Copenhagen Consensus Challenge: Population

Paper Outline

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A Aging

1. Oeppen and Vaupel (*Science*, 2002) observe: "Is life expectancy approaching its lilmit?...Many ... believe it is. The evidence suggests otherwise ... For 160 years, best-performance life expectancy has steadily increased by a quarter of a year per annum..."

2. The median age in Europe is forecasted to rise from 37.7 now to 52.7 in 2050. The ratio of the elderly to the working-age population in West Europe is expected to double from 20% in 2000 to 40% in 2050.

3. The aforementioned demographic trends put state pension systems under enormous stress. So, either payroll contributions will increase exorbitantly [for, instance, Brugiavini (1999) estimated that the theoretical contribution rate that would balance the system in Italy was 44% in 1991], or the debt will sky rocket. As the *Economist* (August 24th, 2002) put it: "On some estimates, by 2050, government debt could be equivalent to almost 100 percent of national income in America, 150 percent in the European Union as a whole, and over 250 percent in Germany and France". (Recall that the debt target ceiling set by the Stability and Growth Pact is only 60 percent of national income!)

4. Given these unpleasant choices, we study how the political power balance is expected to tilt toward down-scaling the welfare state in general and the old-age social security system in particular.

5. We examine the above hypothesis empirically, using panel data on the United States and European countries in the 1970s-1990s. Also, we estimate the magnitude of the effects of aging on key parameters of the welfare state. Their implication for the future of the welfare state will be examined as well.

6. One of the well-publicized proposals for such a reform is to shift from national pensions to individual retirement accounts.

7. Following Razin and Sadka (forthcoming), we develop a political-economy model with which we analyze the political economics of such reforms in aging societies. We show how aging affects the formation of pro- and anti-reform coalitions.

8. We also analyze how rigid balanced-budget rules (like, for instance, the Stability and Growth Pact in the European Union) can discourage the political forces behind the reform. We also discuss the emergence of

coaliltions that can circumvent such obstacles.

9. Immigration of young workers (in particular, skilled workers) can alleviate the burden on young workers in the aging host countries. As the *Economist* recently (September 27th, 2003) put it: "Increasing Immigration would be hugely controversial, but it makes good economic and social sense, and not only from the point of view of pensions ..." In fact, more than a decade ago, the *Economist* (February 15, 1992) pointed out that migration may have positive spillovers: "Demography and economics together suggest that Europe might do better to open wider its doors. Europeans now live longer and have fewer babies than they used to. The burden of a growing host of elderly people is shifting on to a dwindling number of young shoulders".

B Migration

1. Nowadays, in the era of globalization, capital can flow almost freely from rich to poor countries. Similarly, barriers to goods trade are being lifted; and technological improvements lower transportation costs, so that goods can flow freely from one country to another. If capital and goods flows are substitute to labor mobility, then why migration from poor to rich country is still a major concern for rich countries?

2. Observing that labor is generally restricted from moving from poor to rich countries, Lucas (1990) asks: "Why doesn't capital flow from rich to poor countries?" Because, if capital does flow adequately from rich to poor countries, so as to equate internationally the marginal product of capital, then so will wages be equated. Hence, migration will turn to be a non-issue. But this is not the case: wages per effective unit of labor are still much higher in rich countries than in poor countries.

3. Lucas reconciles the puzzle by invoking human-capital externalities. The upshot: equal marginal products of capital do not imply equal wages. Labor still desires to flow from poor to rich countries, but it is administratively restrained from doing this.

4. Razin, Rubinstein and Sadka (in preparation) provide yet another reconcilation of the puzzle: "lumpy" adjustment costs of investment render unequal wages across countries even in the presence of free capital mobility. This hypothesis is tested empirically with panel data on bi-lateral FDI flows among rich and poor

countries. The analysis backs up unobserved thresholds above which flows are positive; thus, quantifying barriers to FDI flows.

5. With free trade in goods, the well-known Stolper-Samuelson (1941) factor-price-equalization theorem seems to have nullified the pressures for migration. Layard et al. (1992) follow this theorem and argue: "Ideally, policy should try to bring jobs to the East *rather than* Eastern workers to the West. International trade ... *can* act as a substitute for migration. A free trade pact that ensures Eastern European countries access to Western European markets is the best single migration policy ..." Nevertheless, this is not the case: wages are still much higher in the rich than in the poor countries, despite the expansion of free trade, and migration remains a key policy issue.

6. In fact, in the presence of a technology divide between rich and poor countries, international trade is likely to be complementary to labor mobility, thereby widening, rather then narrowing, the wage gap between rich and poor countries.

7. Incentives for migration are not shaped only be factor returns. Rather, migration is intertwined with welfare issues. The incentives for migration are shaped by the various ingredients of the welfare state, beyond the economic return (i.e., the marginal product) of labor as a factor of production. Pension contributions and benefits, unemployment and disability benefits, public education to children, health care, etc., are all part and parcel of the incentives for migration. These elements may be equally important as the return to labor in the form of wages in generating the pull-and-push factors of migration. The size of the aforementioned payments and benefits, the scope and the composition of the income redistribution embodied in them, and the degree of eligibility of migrants to benefit from them determine not only the incentives to migrate, but also the effect of migration on the well-being of the native-born population and, consequently, the attitude of this population toward migration.

8. A study, initiated by the U.S. National Research Council, estimamtes the *overall net fiscal* contribution of migrants with at least high school education who arrived in the U.S. at ages between 20 and 35 at approximately $150,000 over their own lifetime; see Smith and Edmonston (1997). Things are less obvious when the migrants are low skilled. For instance, the aforementioned study estimates that migrants with

less than high school education, aged 20-40 years on arrival, impose an overall net fiscal burden of \$60,000-\$150,000 over their own life time.

9. We employ a political-economy model in which we examine how unskilled or skilled migration affect the outcomes of voting on various redistributive policies in the welfare state. The conclusions of the model are tested empirically with panel data on the U.S. and European countries.

10. We also employ lobbying models of the type of Grossman and Helpman (1994) in order to examine how migration quotas may be shaped. As an example, we mention the debate on H1-B visas, where Silicon Valley executives trooped before the Congress, warning of a Y2K computer disaster unless the number of H1-B visas was increased.

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