

## **Executive Summary**

### **Context of Research**

Population ageing is a process no longer confined to industrialized countries. Demographers expect most of the growth of the world's elderly population during the next 50 years to occur in developing countries. A distinctive feature of ageing in these countries, likely to present additional developmental challenges, is the rapidity of the ageing process expected. Many less advanced economies are ageing at a much faster rate than that witnessed in OECD economies, and also at a much earlier stage of their economic development, placing them at a greater disadvantage in terms of their ability to respond to ageing pressures. Not only will the political time frame available to formulate and implement policy responses be shorter, but the availability of financial, institutional and technical resources and capacities to respond to ageing pressures are currently more limited.

Low-income countries with the most severe ageing pressures are those whose social policies covering health and education have achieved successful developmental outcomes, as reflected by reductions in infant mortality and fertility levels, improvements in nutritional status of the population, and universal access to education and health care. Despite these advances, ageing is occurring at a time when social security coverage has not – by a large margin – achieved comprehensive coverage and where formal retirement institutions are limited in coverage to a minority of the better-off elderly. In addition, traditional institutions in the form of filial systems of protection, which have supported the elderly in the past, are gradually eroding due to out-migration, a progressive reduction of family size and an increase in the participation rate of women in the workforce.

### **Research Questions**

Despite the expected growth in elderly populations in low-income countries, international research on elderly welfare is currently limited. The following analysis aims to fill some of these gaps. Gaps in knowledge stem from a combination of factors, including a lack of general awareness of the problem and a lack of importance attached to it. Practical considerations, in terms of the non-availability of comprehensive survey data sets, have also been contributory factors.

Sri Lanka provides a unique case study for reviewing the ageing problem. Not only is the population ageing at a rate unprecedented in the world, but good quality time series data covering income, expenditure and labour force status of the population are available. This paper addresses the following:

- What are the expected demographic developments in Sri Lanka?
- What is the current status of the elderly relative to other groups?
- What are the current systems of retirement protection, and how adequate are they?
- What are the gaps in coverage, and what options are available to extend access affordably?

## Key Findings

### Ageing and dependency

Sri Lanka's old age dependency ratio has progressively increased over the last 20 years and is expected to double over the next 20. By 2040 demographers forecast that one in three of the population will be aged 60-plus. Although these changes constitute a significant development, the implications for growth and income distribution may not be quite as dramatic as these statistics imply. The old age dependency ratio, although informative in describing changes in a country's age composition, does not provide a reliable indication of the economic effects of ageing. A better measure of the latter can be obtained with reference to a country's economic dependency levels, where the numbers of dependants (non-working adults and children) are measured relative to those who are economically active. Despite the progressive increase in the level of age dependency, Sri Lanka's level of economic dependency has remained stable over the last 10 years. This is principally due to the lack of comprehensive social security coverage in the country, which has obliged individuals to work longer in response to rising life expectancy. Although a positive development and one that should be encouraged, over time, as the ranks of the very elderly increase, formal social security systems will need to be strengthened if the welfare of specific elderly sub-groups, including the very elderly without filial support, the elderly lifetime poor and the disabled, unable to work or save adequately for retirement, is not to be compromised.

A country's level of economic dependency – unlike the general dependency measure – is significantly more malleable and responsive to policy intervention. This is principally related to the impact that government policies can have on the denominators of the equation – the labour supply and productivity performance. Many OECD countries are currently responding to ageing pressures via efforts to lower economic dependency levels by means of parametric reforms to pension schemes, including the introduction of incentives as well as directives to progressively raise retirement ages and contribution levels and to reduce benefit levels. In addition, many OECD countries are sourcing labour from outside their borders, including through skilled migrant programmes and other immigration policies to boost their labour supply potential. Such policies, although important in maintaining the economic welfare of the host country, can have a beggar-thy-neighbour impact on source countries, particularly when these migration channels are permanent and targeted at skilled workers. Such policies, geared to meet domestic skill shortages in OECD economies, act to accelerate further ageing pressures in low-income countries.

Temporary migration, by contrast, can confer economic benefits to source countries. Temporary out-migration from Sri Lanka has increased the income-earning potential of many workers, augmented foreign-exchange earnings via remittances and increased the effective labour force participation rate of women. The knowledge and skills acquired by migrants working abroad can be deployed in the domestic workforce on their return, acting to increase the stock of skills – and productivity – in the domestic economy. One million temporary migrants living and working in the Middle East and other countries in the region have augmented Sri Lanka's effective labour supply by making available work opportunities for women. Approximately 80 per cent of migrant workers are women, many of whom, due to domestic commitments and lack of flexible working opportunities would have remained outside the labour force. Despite the

economic benefits derived, emigration is not without costs in particular social costs in the form of the dislocation of families which particularly affects the children who remain in Sri Lanka.

