How Global Aging Will Reshape the Economic and Business Environment of the 21st Century

By Richard Jackson

The world stands on the brink of a stunning demographic transformation brought about by declining fertility and rising life expectancy. The first trend is decreasing the relative number of the young in society, while the second is increasing the relative number of the old. Together, they are leading to a dramatic aging of populations worldwide. The coming demographic transformation is popularly known as global aging, and over the next few decades it could have a profound impact on economic performance, social and political stability and investment risks and opportunities worldwide.

Humanity's graying future

It is today's developed countries that are leading the way into humanity's graying future. For most of history until well into the nineteenth century, the elderly (defined as adults aged 65 and over) comprised only a tiny fraction of the population. In the developed countries today, they comprise 17%. By mid-century, the share is on track to reach 26%, and that is just the average. In the fastest-aging European countries, the elderly share of the population will be approaching 35% and in Japan it will be approaching 40%. Meanwhile, working-age populations in almost every developed country will cease growing and in many cases begin to contract, the only major exception being the United States.

The developing world as a whole is still much younger, but most of it has also entered the demographic transition — the shift from high fertility and high mortality to low fertility and low mortality that inevitably accompanies development and modernization. As this transition unfolds, societies that most people still think of as demographically youthful, with large families and large labor surpluses, will be utterly transformed. By the 2040s, Brazil and Mexico will be nearly as old as the United States — and China will be considerably older. Meanwhile, South Korea will be vying with Germany, Italy and Japan for the title of the oldest country on earth.

The outlook for the developed world

In the developed world, the economic impact of aging is, on balance, likely to be negative. This expectation is based in part on simple arithmetic.

> We live in an era of many challenges,
> from global warming to global terrorism.
> But few are as certain as global aging
> and few are likely to have such large
> and enduring an effect
> on the size of government budgets,
> the performance of national economies,
> and the shape of the world order.

By the 2020s and 2030s, the working-age population of Japan and the faster-aging European countries will be contracting by roughly 0.5~1.5% per year. Even at full employment, the growth in real GDP could stagnate or decline, because the number of workers may be falling faster than productivity is rising. Unless economic performance improves, some countries could face a future of secular economic stagnation, of zero real GDP growth from peak to peak of the business cycle.

Economic performance, in fact, is more likely to deteriorate than to improve. Workforces in most developed countries will not only be stagnating or contracting, but graying — and a large amount of literature establishes that worker productivity typically declines at older ages, especially in eras of rapid technological and market change. At the same time, savings rates are likely to decline as a larger share of the population moves into the retirement years. If savings falls more than investment demand, as much macroeconomic modeling suggests is likely, either businesses will go starved for investment funds or the dependence of the developed economies on capital from higher-saving emerging markets will grow. In the first case, the penalty will be borne in the form of lower output. In the second case, it will be borne in higher debt service costs and loss of political leverage, which history teaches is always ceded to creditor nations.

Even as economic growth slows, the developed countries will have to transfer a rising share of society's economic resources from working-age adults to nonworking elders. In order to maintain the current generosity of their old-age benefit systems, the Center for Strategic and International Studies projects that the governments of developed countries would, on average, have to spend an extra 7% of GDP on pensions and health care by 2030. Yet the old-age benefit systems of most developed countries are already pushing the limits of fiscal and economic affordability. By the 2020s, political warfare over deep benefit cuts seems unavoidable. On one side will be young adults who face stagnant or declining after-tax earnings. On the other side will be retirees, who are often wholly dependent on pay-as-you-go government benefits. In the 2020s, young adults will have the future on their side. Retirees will have the votes on theirs.

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Global aging could also affect the collective temperament of the developed countries in ways that may be even more consequential than the impact on economic growth. With the size of domestic markets fixed or shrinking in many countries, businesses and unions may pressure governments to pursue anti-competitive policies. Historically, eras of stagnant population and market growth — think of the 1930s — have usually been characterized by rising tariff barriers and beggar-thy-neighbor protectionism. The shift in business psychology could be mirrored by a broader shift in social mood. Psychologically, older societies are likely to become more "small c" conservative in outlook and possibly more risk-averse in electoral and leadership behavior. Elder-dominated electorates may tend to lock in current public spending commitments at the expense of new priorities. We know that extremely youthful societies are in some ways dysfunctional — prone to violence, instability and state failure. Extremely aged societies may also prove to be dysfunctional in some ways, favoring consumption over investment, the past over the future and the old over the young.

