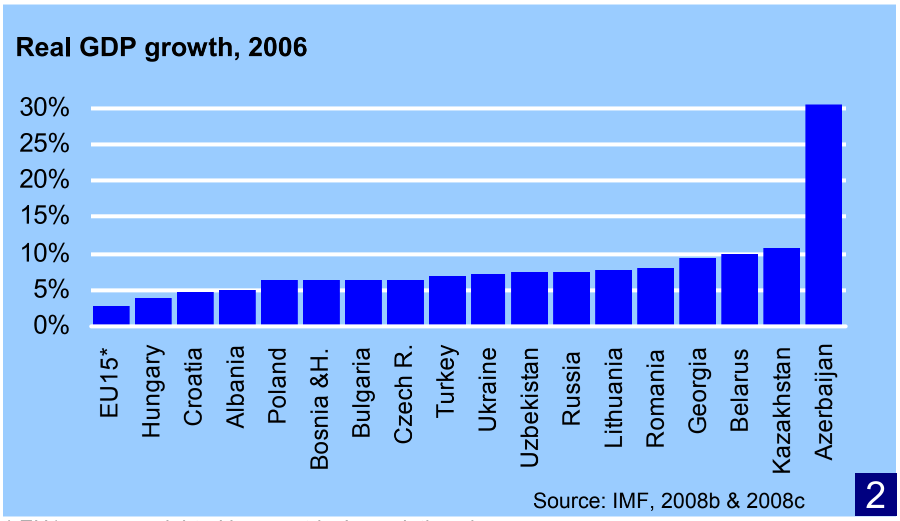
Population size (2007) and ageing vs. GDP per capita (2007)



Source: UN, 2007; IMF, 2008a

Note: Bubbles represent population size in 2007; no data available for Serbia and Montenegro
* EU15 mean weighted by countries' population size

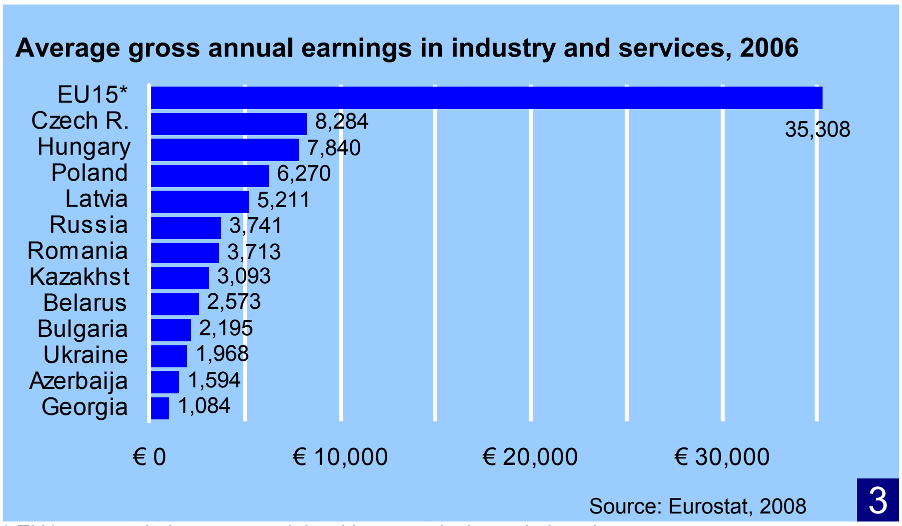
Emerging markets are small, but fast-growing



* EU15 mean weighted by countries' population size

Although the emerging markets in Eastern Europe and Central Asia are still rather small compared with the advanced European nations, they are growing much faster (partly because they are so much smaller). Azerbaijan, for example, had the world's highest rate of economic growth in 2006, thanks mainly to the construction of a new pipeline to transport Caspian oil from to Turkey via Georgia (and the oil transit fees significantly boosted the Georgian economy). Although such growth cannot be sustained, resource-rich economies are likely to continue growing at high rates, providing investors with opportunities for high returns and increasing the spending power of consumers.

There is an enormous pay differential between advanced and emerging economies



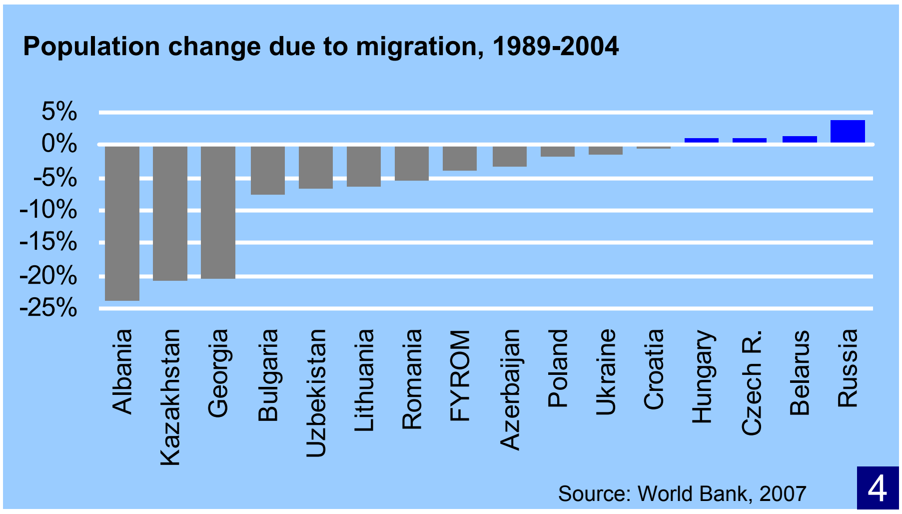
* EU15 except Italy, mean weighted by countries' population size

The enormous pay differential between advanced and emerging economies makes even qualified labour much cheaper in the latter. The supply of cheap labour and the increased spending power of consumers in emerging economies provide Western manufactures with incentives to invest in production in the East in order to save on both the labour costs of production and the costs of shipping their products to the growing emerging markets. The pay differential also encourages workers in Eastern Europe and Central Asia to migrate westwards in search of better employment opportunities. ■

