



Economic Growth & Population Decline – What To Do About Latvia?
Edward Hugh **Riga: March 2012**

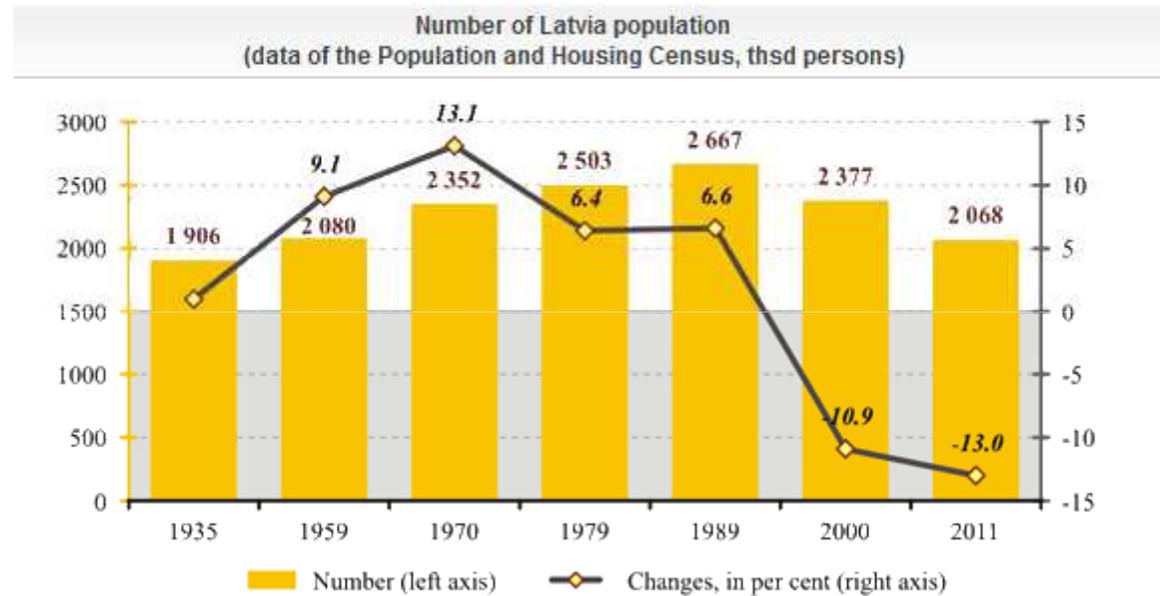


Warning

**It Is Never Too Late To do Something,
But This Is Not An Excuse For Doing Nothing.**



As We All Know, Latvia's Population Is In Sharp Decline



And The numbers Are Worse Than They Seem



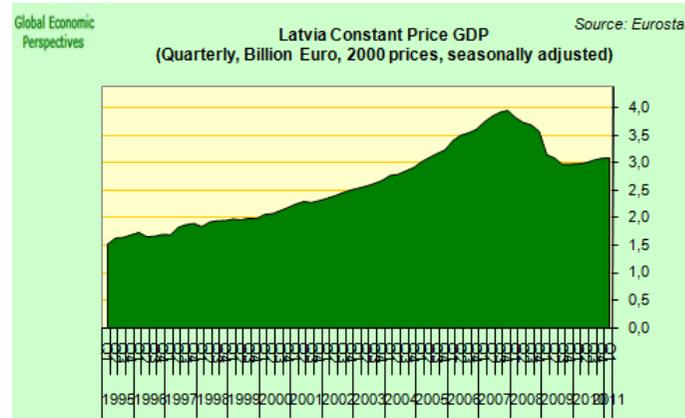
Mihails Hazans.

Hazans explained that, according to his study, approximately 200,000 residents have left Latvia over the past ten years. Official statistics, however, mention only 33,000 emigrants. The number of people of reproductive age is also significantly smaller – by 80,000, therefore a demographic disaster is looming, writes *LETA*.

The professor pointed out that emigration will continue for three or four years at least. The study shows that around ten percent of Latvian residents aged 18 to 65 are planning to leave the country. Therefore Latvia will soon lack people and require immigrants.

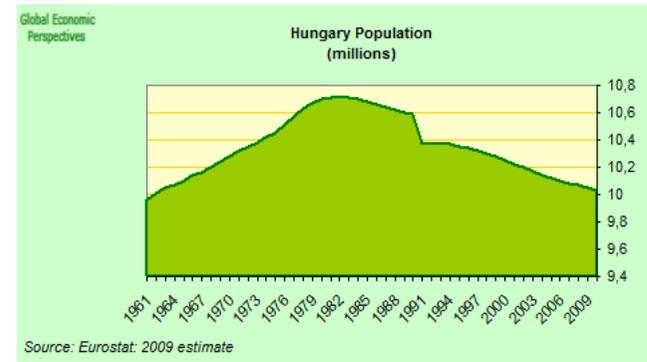
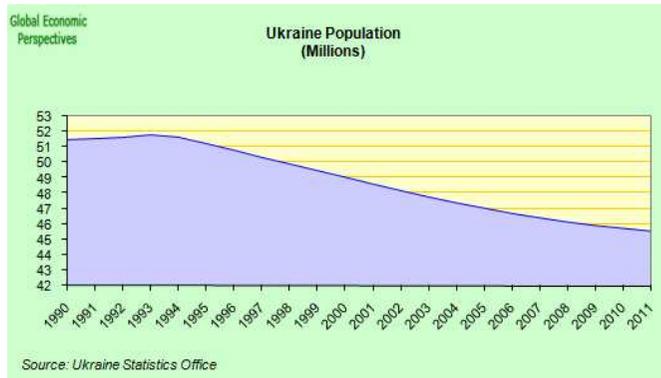
Hazans explained that around 80,000 persons have left Latvia and emigrated to Great Britain over the past few years, 28,000-34,000 – to Ireland, 11,000-13,000 – to the Nordic countries, with the largest diaspora in Norway.

The Economic Collapse Means That Thousands Of Young People Have Been Forced To Leave, Looking For Work



Ageing Is A Global Issue

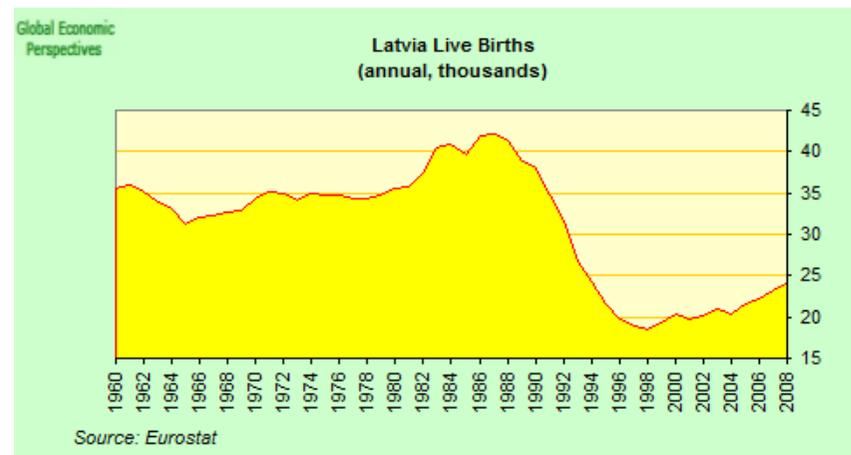
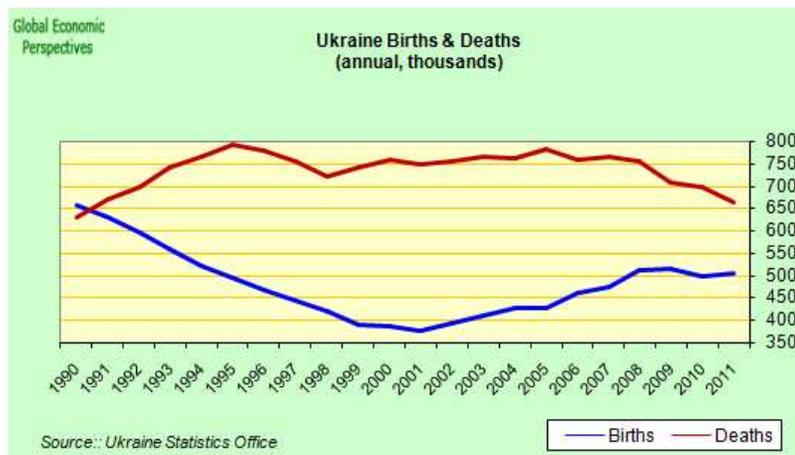
But East Europe's Problems Are Particularly Severe



Among emerging economies, the East of Europe stands out as by far the worst case in the short term. In 2025, more than one in five Bulgarians will be over 65 - up from just 13 percent in 1990. Ukraine's population will shrink by a fifth between 2000 and 2025. And the average Slovene will be 47.4 years old in 2025 – one of the oldest populations in the world.

Why Is The Problem So Severe In The East?

