Deutsche Sozialversicherung
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Old-age provision, health and care in Europe

Today and in the future

Dear Readers,

Old-age provision, health and care are fundamental core issues in every society. These three pillars of social protection arose from the values and standards of the actual social consensus involved and have also shaped them at the same time. Their organisation is determined by the available resources, and they are constantly being subjected to highly dynamic change processes.

The countries of Europe are also facing major challenges in the old-age provision, health and care sectors, albeit certainly with varying degree of subtle differences. However, the initial conditions and development paths for the three security systems can be traced back in all EU Member States. European societies are undergoing demographic changes that are having a major impact on all three systems: people are getting older. As a result, they will have a longer claim to old-age security benefits, they will need more extensive health measures and they will also become more frequently dependent on care. Numerous other developments are also constantly affecting the organisation of these security systems, such as changing labour markets and unequal working lives, which in turn all have implications for the pension systems.

Innovations in the healthcare system are increasing the demands for services, with the potential of becoming cost drivers that have to be absorbed. Care per se is caught in the conflicting area between the professional and informal support. As home care or in an inpatient facility, using benefits in kind, cash benefits or even a combination of both – everything is subjected to the premise of adequate financial resources.

The EC regularly publishes reports about the development of these three security systems in its Member States. These studies enable cautious forecasts to be made. We would like to present three of these studies, the adequacy report, the old-age report and the long-term care report, to you, dear readers, in the current issue of the ED* special bulletin and, together with you, take a look at possible developments in the three social security systems.

We hope you enjoy reading it!

Ilka Wölfle

Demographic change is leaving its mark

Old-age provision, health and care are three of the most profound social issues being discussed in Germany. These issues are also being dealt with intensively at European level. Comprehensive reports are published on this subject every three years and they take a deep look into the future. After all, we are talking about a period of up to half a century: Can the expectations of the welfare state be fulfilled? Can it be financed? Such studies are associated with great uncertainties – one, therefore, prefers to speak of "projections" rather than "forecasts".

The EC submitted its regular reports as usual this year. In May came the "2021 Ageing Report",[1] and in June came the "2021 Pension Adequacy Report"[2] as well as – out of its normal cycle – the "Long-Term Care Report".[3]

[1] 2021 Ageing Report https://ec.europa.eu/info/sites/default/files/economy-finance/ip148_en_0.pdf

[2] Vol. 1: https://data.consilium.europa.eu/doc/document/ST-9145-2021-ADD-1/en/pdf
Vol. 2 (Country profiles): https://data.consilium.europa.eu/doc/document/ST-9145-2021-ADD-2/en/pdf

[3] Vol. 1: https://data.consilium.europa.eu/doc/document/ST-9144-2021-ADD-1/en/pdf
Vol. 2 (Country profiles): https://data.consilium.europa.eu/doc/document/ST-9144-2021-ADD-2/en/pdf

Can the welfare state still meet citizens' expectations in the future?

Today there are three people of active age for every person over 65, in 2070 there will only be two.

Demographic trends

The 2021 Ageing Report predicts that Europe's population will have shrunk by five per cent by 2070 and that its structure will change. The proportion of the working age population (20 - 64 years) will decrease from 265 to 217 million people. This means a 15.5 per cent decrease in the labour supply despite the expected increase in the labour force participation rate.

At the same time, life expectancy will increase by 7.4 years for men and 6.1 years for women, both of which would lead to a given convergence. The so-called "age dependency ratio" is projected to increase by almost 25 percentage points over the projected period. This rate describes the ratio of the over-65-olds to the working-age population. In plain English, this means: that today[4] there are about three people of active age for every person over 65 and in 2070 there will only be two. However, the age composition of the pension cohorts will also change. Currently, four out of ten pensioners are older than 75. By 2070, there will be six.

Expenditure developments at a glance

These demographic assumptions, together with a number of others that cannot be discussed here, are the basis for the "principles" or "reference scenario" of the "AWG"[5]

[4] 2019 was the year meant in each case.