►Ageing populations

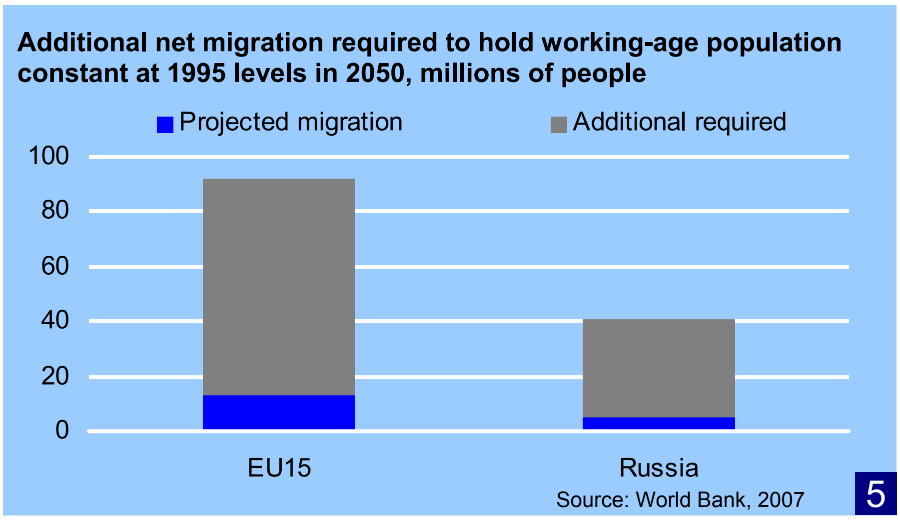
Migration, falling fertility rates, and life expectancy growth drive demographic ageing and population decline in most emerging economies.

Most emerging economies experience negative net migration



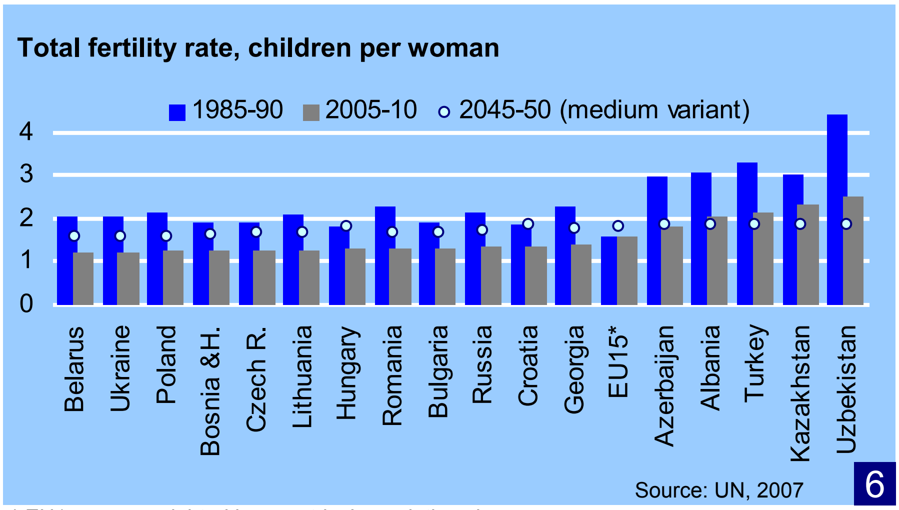
Since the breakdown of the Eastern Bloc, many young workers from Central Asian and other former Soviet republics have been migrating to Russia, making it the second largest immigration country worldwide (World Bank, 2007). At the same time, many young Eastern Europeans migrated to EU15, or more affluent Eastern European countries, such as Hungary and the Czech Republic. The 2004 EU accession accelerated migration from new EU member states to EU15, but made it considerably more difficult for workers from the neighbouring non-EU states to move to new EU member states, e.g. from Moldova to Romania, from Belarus to Poland, and from the Ukraine to the Czech Republic. Overall, EU accession is likely to accelerate population ageing in new EU member states and slightly inhibit it in EU15 and Russia.

Migration alone is unlikely to fully offset the negative effects of demographic ageing on labour supply



However, neither EU15, nor the emerging economies with positive net migration, will be able to alleviate the projected shortage of workforces through migration alone. In order to hold their workforces constant at the 1995 levels in 2050, EU15 and Russia would need to increase immigration seven-fold and five-fold, respectively. This is unlikely to be feasible in the long run.

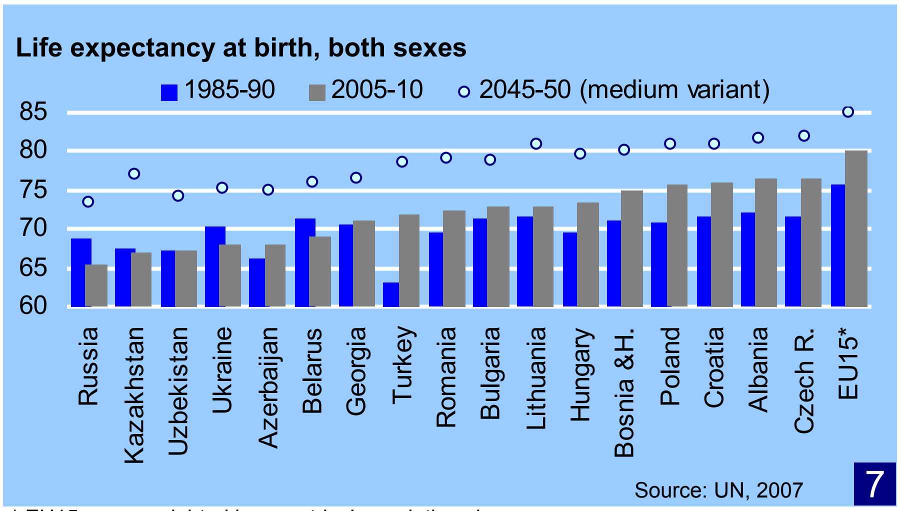
Fertility decline in emerging economies is greater than in EU15



* EU15 mean weighted by countries' population size

Over the last two decades, the total fertility rate (TFR) in EU15 has remained stable at approximately 1.6 children per woman, i.e. below the replacement level of approx. 2.1. Over the same period (since the collapse of Communist rule in 1989), most Eastern European countries have seen very sharp falls in TFR from above or around the replacement level to even below the EU15 average. In Belarus, the Ukraine, and Poland, TFR dropped from 2.1 to 1.2 children per woman. TFR in the region's Muslim countries has fallen no less dramatically, e.g. from 4.4 to 2.5 in Uzbekistan – but not significantly below replacement level. Whether fertility rates will recover is uncertain. The UN medium-variant projection shown in fig. 6 assumes that by 2050 fertility rates in all countries of the region will converge to approximately 1.85 children per woman.

