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Balancing adequacy and sustainability:
lessons from the Global Aging Preparedness Index

By **Richard Jackson**

The world stands on the threshold of a stunning demographic transformation brought about by falling fertility and rising life expectancy. It is called global aging, and it will challenge the ability of many countries to provide a decent standard of living for the old without imposing too big a burden on the young.

The GAP Index

Which countries are most prepared and which are least prepared to meet the challenge? The Global Aging Preparedness (GAP) Index, developed by the Center for Strategic and International Studies (CSIS), provides a unique new analytical tool for assessing the progress countries are making in preparing for global aging—especially in balancing the twin goals of income adequacy and fiscal sustainability (see sidebar on page 10 for GAP Index Country Rankings in these areas).

The GAP Index covers 20 countries, including most major developed economies and a selection of economically important emerging markets. It consists of two separate subindices—a fiscal sustainability index and an income adequacy index.

On the fiscal side, the GAP Index takes into account the projected cost of government benefits to elders (defined by CSIS as adults ages 60 and older). It also considers the fiscal room countries have for accommodating this projected cost by raising taxes, cutting other spending or borrowing. It further factors in the degree of elder dependence on government benefits, which may be a crucial factor in determining how politically difficult it will be to enact new cost-cutting reforms—or even to follow through on already enacted reforms.

On the adequacy side, the GAP Index considers trends in the living standard of elders relative to non-elders, as well as the strength of government safety nets and family support networks.

Note that the GAP Index measures the performance of countries relative to each other rather than against an absolute standard of "preparedness." CSIS considered establishing such a standard, but concluded that any benchmark would be arbitrary. There is no real consensus within countries, much less across countries, on what constitutes an acceptable living standard for retirees or an acceptable old-age benefit burden on workers. Yet almost everyone would agree that countries with a lower burden on workers and higher relative living standard of retirees are more prepared.

What It Means for the Future

The GAP Index contains some good and bad news. The bad news is that very few countries score well on both fiscal sustainability and income adequacy. In fact, there is often a stark trade-off between the two. Three of the seven highest-ranking countries on the fiscal sustainability index (Mexico, China and Russia) are among the seven lowest-ranking countries on the income adequacy index. Conversely, four of the seven highest-ranking countries on the income adequacy index (the Netherlands, Brazil, Germany and the U.K.) are among the seven lowest-ranking countries on the fiscal sustainability index. Not surprisingly, it is the developed countries, with their more generous welfare states, that tend to score better on income adequacy than on fiscal sustainability. In the developing countries—Brazil being a notable exception—the trade-off is usually the reverse.

There are also two countries that score near the very bottom of both subindices: France and Italy. To rein in the rising cost of their pay-as-you-go government old-age benefit programs, these countries have enacted pension reforms that drastically reduce the generosity of the "deal" that future retirees can expect to receive. Yet France and Italy spend so much on government old-age benefits that, even after the reforms, they remain on a fiscally unsustainable course. In other words, both countries are moving toward retirement systems that are both inadequate and unaffordable.

The good news is that a few countries are successfully meeting the challenge. Australia, which combines a means-tested public pension system with a large, mandatory and fully funded private pension system, ranks well into the top half of both subindices. So does Chile, which has a similar mix of retirement policies. The United States, with its relatively inexpensive Social Security system, well-developed private pension system and high elderly labor force participation rate also does a better job of balancing fiscal sustainability and income adequacy than most countries—though it is pulled down in the fiscal rankings by the burgeoning cost of elder health benefits and, despite its high overall adequacy ranking, has a worrisomely high elder poverty rate.

Several other countries are clearly moving in the right direction. Like France and Italy, Germany and Sweden have enacted pension reforms that will result in deep reductions in the future generosity of government retirement provision. But unlike France and Italy, they are on track to fill in the resulting shortfall in the income of tomorrow's elders by increasing employer and individual pension savings and boosting elder labor force participation. Although their fiscal burdens remain high, they have been cut well beneath what they would otherwise be without undermining adequacy.

This contrast points to a crucial lesson. Most of the world's developed countries—plus a few of its emerging markets—will have to make significant reductions in the generosity of government retirement provision in order to avoid overburdening the young. But if these reductions are to be socially and politically acceptable, they must be accompanied by offsetting reforms that help to maintain the living standard of the old.

Clearly, global aging poses a daunting challenge. Yet there are many strategies available to address the challenge. Two in particular—extending work lives and increasing employer and individual retirement savings—are especially important because they can allow countries to escape, or at least to mitigate, the stark trade-off between fiscal sustainability and income adequacy that many now face. Together, they may offer the best means for the world's aging societies to maintain a decent living standard for elders without imposing a steeply rising burden on the young. ■

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GAP Index Country Rankings

Fiscal Sustainability Index		Income Adequacy Index	
1	India	1	Netherlands
2	Mexico	2	Brazil
3	Chile	3	US
4	China	4	Germany
5	Russia	5	UK
6	Poland	6	Australia
7	Australia	7	Sweden
8	Japan	8	Chile
9	Canada	9	Spain
10	Sweden	10	India
11	US	11	Canada
12	Korea	12	Japan
13	Switzerland	13	Poland
14	Germany	14	Switzerland
15	UK	15	Russia
16	Italy	16	France
17	France	17	Italy
18	Brazil	18	China
19	Netherlands	19	Korea
20	Spain	20	Mexico