Oxford Analytica Global Strategic Analysis

INTERNATIONAL: Demographic dividend is not guaranteed

OxResearch Daily Brief Service. (Nov 30, 2010).

Abstract (summary)

Policy challenges associated with a demographic transition towards an older population.

The process of demographic transition widely is believed to offer countries a 'dividend' of higher savings, investment and growth. However, reality is more complex.

Full text

SUBJECT: Policy challenges associated with a demographic transition towards an older population.

SIGNIFICANCE: The process of demographic transition widely is believed to offer countries a 'dividend' of higher savings, investment and growth. However, reality is more complex.

ANALYSIS: The debate about the impact of population growth on development still has many unanswered questions. Nonetheless, it is clear that a population's structure, and not just size, matters for its economic performance. For example, the age distribution of the population affects the proportion of people that may potentially be productively employed.

According to the widely accepted life circle theory of savings, an extremely young or old population would tend to find it difficult to generate enough investment to spur economic development -- the non-productive youth and elderly segments of society would reduce the level of savings and hence investment.

Demographic transition. Experience has shown that, at a given point in a country's development, it experiences a demographic transition -- ie, moves from a situation of high birth and death rates to low birth and death rates, with a period in between where birth rates are high relative to death rates. As a country undergoes this process, the cohorts born in times of high birth rates work their way into adulthood and old age, and so its age structure changes:

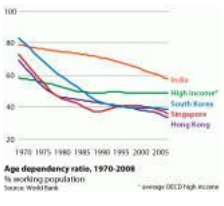
During the period when birth rates are high relative to death rates, the country will experience significant population growth.

At some point, there will be a relatively high proportion of people of working age relative to young and old. This reduces the dependency ratio, defined as the proportion of those below 16 plus those above 64 to those between these two -- in other words, the ratio of those who are generally expected to be economically inactive to those of working age.

The dependency ratio initially tends to fall as birth rates decline, thus reducing the proportion of the very young section of the population, as long as the impact of diminishing death rates has not fully fed through to increasing the older segment of the population.

Temporary opportunity. Such reduction in the dependency ratio provides countries with a window of opportunity -- the 'demographic dividend' -- to generate faster economic growth. This is because the presence of relatively fewer non-productive citizens means that higher savings and investment rates can, in principle, be attained.

However, the demographic aspect of the demographic dividend is temporary, because if birth and death rates continue to fall, or remain low, the population will age naturally. The dependency ratio will move up again as the older segment of the population increases in size, offsetting the reduction in size of the young population (*see LATIN AMERICA: Ageing population poses economic issues - June 25, 2007*).



Examples. Some analyses of the extremely fast economic growth of a number of Asian economies -- including Hong Kong, Singapore and South Korea (*see INTERNATIONAL: Emerging markets reshape global economy - May 6, 2010*) -- between the 1960s and the 1990s attribute part of their expansion to a demographic dividend:

Such studies argue that a sizeable proportion, in some cases up to a third, of the increase in their GDP per capita during those decades could be ascribed to the positive impact of demographic changes.

Nonetheless, it is unclear whether this experience is repeatable elsewhere and, indeed, whether in other countries similar demographic changes could actually have adverse effects.

Moreover, there would seem to be scope for significant economic development even without such demographic changes.

Possible failure. Even if a country experiences an increase in the relative size of its working age population, there is no guarantee that this will translate into economic development (*see INDIA: 'Demographic dividend' may be wasted - July 26, 2010*). What happens will depend on the use that the government and the private sector make of such window of opportunity to:

increase the workforce participation rate -- ie, the proportion of the working age population that is productively employed; and

provide opportunities for the efficient investment of the expected higher levels of savings associated with a larger working age population.

Important areas of public policy that need to make use of the demographic dividend include:

improving and making the public health system more effective (*see INTERNATIONAL: Structural changes ahead for pharma - November 19, 2010*);

increasing the provision and quality of education (*see US/INTERNATIONAL: University cuts create economic risk - October 22, 2010*); and

introducing economic policies that promote labour-market flexibility, openness to trade, and savings (*see INTERNATIONAL: Pragmatic view of globalisation spreads - September 20, 2007*).