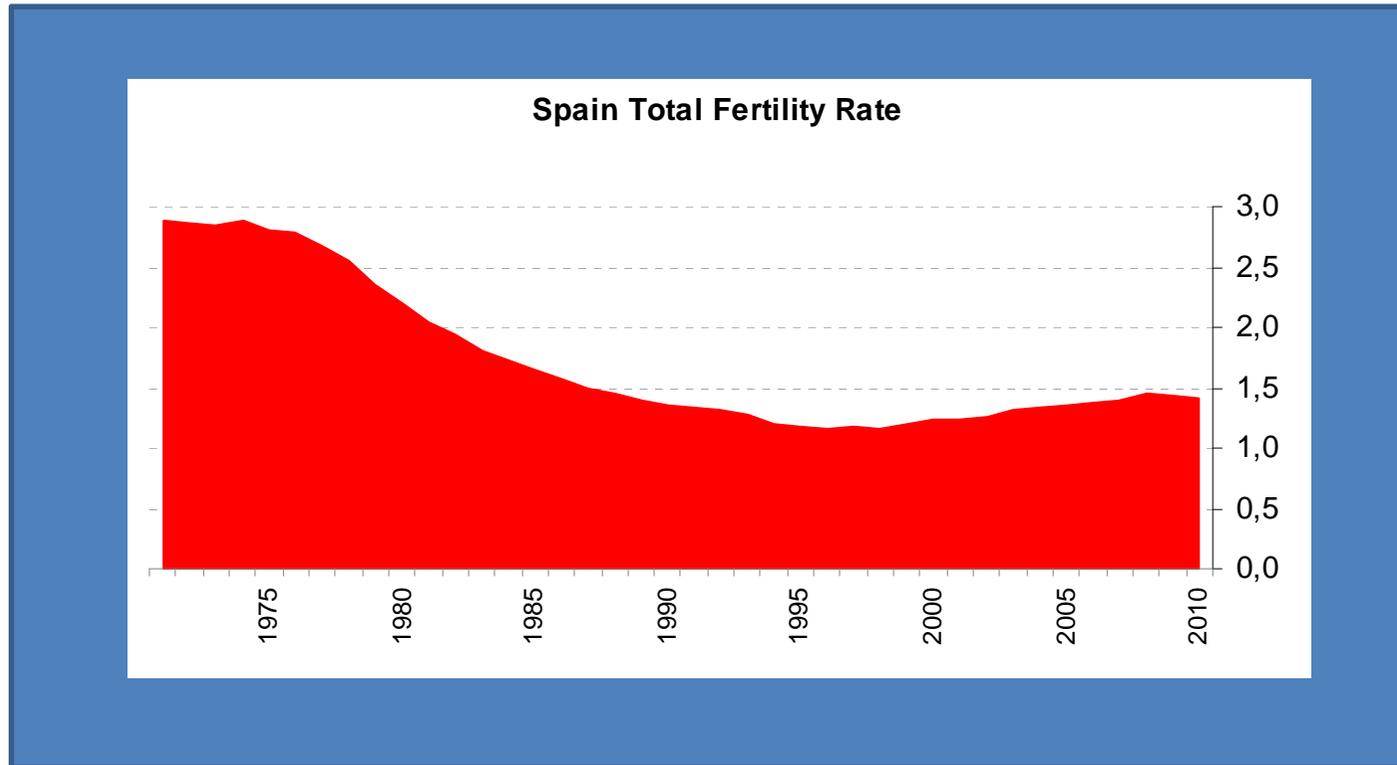
- a) The countries went through their second demographic transition before becoming modern developed economies
- b) The shock of the ending of the USSR lead to population movements unprecedented in Europe since WWII. Many countries had sharp population drops.
- c) The continuing wage differentials with Western Europe and the impact of the global financial crisis lead many young people to emigrate, reducing the potential reproductive population even further.



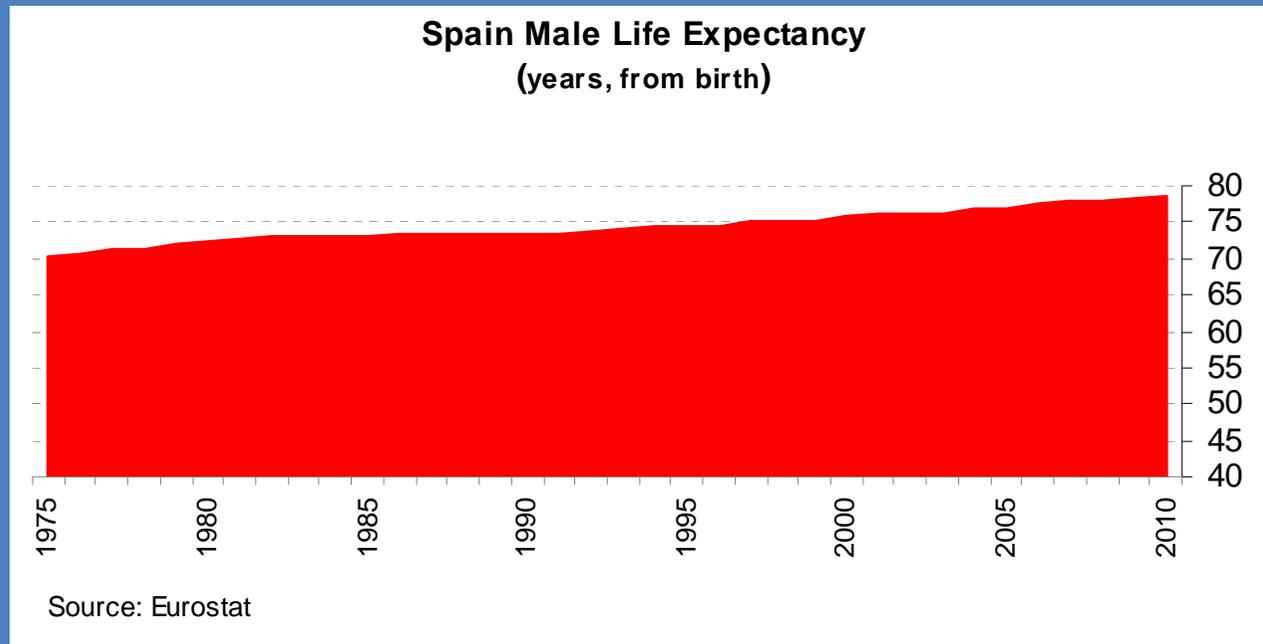
Second Demographic Transition

This process of rapid ageing is due to the combined impact of two factors

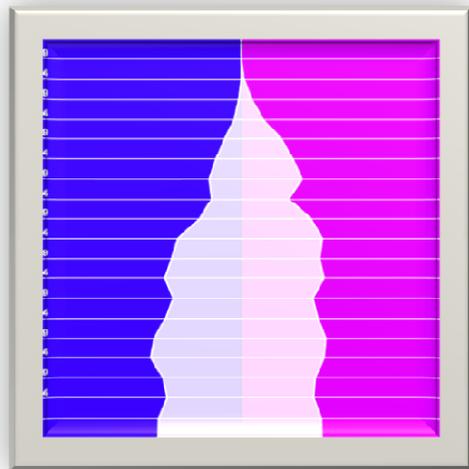
1) Declining fertility



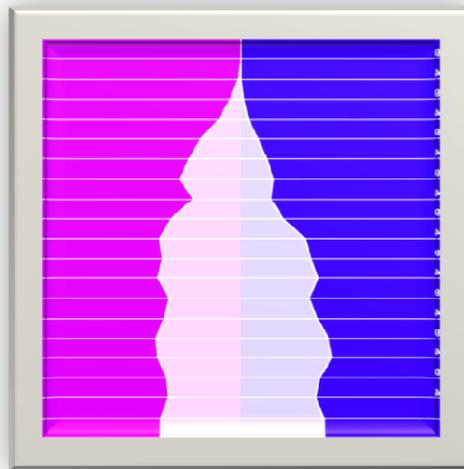
2) Steadily Rising Life Expectancy



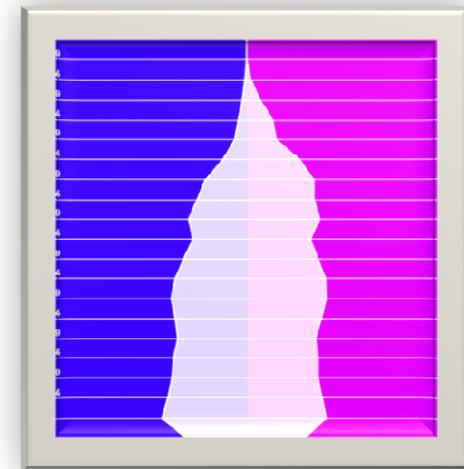
The Changing Shape Of Latvia's Population Pyramid



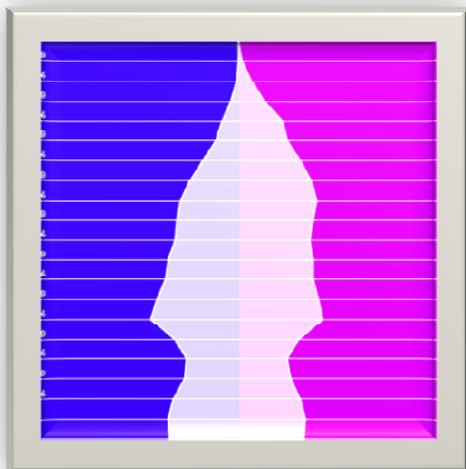
1980



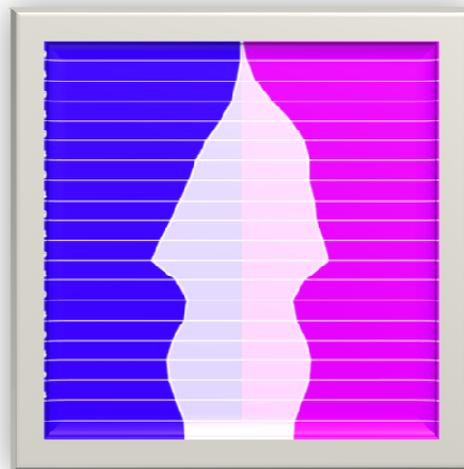
1995



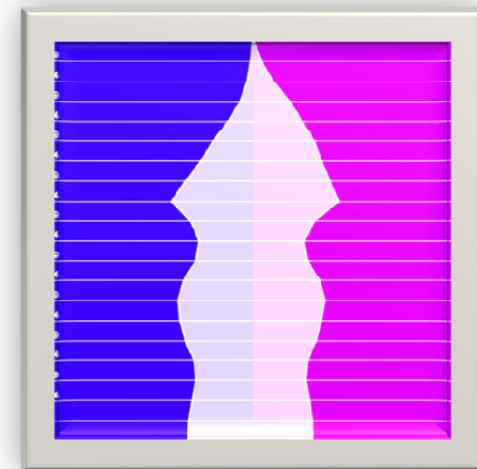
2010



2020



2035



2050

Data Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: The 2008 Revision

Population Ageing – A Unique Historical Challenge

The economic and social implications of the ageing process are going to be profound. According to a recent report from credit rating agency Standard & Poor's:

- the process is seemingly irreversible.**
- No other single force is likely to shape the future of national economic health, public finances, and policymaking over the coming decade**

Strangely, the issue receives only a fraction of the attention that has been devoted to global climate change, even though, arguably, ageing is a problem our social and political systems are, in principle, much better equipped to deal with.

