

Population Changes and International Competitiveness

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Outline

- Competitiveness and Growth
- Implications of Ageing on
 - Consumption and Savings
 - Financial Markets
 - Labour Markets and Productivity
- Implications of Migration on
 - Growth in Recipient and Sending Countries
 - Labour Markets and Income Distribution

Key messages

- Problem is not ageing per se, but ageing coupled with unreformed institutions, mainly (but not only) pension systems
- Migration can only be a short-term relief for unreformed pension systems
- The unavoidable costs of international migration could be reduced by reforming labour market institutions

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Should we worry about Competitiveness per se?

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- Obsession of competitiveness: do we really want “beggar my neighbour policies”?
- Competitiveness is an issue for countries having a tendency to consume more than what they produce
- And fast ageing countries are likely to experience the opposite phenomenon: current account surpluses

Growth is more important!

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- Competitiveness may be important indirectly. Ageing and real appreciation of a currency may involve hypertrophy of services with less productivity growth potential than manufacturing
- But ageing is a global phenomenon (although occurring at varying speed) and markets for these services are expanding
- Thus worry about growth rather than competitiveness

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A Framework

- Long-term growth governed by aggregate production function:

$$GDP = f(K, A * L_q)$$

where K =capital; $L_q = a_q * Edu * L$

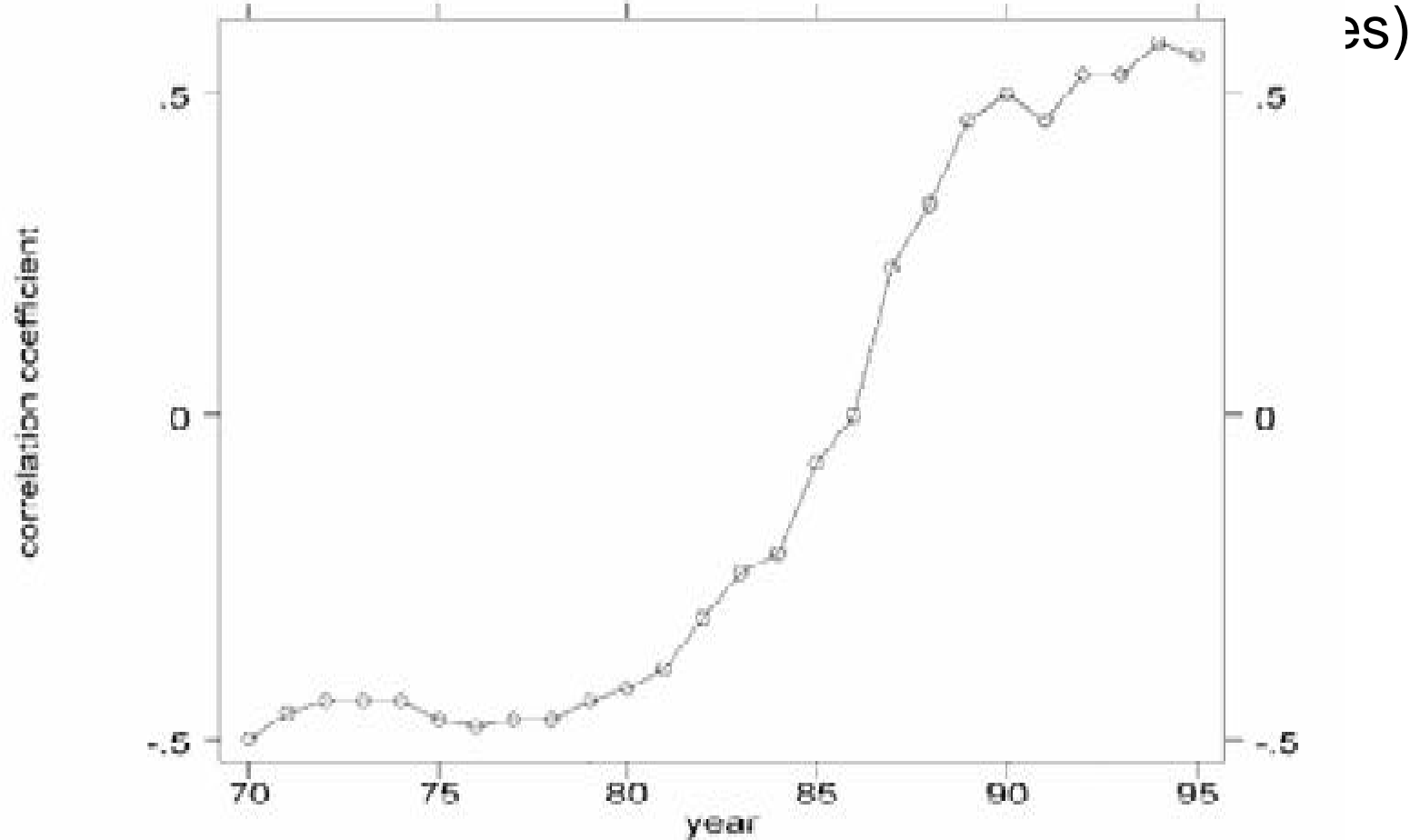
a_q is age-specific productivity; EDU =quality of workforce

Problems with demographic projections

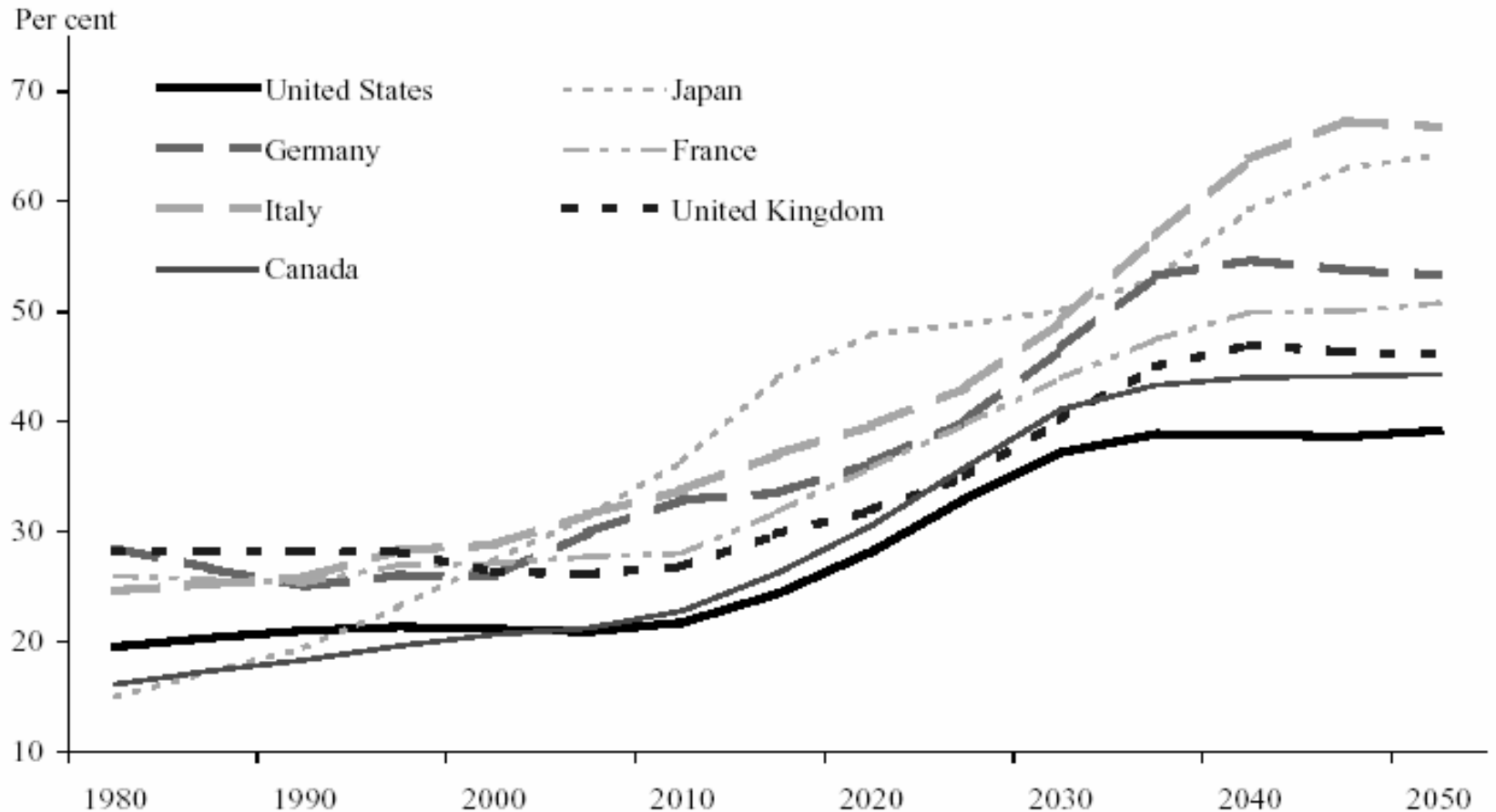
- Assume a strong deceleration of life expectancy gains (from 2.4 years per decade to roughly 1.2). But there is no evidence of this slowdown in the increase of longevity. The increase in conditional life expectancy at higher ages has accelerated.
- Fertility is difficult to predict: socio-economic determinants not fully understood.

