



Demographics and the Destiny of Global Markets

By Sam Parl

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When economic pundits trade heated predictions about the massive economic shifts we see internationally, it is easy to forget the subtleties that shade their forecasts. One such shadow overhanging any intelligent debate about our global economic future is global age demographics, according to Harvard Professor Richard Cooper.

Professor Cooper presented a thorough analysis of future global population dynamics at a luncheon hosted by the Boston Security Analysts Society on April 12, advocating a greater emphasis on age demographics in economic forecasting. "This is an area where economists in particular have not paid enough attention," Cooper warned. Huge upcoming population shifts are unevenly distributed around the world and must be examined regionally. Cooper concluded that United States faces a far less worrisome future than most of its European and East Asian trading partners.

The age crisis

All over the industrialized world, life expectancies have dramatically increased, thanks in part to medical advances and changing lifestyles. In the US, life expectancy has increased a year per decade since Social Security's introduction in 1935. Other countries have seen similar improvements, with Japan currently boasting the highest life expectancy in the world. As wonderful an achievement as this is, Cooper is right to draw the attention of economists to the darker side of the phenomenon: aging populations.

In many European and some Asian countries, there is a growing sense of foreboding about the future. Not only are their populations expected to decline overall, but the compositions of these populations are expected to change dramatically. In Japan, the median age is expected to rise from 44.6 to 54.1 between 2010 and 2040, while in Germany and Italy the median age is expected to rise from about 44 years to around 50 years over the same period. Half the population of Europe and over half the population of Japan will be over the age of 50 at that point. Things aren't much better in some of the BRICs.

China and Russia are expected to see the most challenging rises in median age over the next few decades. China will see its median age go from 35.2 to 47.1 between 2010 and 2040, while in Russia it will go from 38.5 to 47. India and Brazil will see their populations reach a median age more in-line with the current American median age, which is only expected to grow by about 2 years.



The birthrate effect

The primary engine of a nation's population growth has always been the birthrate. A birthrate of 2.1 children per family is the replacement rate required to sustain a population level absent immigration. Most of the post-industrial world, however, has been facing birthrates far below the replacement rate, leading to declining population levels.

In Europe, the birthrates range from 1.8 in some northern countries to 1.2 in parts of the south. Consequently, Europe (which includes Russia, in Cooper's accounting) can expect to experience a decline in population of about 30 million people by 2040. These low birth rates are going to have dramatic consequences for local culture, all but wiping out the proverbial large Italian family. Cooper predicts that in two decades the average Italian child will lack any near-blood relations other than parents and grandparents. He sees a similar consequence in China, where the one-child policy has begun to show its effect.

China actually experiences a much higher birth rate than many of its neighbors. While China's birthrate is currently 1.6, both Taiwan and Korea have birthrates near 1.3, while Japanese families have, on average, 1.2 children. Meanwhile, Hong Kong and Singapore have some of the lowest birthrates in the world, at about 1 child per family. All of these birthrates are well below the replacement rate.

The United States is something of an outlier in the industrialized world, experiencing a birthrate of 2.1 children per family. This, in combination with its high rate of immigration, promises a somewhat brighter future for the US than for its Asian and European trading partners. In the US, population is expected to rise from 310 million in 2010 to 406 million in 2050.

The hobbled workforce

The aging of the industrial world and its diminishing birthrates will likely translate to significant declines in its young adult (defined by Cooper as aged around 20 years) populations between 2010 and 2040. China and Japan can expect to see this demographic decline by about one third, while Germany should experience a decline of 15%, and Europe as a whole will be home to 18% fewer young adults. India and Brazil can expect slight increases in their young adult populations (3% and 1% respectively), but among today's major powers, only the US stands to experience a significant increase in its young adult population (about 22% growth).

Cooper expects most of the world's population growth, and consequently the highest concentrations of young adults, to be located in sub-Saharan Africa. Worldwide, Cooper sees a 4% increase in the young adult population.

This dramatic population shift will have dire consequences for what Cooper calls the "demographic dividend" – the ratio of working individuals to children and retirees. Because



young adults make up a significant portion of the work force, their expected decline will mean that, absent major productivity gains, it will become more difficult to support dependent populations.

The US currently has a demographic dividend of 4.8, but this number will decline to 2.6 by 2050. Japan already has a demographic dividend of 2.6, and Cooper expects this ratio to decline to 1.2 over the next forty years. Cooper thinks that in Italy, Spain and Germany, demographic dividends will more closely resemble Japan's than that of the United States. This should serve as a warning to those countries, because Cooper also sees this "demographic drag" as one of the reasons why Japan never fully recovered from its economic crisis in the early 1990s and its subsequent "Lost Decade."

Social Security and retirement

On a positive note, the long-term security of the American social safety net is not quite as precarious as we sometimes imagine. The costs of Social Security in other industrialized nations are much higher, and those programs are much more in jeopardy. Though Social Security in the U.S. may indeed require an overhaul, Japan has already demonstrated that it is very possible to support a dependent population that the US won't even approach until 2050. In fact, Japan's experience also points to a prudent first step in any solution to the problems faced by Social Security: raising the retirement age.

In Japan, the retirement age is 70 years old, compared to the current age of 65 in the US. Although the US has already opted to raise the retirement age to 67, that change will not take effect for about half a decade. With the growing need for education in a post-industrial economy, a higher retirement age is necessary to keep an average individual's time in the workforce from declining. Workers are not joining the workforce until much later in life than they once did. If today's young workers are to stay productive for as long as previous generations, they must be discouraged from early retirement.

China vs. India: Competing education models

Analysts should also look to factors beyond the demographic composition, however, when evaluating a country's economic future. While the demographic dividend is very important to a country's fiscal and economic health, cultural and political factors can prevent it from properly capitalizing on any innate demographic advantage.

Decades ago, China and India both approached the question of how to direct education funding within the country from opposite directions. China allocated its education budget and its impressive regulatory power towards elementary education like basic math and reading. India focused its efforts on higher education, creating world-class universities like the Indian Institute of Technology. While the latter has produced some very fine individuals, the former seems to have proven a better recipe for success. Cooper acknowledged that India is making efforts to catch up, but he dismissed them as "belated



and poorly financed.” In 2050, he sees half or less of the Indian workforce with a primary education and almost a quarter illiterate. This will no doubt greatly diminish if not negate any demographic advantage India may have over other nations.

In conclusion

Many Asian and European economies will likely develop increasingly problematic demographic dividends, which Cooper thinks may produce a “demographic drag” effect similar to what we saw in Japan, retarding growth. In countries that rely heavily on family for entrepreneurial funding, like China, the coming scarcity of relatives is likely to have significant cultural and economic implications.

Out of the looming demographic devastation, however, the US ultimately emerges as a beacon of sustainability. Despite the apocalyptic predictions erupting from all quarters, the US actually enjoys a very promising outlook compared to similar economies. Nonetheless, there is work to do to keep social programs financially feasible and retain the US competitive edge. A higher retirement age will just be the start.

It is difficult to overstate the importance of population expansion for both the social safety net and national GDP growth, but it is clearly not the only important factor that decides a country’s economic fate. Cultural factors play an important role, for example, where women are often still excluded from the workforce. Cooper is right, however, to draw economists’ attention to the under-analyzed effects of demographic shift on the world’s financial future. Only by recognizing that the future world will be a radically different place from what we know now can we prepare ourselves.

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