[5] AWG on Ageing Populations and Sustainability https://europa.eu/epc/working-groups-epc/working-group-ageing-populations-and-sustainability_de

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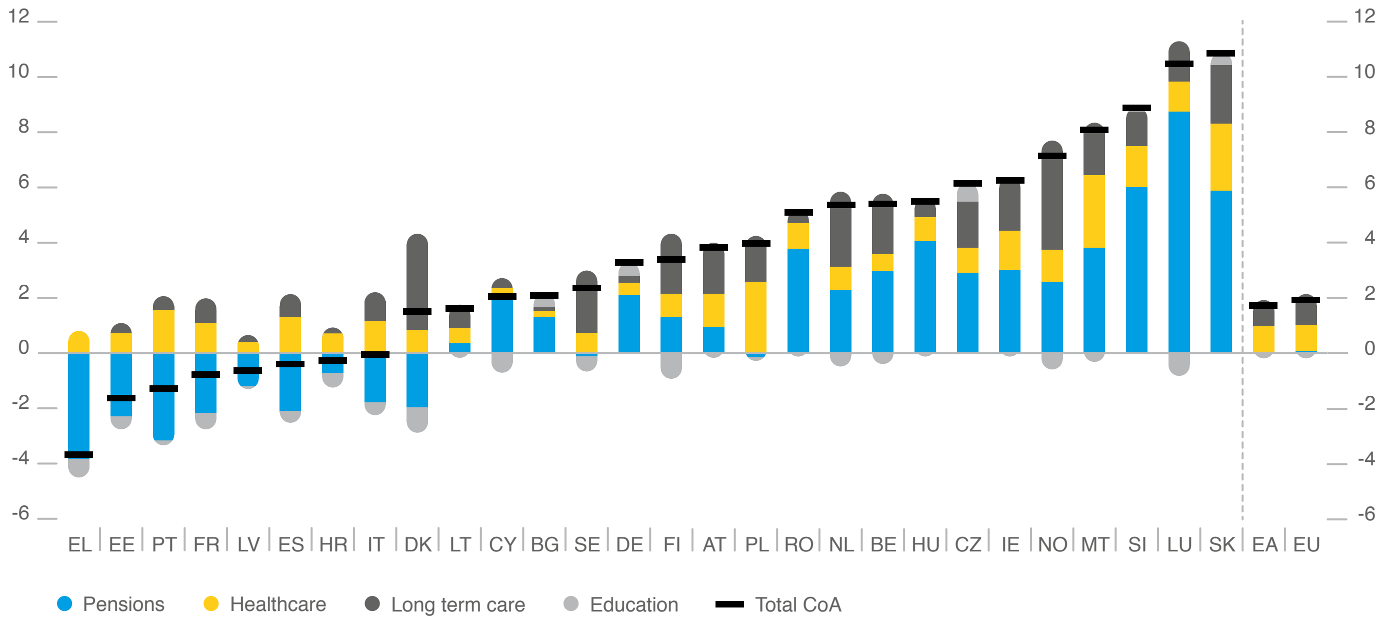
Projected change in age-related expenditure (2019 - 70), by expenditure component, percentage of GDP



Source: Commission services, EPC.

(Ageing Working Group of the Council's Economic Policy Committee). This scenario is also relevant with regard to fiscal monitoring by the Member States.

Based on this scenario, the Ageing Report projects an overall increase in age-related costs from today's 24 per cent of Gross Domestic Product (GDP) to 25.9 per cent across all of the expenditure areas. However, there will be considerable differences between Member States in this respect. Germany is among the 15 countries where the increase is most significant.

An itemised breakdown of the increase is revealing. "Main drivers" of the increase in the Member States as a whole will be the expenditure on health (+ 0.9 percentage points) and long-term care (+ 1.1 percentage points), whilst the contribution from pension costs, after a temporary increase, will fall back to the level of the year in which it started. By contrast, spending on education and training is expected to fall slightly.

However, the composition of the "cost drivers" is somewhat different here in Germany. Pensions will account for the lion's share (2.1 percentage points), whereas health and long-term care costs will only increase by 0.4 and 0.2 percentage points respectively.

Pensions – where do we stand today?

The pension adequacy report addresses two key questions: are pensions – both now and in the future – adequate for maintaining living standards and can they prevent poverty in old age?

Following a decline in poverty and social exclusion amongst older people (in terms of lack of access to basic goods), there has been a slight increase in levels to 18.5 per cent over the last three years (up to 2019) throughout the EU. The level in Germany is slightly higher than this. At the same time, the income level (median income) for older people has fallen slightly in relation to

Low retirement incomes are often the result of low earnings and interrupted working careers.

that of younger people since 2016. It was 89 per cent in 2019. If we look at the so-called "aggregate wage replacement rate"[6], the EU average is only 57 per cent. Germany, at 44 per cent, is even lower in this respect.

Low retirement incomes are often the result of low earnings and interrupted working careers. According to the report, minimum and basic benefits can make an important contribution to adequacy here. Some Member States have already developed these elements during recent years.

