

**Testimony before the
Commission on Security and Cooperation in Europe**

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2050: Implications of Demographic Trends in the OSCE Region

by
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Mr. Chairman and Commission Members, I am grateful for the opportunity to testify before the Commission on this important topic.

Many have observed that the recent global economic crisis is helping to accelerate the relative decline of today's developed countries and to drive the rise of today's emerging markets. It is less well understood that demography is pushing in the same direction, though over a much longer time horizon. Demographic change shapes economic and geopolitical power like water shapes rock. Up close the force may appear trivial, but given enough time it can move mountains. The long-term prosperity and security of the United States may depend in crucial ways on how effectively it prepares for the demographic transformation now sweeping the world.

The Demographic Transformation

Most of the developed world finds itself on the cusp of an unprecedented new era of rapid population aging and population decline. The developed countries have of course been aging for decades, due to falling birthrates and rising life expectancy. But during the 2010s and 2020s, this aging will get an extra kick as large postwar baby boom generations move fully into retirement. According to the United Nations Population Division (whose projections are cited throughout this testimony), the median ages of Western Europe and Japan, which were 34 and 33 respectively as recently as 1980, will soar to 47 and 52 by 2030, assuming no increase in fertility. In Italy, Spain and Japan, more than half of all adults will be older than the official retirement age—and there will be more people in their seventies than in their twenties.

Meanwhile, the working-age population has already begun to contract in several large developed countries, including Germany and Japan. By 2030, it will be contracting in nearly all developed countries, the only major exception being the United States. In a growing number of countries, total population will also begin a gathering decline. Unless birthrates or immigration

surge, Japan and some European nations are on track to lose nearly one-half of their total current populations by the end of the century.

These trends threaten to undermine the ability of today's developed countries to maintain global security. There is, to begin with, the direct impact on population size and GDP size, and hence the manpower and economic resources that nations can deploy—what RAND scholar Brian Nichiporuk calls “the bucket of capabilities” perspective. But population aging and population decline can also indirectly affect capabilities—or even alter national goals themselves. Rising pension and health-care care costs will place intense pressure on government budgets, potentially crowding out spending on other priorities, including national defense and foreign assistance. Economic performance may suffer as workforces gray and rates of savings and investment decline. As societies and electorates age, growing risk aversion and shorter time horizons may weaken not just the ability of the developed countries to play a major geopolitical role, but also their will.

The weakening of the developed countries might not be a cause for concern if the world as a whole were becoming increasingly pacific. But this is unlikely to be the case. Over the next few decades, the emerging markets will be buffeted by its own potentially destabilizing demographic storms. China will face a massive age wave that could slow economic growth and precipitate political crisis just as it is overtaking the United States as the world's leading economic power. Russia will be in the midst of the steepest and most protracted population implosion of any major power since the plague-ridden Middle Ages. Meanwhile, many other developing countries, especially in the Muslim world, will experience a sudden new resurgence of youth whose aspirations they may not be able to meet. The risk of social and political upheaval could grow throughout the developing world—even as the developed world's ability to deal with the threats declines.

Yet if the developed world seems destined to see its geopolitical stature diminish, there is one partial but important exception to the trend: the United States. While it is fashionable to observe that U.S. power has peaked, demography suggests that America will play as important a role in shaping the world order in this century as it did in the last.

The Impact on Economies

Although population size alone does not confer geopolitical stature, no one disputes that population size and economic size together constitute a powerful double engine of national power. A larger population allows greater numbers of young adults to serve in war and occupy and pacify territory. A larger economy allows more spending on the hard power of national defense and the semi-hard power of foreign assistance. It can also enhance what political scientist Joseph Nye Jr. calls “soft power” by promoting business dominance, leverage with NGOs and philanthropies, social envy and emulation, and cultural clout in the global media and popular culture.

The expectation that the aging of its populations will diminish the geopolitical stature of the developed world is thus based in part on simple arithmetic. By the 2020s and 2030s, the working-age population of Japan and many European countries will be contracting by between roughly 0.5 and 1.5 percent 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—in other words, of zero real GDP growth from peak to peak of the business cycle.