Life expectancy in emerging economies is considerably lower than in EU15

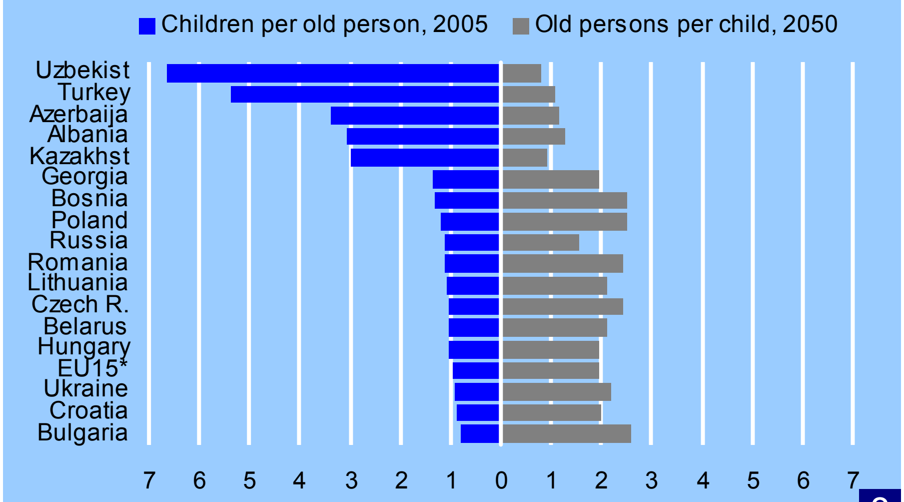


* EU15 mean weighted by countries' population size

The contrast between the trajectories of life expectancy in Turkey, Albania, and the new EU member states, on the one hand, and Russia and some other countries of the former Soviet Union, on the other, could not be more marked. In the former, life expectancy increased faster over the last two decades than in EU15. However, in Russia, Ukraine and Belarus, life expectancy has actually fallen. In none of these emerging market economies, not even the richest among them, is life expectancy as high as in the EU15. Nor does the UN expect any of them to catch up with EU15 by 2050 – though the gap in life expectancy is forecast to narrow quite considerably.

Even if rapid fertility decline in emerging economies stops, there will be more old persons than children in 2050

Projected ratio of old persons (65+) to children (0-14), 2005-2050



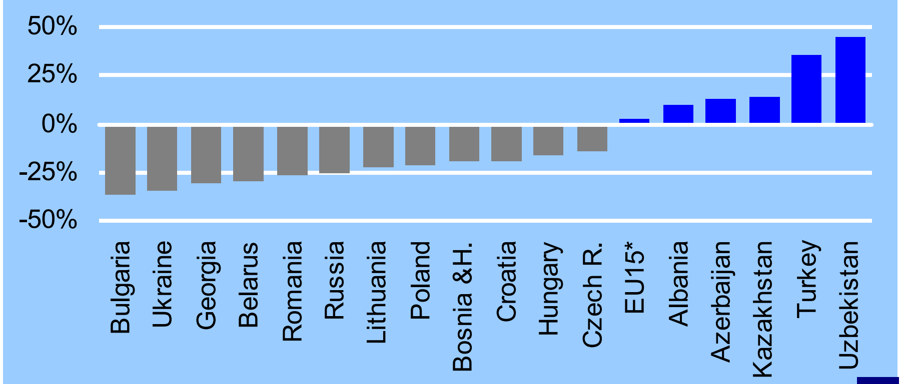
Source: UN, 2007, medium variant 8

* EU15 mean weighted by countries' population size

Due to rapid fertility decline, the age structure of the population in emerging economies has been profoundly changing over the last two decades. Although most emerging economies still have more children than old persons, it is expected that by 2050 there will be more old persons than children. Even in Muslim countries, which now have several times more children than old persons, in forty years' time there will be approximately equal shares of children and old persons. Turkey, for example, now has more than five children per every old person. By 2050, it will have more than one old person per every child.

Most emerging economies are set to lose a significant share of their populations

Projected population change, 2005-2050



Source: UN, 2007, medium variant 9

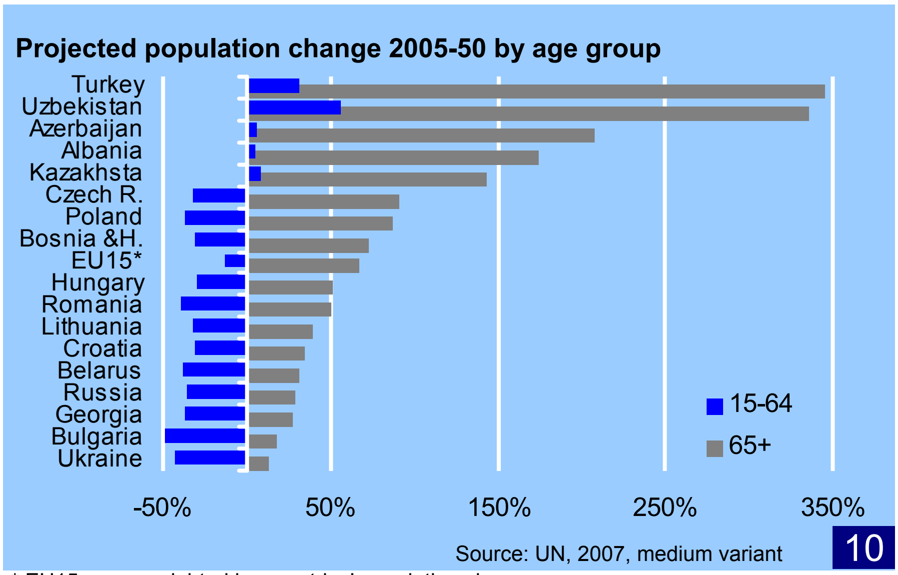
* EU15 mean weighted by countries' population size

