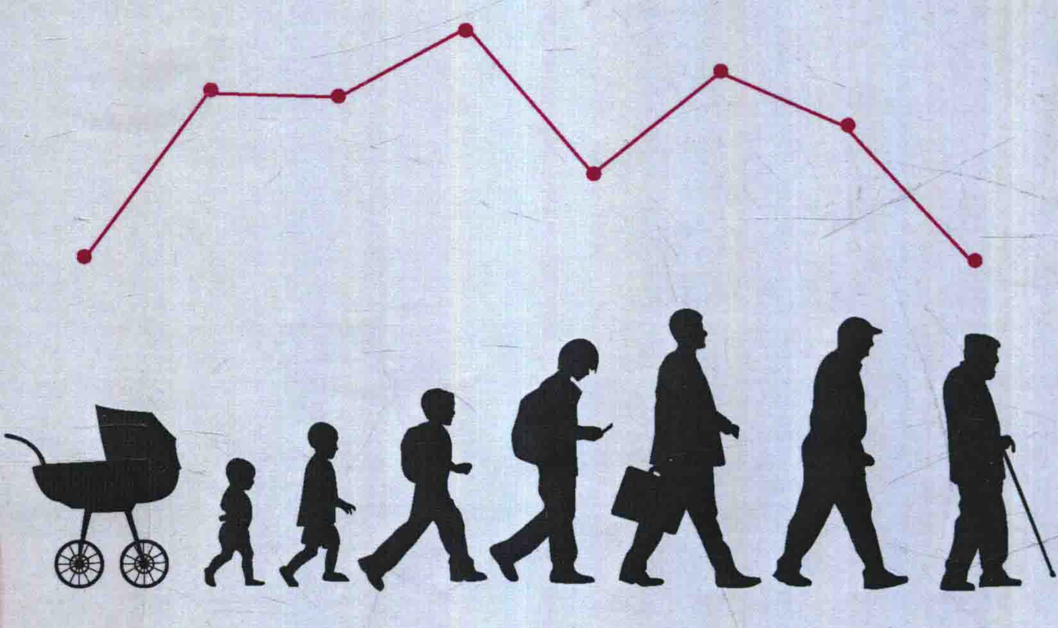
Asymmetric Demography and the Global Economy

Growth Opportunities and Macroeconomic Challenges in an Ageing World



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To Ana, Paula, and Sebastian

Figures

Tables

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Contents

Introduction: The Project, the Results, and Policy Implications

José María Fanelli

The global economy has experienced deep structural transformations since the demise of the Bretton Woods system gave rise to the second globalization. From the point of view of emerging countries, three dimensions of the transformations are particularly relevant: the changes in the international growth dynamics, the expansion of capital movements, and the global demographic transition (Dervis, 2012; World Bank, 2012a).

The main purpose of this book is, precisely, to contribute to our understanding of why the demographic transition matters to the domestic macroeconomy and to global capital movements via the effects on the growth potential, the current account, and the economy's international financial position. We approach these questions from the perspective of "systemically important" emerging countries—that is, members of the G20—but considering both the national and the global side of the problem so as to identify issues that are relevant to these countries and the G20 policy agenda.

Growth, Global Capital Flows, and the Demographic Transition

Concerning growth dynamics, the developing economies' share of global income rose from 30 percent in 1990 to 50 percent in 2010 and growth miracles occurred in populous economies like China and India—whose weight in the world economy has increased. Thanks to the acceleration of growth, various emerging countries reached middle-income status in the 2000s. According to World Bank data, middle-income countries accounted for 13 percent of the global economy in 1990 and that share climbed to 30 percent in 2010. As a result, a set of developing countries is now considered "systemically important." This was reflected in the international political arena with the creation of the G-20, which brought together developed and developing countries to discuss global financial problems and elaborate initiatives to improve the international financial architecture.

The expansion of global capital flows between developed and emerging countries has been such that it has become an autonomous factor promoting the structural transformations in emerging economies' markets and institutions. According to the Institute of International Finance data, in 1990 private capital flows involving emerging countries totaled 128 billion dollars. By 2010 they had grown to 1180 billion dollars. Together with the transformations in the process of creation and accumulation of financial assets, a key driver of change was the need to adapt the institutional framework—from the macroeconomic policy regime to financial regulations—to be able to absorb increasing amounts of private capital flows in the form of foreign direct investment and portfolio investment (Mateos y Lago, 2009; United Nations, 2009b).