Questioned thesis. The demographic dividend thesis is not universally accepted. For example, research on the Taiwanese economy failed to show a causal relation between changes in the population age structure and an increase in saving rates. Rather, what was identified was that succeeding population cohorts tended to save a higher proportion of their income -- although the analysis was unable to explain why. In other words, increased savings and investment can occur without any significant reduction in dependency ratios. Therefore, the lifecycle hypothesis may not hold in all situations.

Part of the reason for falling fertility rates tends to be the growing urbanisation of societies and consequent increased cost of raising a child, as well as reduced child labour:

This would imply that falling fertility rates may not necessarily lead to a reduction in the total amount dedicated to raising children, but to an increase in expenditure per child, both by families and, as education provision is expanded and improved, the state.

Therefore, the apparent link between lower dependency ratios and economic growth may, at least in some cases, be more coincidence or correlation than causation.

Negative scenario.A reduction in the number of children can provide 'breathing space' for countries, enabling them to develop infrastructure and policies capable of leading to higher growth levels in future. Yet trying to coordinate such a combination of demographic and institutional changes may prove difficult, and a country could find itself in a situation where it has a high proportion of working age citizens who are not productively employed, leaving it unprepared for an inevitable ageing of its population.

In such cases, rather than a demographic dividend, the country could experience problems with disaffected youths, particularly males, prone to involving themselves in anti-social and violent behaviour.

Supporting an older population. Regardless of the existence -- or not -- of a demographic dividend, the demographic transition will eventually cause the average age of the population to increase. Such population ageing, which all developed and many developing countries have experienced or are currently undergoing, will bring a number of challenges, chiefly how to support the old population without slowing economic growth:

Further increases in labour productivity will be required in order to avoid a reduction in per capita income as the dependency ratio rises.

Countries -- mostly developed -- already facing a higher share of older people in their population are finding it difficult to ensure their well being, even with sophisticated social policies around pension provision. Developing countries will possibly face major hurdles.

CONCLUSION: The existence of a demographic dividend is not guaranteed. An ageing population provides a development opportunity, but poses formidable policy challenges. For rich countries that now have a proportionately high number of pensioners, a possibility is to draw on the increased number of working age populations elsewhere through immigration, although this is likely to face political opposition.

Indexing (details)

Subject	International; Economic conditions; Education; Employment; Government; Economic growth; Public health; Immigration; Investment policy; Labor market; Pensions; Public policy; Population; Private sector; Productivity; Public sector; Reforms; National security
Location	Asia, Hong Kong, India, Latin America, Singapore, South Korea, Taiwan, United States, US

Company	Organization for Economic Cooperation & Development
Classification	1110: Economic conditions & forecasts, 1200: Social policy, 9180: International
Identifier / keyword	Asia, Hong Kong, India, Latin America, Singapore, South Korea, Taiwan, United States, US, International, Economic conditions, Education, Employment, Government, Economic growth, Public health, Immigration, Investment policy, Labor market, Pensions, Public policy, Population, Private sector, Productivity, Public sector, Reforms, National security
Title	INTERNATIONAL: Demographic dividend is not guaranteed
Publication title	OxResearch Daily Brief Service
Pages	n/a
Publication year	2010
Publication date	Nov 30, 2010
Year	2010
Publisher	Oxford Analytica Ltd
Place of publication	Oxford
Country of publication	United Kingdom
Journal subject	BUSINESS AND ECONOMICS
Source type	Reports
Language of publication	English
Document type	News
ProQuest document ID	818687092
Document URL	http://libproxy.nps.edu/login?url=http://search.proquest.com/docview/818687092?accountid=12702
Copyright	Copyright Oxford Analytica Ltd. 2010. No publication or distribution is permitted without the express consent of Oxford Analytica.
Last updated	2011-05-16
Database	OxResearch