Low fertility is the main cause of population decline in most emerging economies. Even in countries with positive net migration, such as the Czech Republic and Russia, the population in 2050 is expected to have shrunk by 13% and 25%, respectively. The populations of countries with negative migration, such as Bulgaria and the Ukraine, are expected to shrink by approximately one third. At the same time, the populations of countries with above-replacement-level fertility, such as Turkey and Uzbekistan, are expected to have grown in 2050 by 36% and 44%, respectively. ■

►Diminishing workforces

The countries of Eastern Europe and Central Asia face a common challenge of providing for the needs of the growing old-age population while sustaining workforce supply for their emerging economies.

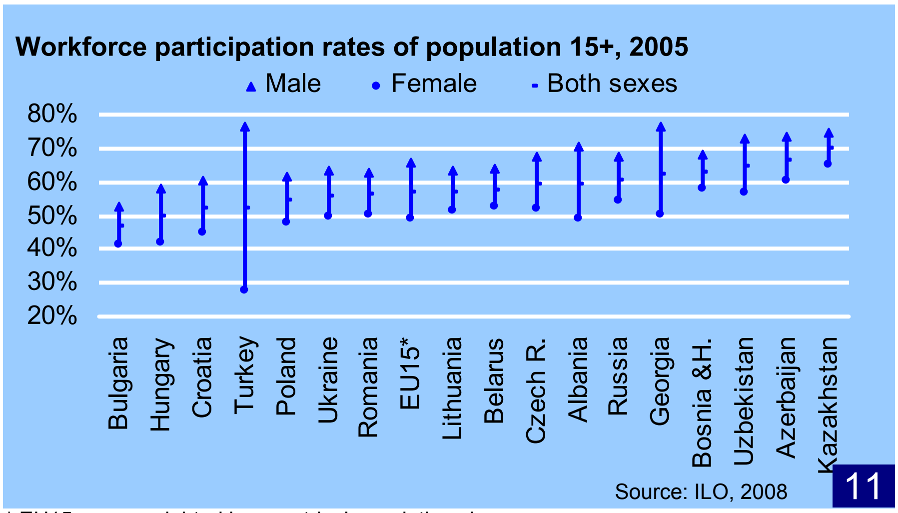
The demographic double whammy: diminishing work-forces and growing old-age populations



* EU15 mean weighted by countries' population size

Between now and 2050, working age populations in Eastern Europe will shrink at the same time as their older populations will grow. Bulgaria is forecast to lose *one half* of its working-age population, with only slighter smaller falls in the rest of the region. It is arguable, however, that the demographic challenge will be greatest in the Muslim countries – despite the continuing growth in their working age populations – because of the dramatic growth in their old-age population. For example, the old-age population in Turkey and Uzbekistan will increase more than three-fold by 2050.

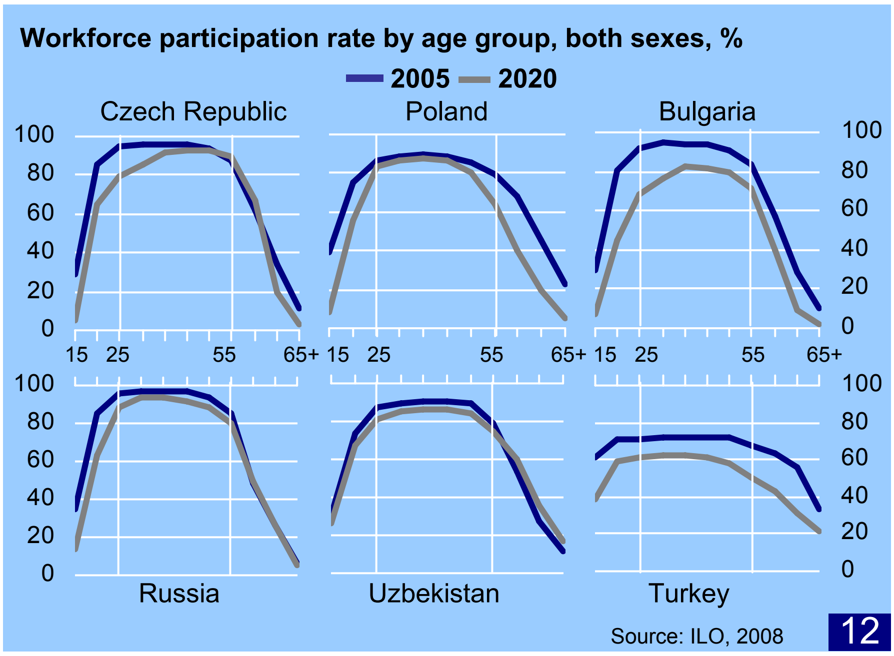
Potential labour supply in emerging economies can be mobilised more effectively



* EU15 mean weighted by countries' population size

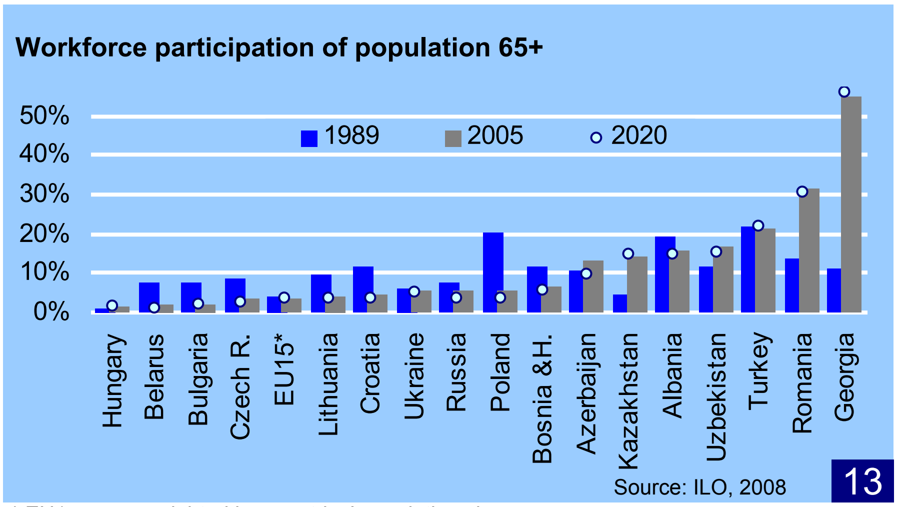
Workforce participation rates in many Eastern European countries are below, or on par with, EU15. If it is important for the EU15 to mobilise more of their potential labour supply, it is even more important for the emerging economies to do so. Unemployment – and relatively high levels of participation in the grey economy – are the main causes of the problem, though Turkey does have a very large male-female gap in workforce participation.