Old-age poverty is often also female-related. The gender-based "pension gap" is still 29.5 per cent (2019). However, it has still fallen by 2.8 percentage points since 2016, and it has also decreased in Germany. Model calculations from four countries show that the pension gap will narrow significantly by 2050 due to career changes.

It is also interesting to note that the length of retirement has shortened in many countries: The retirement age is rising faster than life expectancy. An average of 40 years are now spent actively and 20 years are spent in retirement in the life cycle.

Pensions – looking into the future

A look into the future does not bode well, at least as far as the benefit side is concerned. The adequacy report unequivocally warns of a coming decline in the pension levels. Those who retire in 2059 will draw a lower pension in relation to their earned income than a new retired

[6] It compares 10-year cohorts before (labour income) and after (pensions) retirement.

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had in 2019 – even with the same career. Although the report assumes longer working lives in the future, these will still lag behind the increase in the statutory retirement age. Methodologically, this statement is based on a comparison of theoretical replacement rates[7].

Today (2019), the net replacement rate (taking taxes into account) in the case of Germany is 57.8 per cent, which is in the lower range, compared to the front-runner Netherlands with over 100 per cent. In the future – by 2059 – the level is expected to fall drastically in many Member States, whereas it should rise slightly in Germany. If we extend the horizon to 2070 and use a ratio of average pensions to average wages as a yardstick, we will see a decline in almost all Member States that will average about 9.5 percentage points.

The report pays considerable attention to the gap between the statutory and the actual retirement age, where the EU average is expected to double from today's one to two years. This has to be distinguished from the gap between the actual retirement age and actually leaving the labour market. If both effects are taken together, then the difference will increase by almost another year.

If we now look at the age at which people actually end their working lives, then the following picture emerges: The EU average is now 63.8 years for men and 63 years for women. The projections for the year 2070 assume that the average will increase to 65.4 and 64.8 years respectively.

The ageing report pays particular attention to the issue of minimum and basic pensions, including specific benefits that should protect against poverty in old age. However, with a few exceptions, expenditure on these items is well below one percentage point of GDP. This can be explained by the fact that in many countries minimum pensions coincide with general social assistance benefits, which were not included in the projections.

On the cost side, the focus was mainly on the development of the share of public pension expenditure in relation to the GDP. This was based on quite a broad understanding of "public pension expenditure". In accordance with the rules of national accounting, all systems for which a government assumes ultimate financial responsibility come under

[7] It is "theoretical" because it is based on sample cases. "Replacement" is attained by comparing the level of the first pension payment with the level of the last salary before retirement. This assumes an uninterrupted working career of 40 years with national average earnings. It should not to be confused with the "aggregate wage replacement rate" mentioned above.

this category. Therefore, minimum and basic pensions for those who have not acquired sufficient earnings-related entitlements are included, but benefits from the general social welfare scheme are not. Special schemes such as those for civil servants were also included, as were early retirement pensions, survivors' pensions and invalidity pensions.

As shown above, under the projection, the share of pension expenditure, after a temporary increase, will fall back to today's level by 2070. Specifically: expenditures as a share of GDP are projected to increase slightly on average from 11.6 to 11.7 per cent. The increase will be significantly higher, at two percentage points, here in Germany. However, this is gross expenditure. If one takes into account that taxes and social security contributions that are often levied on pensions, then one can obtain the net expenditure. It is 1.5 percentage points lower on average in Europe. Germany is one of the countries where the tax share will increase the most.

Demographic change could push up health expenditure.

Healthcare costs increase from the age of 55 for men and 60 for women.