Economic performance, in fact, is more likely to deteriorate than improve. Workforces in most developed countries will not only be stagnating or contracting, but also graying. A vast literature in the social and behavioral sciences establishes that worker productivity typically declines at older ages, especially in eras of rapid technological and market change. Economies with graying workforces are also likely to be less entrepreneurial. According to the 2007 Global Entrepreneurship Monitor, which surveys fifty-three countries, new business start-ups in high-income countries are heavily tilted to the young. Of all “new entrepreneurs” (defined as an owner of a new business founded within the last three and one-half years), 40 percent are under age thirty-five and 69 percent are under age forty-five. Only 9 percent are aged fifty-five or older.

At the same time, savings rates will 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, 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. Graying means paying—more for pensions, more for health care, more for nursing homes and social services for the frail elderly. According to CSIS projections, the cost of maintaining the current generosity of today’s public old-age benefit systems would, on average across the developed countries, add an extra 7 percent of GDP to government budgets by 2030. The extra cost in most continental European countries, with their expansive welfare states, would be even greater.

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 public plans. In France, Germany, Italy, and Spain, over 70 percent of the income of the typical elderly person comes in the form of a government check, compared with roughly 40 percent in the United States. In the 2020s, young people will have the future on their side. Elders will have the votes on theirs.

Faced with the choice between economically ruinous tax hikes and politically impossible benefit cuts, many governments will choose a third option: cannibalize other spending on everything from education and the environment to foreign assistance and national defense. As time goes by, the fiscal squeeze will make it progressively more difficult to pursue the obvious response to emerging military manpower shortages—investing massively in military technology,

and thereby substituting capital for labor. Secretary Gates recently warned that the hollowing out of the defense budgets of our European allies already renders the long-term outlook for NATO “dim, if no dismal.” Demographic trends threaten to make a bad situation even worse.

To be sure, there is significant variation in the demographic outlook across Europe. In France and northern Europe, including the low countries, Scandinavia, and the UK, the fertility rate now averages a relatively buoyant 1.9, not much less than the U.S. rate of 2.1. In Italy and the rest of Mediterranean Europe, the fertility rate averages 1.4.—and in Germany and Central Europe, it averages 1.3, on par with Japan. If the demographic outlook for northern Europe is challenging, the outlook for the rest of Europe can only be described as bleak. While Europe’s northern high-fertility zone faces a future of zero workforce growth between now and 2050, the working-age population of Italy and Mediterranean Europe is projected to decline by 22 percent; that of Germany and Central Europe is projected to decline by 29 percent.

This variation poses a serious threat to the economic viability of the European Union, and, in particular, the EMU. The monetary union, of course, is already being buffeted by the sovereign debt crisis. Yet this near-term challenge pales before the longer-term challenge posed by the aging of Europe. The viability of the EMU depends crucially on the effective coordination of fiscal policy among member countries. Yet member countries not only have diverging demographics, but welfare states that vary greatly in their generosity. As the fiscal pressures of aging mount at different rates in different countries, coordination will become increasingly problematic. Some governments may rise to the fiscal challenge and rein in spending. But if others do not, they could end up unleashing inflation on the prudent and profligate alike.

The Impact on Social Mood

The impact of population aging on the collective temperament of the developed countries is more difficult to quantify than its impact on their economies, but the consequences could be just as important—or even more important. With the size of domestic markets fixed or shrinking in many countries, businesses and unions may lobby for anticompetitive changes in the economy. We may see growing cartel behavior to protect market share and more restrictive rules on hiring and firing to protect jobs. We may also see increasing pressure on governments to block foreign competition. Historically, eras of stagnant population and market growth—think of the 1930s—have been characterized by rising tariff barriers, autarky, corporatism, and other anticompetitive policies that tend to shut the door on free trade and free markets.

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 lock in current public spending commitments at the expense of new priorities and shun decisive confrontations in favor of ad hoc settlements. Smaller families may be less willing to risk scarce youth in war. 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.

Meanwhile, the rapid growth in ethnic and religious minority populations, due to ongoing immigration and higher-than-average minority fertility, could strain civic cohesion and foster a new diaspora politics in some countries. With the demand for low-wage labor rising, immigration (assuming no rise over today's rate) is on track to double the percentage of Muslims in France and triple it in Germany by 2030. Some large European cities, including Amsterdam, Marseille, Birmingham and Cologne, may be majority Muslim. The problem is not growing diversity itself, but rather the failure of many European countries to assimilate migrants economically and socially. In the United States and the other traditional "immigration countries" like Australia and Canada, migrants constitute an important comparative advantage.