not necessarily related to the womenisation of the workforce

(c)



Old-age dependency ratios in G7 (at given old-age threshold)



Source : Eurostat; United Nations (1998).

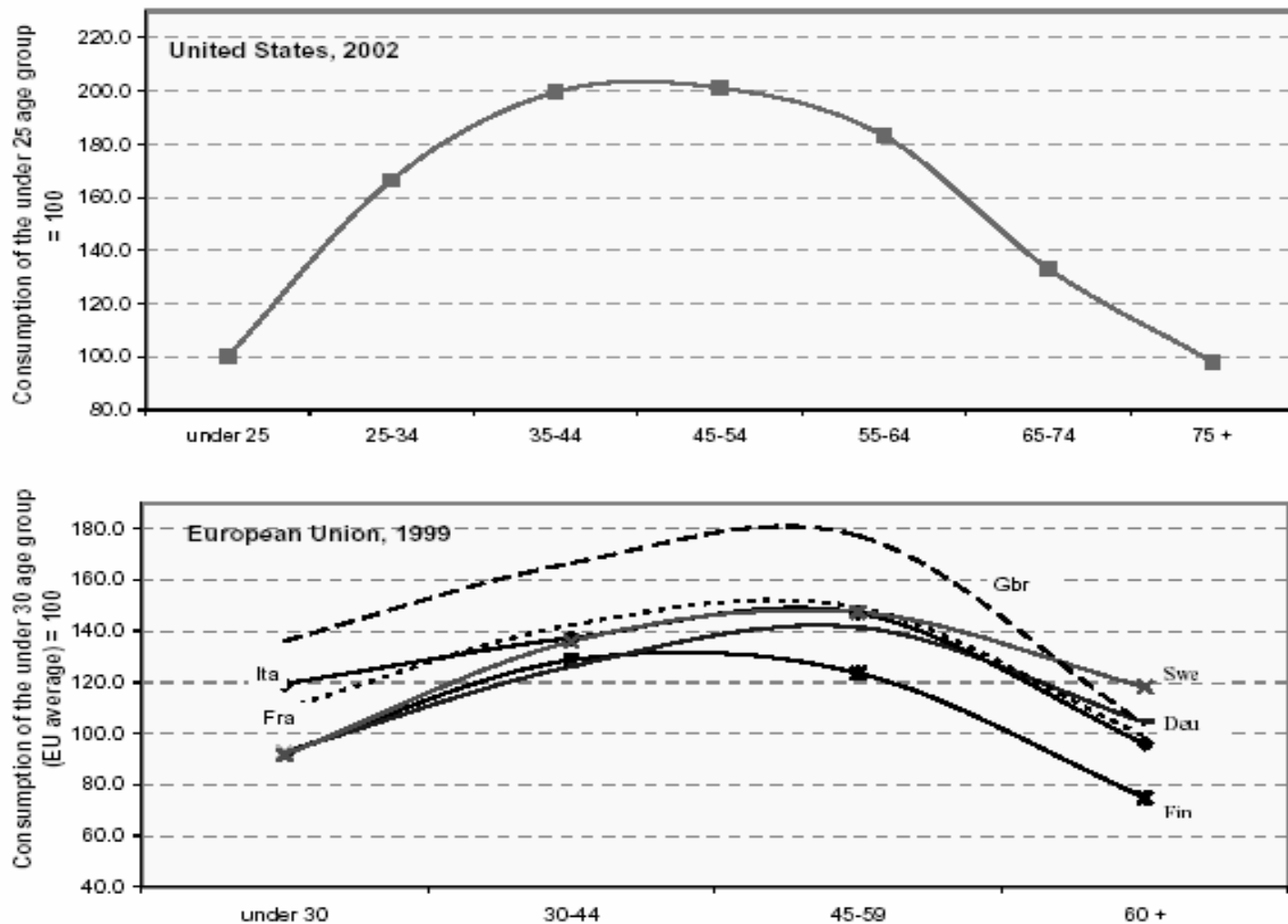
Effects on Consumption and Savings

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- Life-cycle model: consumption smoothing; older people with higher propensity to consume
- Lower aggregate savings, lower rate of capital accumulation
- Changes also in the composition of consumption: more services related to ageing