As far as we are able to understand the issue at this point, population ageing will have major economic impacts and these can be categorised under four main headings:

i) ageing will affect the size of the working age population, and with this the level of trend economic growth in one country after another

ii) ageing will affect patterns of national saving and borrowing, and with these the directions and magnitudes of global capital flows

iii) through the saving and borrowing path the process can influence values of key assets like housing and equities

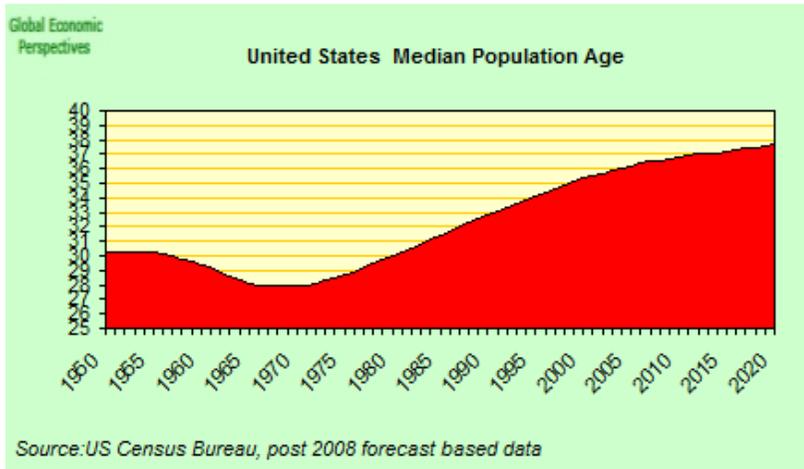
iv) through changes in the dependency ratio, ageing will influence pressure on global sovereign debt, producing significant changes in ranking as between developed and emerging economies.

Life Cycle Effects

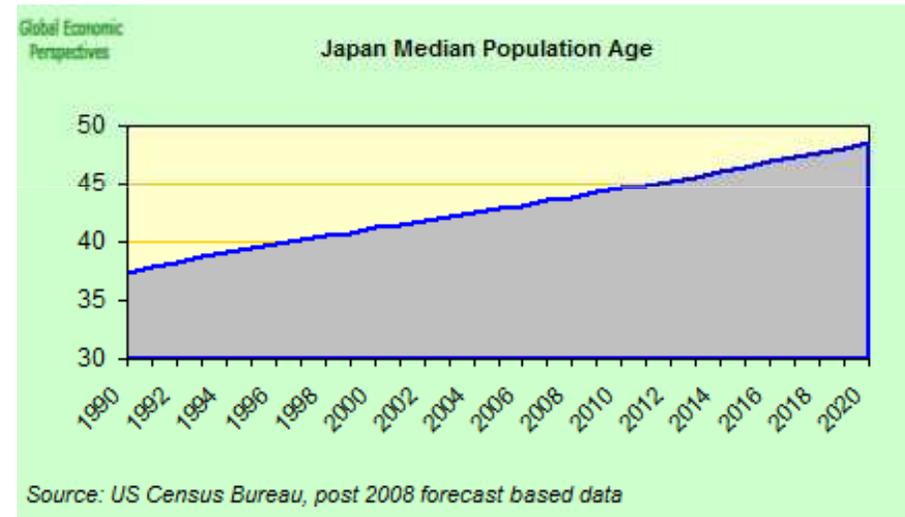
There is a generally accepted wisdom in academic work known as the “life cycle hypothesis” (Franco Modigliani). This suggests that the population’s financial behaviour changes depending on age. In terms of adult life, those in their twenties and early thirties tend to be net borrowers as they are relatively low earners at the same time as they look to buy housing, expensive durables and fund their burgeoning families.

At some point around middle-age this group then tends to move from being net borrowers to net investors as they move into their economic prime and accumulate financial assets to hopefully fund their retirement. As they approach retirement this group then start to shed the financial assets they’ve been accumulating to fund their nonworking days.

One Hypothesis - Could Something As Simple As Shifting Median Population Age Help Us To Understand Economic Dynamics?

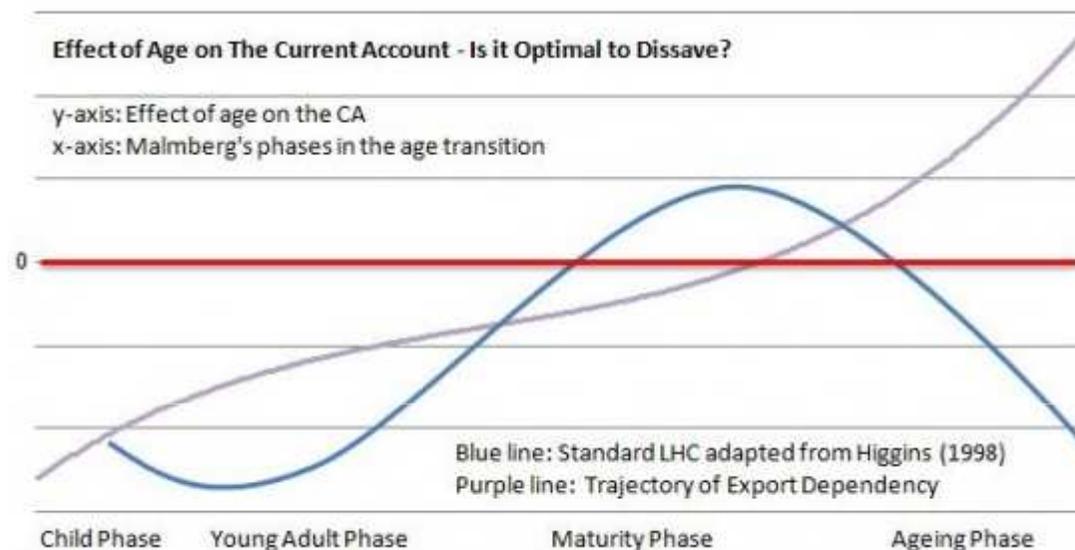


Ours is an age of rapidly ageing societies.



What is so modern about our current situation is not the ageing itself, but its velocity, its global extension, and the differing rates of ageing even between countries in the same income group (developed economies, emerging markets, less developed economies etc).

Median Age And The Imbalances



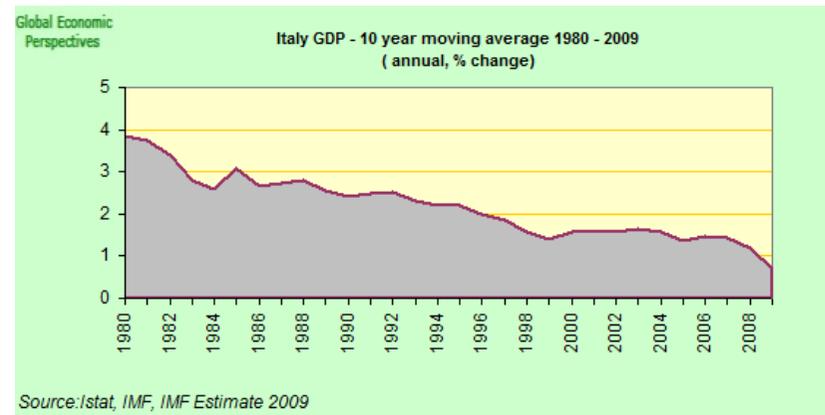
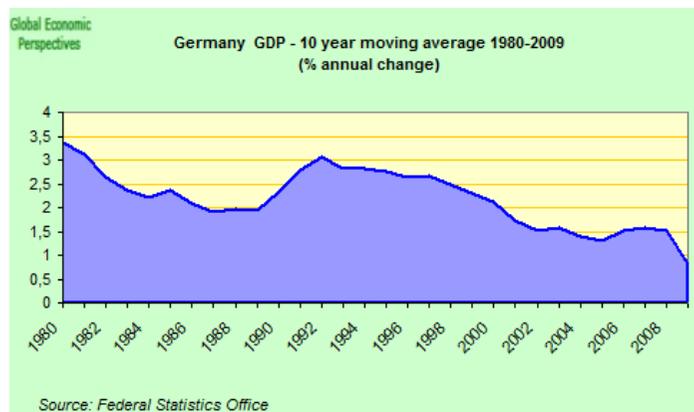
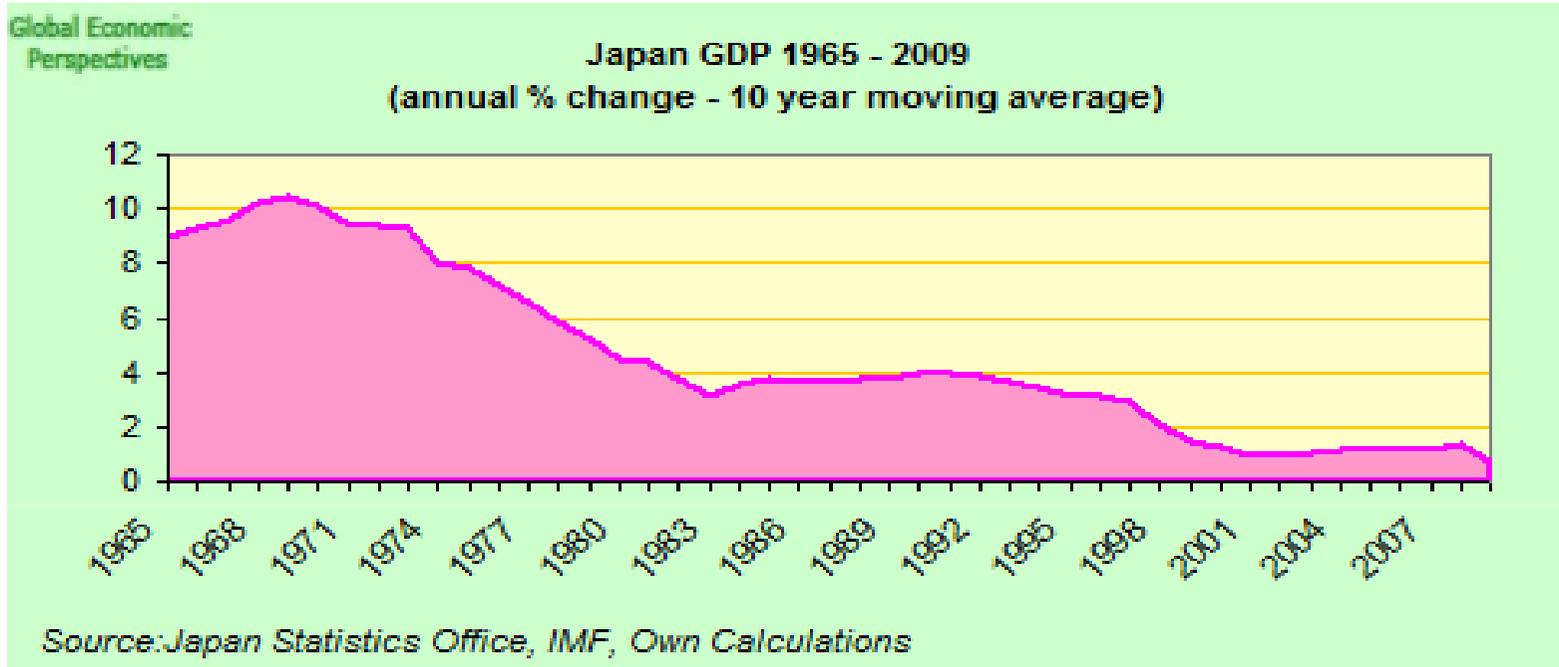
A country's current account shows a non linear relationship with median population age and the latter is also reflected in the level of export dependency for economic growth. This hypothesis was first explored by the young Danish economist Claus Vistesen.