Workforce participation rates decline sharply after age 55



ILO projections for workforce participation – based on the statistical extension of past trends – suggest that the total participation rate across the various countries of the region is set to decline. Better educational opportunities decrease workforce participation rates for the population aged 15-25. In countries like Poland, Bulgaria and Uzbekistan, unemployment rates are high in the 25-55 age group. Although negative incentives, such as a higher retirement age in the Czech Republic and poor pensions in Uzbekistan, may increase the workforce participation rate of the 55+ population in some places, in most of the region the workforce participation rate of older people is expected to remain rather low.

Positive incentives and flexible working arrangements may increase workforce participation of older people



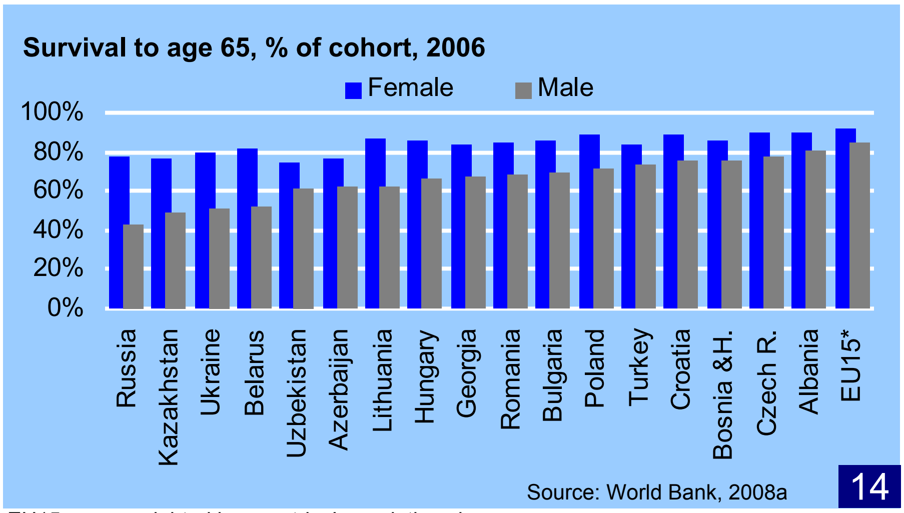
* EU15 mean weighted by countries' population size

The workforce participation of older people has declined in most emerging economies over the last two decades. There are instances, however, of harsh pension and economic reforms compelling many people aged 65 and over to stay in the workforce. In Romania, for example, land reform and the change of pension arrangements for agricultural workers appear to have had this effect. None of the countries of the region have adopted a more positive approach to 'enabling' older workers to stay in the workforce if they should so wish. ■

►Inadequate healthcare

Emerging economies can substantially mitigate the decline of workforces due to demographic ageing through investment in health promotion and healthcare (more effective and less controversial than pronatalist policies?).

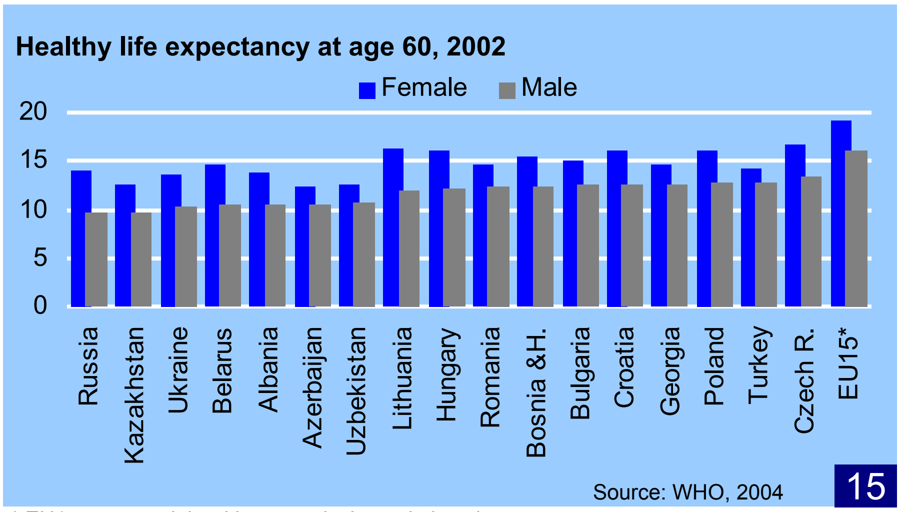
Many men in Eastern Europe and Central Asia do not survive to age 65



* EU15 mean weighted by countries' population size

Most Eastern European and Central Asian populations are characterised by relatively low male survival rates. In Russia, for example, only 43 out of 100 men survive to age 65 (compared to more than 80% in EU15), and a substantial proportion of this premature mortality is attributable to high levels of smoking and alcohol consumption. Healthcare is also generally poorer than in EU15. There is plenty of scope therefore for investment in health promotion and healthcare to increase the healthy lifespan of their populations. Albania, with a predominantly rural population which enjoys relatively low rates of premature mortality, is the odd-man-out in the region.