Partial consumption smoothing

Figure 3.1 Relationship between consumption and age groups



Financial markets

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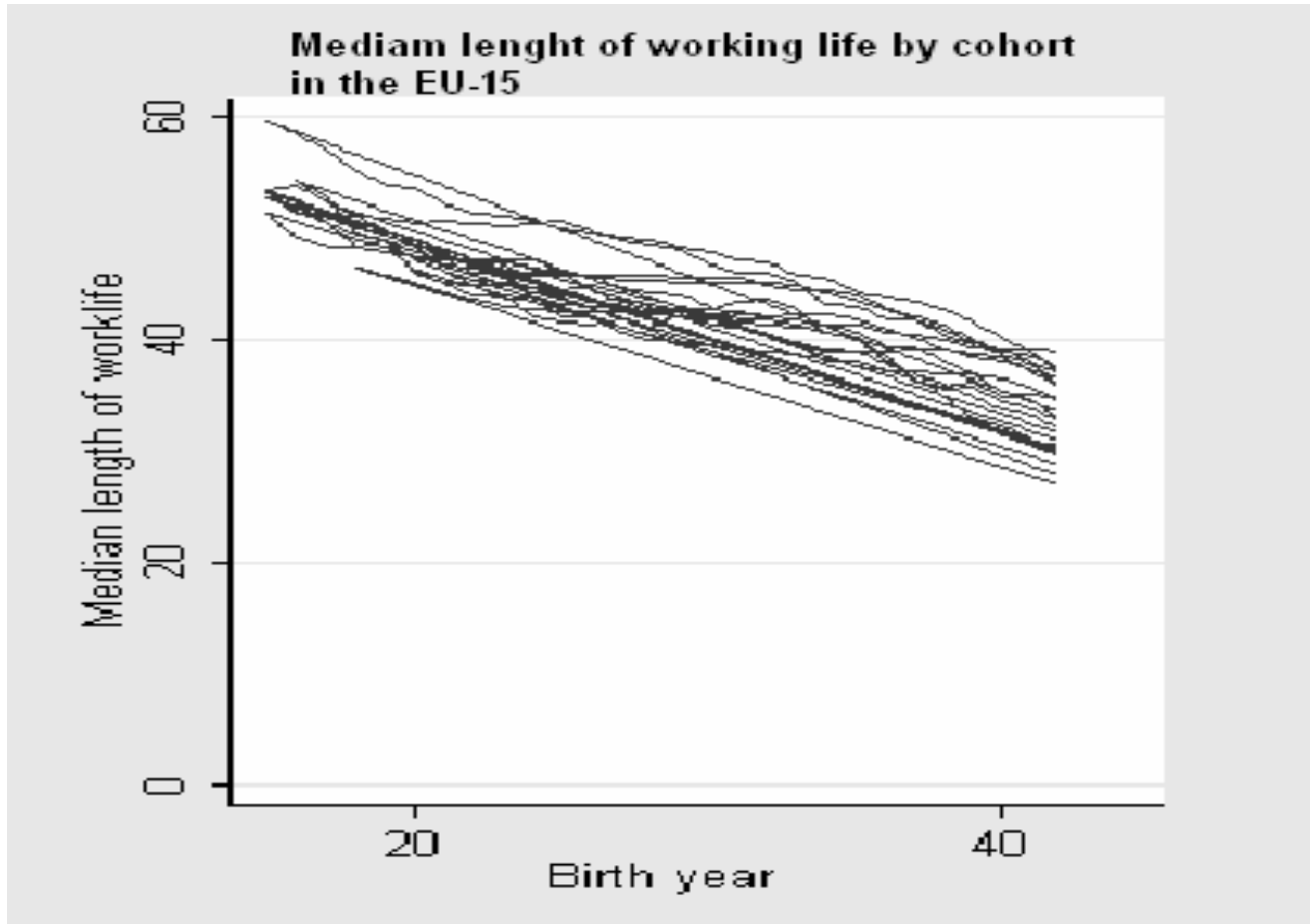
- Less capital accumulation (K)
- Milder effects if reforms of pension systems:
 - preventing a further rise of social security contributions
 - developing funded schemes and annuity markets (portfolio allocation diverted away risky assets?)
 - inducing prime-age individuals to quickly react to unavoidable reductions in the generosity of pension systems by saving more for their old age
- Evidence that private savings and retirement decision react to changes in pension rules

Labour Force (L)

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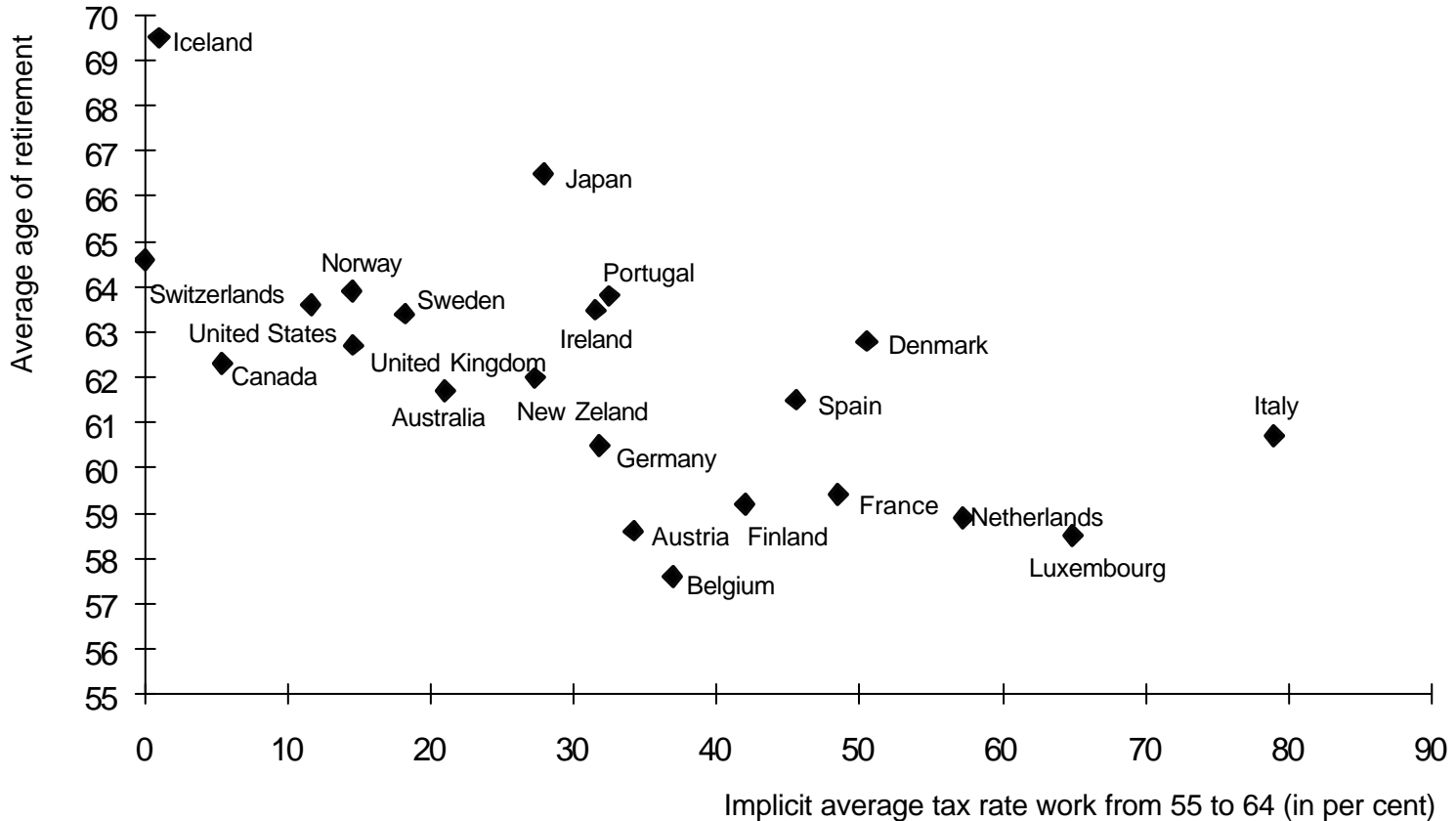
- Decline in labour supply can be mitigated by:
 - increasing retirement age
 - increasing participation before retirement age
 - higher quality - higher labour productivity

