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## The Demographics of Stagnation

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Economic Growth**

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# The Demographics of Stagnation

## Why People Matter for Economic Growth

*Ruchir Sharma*

In every single region of the world, economic growth has failed to return to the rate it averaged before the Great Recession. Economists have come up with a variety of theories for why this recovery has been the weakest in postwar history, including high indebtedness, growing income inequality, and excess caution induced by the original debt crisis. Although each explanation has some merit, experts have largely overlooked what may be the most important factor: the global slowdown in the growth of the labor force.

One way to calculate the world's potential growth rate is to add the rate at which the labor force is expanding to the rate at which productivity is rising. Since 1960, gains in both factors have contributed equally to potential economic growth. And in the last decade, the gains in both appear to have leveled off. The difference between these two drivers, however, is that there is a debate about whether the decline in productivity growth is real. Productivity measurements have arguably failed to capture

savings in money and time generated by new technologies, from superfast Internet connections to artificial intelligence. But it is hard to deny that the growth in the size of the labor force—which is driven mainly by increases in the number of working-age people, those between the ages of 15 and 64—has slowed across the world.

Between 1960 and 2005, the global labor force grew at an average of 1.8 percent per year, but since 2005, the rate has downshifted to just 1.1 percent, and it will likely slip further in the coming decades as fertility rates continue to decline in most parts of the world. The labor force is still growing rapidly in Nigeria, the Philippines, and a few other countries. But it is growing very slowly in the United States—at 0.5 percent per year over the past decade, compared with 1.7 percent from 1960 to 2005—and is already shrinking in some countries, such as China and Germany.

The implications for the world economy are clear: a one-percentage-point decline in the population growth rate will eventually reduce the economic growth rate by roughly a percentage point. A collapse in the growth rate of the working-age population was already under way before the financial crisis, and the trend explains a good chunk of the persistently disappointing recovery since. Governments can offer incentives to boost fertility rates and lure more adults into the work force—and many already are—but these half measures can only partially offset the larger forces at work. Ultimately, then, the world should brace itself for slower growth and fewer economic standouts.

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## THE POPULATION PLATEAU

According to UN forecasts, the world's population will rise from 7.3 billion today to 9.7 billion by 2050. Alarmists of all stripes have seized on the prediction: neo-Malthusians fear that agricultural productivity won't be able to keep up with all those extra mouths to feed, neo-Luddites worry that the advent of the robotic age will leave this exploding population largely unemployed, and anti-immigrant forces in the West raise the specter of a rising tide of what one British cabinet minister called "desperate migrants marauding around."

But all these fears are misplaced. Although 2.4 billion sounds like a lot of people to add to the planet by 2050, the figure in fact takes into account a dramatic slowdown in the population growth rate—a decline driven largely by the thinning ranks of working-age people. Slower population growth reduces the pressure on the food supply, as does the aging of the population, because elderly people consume up to a third fewer calories than young people. But such demographic decline is nonetheless toxic for the economy. The primary threat most countries now face, in fact, is not too many people but too few young workers.

For much of the postwar era, global population grew at nearly two percent per year, which meant that the world economy could also expect to grow at a baseline rate of close to two percent a year—and a couple of percentage points more than that when output per worker was also growing. Around 1990, however, population growth fell off a cliff. Since then, the rate has halved, to just around one percent. The difference between one percent and two percent

may seem small, but if the population growth rate had stayed at two percent since 1990, there would be 1.4 billion more people today, and shrinking work forces would not pose such a threat to economic growth.

This demographic shift is the delayed result of slow-moving changes in death and fertility rates over the last half century. On one side of the ledger, advances in medicine and nutrition have extended the average human's life span from 50 years in 1960 to 69 years today, with more progress sure to come. Already, the majority of global population growth is a consequence of the expanding share of people over 50, and the fastest-growing segment of the population is, by far, people older than 80.

On the other side of the ledger is the global baby bust. Since 1960, the average number of births per woman worldwide has fallen from 4.9 to 2.5. In part, this drop-off in the fertility rate owes to rising prosperity and educational levels among women, many of whom decided to pursue careers and have fewer children—or not have children at all. But the decline has mostly been the result of aggressive birth-control policies adopted in the developing world in the 1970s. China introduced its one-child policy in the late 1970s, and the fertility rate fell from 3.6 in 1978 to 1.5 today. In India, where the government went so far as to embark on a forced sterilization campaign in the late 1970s, the fertility rate plummeted, from 5.9 in 1960 to 2.5 in 2015. Today, more and more countries are nearing the replacement fertility rate of 2.1, below which the population starts to shrink. Already, nearly half of all the people on earth live in one of the 83

countries—including Brazil, China, Germany, Iran, Japan, Russia, and the United States—where the fertility rate is below that level.