Health

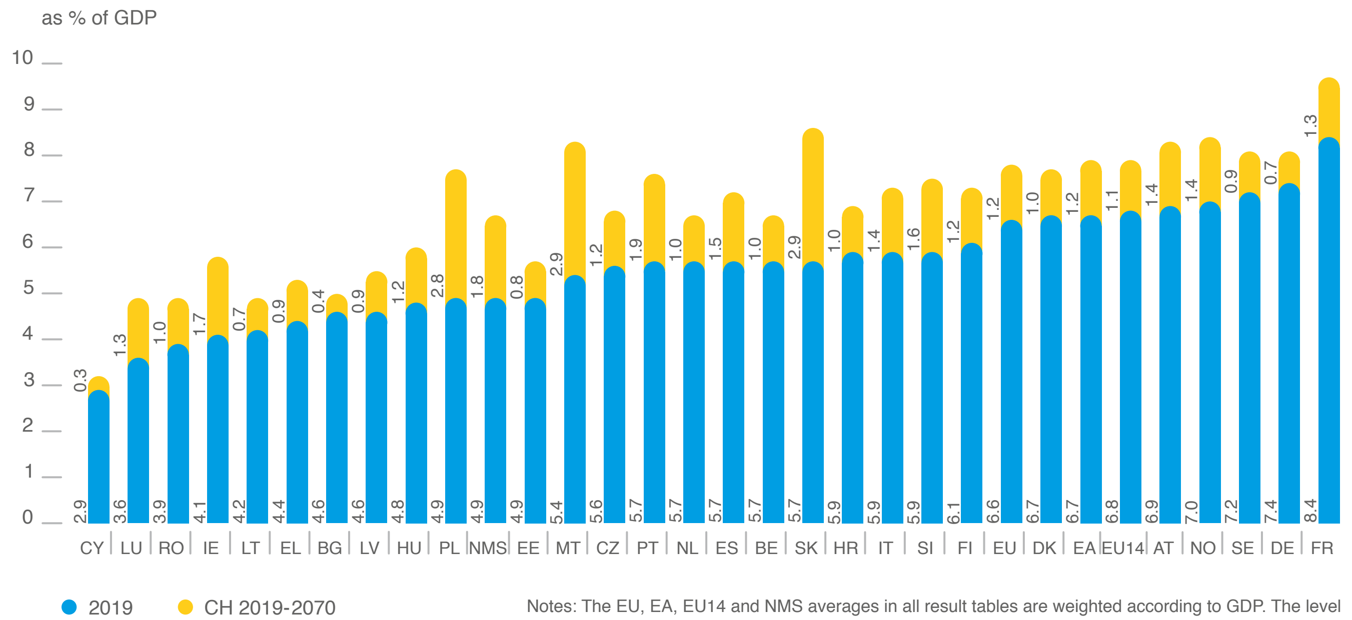
Health spending[8] as a share of GDP in 2018, hit a European average of 10 per cent. Of this, 7.8 percentage points is public spending whereas the figure is 8.9 per cent in Germany. Healthcare costs increase from the ages of 55 for men and 60 for women. Demographic change may become a cost driver for health spending if it is not possible to counter this and give people more healthy years. This is where the commitment of the social insurance funds to design efficient health care and to strengthen prevention comes in. Medical progress had a far greater effect in the past than demographic factors.

The average European cost increase is calculated at 0.9 percentage points –- up from 6.6 to 7.5 per cent of GDP. In contrast, it is only 0.4 percentage points for Germany – almost at the lowest end of the comparative scale – up from 7.4 to 7.8 per cent of GDP. This might also be related to the relatively high proportion of privately insured persons. It is assumed that the insured collectives of private insurance age grow faster than those of statutory health insurance – not least because of the more difficult access to private insurance. As the ageing report explicitly points out, this reduces the burden on the public sector.

As already indicated – different assumptions about whether additional years of life gained will be spent in good or poor health had a major impact on the result. If it will be good

[8] Only in this context long term care is included. The ageing report uses the term "long term nursing care" here, p. 104.

Projected increase in public healthcare spending due to demographic change in the period from 2019 to 2070



Source: Commission services, EPC.

Notes: The EU, EA, EU14 and NMS averages in all result tables are weighted according to GDP. The level of public expenditure in 2019 is the first year of projected expenditure based on latest available data. Health care expenditure excludes long-term nursing care.

health, then the projections are much more favourable; in the case of Germany, as public spending on health (as a proportion of GDP) is even projected to fall. However, if conceivable non-demographic cost drivers are considered, such as innovations in the healthcare sector or a change in demand behaviour, then the values are significantly worse than in the purely demographic, basic scenarios. The average European increase would be 3.1 percentage points, whereas it would be 2.5 percentage points for Germany.

The report concludes at this point by saying that demographic and non-demographic factors will continue to exert huge pressure on the sustainability of publicly financed health expenditure in the future. The public sector will continue to bear the main share of healthcare costs in the future.

Long-term care – where do we stand today?

Long-term care covers a wide range of services and they can be provided – as in Germany – both in kind, in cash or as a combination of both. The projections are limited to public expenditure.

There is also a not inconsiderable privately financed share. Currently, on average in Europe, about 20 per cent of care costs are financed privately, usually as supplementary payments ("out of pocket". In Germany, the figure is almost 30 per cent; also because long-term care is designed according to the "partial cascade principle" and is not fully insured.