Reversing the trend to shorter working lives

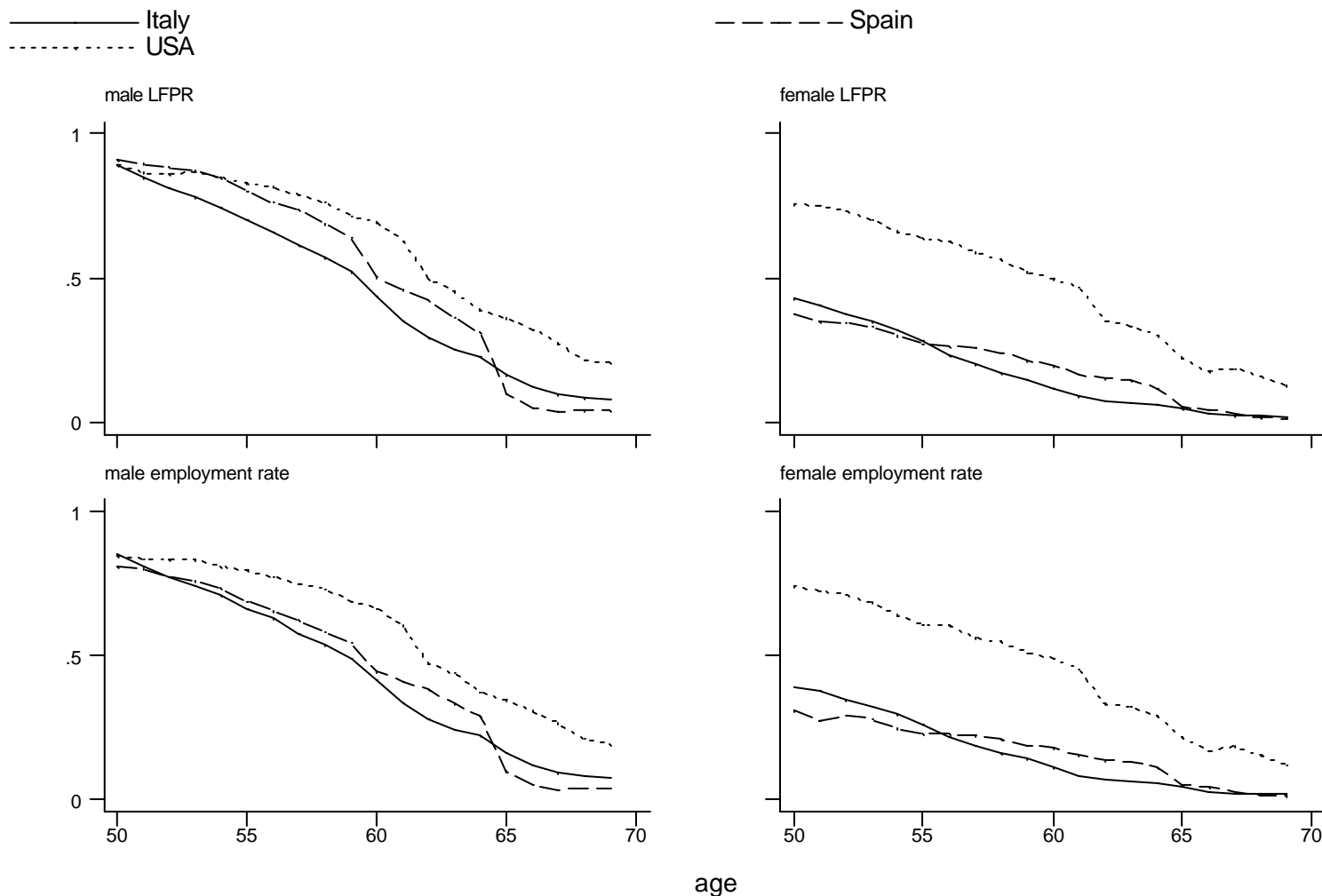


It is a matter of pension rules

Implicit tax rates on continued work and average age of retirement, males, 1995

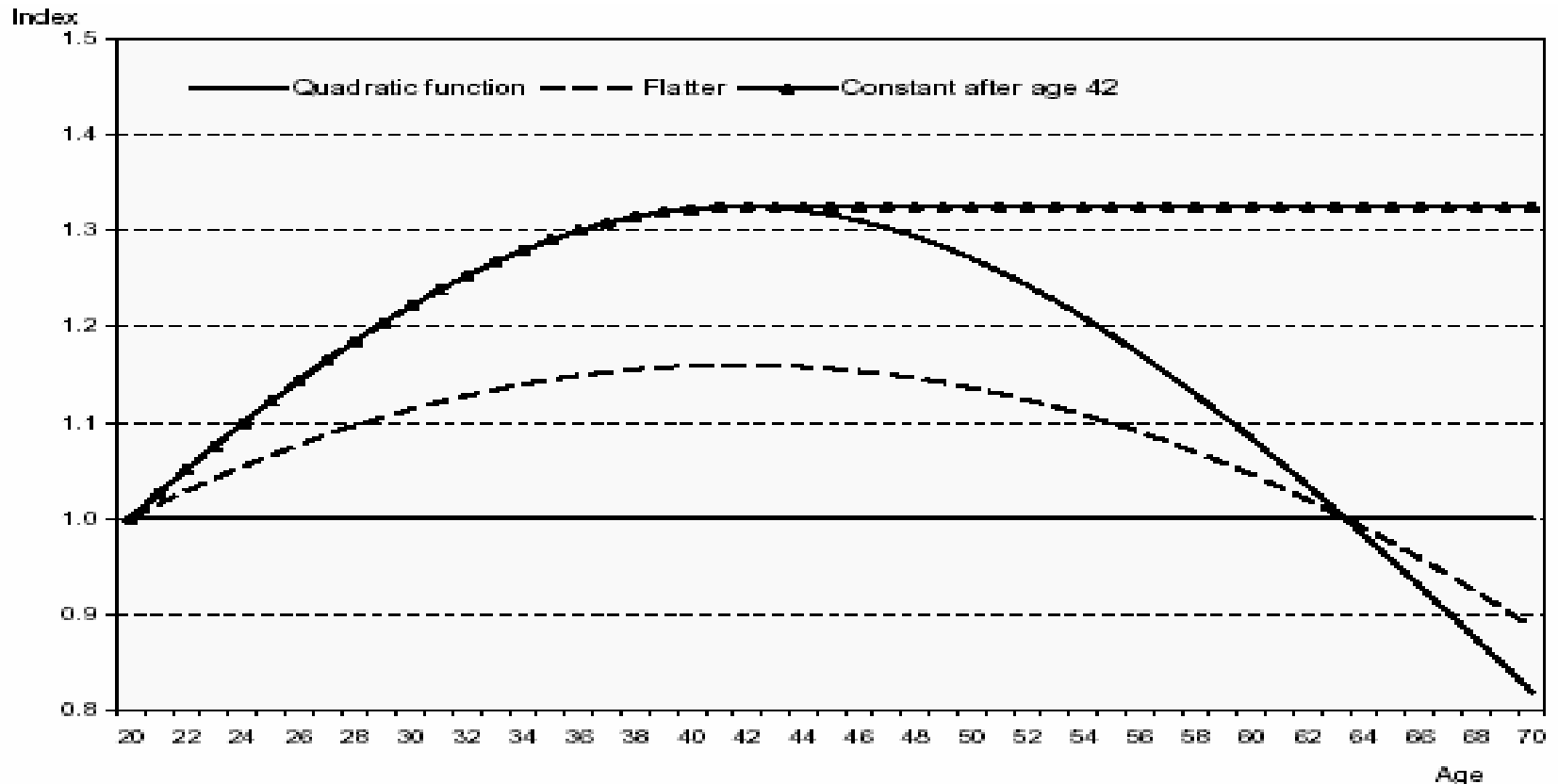


Increasing participation involves also policies at entry, re-entry. Labour market policies for women