### PEOPLE POWER

Because it takes 15 to 25 years for babies to mature into working-age adults, the economic impact of falling fertility rates is only starting to become visible. To get a better handle on how demographics will limit national economies in the future, I looked at population trends in the 56 cases since 1960 in which a country sustained economic growth of at least six percent for a decade or more. On average, the working-age population grew at 2.7 percent during these booms, suggesting that explosions in the number of workers deserve a great deal of the credit for economic miracles. This connection has played out in dozens of cases, from Brazil in the 1960s and 1970s to Malaysia in the 1960s through the 1990s.

As for how fast the working-age population needs to grow to raise the likelihood of an economic boom, two percent per year turns out to be a good benchmark. In three-quarters of the 56 cases, the working-age population grew faster than that average during the duration of the economic boom. As that suggests, a country is unlikely to experience a decadelong boom if its working-age population is growing slower than two percent annually. Yet most of the world now fits into that category. As recently as the 1980s, 17 of the 20 largest emerging economies had working-age population growth rates above two percent. In this decade, by contrast, only two countries do, Nigeria and Saudi Arabia. The take-

away: a world with fewer fast-growing working-age populations will experience fewer economic miracles.

To be sure, economic booms don't always require population booms: in a quarter of the cases, the countries did manage long stretches of strong economic growth without reaching the threshold of two percent population growth. Several of these countries were already relatively wealthy, such as Chile and Ireland in the 1990s, when some combination of reform and new investment increased productivity and compensated for weak population growth. Others were witnessing a return to economic calm during a period of reconstruction, as Japan, Portugal, and Spain were in the 1960s and as Russia was a decade after the fall of the Soviet Union, with an added boost from high oil prices in the last case. Today, no country can expect a similar boost, not when commodity prices are falling and political unrest is rising.

Still, the probability of an economic boom is much lower in the absence of strong population growth, and even in many parts of the developing world, population growth is slowing or reversing. Over the next five years, the working-age population growth rate will likely dip below the two percent threshold in all the major emerging economies. In Brazil, India, Indonesia, and Mexico, it is expected to fall to 1.5 percent or less. And in China, Poland, Russia, and Thailand, the working-age population is expected to shrink.

The decline in China is perhaps most worrying, as the country has long served as an engine of global economic growth. In 2015, the growth rate of its working-age population dipped below zero for the first time in at least half a



*Gone gray: a nursing home in Hanover, Germany, January 2013*

century. At the same time, thanks to the huge strides in health care that China has made, the elderly's share of the population is growing much faster there than in industrial countries such as France or the United States. This rapid aging adds to the list of reasons, including an unprecedented debt binge, to doubt that China can keep up its rapid economic expansion.

Indeed, countries with shrinking working-age populations have found it nearly impossible to produce strong economic growth. Going back to 1960, there are 698 decadelong periods for which data on a country's population growth and GDP growth are available. In 38 of these cases, the working-age population shrank. The average GDP growth rate in these countries was a measly 1.5 percent. Only three of them managed to sustain GDP growth rates of six percent or higher, and all three were small countries bouncing back from political turmoil: Portugal in the

1960s and Belarus and Georgia between 2000 and 2010.

This disappointing record suggests that China's economy will almost certainly not grow at six percent in the coming years. In fact, although China's official numbers still put the growth rate at around seven percent, independent estimates show that it has already fallen below six percent. The implications for economies elsewhere are dire: in the last five years, China accounted for about a third of global economic growth, a contribution around twice that of the United States.

Fortunately, in a few other populous countries, the working-age populations are still expanding at a rate near or above two percent a year. This group includes Bangladesh, Kenya, Nigeria, and the Philippines. Demographers expect these populations to keep growing rapidly for the next decade. But even these countries have their work cut out for them. They must avoid



falling for the fallacy of the demographic dividend: the idea that population growth automatically translates into an economic boom.

The truth is that most of the time, it doesn't. More than 60 percent of those 698 cases I looked at had working-age population growth rates above two percent, but only a quarter of those population booms led to average growth rates of six percent or higher in the same decade. Today, then, even Nigeria can't assume that its booming working-age population—projected to grow at three percent a year between 2015 and 2020—will automatically translate into a booming economy. Leaders still need to create the conditions necessary to attract investment and generate jobs.

To see what happens when leaders fail to capitalize on a potential demographic dividend, consider the Arab world. Its working-age population grew by an average annual rate of more than three percent between 1985 and 2005—nearly twice as fast as the rate in the rest of the world. But the region never experienced an economic boom. At the beginning of this decade, many Arab countries suffered from crippling high youth unemployment rates: around 30 percent in Egypt, Iraq, Saudi Arabia, and Tunisia, the last being where the chaos of the Arab Spring began.