Therefore, it is only natural that the long-term care report dealt extensively with the affordability of quality care services. **Adequate access** is restricted by many factors, not least the financial barriers. In most systems, people in need of care have to pay high personal contributions,

In most systems, people in need of care have to pay high personal contributions, often supplemented by unpaid informal care work.

Unpaid informal care work is typically performed within the family or amongst friends.

often supplemented by unpaid informal care work. An OECD model study came to the conclusion that in many of the countries they looked at in the case of a moderate need for care, not even 40 per cent of the care costs are covered by public social protection systems, while the income and assets situation of those affected played a major role. But also in the case of severe care needs, the personal contribution can quickly approach or even significantly exceed a median income. Therefore, the major challenge here is to reduce the personal contributions from those who cannot afford it. This problem is all the more urgent because it is apparent that it is people in low-income groups who have a greater need for care.

Much of the report was devoted to the issue of the **working condition**s of nursing staff, not least because of the strain on their health. In a 2015 survey, 37 per cent said their job had a negative impact on their health as compared to 25 per cent in other occupations. The consequence, according to a 2020 study by Eurofound (European Foundation for the Improvement of Living and Working Conditions): 38 per cent do not think they will be able to hold their jobs until they are 60. This is a worrying prospect if you consider the already decided upon or planned increases in the statutory retirement age that will go well beyond the age of 65. Even if the particular stresses are typical of the job, they can at least be alleviated through specific measures such as better staffing, according to the long-term care report.

Reference has already been made to **informal**, unpaid care, which is typically provided in the context of family or friends. This is a reality that is highly critical with regard to follow-up costs. After all, the number of informal carers in the EU is currently estimated at 53 million. In most cases, carers do not have appropriate training and they are not in an employment relationship with the person being cared for. However, most Member States provide informal carers with pension rights, similar to Germany. Cash benefits paid to informal carers are also not uncommon, either directly (9 Member States) or, as in Germany, indirectly through cash benefits paid to the care recipient (11 Member States). The direct costs of state benefits to this group of people are estimated at 0.2 per cent of GDP across Europe. It is twice as much in Germany. The care report ends at this point with the appeal to provide more social security and other assistance for informal caregivers but not at the expense of expanding formal care.

Public long-term care expenditure – today and tomorrow

Public expenditure on long-term care currently averages 1.7 per cent of GDP in the EU. The AWG standard scenario projects an increase to 2.8 per cent in 2070. The increase should be significantly lower in Germany, from 1.6 per cent today up to 1.8 per cent. Demographic development also plays a role here, as it is becoming more noticeable, especially in the privately financed expenditure sector (through the substitute care insurance), which relatively relieves the public sector.

Future cost developments will be mainly affected by two drivers: demographic change as well as non-demographic factors, such as the decreasing availability of informal care due to societal change.

Policy recommendations

The reports are not restricted to just presenting facts and projections, as they also contain many **policy recommendations**. It also includes the advice (not new) to place old-age provision on a broader financing basis in a changing economic and labour market environment and against the background of demographic change, especially through progressive contribution structuring. Wage-related contributions should also be better supplemented by other sources that are less burdensome on earned income, such as investment income or assets. In Germany, this has been the subject of political debate for health and long-term care insurance for many years under the heading "citizens' insurance." The French solidarity tax, the revenue from it is targeted at social security systems, was specifically mentioned in the report as an example of funding base diversification and. In contrast, the possible contribution of consumption and especially environmental taxes was discussed with caution. It also calls on Member States to do more to address gender inequality, through extending credits for care-related career breaks. In general, atypical and self-employed working should be better protected.

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Cost developments are a ected by demographic change, but also by non-demographic factors.

With regard to the health and care sector, the reports contain passages that can be understood in the sense of a cautious privatisation of the cost burden. This starts with the assessment that the private share might have to increase for non-life-saving treatments. However, at the latest in the long-term care sector, it was explicitly stated how the rise in costs could also be slowed down by concentrating public spending on those people who need care most urgently and can least afford it. This would contradict the approach in Germany as well as in other countries, of not making long-term care benefits dependent on material needs.

Summary

It is hard to do justice to hundreds of pages of careful analysis in a few concluding sentences. If you want to take a few key messages with you, they might be these:

- expenditure on old-age provision will be stable in the long term. This may come as a surprise initially, but it comes at a stiff price: through later retirement and a substantial decline in the wage replacement rate.

- first among the long-term cost drivers is healthcare spending. However, by no means is it only demographic change that gives cause for concern here.

- However, the cost of long-term care also contributes significantly to the increase in age-related public expenditure. Pressure also arises from the declining availability of informal care.

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