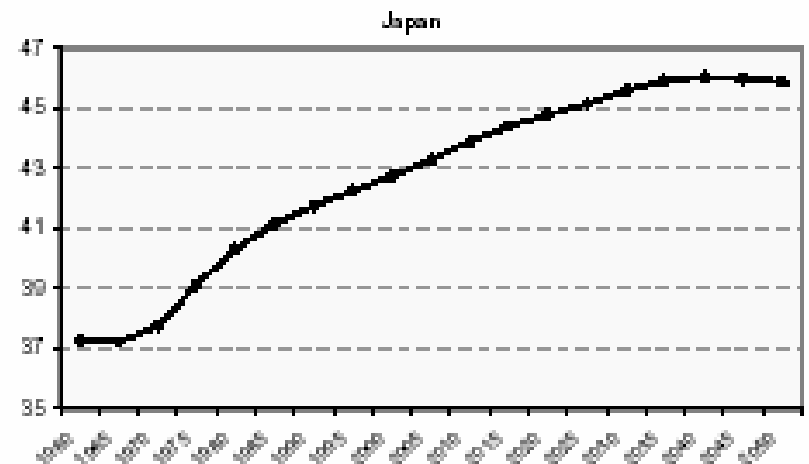
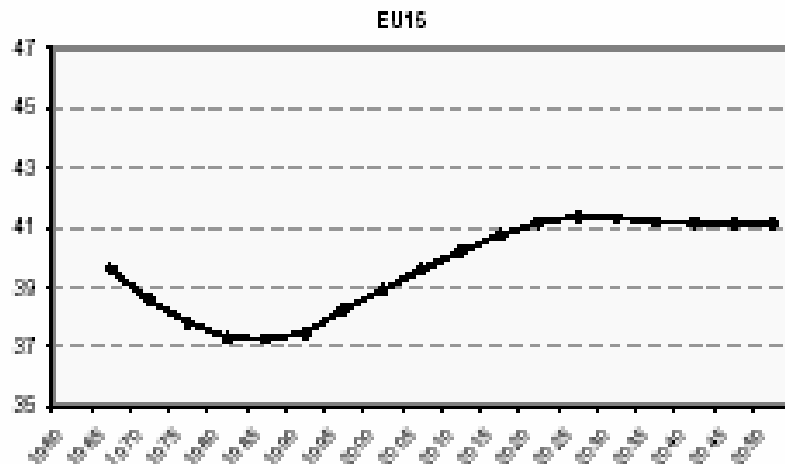
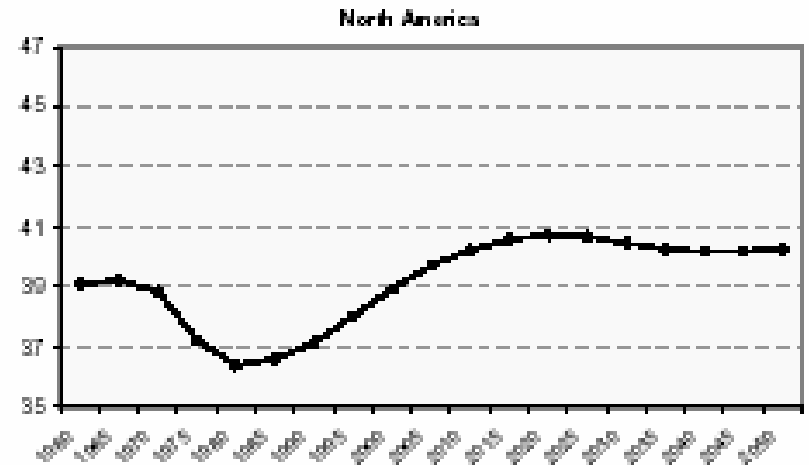
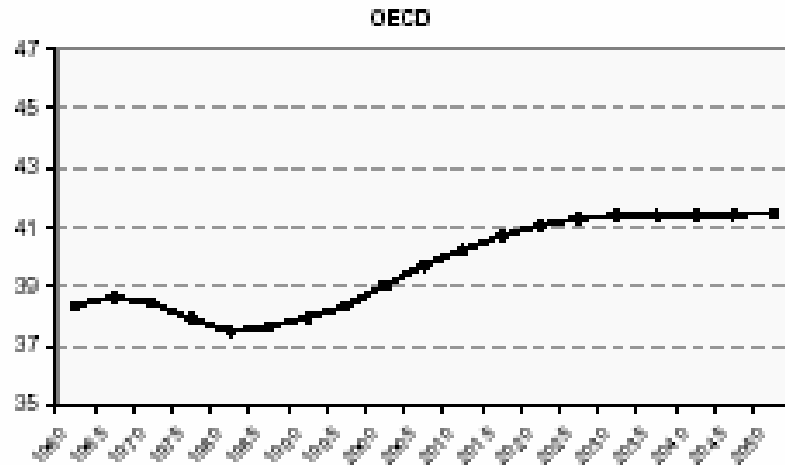
Source: Brugiavini, 2000

Effect on productivity (a_q) depend on age-productivity profiles



Source : OECD calculations.

Given ageing of the labour force



Putting the pieces together (OECD simulations)

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- If *unreformed pensions*, increasing contribution rates reduce L and K; improvements in quality of labour and higher K/L ratios (capital deepening) can only partly offset negative effects on growth. OECD predicts widening income per-capita between US and Europe.
- With *reformed pensions*, stronger effect on growth of capital deepening and lower decline in labour supply. According to the OECD, however still no convergence of Europe to the US.
- In order to close the gap one should also *reform labour-product markets* increasing participation at all age groups

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Important caveat

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- Even if all immigrants pay social security contributions and do not collect social transfers (welfare shopping), only permanent flow of migrants can reduce the pension-ageing problem
- Their own pensions will have to be financed too. Increase in the stock of migrants allows just to postpone the problem.
- Same result could be obtained by issuing public debt to foreign holders

However migration...

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- Can foster growth by allowing for a better allocation of resources
- Complementing in this capital flows and trade- product market integration
- Example of the potential gains from the Eastern Enlargement of the EU.
Transitional arrangements as missed opportunity for European growth

Costs and benefits of migration

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- CBA for receiving country, sending country and region as a whole
- Depend on institutions:
 - labour market clearing?
 - wage rigidities and unemployment
 - with regional wage and employment disparities
 - welfare (unemployment) benefits

Summary of simulation results

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- *Total* gains from migration are large: +0.2-0.4% GDP with migration of 1%
- Most gains accrue however to migrants and their families
- Small gains or losses for natives in receiving and sending countries depending inter alia on assumptions on wage rigidities....

