Shrinking populations mean less growth and a more fractious world (economist.com)

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Politicians must act now to avert the worst

illustration: álvaro bernis

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If current forecasts are accurate, 2064 will be the first year in centuries when fewer babies are born than people die. Birth rates in India will fall to below the level seen in America last year. Even with immigration and successful pro-natal policies, America's population will only have a little bit of growth left. By 2100 there will be many fewer migrants left to attract. The world's fertility rate will hit 1.7. Just two Pacific islands and four African countries will manage to reproduce above replacement level.

Sooner or later, therefore, every big economy will collide with a demographic wall. The bill from pensions and hospitals will pile on fiscal pressure. Sapped of workers and ideas, economic growth could collapse while public debt balloons. Just how catastrophic the situation becomes depends on whether policymakers maintain budgetary discipline, withstand pressure from angry older voters and, crucially, are willing to inflict pain on populations now in order to save future generations from more later on.

America and Europe at least have longer to prepare than East Asia, which is already starting to feel the strain. South Korea has been ageing for a while, but only in the past four years has its population started to decline. It will now continue to fall for decades, as larger generations die off. By 2036 twice as many Koreans will be over the age of 65 as under 18. China will reach a similar point by 2040. America will take until 2100 to catch up.

Still, rich countries will need to spend 21% of gdp a year on old folk by 2050, up from 16% in 2015, according to the imf. A quarter of that will go on pensions. The rest will be required for health- and social-care provision. It is possible that artificial intelligence and pharmaceutical advances will cut the budget. But recent history suggests that such advances are more likely to raise it.

The exact size of the demographic hit does not just depend on how quickly populations age, but also on what they expect from the state. In this regard, South Korea has a somewhat bleak advantage. The imf reckons that its debt-to-gdp ratio, a modest 55%, is unsustainable in the long run and the government is still struggling to get its deficit below a 3% target. Yet few of its elderly were promised state pensions. Instead, nearly 40% of them are in poverty, the highest rate in the oecd club of mostly rich countries.

China is more likely to buckle under the pressure. By 2050 the country's leaders will have 100m pensioners on their hands—all of whom have been promised a basic state pension. Already, one-third of local pension providers are running deficits. Economists reckon that the central government's state-pension fund will run dry by 2035, unless officials take action. Europe's generous pensions, and America's growing social provision, mean that the West risks a similar fate, albeit at a slightly later date.

The size of the hit will also depend on how economies adapt to a decrepit world. Take government borrowing. Its sustainability reflects the gap between interest rates that prevail when inflation is stable—the so-called neutral rate—and economic growth, which boosts tax receipts. Ageing populations bring gloomy prospects for growth. Research shows that older workers tend to be less mentally agile, and therefore less productive. Shrinking populations could be even worse for growth, which economists believe requires the constant generation of new ideas. Charles Jones of Stanford University has modelled what happens in a world where there are ever fewer people to dream up innovations. The total stock of ideas, he finds, will grow more and more slowly. Economic growth will come to halt; living standards will stall.

What is less clear is whether interest rates will be low enough to keep a lid on debt-to-gdp ratios. Perhaps the neutral rate, which incentivises an equal amount of savings as investment in an economy, will track economic growth, as many expect. A proliferation of old folk means more people saving for retirement. And a paucity of investments from young entrepreneurs means that these savers will have little choice but to accept lower rates. Yet Charles Goodhart of the London School of Economics and Manoj Pradhan of Talking Head Macroeconomics, a research firm, disagree that this is the most likely outcome. They think a spending spree by grey consumers, fuelled by government handouts to the old, could drive up the neutral rate of interest. Because governments would then struggle to repay even their existing debts, they will resort to inflating them away.

Over the hill

There are steps Western governments could take to soften the blow. Credible monetary policy, which reassures investors that central bankers will quash spending binges prompted by ageing populations, would help. If governments were to rein in deficits in anticipation of future danger, that would make an even bigger difference. Pensions will have to be cut back as public finances adjust to longer lifespans. The imf reckons that rich-world governments will need to raise the retirement age by five years by the end of the century, even as increases in life expectancy slow.

These reforms would be unpopular now. Who wants to be the politician to inform millions of retired bureaucrats, soldiers and teachers that their pensions are being slashed in order to look after future generations? But in years to come, when the grey vote carries even more sway, they will become just about impossible—making it all the more important for politicians to act sooner rather than later. Although assessing the impact of shrinking populations can sometimes feel like peering into a distant future, the threat is already playing on the mind of leaders such as Emmanuel Macron, France’s president. Last year he risked his position by proposing reform of the country’s pension system, and faced protests that were widespread even by French standards. Other politicians will have taken note.