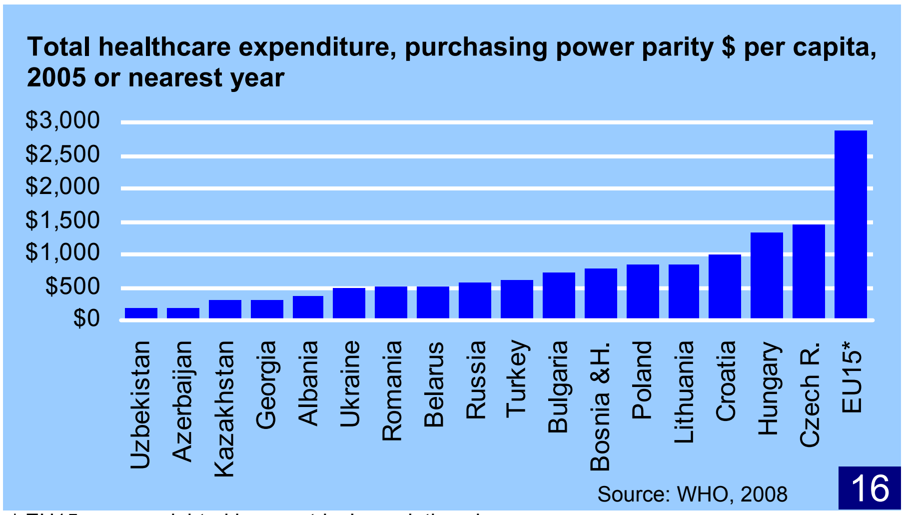
Older people in Eastern Europe and Central Asia live shorter than in EU15



* EU15 mean weighted by countries' population size

Healthy life expectancy at age 60 years is lower for people in Eastern Europe and Central Asia than for their counterparts in EU15. Investment in health promotion and modern healthcare can decrease mortality and morbidity in the older population as well as in the younger population. The pay-off is that older people are able to stay in the workforce for longer.

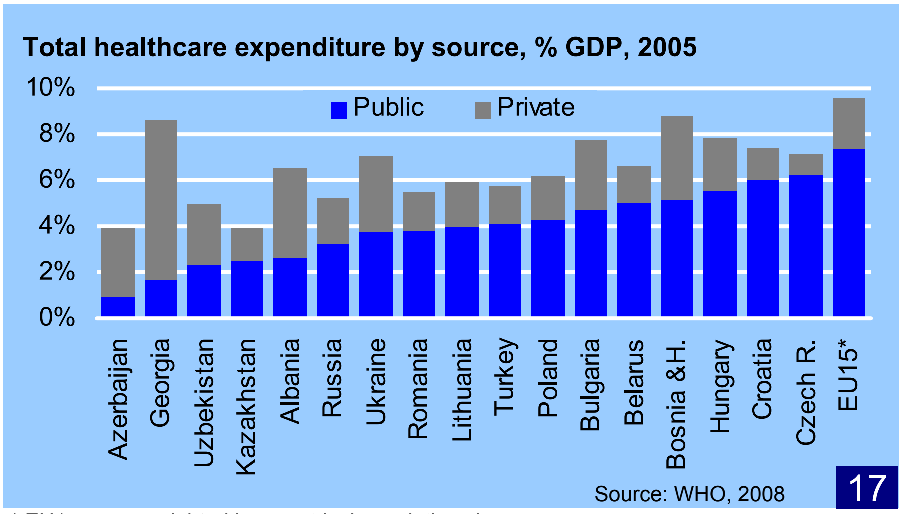
Health care expenditure in emerging economies is far below the EU15 average



* EU15 mean weighted by countries' population size

Even in the most affluent emerging economies, such as the Czech Republic and Hungary, healthcare expenditure is less than 50% of spending in advanced European economies. Eastern European and Central Asian nations have a pattern of disease which is similar to advanced European nations, i.e. dominated by cardio-vascular, chronic respiratory, cancer, diabetes, and other cost-intensive 'diseases of civilization', rather than cost-contained infectious diseases. Without significant investment in modern medical technologies and extensive health promotion programmes, emerging economies will continue to lose a significant share of their working age population through chronic ill-health or premature death.

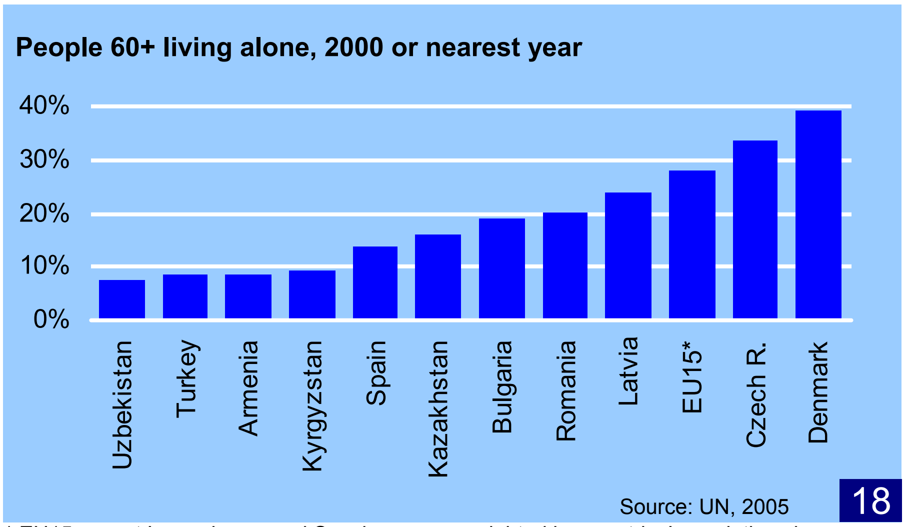
Governments in emerging economies have a potential to provide better public healthcare



* EU15 mean weighted by countries' population size

In most countries of the region, the ratio of public to private expenditure on healthcare is substantially lower than in EU15, and in all of them public expenditure accounts for a lower proportion of GDP. In some of the fastest-growing emerging economies, especially energy-rich Azerbaijan, Kazakhstan and Russia, the proportion of GDP spent on publicly provided healthcare is less than half the EU15 average. Is there room perhaps for governments across the region to attract additional private funding to their underfunded public healthcare systems?