Effects on Income Distribution

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- Explain opposition to migration
- Losses for manual labour (-0.2% to -0.55%) in receiving countries
- With rigid wages unemployment rate increases in receiving countries by 0.1-0.2 percentage points, and falls in sending countries

Welfare systems increase trade-off natives/foreigners

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Migration, hence total GDP in enlarged EU, *increases* with UB replacement rate in recipient country. But steeper trade-off between native (-) and migrants income (+).

Final remarks

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- Ageing is not a problem if institutions can be adjusted to accommodate an ageing workforce. Can they?
- The benefits of migration are not in terms of public finance, but of growth. They will be larger again if reformed labour market institutions and properly working redistributive system

Can we change scenario?

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Political obstacles to reforms of pension systems

Pressures to close borders to migrants, inducing more illegal migration

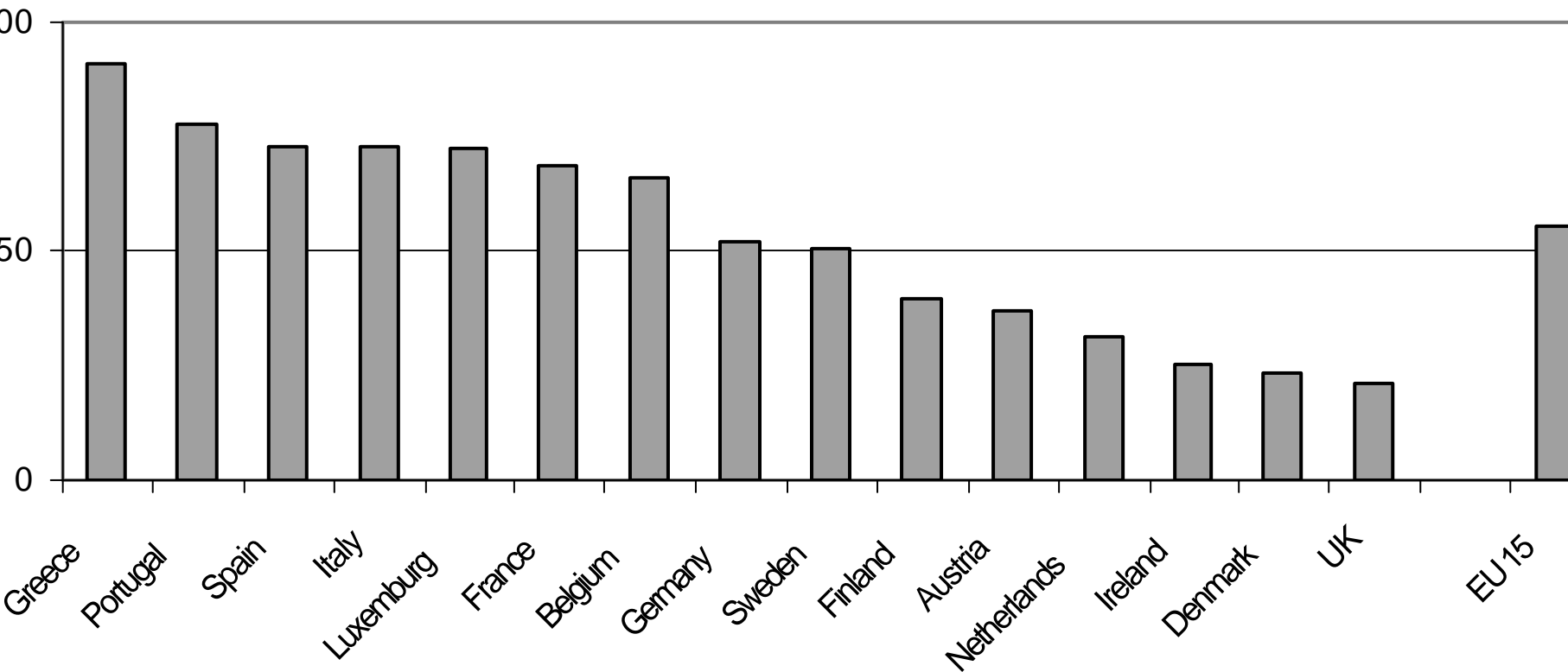
Resistance to improve redistributive properties of welfare systems, making them also more adequate to accommodate large flows of migrants

We cannot change the minds of citizens, but we can inform them

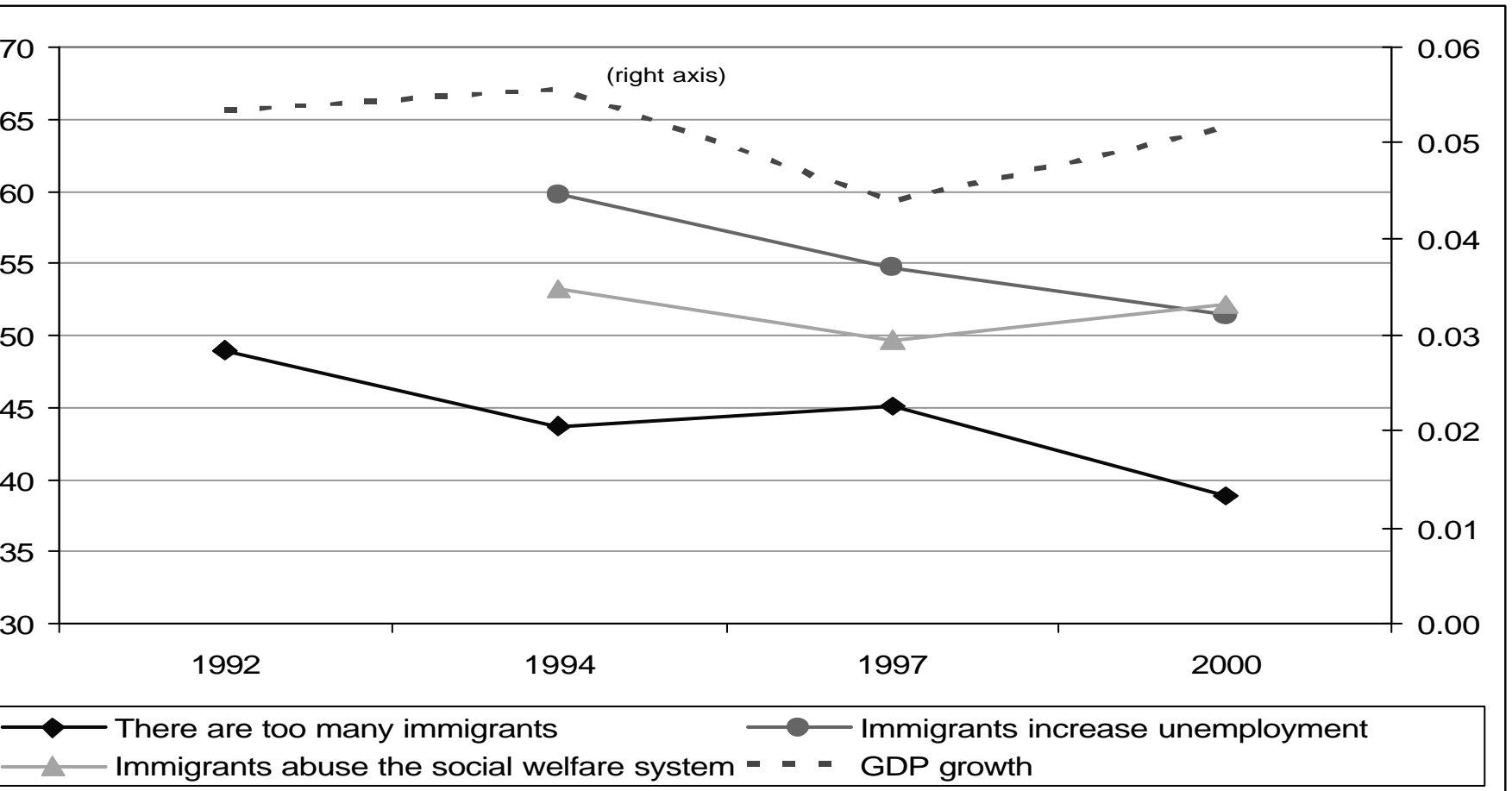
Perceived effects of increasing retirement age