It's not just in the developing world where economic growth depends on a rising number of workers. In recent decades, the United States has earned a reputation as the most dynamic of the advanced economies, far more innovative than Europe, far less hide-bound than Japan. But much of its recent success can be traced to something more mundane: the increase in young people

entering the work force. For 30 years, the working-age population in the United States has grown much faster than those of its major industrial rivals: twice as fast as those populations in France and the United Kingdom, five times as fast as that in Germany, and ten times as fast as that in Japan. No wonder the U.S. economy has also grown faster.

As in much of the developing world, population forecasts for the developed world are discouraging. Looking at the leading developed economies over the next five years, the number of working-age people is expected to remain static in France, shrink a little in Spain, and contract at the rapid pace of 0.4 percent a year or more in Germany, Italy, and Japan. The forecast for the United States looks less bleak, with a positive working-age population growth rate of 0.2 percent, about the same as in Canada and the United Kingdom. The best news for advanced economies is confined to the smaller ones: in Australia and Singapore, the working-age populations are still growing at a reasonably fast clip of close to one percent. But these countries are too small to compensate for weaker growth in other rich nations.

### **ACCEPTING THE INEVITABLE**

Governments have already started trying to fight the population slowdown, beginning with strategies to attack falling fertility rates. According to the UN, the share of developing countries with active population-control policies, after rising sharply in the 1970s and 1980s, has leveled off at about 60 percent since the mid-1990s. Lately, some of the biggest developing countries have reversed course—most notably, China, which ended its one-child policy last year.

At the same time, the share of developed countries that have implemented so-called baby bonuses and other policies to boost fertility rates has risen, from about 30 percent in 1996 to 70 percent today. In places where the fertility rate is falling below the replacement level of 2.1, a growing number of governments are subsidizing motherhood in an effort to encourage women to have more than two children. In some countries, such as Chile and France, the subsidies grow even more generous with the third, fourth, and fifth child. But several of the countries that pioneered these programs, including Canada in 1988 and Australia in the last decade, found that they had a limited impact and later pared them back.

The second set of strategies is aimed at bringing more adults into the labor force, including the elderly, foreigners, and women. In 2007, Germany increased the retirement age from 65 to 67. Most other European countries have since followed suit, and some have started indexing their retirement ages to rising life expectancy. In the same vein, before anti-immigrant movements started taking off in Europe and the United States in 2015, the competition to attract foreign workers had been heating up. According to the UN, in 2010, just ten countries had announced plans to increase the size of their populations through immigration; by 2013, 22 had.

Then there are the ongoing efforts to lift the female labor-force participation rate, which flatlined at around 57 percent worldwide after 1990, before slipping to 55 percent this decade. According to the Organization for Economic Cooperation and Development, if its member states eliminated the gender gap in labor-force participation, they would see their GDPs

rise by a cumulative 12 percent over the next 15 years. The group found that the biggest gains would accrue to countries in which female participation has traditionally been low, including Italy, Japan, and South Korea. Japan already seems to have gotten the message. Since coming to power in 2012, Prime Minister Shinzo Abe has acknowledged the role that women could play in fixing the country's aging problem, and he has made "Womenomics"—a set of policies aimed at getting firms to hire more women—a centerpiece of his plan to revive the economy.

Yet none of these strategies can bring enough adults into the work force to compensate fully for the decline in the working-age population. Attracting immigrants, for example, has proved impractical on a large scale. One reason Germany accepted nearly one million refugees in 2015 was that its leaders recognized the economic need for new blood in an aging society, but even the authors of that controversial policy have admitted that the country cannot accept that many newcomers on a regular basis. (To counter the projected decline in its working-age population through 2030, Germany would have to accept roughly 1.5 million immigrants every year.) Besides, the contest to attract immigrant labor, particularly skilled labor, is a zero-sum game among countries and so does not represent a viable strategy on a global level. The most governments can do is muffle the impact of depopulation; they can't defuse it.

In a world with fewer young people, economic growth will be harder to come by. But at least the alarmists' fears may subside. Immigrants will be less likely

to be viewed as bogeymen, and the Malthusian nightmare that humanity won't be able to feed itself should fade. Similarly, neo-Luddite warnings about robots stealing human jobs could also prove beside the point. The automation revolution is in its early stages, but it is possible that the robots will arrive just in time to ease the threat posed by depopulation. As the ranks of working-age humans thin, smart machines could do the labor they once did. Regardless, it's hard to see how the world economy can find enough new workers to grow as fast in the future as it has in the recent past. 🌐

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