Growth Function That Looks Like An Inverted “U”

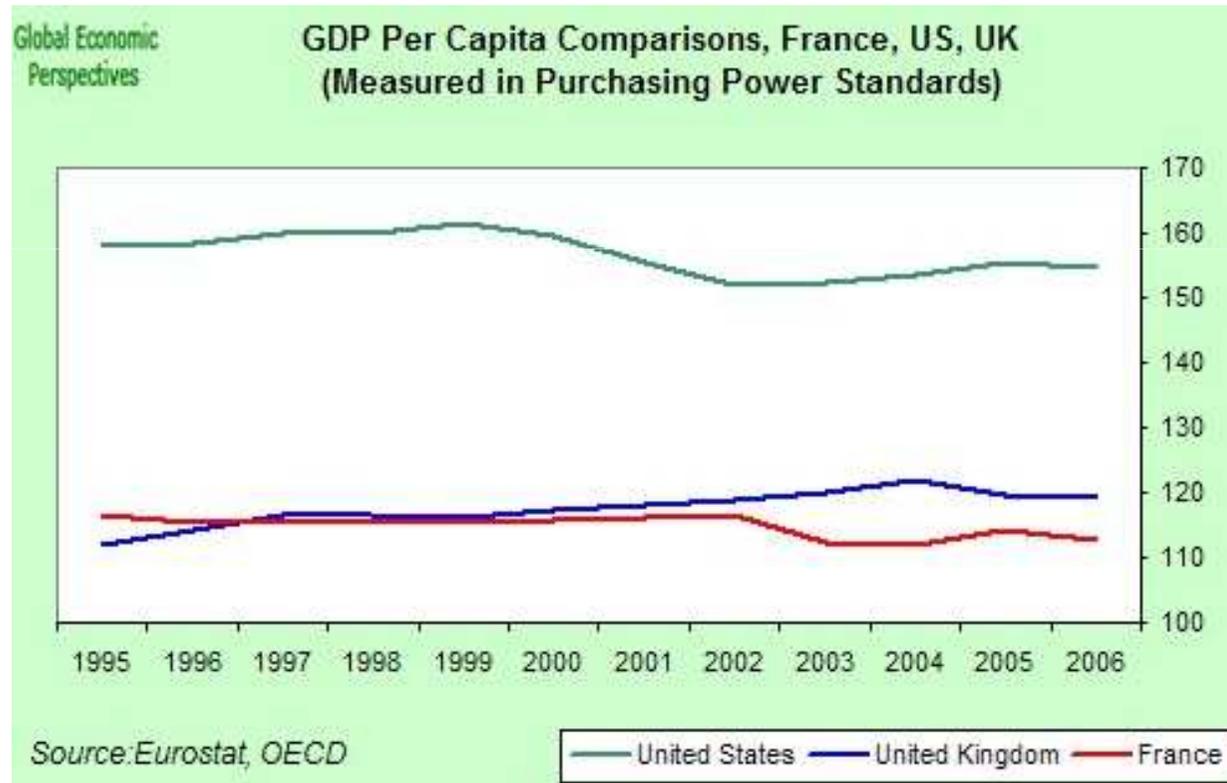
Those countries where population momentum has slowed, even to the point where their populations may now decline (Italy, Japan, Germany, for example) do not seem able to achieve their former high rates of economic growth, and, even worse, they seem to be losing ground in per capita income terms with those economies whose populations continue to grow reasonably rapidly.

Leaving aside all the complex and intricate details, I simply wish to make one clear and central point, and that is that the relationship between population growth and per capita income growth does not seem to be a simple linear one, and arguably it is this property which has thrown many previous researchers off track since in running growth correlations they have normally tended to treat the relation as if they was.

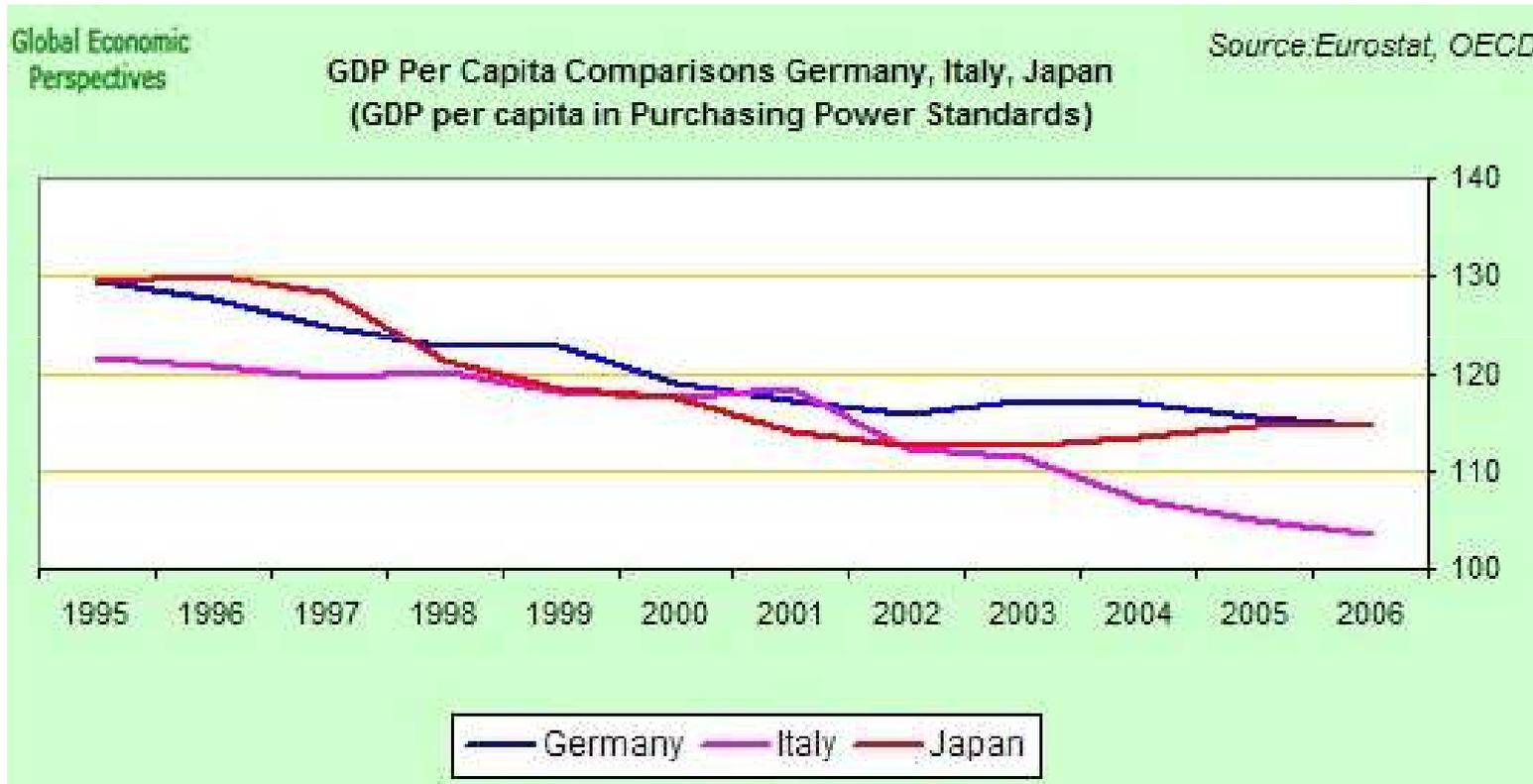
Running Out Of Energy?