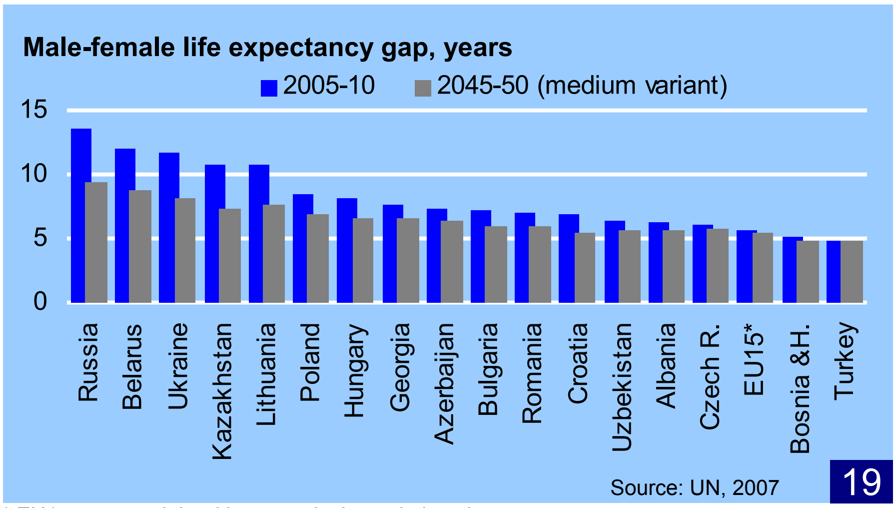
In most emerging economies demand for long-term care is offset by greater supply of informal care



* EU15 except Luxembourg and Sweden, mean weighted by countries' population size

However the demand for long-term care in Eastern European and Central Asian countries compares with the longer-lived EU15 populations, it is clear that most countries of the region do not have well-developed formal services for the provision of long-term care and rely very heavily on family care-givers. Demand for long-term care is likely to grow throughout the region along with the growth in the older population. In the less developed emerging economies much of this increase in demand will be met by informal caregivers; and even the most affluent of these economies will have a challenge to establish and fund formal long-term care services.

Supply of spousal long-term care in emerging economies is likely to increase



* EU15 mean weighted by countries' population size

In the coming decades, male life expectancy in most emerging economies is forecast to grow faster than female life expectancy. Since a narrowing male-female life expectancy gap should reduce the number of widows in the population, we can expect that an increase in the (potential) supply of informal spousal long-term care in emerging economies will grow. This is an important development because usually older women require more long-term care than older men (OIA-HSBC, 2007). Therefore, a growing demand for long-term care for older people in emerging economies is likely to be *partially* offset by an increasing supply of male spousal care. ■

►Imbalanced pensions

Reform is required in most emerging economies to improve the solvency of public pension systems and create conditions for the development of voluntary private pension plans.

Eastern Europeans have shorter lives and shorter working lives

Statutory retirement age, 2007

Country	Female	Male
Turkey	44	49
Russia	55	60
Ukraine	55	60
Belarus	55	60
Uzbekistan	55	60
Czech R.	56-60	61.5
Azerbaijan	57	62
Hungary	60	62
Lithuania	60	62.5
Bulgaria	57.5	62.5
Kazakhstan	58	63
Croatia	58	63
Albania	60	65
Romania	60	65
Bosnia &H.	65	65
Georgia	60	65
Poland	60	65
EU15*	63.4	64.2

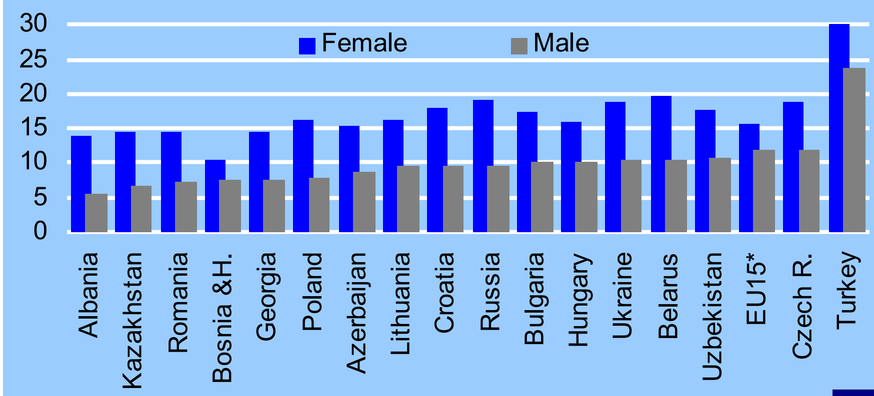
Source: World Bank, 2008b 20

* EU15 mean weighted by countries' population size

Whereas in most EU15 nations the retirement age is 65 for both men and women, it is significantly lower in many of the emerging economies. A lower retirement age for women is usually justified on historical grounds, though some countries link early retirement with pronatalist policies. For example, Czech women with two and more children can retire up to three years earlier than their less fecund counterparts.

In most emerging economies the retirement age is imbalanced in favour of women

Healthy life expectancy after statutory retirement age, 2007

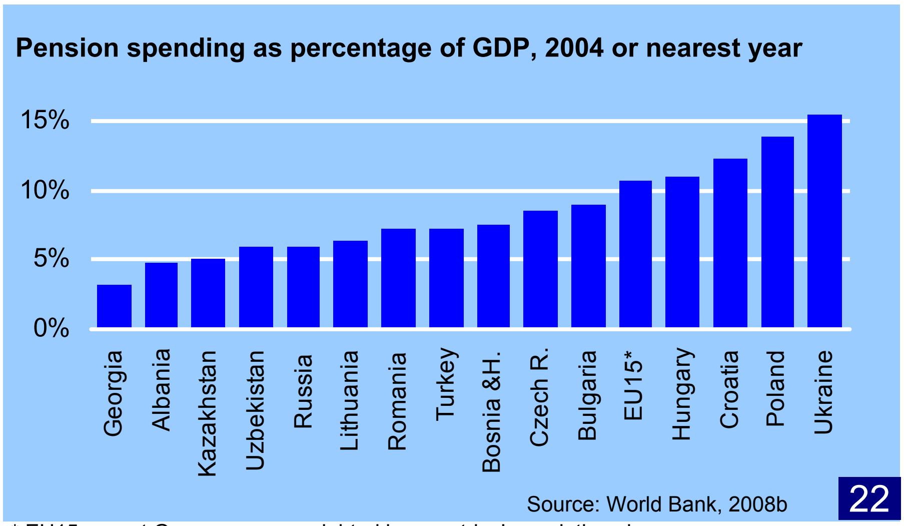


Source: WHO, 2004; World Bank, 2008b 21

* EU15 mean weighted by countries' population size

Whereas men in most emerging economies enjoy fewer years of retirement than in EU15, women enjoy the same or a higher number of years of retirement. Even though a number of countries in the region have increased the Communist-time retirement age of 55 for women and 60 for men, they failed to deal with the historical gender inequality.