In Europe, the demographic ebb tide may deepen the crisis of confidence reflected in such best-selling books as "France is Falling," by Nicolas Baverez; "Can Germany Be Saved?" by Hans-Werner Sinn; or "The Last Days of Europe," by Walter Laqueur. The media in Europe are already rife with dolorous stories about the closing of schools and maternity wards, the abandonment of rural towns, and the lawlessness of immigrant youths in large cities. A recent cover of *Der Spiegel* shows a baby hoisting 16 old Germans on a barbell with the caption: "The Last German -- On the Way to an Old People's Republic." In Japan, the government half-seriously projects the date at which there will be only one Japanese citizen left alive.

U.S. Demographic Exceptionalism

Over the next few decades, the outlook in the United States will increasingly diverge from that in the rest of the developed world. Yes, America is also graying, but to a lesser extent. The United States is the only developed nation with replacement-rate fertility of 2.1 children per couple. By 2030, its median age, now 37, will rise to only 39. Its working-age population, according to both United Nations and U.S. Census Bureau projections, will also continue to grow through the 2020s and beyond, both because of its higher fertility rate and because of substantial net immigration, which America assimilates better than most other developed countries.

None of this is meant to downplay the serious structural challenges facing the United States, which include a bloated health-care sector, a chronically low savings rate, growing dependence on foreign capital, and a political system that finds it difficult to make meaningful resource trade-offs between competing priorities. All of these threaten to become growing handicaps as our population ages—and, if not addressed, will ultimately undermine our national prosperity and national power.

Yet unlike Europe and Japan, the United States will still have the youth and the economic resources to play a major geopolitical role in the decades ahead. In the end, the biggest challenge facing America by the 2020s may not be so much its inability to lead the developed world as the inability of the other developed nations to lend much assistance.

Tomorrow's Geopolitical Map

The demographer Nicholas Eberstadt has warned that demographic change may be "even more menacing to the security prospects of the Western alliance than was the Cold War for the past generation." Although it would be fair to point out that such change usually poses

opportunities as well as dangers, his basic point is incontestable: Planning national strategy for the next several decades with no regard for population projections is like setting sail without a map or a compass. In this sense, demography is the geopolitical cartography of the twenty-first century.

Although tomorrow's geopolitical map will be shaped in important ways by political choices yet to be made, the basic contours are already emerging. During the era of the Industrial Revolution, the population of what we now call the developed world grew faster than the rest of the world's population, peaking at 25 percent in 1930. Since then, its share has declined. By 2010, it stood at just 13 percent and it is projected to decline still further in the future to 10 percent by 2050. The collective GDP of the developed countries will also decline as a share of the world total—and much more steeply. According to new projections by the Carnegie Endowment for International Peace, the G-7's share of total G-20 GDP will fall from 72 percent in 2009 to 40 percent in 2050. Driving this decline will be not just the slower growth of the developed world, as workforces in Japan and Europe age and stagnate or contract, but also the surging expansion of large, newly market-oriented economies, especially in East and South Asia.

There is only one large country in the developed world that does not face a future of stunning relative demographic and economic decline: the United States. Thanks to its relatively high fertility rate and substantial net immigration, its current global population share will remain virtually unchanged in the coming decades. According to the Carnegie projections, the U.S. share of total G-20 GDP will drop significantly, from 34 percent in 2009 to 24 percent in 2050. The combined share of Canada, France, Germany, Italy, Japan, and the UK, however, will plunge from 38 percent to 16 percent. By the middle of the twenty-first century, the dominant strength of the U.S. economy within the developed world may have only one historical parallel: the immediate aftermath of World War II, exactly 100 years earlier at the birth of the “Pax Americana.”

All told, population trends point inexorably toward a more dominant U.S. role in a world that will need us more, not less. For the past decade or so, the United Nations has published a table ranking the world's twelve most populous countries over time. In 1950, six of the top twelve were developed countries. In 2000, only three were. By 2050, only one developed country will remain—the United States, still in third place. By then, it will be the only country among the top twelve with a long historical commitment to democracy, free markets, and civil liberties.