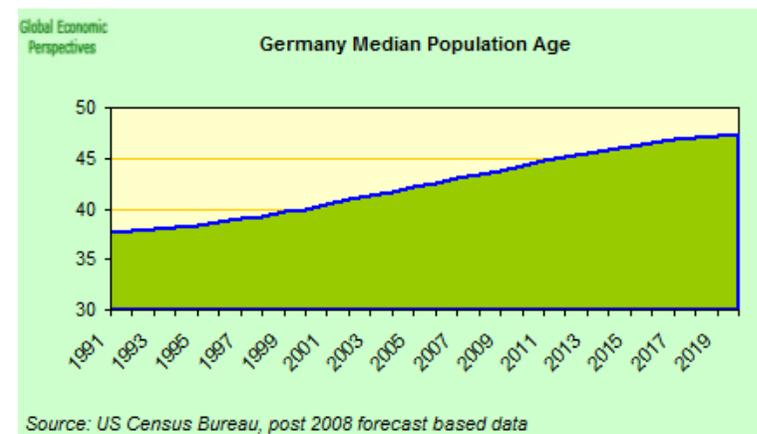
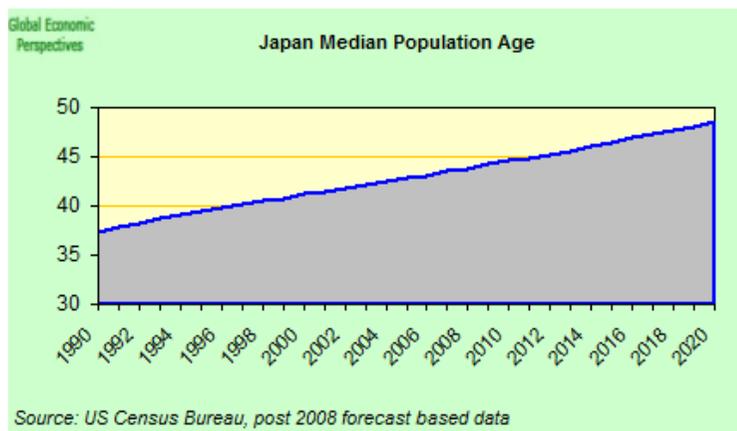
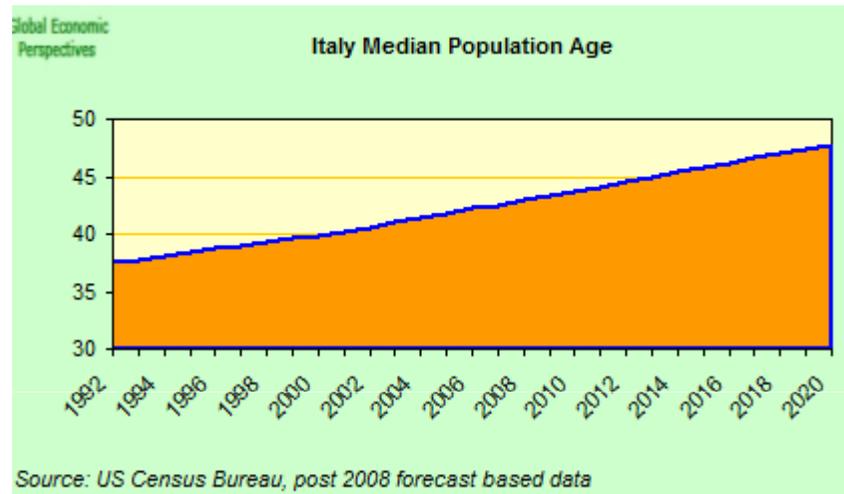
Per Capita Income In Higher Population Growth Economies



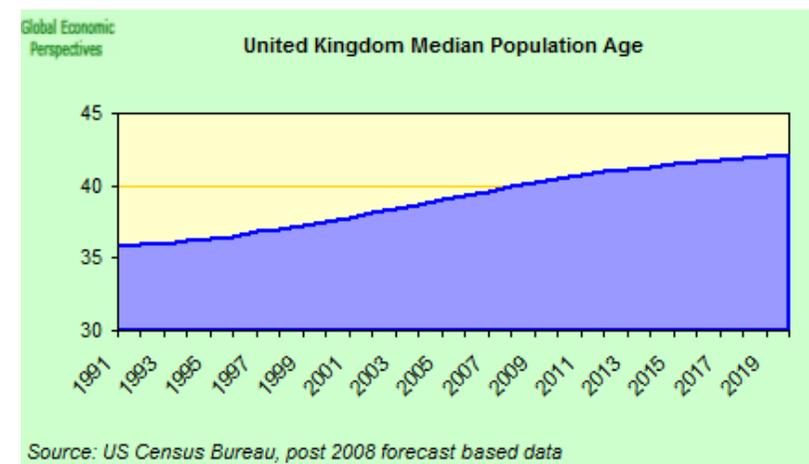
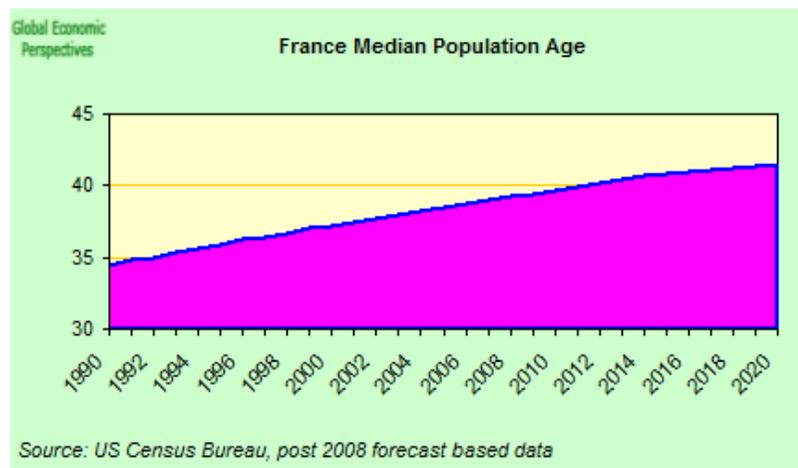
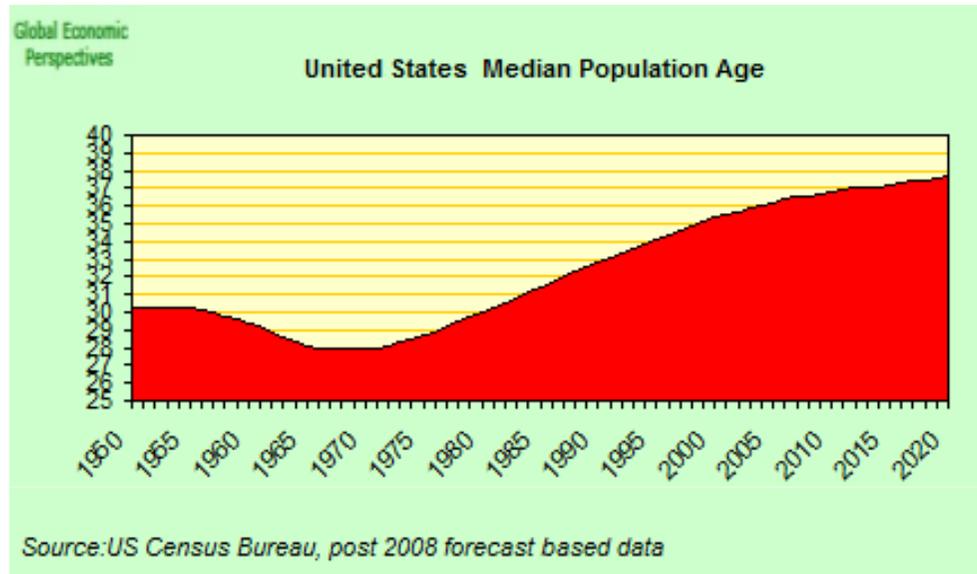
Versus Per Capita Income Growth In The Slow Population Growth Group



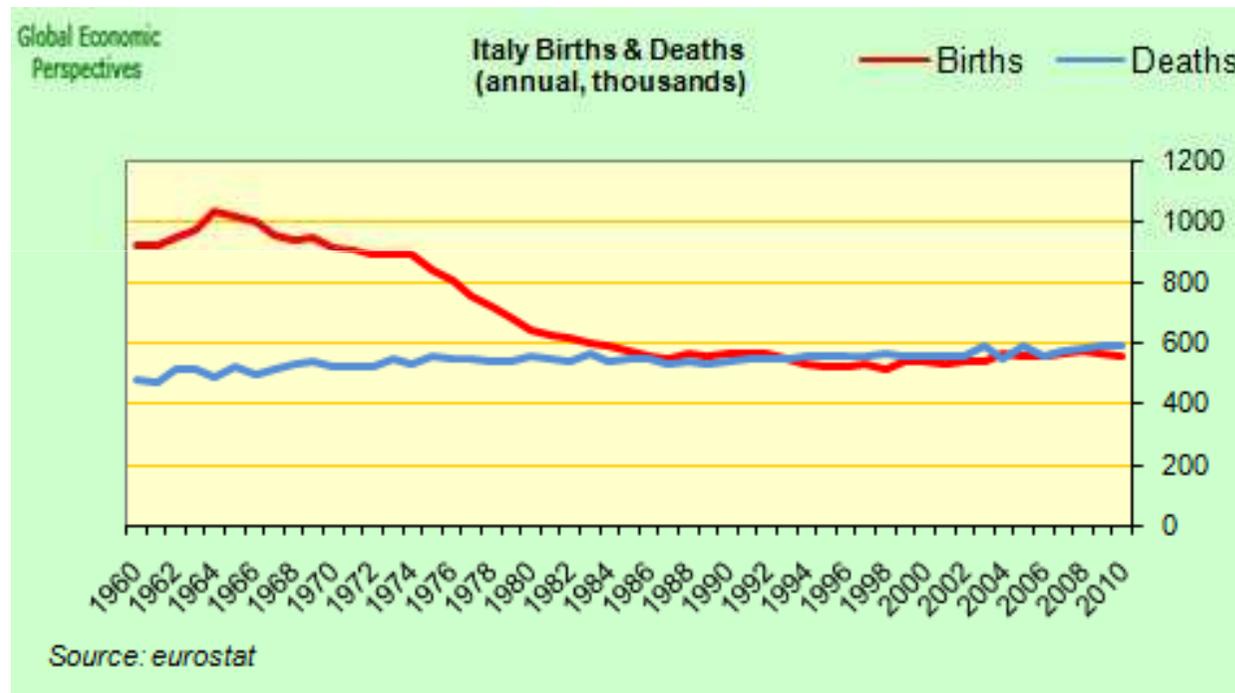
So We Need To Think About the Differences Between High Median Age