The structural transformations in the international economy induced by the demographic transition have been no less impressive. The United Nations (2004) distinguishes three stages in the demographic transition. The first is the age of the child: a period when those under 15 years make up at least 30 percent of the population. The second is the demographic window of opportunity: a period when they have fallen permanently under 30 percent, but persons 65 years and older are still relatively few. The last stage begins when those 65 years and older have permanently increased to at least 15 percent of the population. This transition occurs over an extended period and the three stages almost always follow in sequence. Before entering the window, a country is labeled "young" and it is called "old" after it exits.

From the perspective of the global economy a key feature of the demographic transition is that it shows large asynchronies across countries and regions and, as a consequence, the share of emerging and advanced economies in the global population, as well as the countries' age structure, has been showing significant transformations. The evolution of the G20 countries well illustrates this point. In 1980 the emerging country members of the G20 accounted for 78 percent of the total G20 population. In 2010 that share was 81 percent. This is a consequence of the fact that developing countries are much less advanced in the demographic transition. In 1980 the window of opportunity was open in all rich countries and in 2010 it closed in all but the United States, Australia, Korea and Saudi Arabia. This contrasts with the case of developing countries: in 1980 only Russia was at the window of opportunity stage while four G20 countries reached that stage in 2010.

Despite the apparent benefits, these structural transformations have also been a source of concern for emerging countries. For one thing, these countries have not all benefited equally from the new opportunities. Some countries grew significantly more than others. Many regions of the developing world are still poor and unable to accelerate growth while a number of previously successful middle-income economies were caught in the so-called middle-income trap (Eichengreen et al., 2012). The fact that economies that had successfully achieved the status of high middle income—for example, the three largest Latin American economies—were subsequently caught in a low-growth trap after achieving such status worries policy makers in countries that have relatively recently achieved the middle-income status, as is the case of China (Eichengreen et al., 2012; Zheng Bingwen, 2011). For another, the expansion of global capital markets was accompanied by macroeconomic and financial instability. Many systemically relevant emerging countries experienced severe financial turmoil, especially in the 1980s and 1990s. Indeed, the recurrence of financial instability was a primary reason for the creation of the G20 following the Asian crisis of the 1990s (Eichengreen and Baldwin, 2008; Fanelli, 2008). More recently, emerging markets were hit by the shocks associated with the 2008–09 financial crises and the subsequent stabilization policies implemented by advanced economies to cope with the sequels of such crises (Claessens et al., 2010). These latter policies gave rise to new challenges for the global economy, such as the currency war, the uneven build up of reserves, financial protectionism, and the instability of interest rates that accompanied the initiation of the process of normalization of extremely accommodative monetary policies in the United States (IMF, 2014; Medhora, 2007; Obstfeld and Rogoff, 2009).

In the postcrisis scenario, the need to deal simultaneously with the long-lasting sequels of the crises and the ongoing structural changes poses new collective action challenges to the global community In order to size the growth opportunities associated with the second globalization while coping with instability, emerging countries have been implementing sweeping institutional reforms and the international financial architecture has been transformed as well. But the task of adapting the rules of the game so as to provide effective governance to capital flows and ensure global stability has proved to be far more difficult than expected, as the experience with the implementation of different generations of reforms inspired in the Washington Consensus illustrates (Fanelli and McMahon, 2005). Indeed the emerging countries' experience with globalization suggests that growth traps, macroeconomic and financial instability, and imperfections in international capital markets associated with flaws in the domestic and global institutional framework may not be independent phenomena (Fanelli, 2008).

The interactions between growth, institutions, and global capital flows have received a great deal of attention in recent decades and have been thoroughly investigated (Lane and Milesi-Ferretti, 2001; Rajan, 2005). In contrast, the linkages between the demographic transition, the domestic macroeconomy, and international capital flows have received far less attention. The literature has made important contributions on the consequences of ageing for the government's inter-temporal budget constraint and the persistence of global imbalances has motivated studies on the effects of demographic changes on the current account (Bryant, 2006; Cooper, 2008; Kim and Lee, 2007; Wilson and Ahmed, 2010). Some economists have even advanced the hypothesis that demography may have a role in explaining the global imbalances and the liquidity trap (Bernanke, 2005, 2007; Blanchard and Milesi-Ferreti, 2009, 2011; Krugman, 2013). But the focus has targeted