People in their late 50's should give up work to make way for younger and unemployed

agree



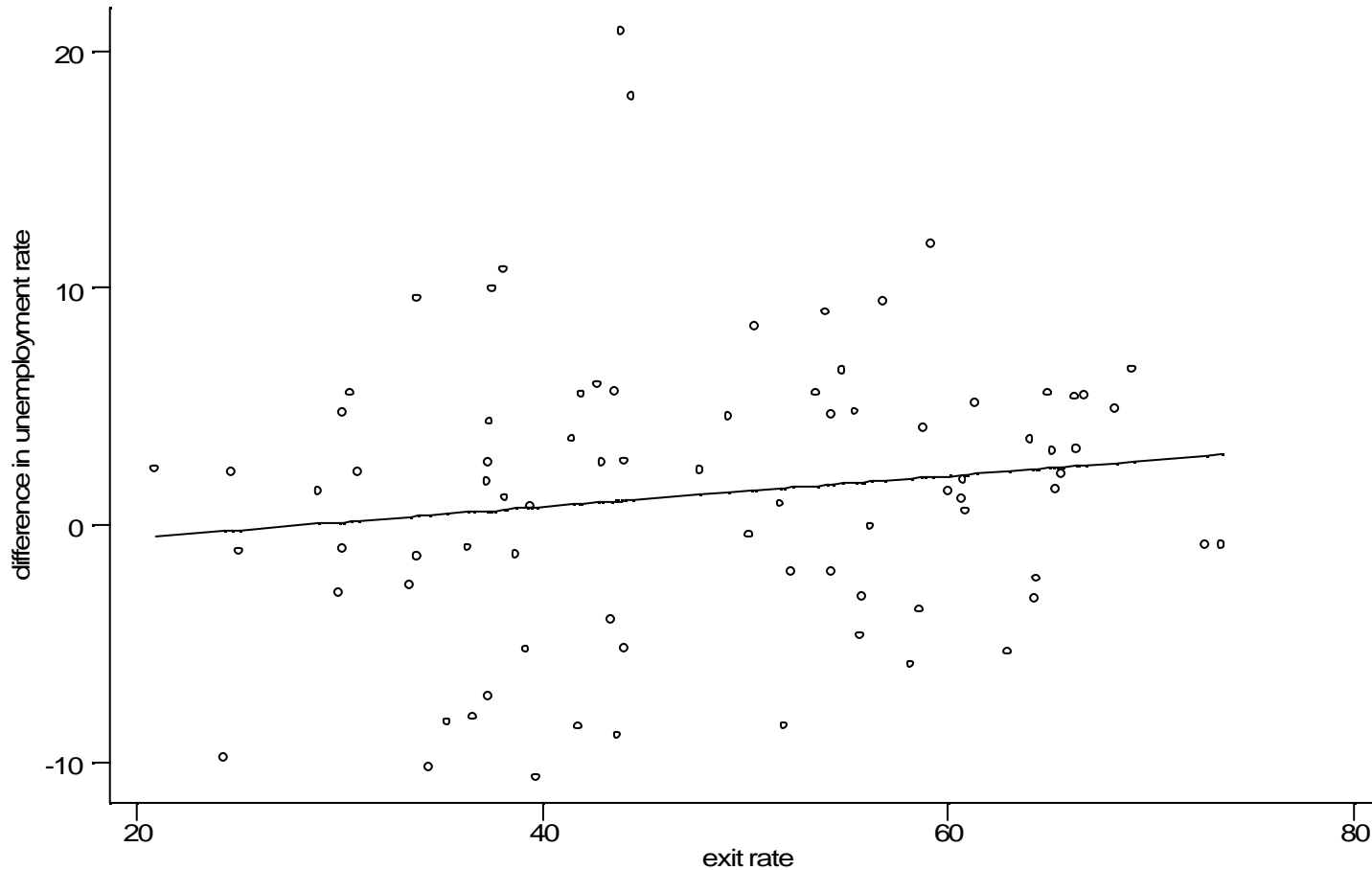
Perceptions of migrants



There is not a fixed number of jobs!

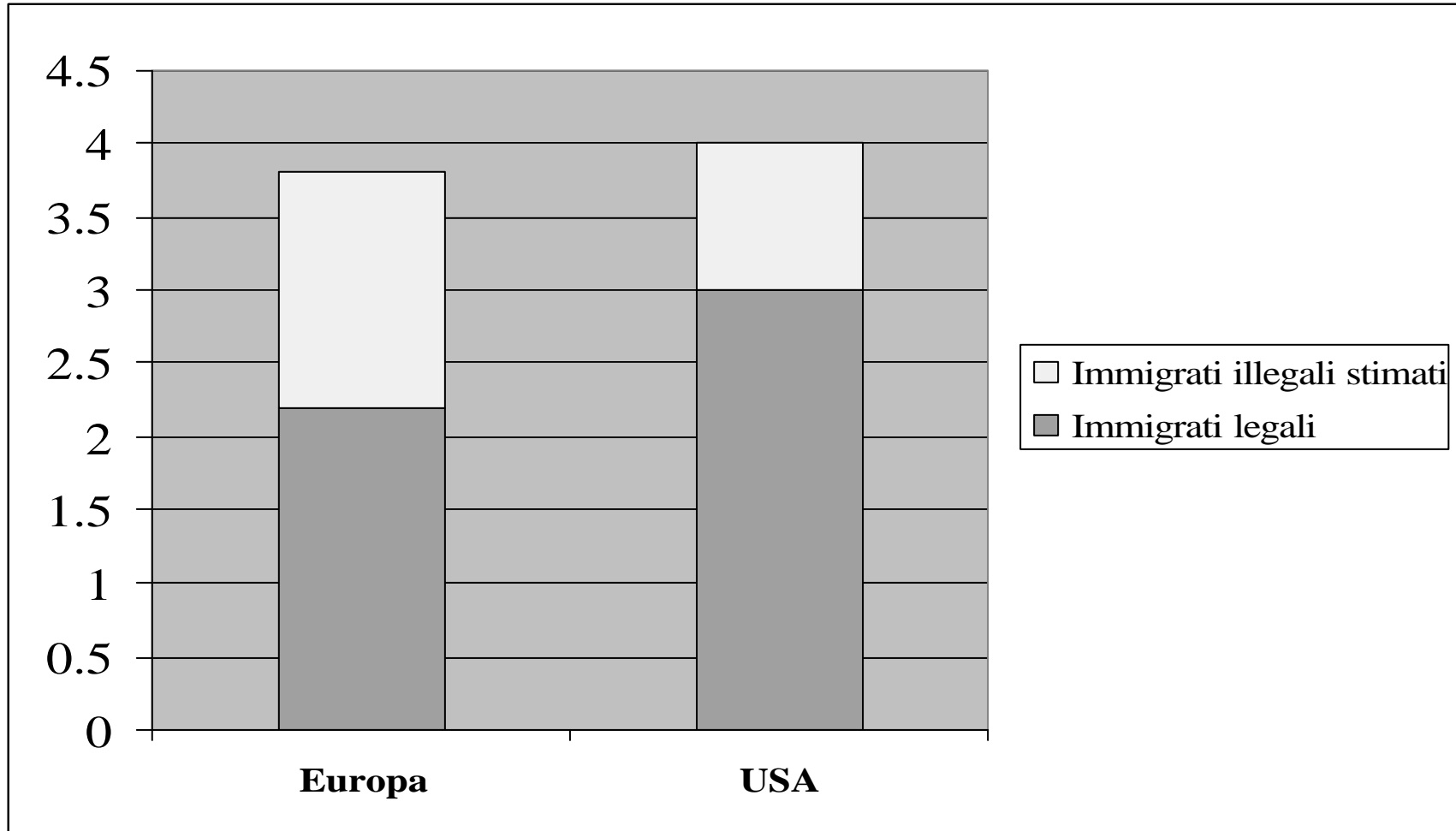
(youth unemployment and early retirement)