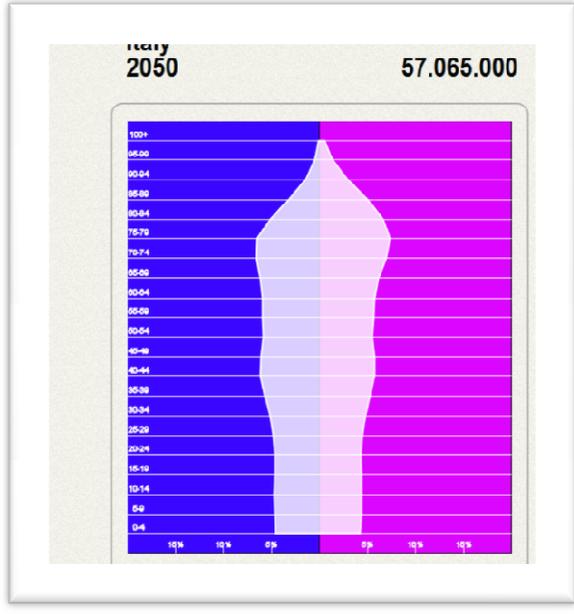
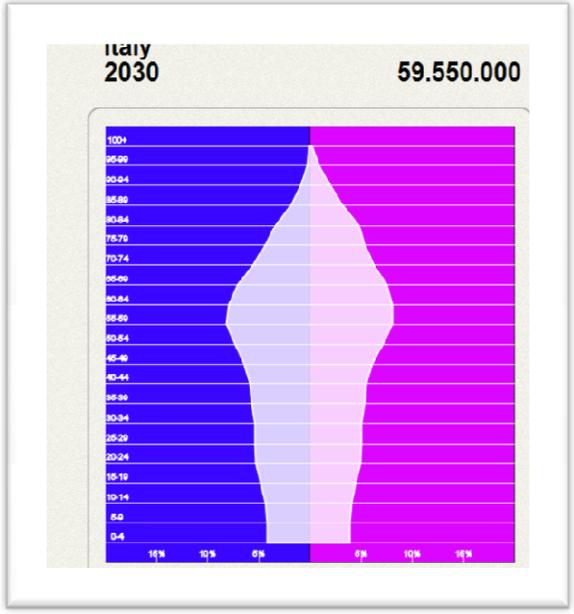
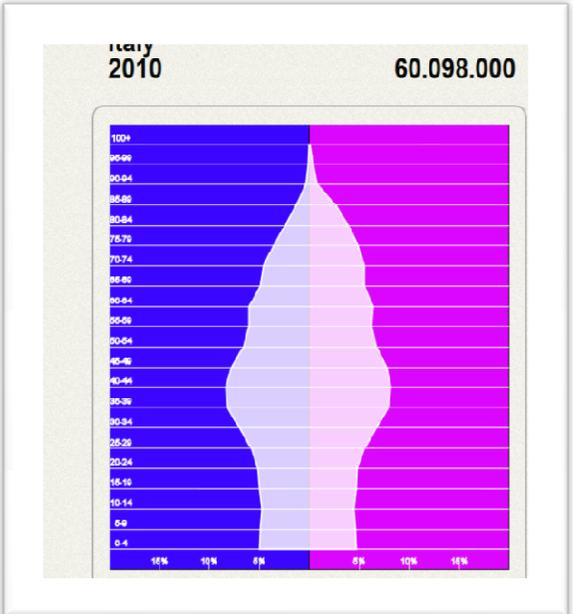
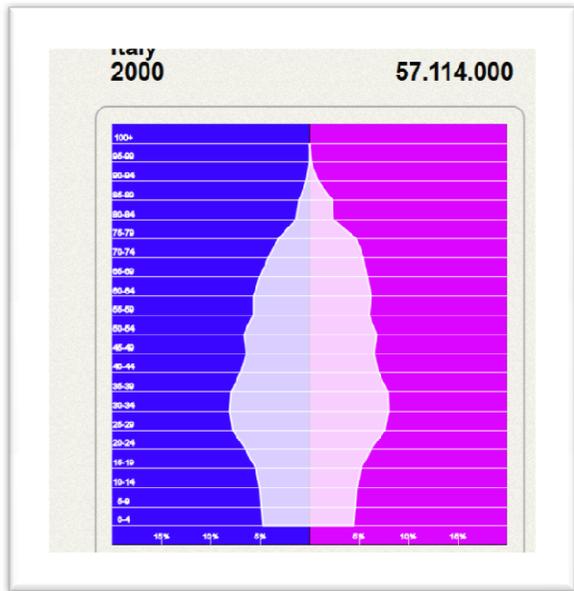
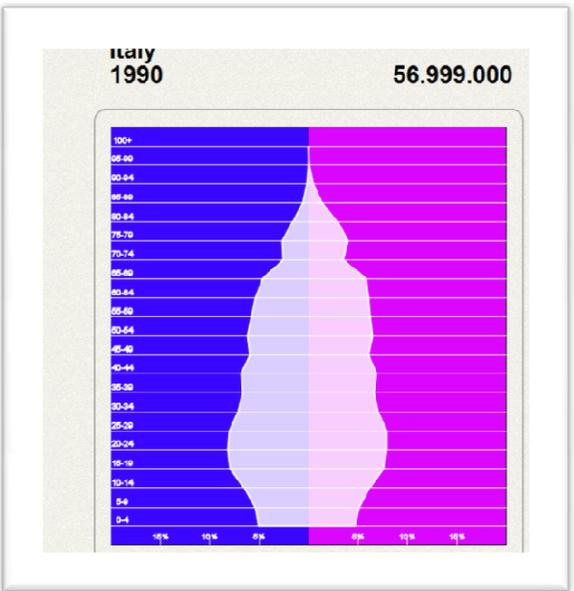
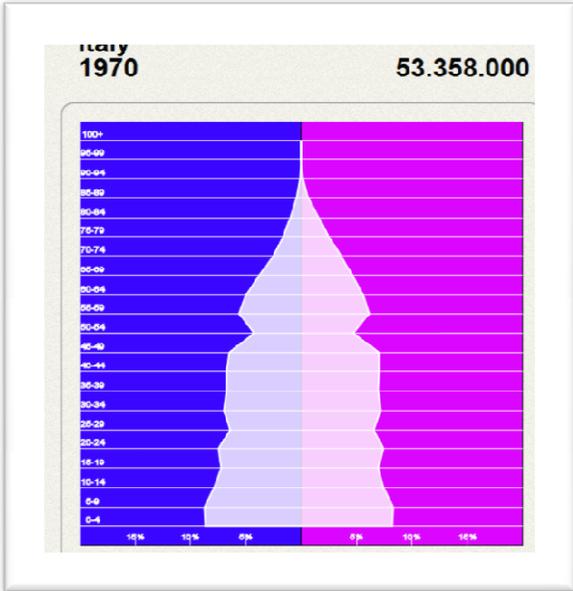
And Lower Median Age Countries



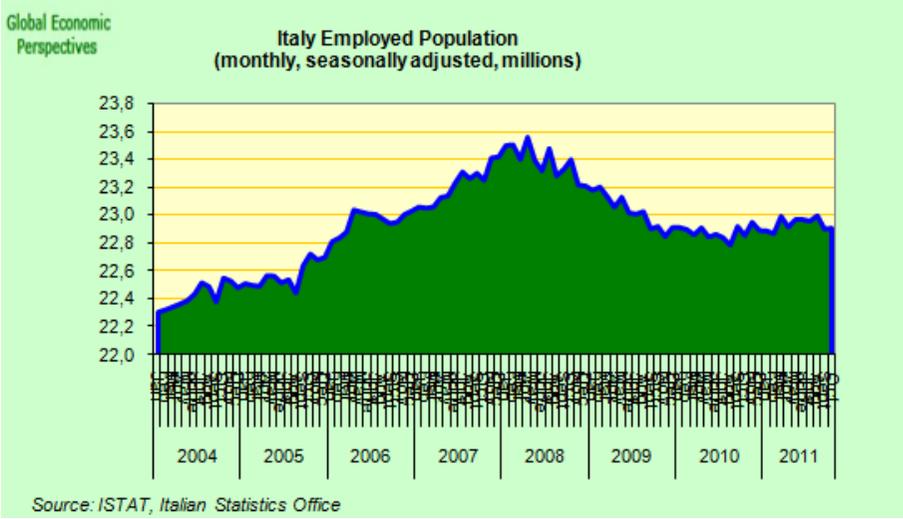
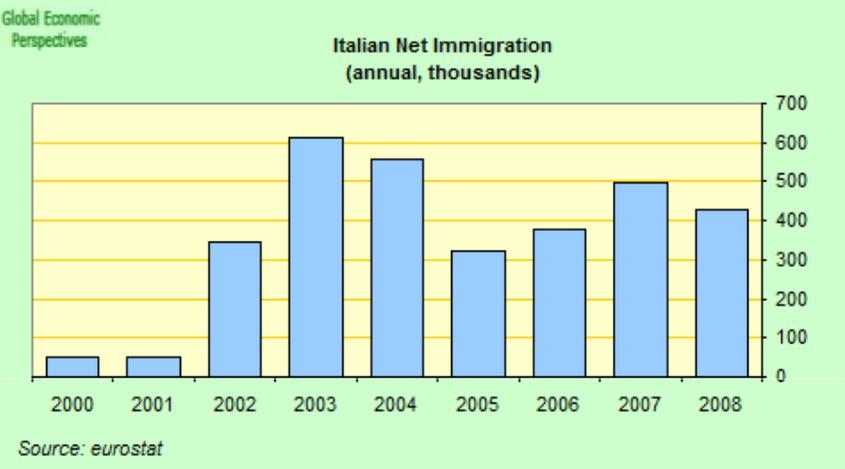
Many Societies – Like The Italian One Have Had Stationary Populations Ex-immigration