The outlook for the emerging world

While demographic trends in the developed world will be leaning against economic growth, demographic trends in most of the developing world will be leaning with it. The difference in outlook is due to the fact that the developed and developing worlds now find themselves at different stages of the demographic transition. The decline in fertility and mortality rates that drives the transition ultimately results in aging populations and slower economic growth. But first, it opens up a window of opportunity for economic and social development known as the demographic dividend.

As developing-world fertility rates have plummeted — first in East Asia beginning in the 1970s, then in a growing number of other regions — the number of child dependents has declined and the share of the working age population has risen, often dramatically. All other things being equal, the increase in the ratio of workers to dependents will alone boost living standards. In addition, it may alter economic behavior in ways that further accelerate the pace of living-standard growth. Labor-force participation rates may increase, because fewer children free up adult time, and especially the time of women, for participation in the market economy. Over time, savings rates may increase as well as more of the working-age population begins to age into the high-saving middle years. Declining family size, together with rising life expectancy, also increases incentives to invest more in the "quality" of children, and thus of the future workforce. Nor is this dynamic merely theoretical. Development economists who have studied the demographic transition agree that it has given a powerful boost to economic growth in emerging East Asia, accounting for 25~40% of the increase in the region's living standards since the mid-1970s.

To be sure, favorable demographics alone do not guarantee economic success. Policies, institutions, and culture also matter. The child dependency burden has been falling and the share of the population in the working years has been rising since the mid-1970s in every region of the developing world except sub-Saharan Africa. Yet no other region has managed to achieve sustained growth rates in living standards that even approach East Asia's. Between 1975 and 2011, real GDP per capita in emerging East Asia rose by a staggering 1,070%. In South Asia, it rose by 257%, in Latin America by 60%, and in the Greater Middle East by just 27%.

It is also important to recognize that the period of demographic dividend does not last indefinitely. As the demographic transition unfolds, the decline in the number of children is eventually overtaken by the growth in the number of elderly, and dependency burdens once again rise. The emerging markets of East Asia, where fertility fell faster than elsewhere in the developing world, are now approaching this tipping point. All are now aging rapidly and, within a decade, all, including China, will have stagnant or contracting working-age populations. The period of demographic dividend, and along with it the window for rapid economic development, is also about to close in Central and Eastern Europe. In contrast, the period of demographic dividend in South Asia, Latin America, and the Muslim world will last much longer — probably until the 2030s or 2040s. Still, every country that embarks on the demographic transition will eventually reach the tipping point where demographic trends begin to lean against growth.

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As today's emerging markets enter the final stage of the demographic transition, they will encounter many of the same difficulties now confronting today's developed economies. There is, however, an important difference — and one that may make their aging challenge even more daunting. The developing world's age waves will be arriving in societies that are not only less affluent, but that in many cases have not yet had time to put in place the full social protections of a modern welfare state. In most developing countries, only a fraction of the workforce is earning a benefit under any type of pension system, either public or private. From China and India to Mexico and Malaysia, the majority of elders still depend heavily on the extended family for economic support. Yet traditional family support networks are already under stress as countries urbanize and industrialize, and will soon come under intense new demographic pressure as family size declines. An aging crisis of potentially immense dimensions looms in the future of some emerging markets if they fail to construct adequate old-age safety nets.

The new global economic order

Yet these caveats notwithstanding, there is little question that demographic trends will continue to drive the relative rise of today's emerging markets — and the relative decline of today's developed economies. According to projections by the Carnegie Endowment for International Peace, the emerging-market share of the combined GDP of the G-20 countries will rise from 28% in 2009 to 59% in 2050, while the developed-country share will fall from 72% to 41%. Driving this stunning shift will be not just the demographically led slowdown in economic growth in the developed world, but also the surging expansion of large, newly market-oriented economies in the developing world, especially in East and South Asia.

Although demography may not be destiny, it will fundamentally reshape the environment in which governments, businesses and investors must operate. Demography is the economic and geopolitical cartography of the twenty-first century.

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