Early retirement (exit rate, born 1931-40) and changes in youth unemployment (aged 21-30), Men



Source: Boldrin et al. (1999) using three European Labour Force Surveys for the years 1986, 1991, and 1999

Closing borders means more illegal migrants

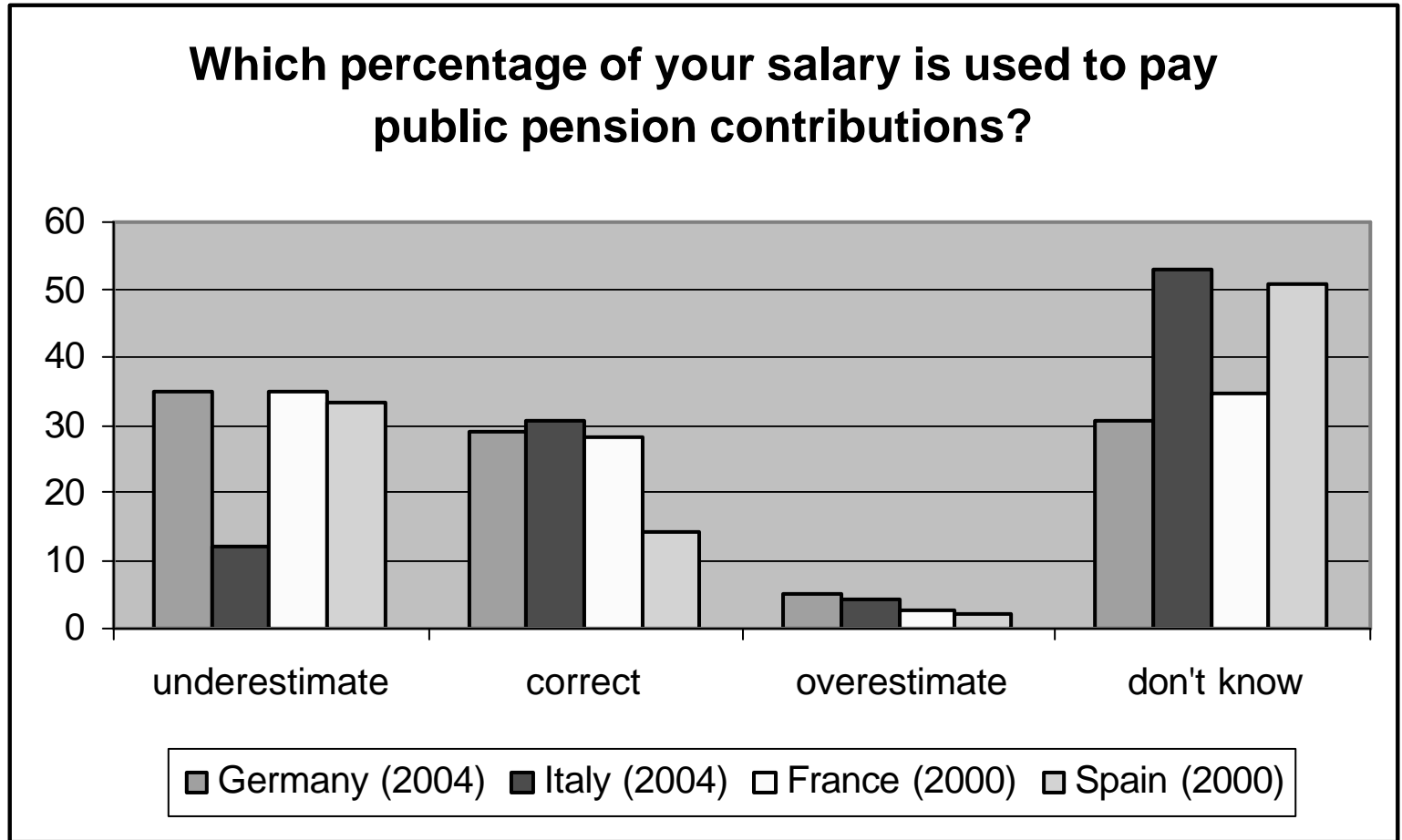


Informing Citizens

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- Widespread belief in the lump-of-labour fallacy.
- But the number of jobs is not fixed but reacts to incentives, including labour taxes and social security contributions, difficulties in finding workers, wages, etc...
- Important also to inform about actual costs of unreformed pension systems

Aware of the costs of pension systems?



Better ways to inform? The orange envelope

You can receive a pension from more than one source

Besides their national pension, many people also receive a pension from elsewhere. This may be an occupational pension from their employer or perhaps a pension from their own private pension saving. This money is not described here, but it makes your total pension higher.

If you draw your national pension from

age 61: With 0% growth you receive SEK 8,800 per month With 2% growth you receive SEK 13,000 per month

age 65: With 0% growth you receive SEK 11,600 per month With 2% growth you receive SEK 18,400 per month

age 70: With 0% growth you receive SEK 16,700 per month With 2% growth you receive SEK 29,300 per month

Example: Your national pension at age 65 and zero per cent growth consists of: SEK 9,400 income pension (incl. any supplementary pension) and SEK 2,200 premium pension (for the calculation assumptions for premium pension, see *Forecast* in the Glossary).

Make your own forecast on the internet

Go to www.pension.nu and use the amounts below, which come from pages 2 and 5 of this annual statement:

SEK 702,476

SEK 18,385

Would you like more information?

Visit www.pension.nu (the Insurance Office) or www.ppm.nu (the Premium Pension Authority). You can also phone the Insurance Office's help line on 020 – 524 524.