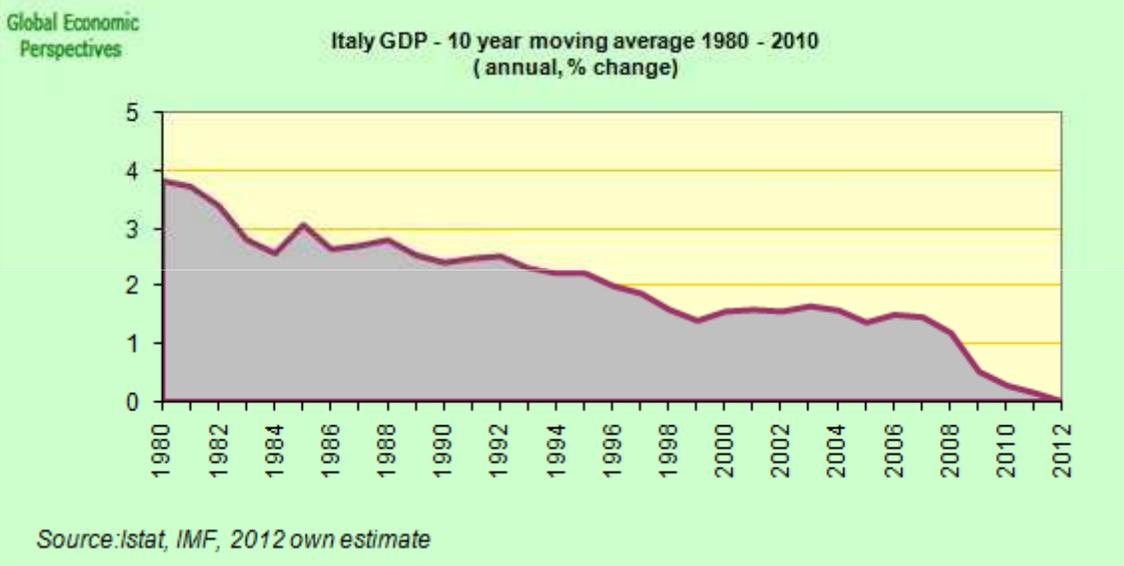
But The Population Pyramids Have Been Shifting, And Will Continue To Do So



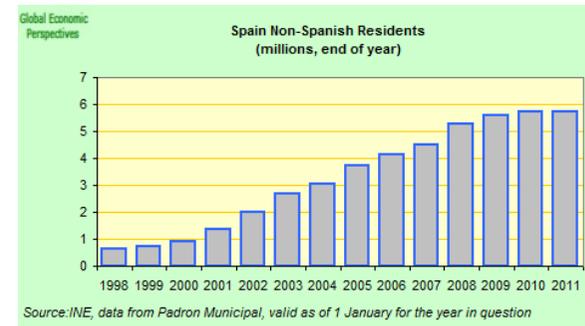
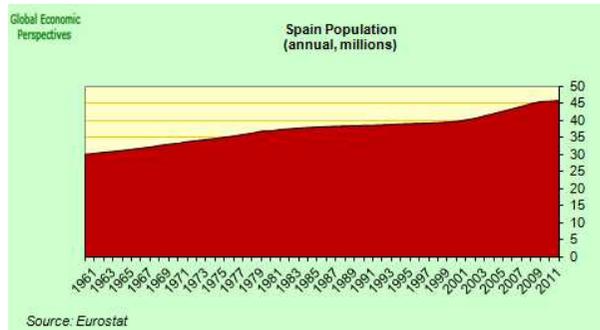
Before The Crisis Immigration Drove The Italian Population And The Workforce Upwards



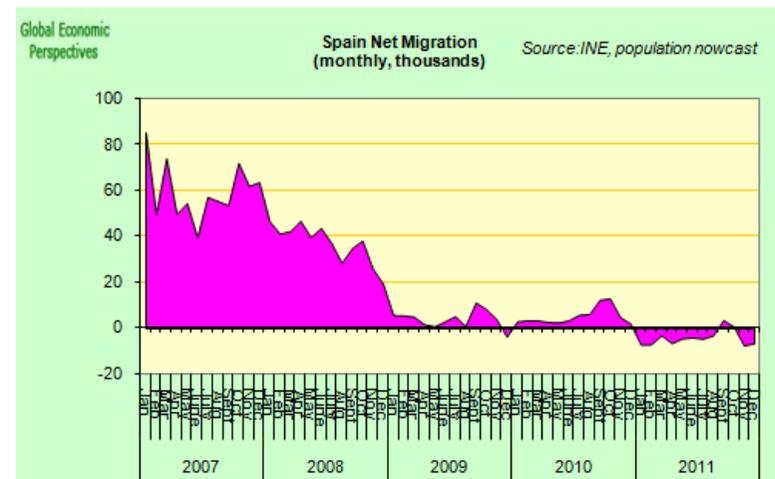
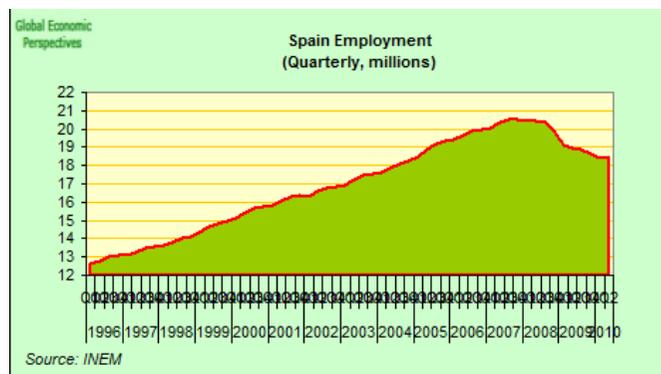
But This Was **Not** Reflected in Growth