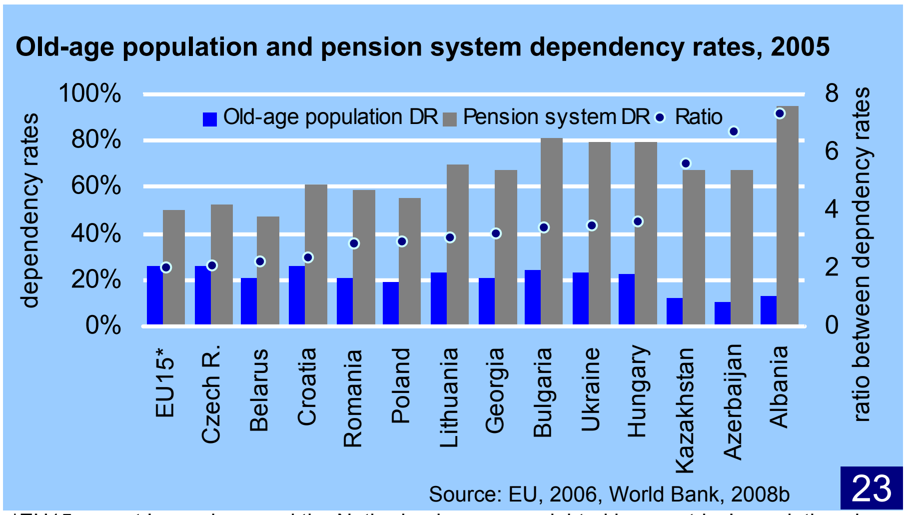
Pension spending varies considerably across the region



* EU15 except Greece, mean weighted by countries' population size

Although pension spending in most Eastern European countries is significantly lower than in EU15, it is higher in Croatia, Poland, and the Ukraine. All these countries could improve the sustainability of their pension systems by equalising the retirement age for men and women. Many countries of the region could also do a lot to improve the solvency of their pension systems by better governance and a clamp down on the shadow economy.

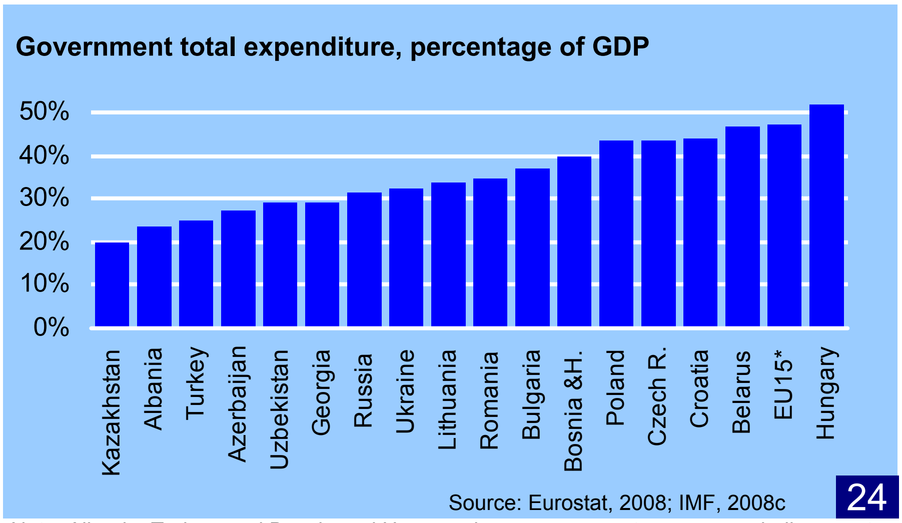
More effective governance can improve the solvency of pension systems



*EU15 except Luxemburg and the Netherlands, mean weighted by countries' population size

While in most countries of the region old-age population dependency rates (population 65+/population 15-64) are lower or on par with EU15, pension system dependency rates (pensioners/contributors) are higher. The high ratios between these dependency rates suggest that a large proportion of the working-age population does not contribute to pension systems due to the evasion of pension contribution payments by employers and employees and the prevalence of the grey economy.

Most emerging economies have relatively small states



Note: Albania, Turkey, and Bosnia and Herzegovina – government revenue excluding grants
* EU15 mean weighted by countries' population size

The essential challenge of demographic ageing in the emerging economies in Eastern Europe and Central Asia is the same as for the EU15, how to provide for the needs of the growing number of older people while preserving robust rates of economic growth. Although some of the most advanced Eastern European economies (and the state-run economy in Belarus) already have high government expenditure and a further increase of taxes could reduce their competitiveness, most of these countries have relatively low levels of government expenditure (which is reflected in the healthcare and pension arrangements they provide for their populations). They also have considerable room for manoeuvre when it comes to increasing public expenditure, not least because of their relatively grey economies. ■

Notes

The region of Eastern Europe and Central Asia includes the following Eastern European, Central Asian, and transcontinental countries:

Eastern Europe – Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, the Former Yugoslav Republic of Macedonia, Moldova, Poland, Romania, Serbia and Montenegro (including Kosovo), Slovakia, Slovenia, and the Ukraine;

Central Asia – Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.

Transcontinental – Armenia, Azerbaijan, Georgia, Kazakhstan, Russia, and Turkey.

EU15 includes the following members of the European Union prior to the 2004 accession: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

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