### **North- South ageing dynamics**

Higher levels of economic dependency in low-income countries are attributed to larger shares of children in total populations and a larger proportion of women outside the labour force. The average participation rates of women in Sri Lanka, India and Bangladesh are 32 per cent, 30 per cent and 8 per cent respectively. This compares with rates of 68 per cent, 64 per cent and 72 per cent in the UK, Germany and the US. Although social and cultural factors play a role in accounting for these differences, the broader policy environment, including the lack of labour market flexibility, is also an important contributory factor. Policies in low-income countries should acknowledge these differences and aim to facilitate the entry and re-entry of women into the workforce.

Higher levels of economic dependency in advanced economies – both now and in the future – are related to the larger share of the non-active elderly in the dependent population. North-South ageing dynamics will therefore proceed on divergent paths. Developing countries, including those in South Asia can be expected to experience downward pressures on economic dependency levels over the next 30 year period as children progress into the working age population and augment the labour supply potential. With appropriate policy intervention a progressive increase in the number of women in the workforce will also yield beneficial effects on per capita income. In addition, as the ranks of the elderly electorate expand creating a demand for more comprehensive social security coverage, a contraction of the labour supply is likely to be felt among older age cohorts creating upward pressure on economic dependency. Despite these considerations, the net effects should act to check the growth of economic dependency. A simulation exercise forecasts that Sri Lanka's economic dependency levels will remain broadly stable until 2050, rising thereafter as the currently lower fertility levels feed through as a smaller working age population. Economic dependency will rise more rapidly than forecast where retirement coverage expands and in a situation where the growth of the labour force is unable to absorb the growth of the working age population. By contrast, economies in the North will experience significant upward pressures on economic dependency levels as working age populations enter retirement, contracting the labour supply.

Rising levels of economic dependency do not, however, automatically compromise a country's standard of living. Where such increases are matched or exceeded by the growth of output, welfare, measured by per capita incomes, can be maintained. The level of economic dependency, in addition to its relative growth, can therefore have important implications for per capita income levels. *Ceteris paribus* the higher a country's economic dependency, the lower a country's per capita income for any given level of output growth, and the smaller the real gains conferred on the population.

Regardless of the expected ageing developments, Sri Lanka's level of economic dependency is consistent with that of other countries in the region including India, Bangladesh and Pakistan and far exceeds the level in many OECD countries which have been ageing for some time. Policies to respond successfully to ageing pressures therefore involve lowering a country's economic dependency through measures aimed at

augmenting the labour supply and enhancing productivity. The labour supply can be augmented by increasing the number of years in work, the retirement age and levels of worker participation, reducing unemployment rates and increasing the working age population (positive net migration).

A credible avenue for Sri Lanka to explore, and for policy interventions to target, includes policies aimed at increasing the labour force participation rate of women. The female participation rate is low (32 per cent) in relation to per capita income and the educational attainment of women, and compares with an average of 66 per cent for men. Such a gender gap stems not only from cultural and social factors but also from the lack of flexible working opportunities in the labour market to allow workers to combine career and domestic aspirations. The introduction of family-friendly policies including increasing part-time working opportunities would be highly relevant in this respect. It has been estimated that a 20 per cent increase in the labour force participation rate of women could reduce economic dependency levels by as much as 40 per cent over the 2001-80 period, with positive repercussions for output and competitiveness.

### **Elderly welfare**

Evaluation of household survey data sets reveals that many elderly people continue to remain economically active until late into their lives, many have multiple income sources and 90 per cent live in multiple-person households. As a result, the incidence of poverty amongst the elderly, or more accurately households with elderly, is below the national average. By contrast, poverty incidence amongst households with children is significantly above the national average even after incomes are equalized for household size and composition. Consistent with the poverty profile of the population as a whole, elderly poverty has a strong spatial dimension. Poverty amongst rural and estate elderly – measured by the poverty headcount – is 16 per cent and 50 per cent respectively compared with a 4 per cent rate for urban elderly. Sources of income were seen to change significantly with ageing: income from employment declines whilst that from transfers, including pensions, government and family, increase their share of the total. Given the limited degree of social security coverage, the family, as expected, provides a significant pillar of support to current retirees. This is unlikely to remain a viable option in the future, however, as average household size continues to decline, placing greater inevitable demands on formal mechanisms of protection.

### **Retirement coverage and adequacy**

Retirement systems currently cover 25 per cent of Sri Lanka's working age population; the vast majority of the population do not have formal social protection for old age. And those who are covered, a large proportion are located in the top two income quintiles, suggesting that Sri Lanka's retirement system does not adequately meet the needs of the poor.