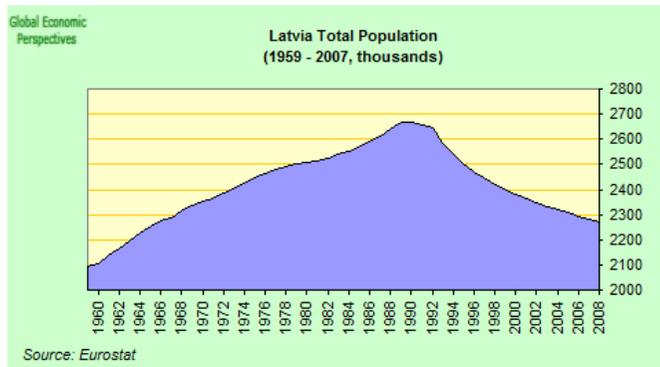
The Same Thing Happened In Spain



**Population Surged With Strong Immigration
But Then The Housing Bust Sent Everything
Into Reverse Gear**

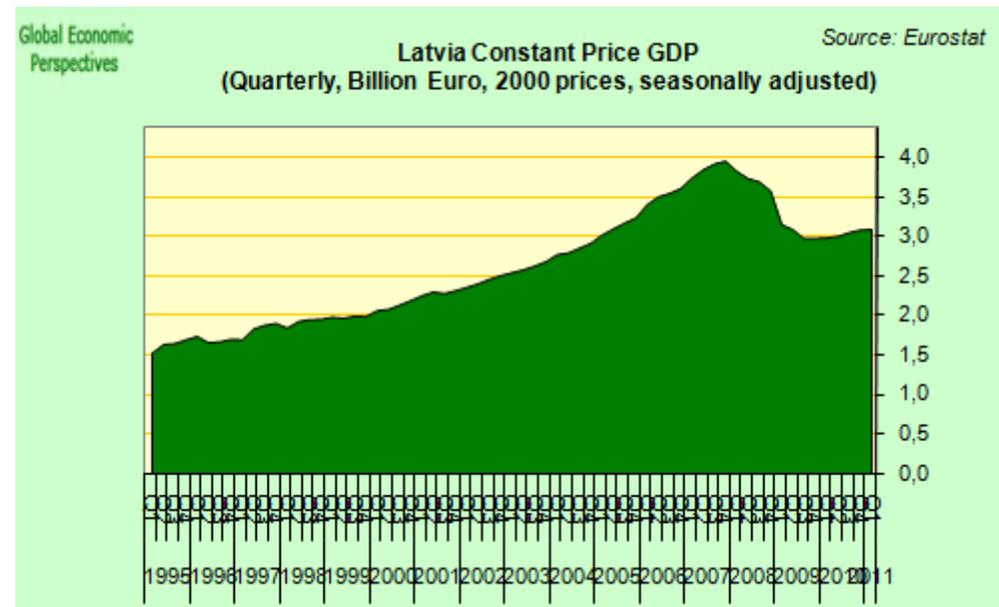


Latvia Has Similar Problems



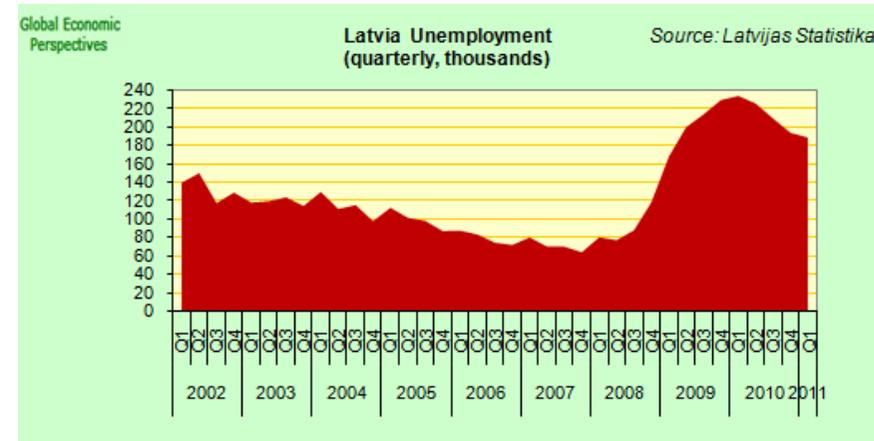
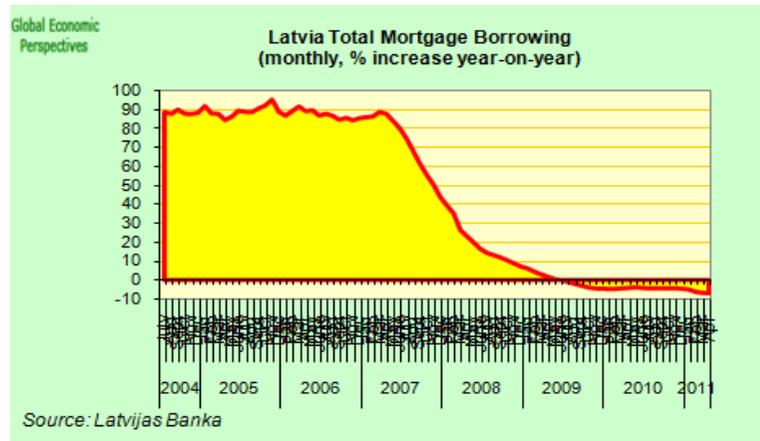
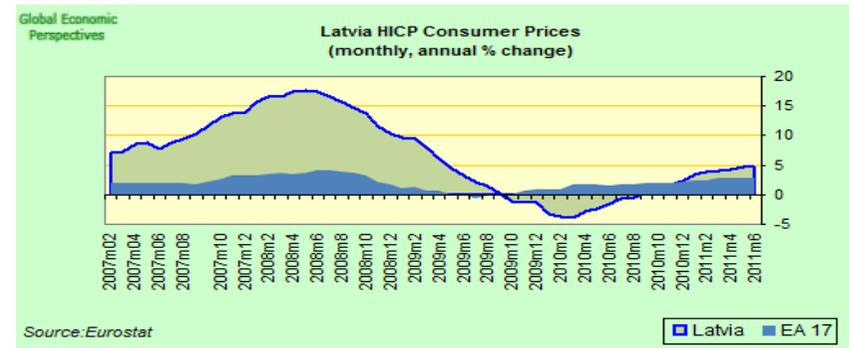
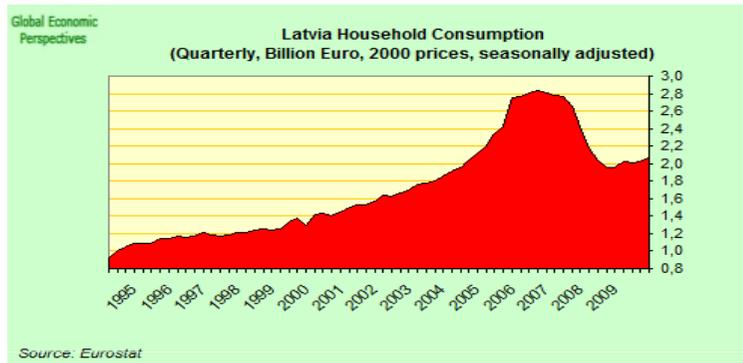
Population has been falling, due to low birth rates and outward migration.

But now the economic crash, and the absence of strong recovery, is accelerating the process as young people leave in search of work.



Stability & Sustainability!

The Pedal Went To The Metal In The Vain Hope Of Stopping The Rot



But This Only Created An Unsustainable Boom That Then Went Bust

Not Just Working Age Population

Most of the literature on the impact of immigration on ageing focuses on the impact of immigration on the labour market and the welfare state. A drawback of this focus then is that the impact of ageing and immigration on capital formation and economic growth usually are ignored.

Most “overlapping generations” economic models assume that the younger generation works, borrows to buy a house and pays pension contributions, whereas the older generation lives from previous saving, pension benefits and (later) dissaving. Modern economic growth is increasingly fuelled by either exports and credit growth, and the latter implies that an ageing economy experiences a decline in economic growth. Immigration then might help counter this decline.

Growth Is Also Involved!

The Counter Argument

“There may be many reasons to favour increased immigration.... But it would be wrong to advocate increased immigration as necessary to deal with the fiscal consequences of an ageing population, or as a means to avoid large future tax increases or benefit reductions”.

US Economist Marty Feldstein

Two Principal Points

i) immigration is not necessary to deal with the fiscal consequences of ageing populations

ii) it is false that immigration constitutes a way of handling ageing which enables you to do so without large tax increases or benefit reductions since increased immigration would do little to reduce the future fiscal burden. The increased revenue from a large rise in immigration would finance only a small part of the coming rise in the cost of pension and health benefits.

My opinion - Feldstein is both right and wrong

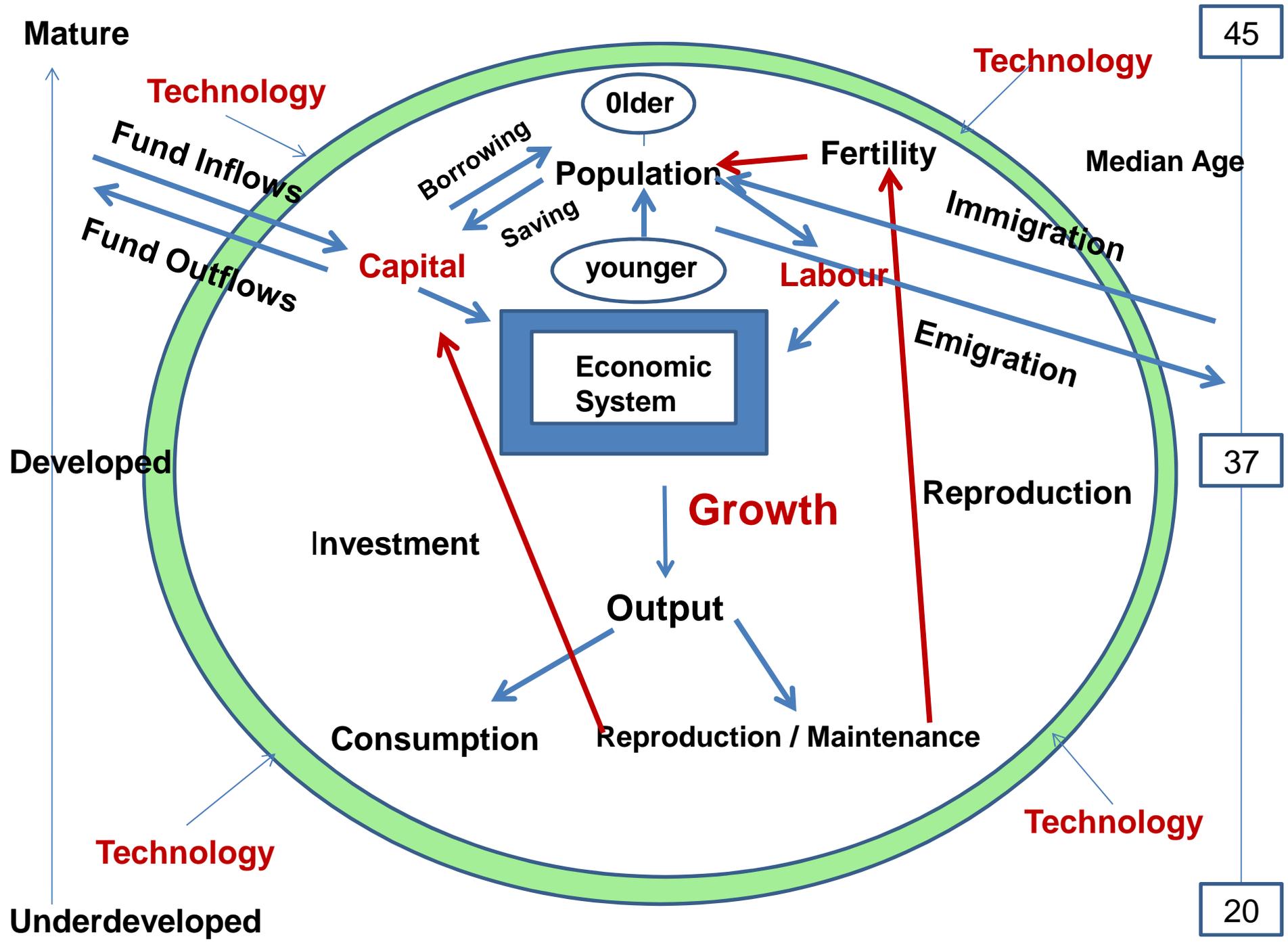
He is right that immigration alone won't be enough to address the problems we face. We also need structural reforms in labour markets to encourage higher participation rates. We need to move away from Paygo to fully funded pension systems.

But he surely goes too far. Migrants can help keep our welfare systems afloat as we transit from one system to the other. They help fill the gap of the “missing generation” of contributors.

Most migrants are in their 20s and 30s, so they will also form homes and families, helping push the birth rate up a bit.

Human Capital Loss Gives The Key To The Italian Problem

- **It is hard to say why Italy has fared so badly in terms of growth, given the recent strong immigration.**
- **A number of factors are involved, but one that stands out clearly in the annual brain drain out of Italy.**
- **Each year somewhere between 5% and 10% of Italian university graduates leave their country, never to return.**
- **So some of the migration represents a “bad swop” of highly qualified people for people with far lower education levels.**
- **Reform in Italy’s “insider-outsider” labour market, and changes making it easier for young people to start their own businesses would be a big step forward.**



Time To Act – What Can Be Done?

Short Term:

- **Continuing and Continuous Structural Reform**
 - **Labour Market Reform**
 - **Pension Reform**
 - **Health System Reform**
 - **Immigration**

Long Term:

- **Stabilising Population & Stabilising Debt**
 - **Aid For Would-be Mothers**
 - **Shifting Public Resources from Old Young**
 - **Europe Wide Institutional Changes**
 - **More Realism In Policymaking - Acceptance That The Modern Growth Era (Like Modernity Itself) Doesn't Last Forever.**

We Still Have Time

If the victim is in deep or dangerous water but there is a dock to stand on, try a reaching assist with a long, sturdy object



Thank You For Your Attention