A large proportion of those not covered are outside the labour force, the majority (70 per cent) of them women. These statistics highlight the prevailing gender bias in access to social security in Sri Lanka, as in many other low-income countries. All schemes as they are currently designed are employment-based, which by definition excludes those outside the labour force – principally women, yet the majority of the very elderly both currently and in future (80 per cent) will be women. Policies to expand social security coverage are likely to disproportionately benefit women and their welfare in old age.

## **Extending access**

Although Sri Lanka's social security coverage is high by regional standards it is low in relation to per capita income. Historical experience suggests that few countries have achieved comprehensive coverage in the absence of some mechanism to redistribute income from the working to the non-working population and from the lifetime wealthy to the lifetime poor. Empirical work in countries introducing universal or near universal coverage have found that pension provision for the elderly, even in a situation where cash injections are small, can confer significant improvements in the welfare of recipients. Introduction of the old age pension in the Indian states of Tamil Nadu and Kerala for example, had a positive impact on the nutritional status of beneficiaries. In South Africa the old age pension, contrary to popular belief, has successfully crowded-in family support, rather than supplanting it. If the welfare of future generations of elderly is to be maintained, the Sri Lankan government will need to develop a strategy that explicitly recognizes the need for redistribution to elderly groups. As ageing progresses expansion of retirement coverage is likely to become a political as well as an economic necessity as the size of the elderly electorate increases. Such political pressures should not dictate the speed and the level of coverage of such policies, whose design should be informed by affordability and the relative poverty reduction impact.

Despite progressive ageing, policies to enhance the status of the elderly must be informed by the relative economic situation of the elderly versus other groups in the population. Welfare programmes for the elderly have an opportunity cost in terms of fewer resources available for children, the disabled and the unemployed. The report evaluated, through modelling work, the relative impacts of two alternative policy options on the poverty headcount: a universal child benefit versus a universal age benefit. The former was found to reduce the poverty headcount to a much greater degree (45 per cent compared with 8 per cent) mainly because of the higher poverty incidence amongst households with children. Priorities for social security coverage should therefore be carefully assessed and channelled at the margin to maximize both growth and equity objectives in a manner affordable to the government.

Achieving comprehensive coverage need not compromise fiscal sustainability or growth objectives. A realignment of existing resources could free the necessary revenues required to extend coverage. Sri Lanka already has a sizeable social assistance programme, the cost of which exceeds the health budget. Samurdhi – the government's main poverty alleviation programme – covers 55 per cent of the population, a large proportion (75 per cent) of who are non-poor.

Alternatively, an expansion of social assistance programmes could be financed by progressively increasing the tax to GDP ratio. Modelling work increasing its ratio from the current level of 17 per cent to 30 per cent of GDP by 2050 could reduce the public sector wages and pensions bill as a share of recurrent revenues from the current level of 47 per cent to 26 per cent by 2050, even under the most generous scenario of wage-indexing pensions and public sector salaries and despite a 30 per cent increase in pensioner numbers. Despite popular belief, therefore, the public sector pension scheme will not create unsustainable burdens on the budget if it is index-linked to wages.

## Conclusion

Regardless of future population ageing developments, Sri Lanka's economic dependency levels, consistent with those of other countries in the region, far exceed those of many OECD countries – including Japan whose share of elderly is the highest in the world. The current levels place unnecessary burdens on the population, acting to lower potential output. Policies to augment the labour supply should form a central strategy to lower economic dependency levels and respond to ageing pressures. Policies to enhance labour productivity ranging from macroeconomic stability and investment in physical and social capital to consolidation of the peace, are all relevant in responding to ageing pressures and accelerating the country's growth potential.

The analysis has found that Sri Lanka's contribution-based retirement system has currently reached its limits. If Sri Lanka is to achieve comprehensive coverage it will need to do so via redistributive policies that transfer income from workers to non-workers. A universal pension benefit was evaluated as unaffordable in the medium to long term, due to a tripling of the elderly population by 2050. A means tested benefit would, however, provide a credible alternative. The means test would need to be set at a generous level, at least initially, and guided by affordability, in order, both to limit the growth of inequality and disincentives to save among low-income workers.

Before an extension of social assistance can proceed, Sri Lanka needs, as a priority, to reform its current programme, to better target government resources on those most in need. The introduction of an age-related pension – whether means-tested or universal – is likely to have negative implications for economic dependency levels and the labour supply, particularly among older age cohorts who, in the absence of social assistance, would continue to work. Such trade-offs will need to be acknowledged, if policies are to remain fiscally sustainable; however, the continued expansion of the country's working age population will act to counterbalance this. The introduction of a universal child benefit was evaluated as having a more powerful impact on the poverty headcount than a universal pension. Relative poverty effects could be expected to change in future, however, as the share of the elderly increases and that of children declines: such relative effects should be evaluated on a regular basis and monitored to guide policy decisions.