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Comment on: Thomas Lindh, "Is Human Capital the Solution to the Ageing and Growth Dilemma?"

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I hope for your understanding starting with a very personal observation. When being invited to discuss a paper in a seminar like this my usual aim is contributing from my experience at least a little. But this time, when I agreed to discuss the paper of Thomas Lindh I did not foresee that I will be given a very precious present: under the impression of last years fierce discussions on pension reform in this country and in some others I began writing on the macro-economics of population ageing – not for the sake of academia but as a guideline for policy-makers and politically interested people. And preparing for this particular workshop I found – with all due modesty – that Thomas Lindh's paper arrives at basically the same conclusions as I. Therefore I am going to underline his findings rather than criticizing it.

Let me summarize how I see his findings.

First: in dealing with the perspectives of demographic changes in the decades to come, it is imperative to see the strategic options and the consequences as an unprecedented macro-economic problem. The dimension of the problem would be misunderstood, and is not adequately understood in fact, at least in Austria so far, when assuming that a mere adjustment of some parameters of the public PAYG-system is sufficient to meet the challenge. A parametric reform is indispensable, of course, but if not complimented by a comprehensive macro-economic strategy it will be insufficient and be doomed to fail in the long run.

Second: no isolated line of remedy will be sufficient to cope with the magnitude and the complexity of the problem, rather a strategic combination of major approaches and of many societal adaptations in detail seems promising.

Of course, the main ingredients of that strategy will be

* lowering the dependency ratio by raising the activity rate,

* increasing productivity per capita by additional investment in human capital and by deepening capital intensity,

* the use of international opportunities to invest into the economies of demographically younger nations and to earn profits from such investments in order to partly support the social system of the “older” countries: outsourcing instead of immigration,

* a careful handling of the intergenerational redistribution problems that inevitably will occur.

The coordinated use of some more particular instruments to support the strategies will be necessary to stabilize the social system, at least to preserve the level of per capita welfare of today: among them not at least limits to the generosity of the pension system, measures to raise birth-rates in the longer term, fiscal and other measures influencing the savings rate and the efficiency of capital markets etc.

When this is clear even to policy makers - which seems not to be the case in Austria yet - there remain still very difficult problems in implementing a comprehensive strategy.

Some short comments on aspects discussed by Thomas Lindh:

There is widespread unanimity as to the necessary increase in participation rates in the population out of various sources: length of working life, higher female participation, immigration.

When thinking of possible sources of human capital, we should not neglect the potential of lowering the currently high unemployment. The unemployment rate in Western Europe this year is some 4 to 5 percent of the labor force above the level it has been during times of full employment in the early seventies, before growth rates shrank and the baby-boom generation entered the labor markets. As the ceteris-paribus-impact of ageing by 2030 will be decreasing the European GDP by some 10 to 15 percent, the consequence of integrating this unused part of the labor force would cover about one third of the problem. Certainly, the effects of a lower unemployment rate are not independent of higher participation rates caused by the other sources mentioned.

This leads me to the core of my support for Lindh’s arguments: productivity and human capital. In various articles we find a long list of factors influencing labor productivity trends downward under the impact of ageing: lower savings rates, higher risk aversity, less innovative capacity, lower capacity to work because of diminishing physical condition and so on.

But there are also arguments that would suggest forces working in the positive direction:

* First and fundamentally: the extrapolation of past trends of the decades after the end of the baby-boom, i.e. since about the early seventies, is conducive in many instances to misleading conclusions, as the very same reason that has led to increasing unemployment and decreasing participation rates – the sharp swing from big cohorts to very small ones - now turns into the opposite and will create - even without strategic intervention - some capacity to reduce the problem. For example the relative shift from labor to capital income will be reversed and therefore the direction of technological progress. The increasing scarcities on the labor market in coming decades will more or less automatically increase labor productivity through enforced labor saving technological progress.

* Early retirement in recent years has been an unnecessary loss of human capital while not significantly raising the employment rates. A reversal of this trend will – accompanied by adequate measures in labor-market-, wage-, wage-taxation- and education policies result in an increase of GDP,

* Intergenerational differences in human capital embodied will most probably decrease as a result of improved education in the last decades

I am sure about a sufficient automatic reaction of technical progress in this direction, but I think such effects will offset at least partly the dampening influences on productivity growth.

This is all the more plausible as the increased cohorts of aged persons to some extent not only demand more labor and GDP for their needs but in themselves provide also specific capacity to meet such needs, think of personal care for handicapped older persons. The question is, will the market forces work sufficiently to balance the specific demands and supplies. Certainly not. But, again, this can be encouraged and supported.

Next point, and a very crucial one. Thomas Lindh summarizes his quantitative simulations ("number crunching") convincingly: "it seems possible that in combination with higher utilization of the human capital and support from higher capital intensity, some labor import and technological change, at least can be kept up to such an extent that living standards on average continue to rise in an ageing society."

He proceeds to the discussion of distributional problems.

I would like to stay here for a moment. For me, still the question remains, how could we generate enough increase in human capital and social capabilities?

Answer: by intensified and improved learning on all levels, in all organizations and at (nearly) all ages. I was impressed a year ago when at a WIFO symposium Gosta Espin Anderson exclaimed: if you wish to solve the ageing problem for the long run, invest in your children! There are three things to be done with priority: education, education and education. And I confess I have much more affection for this view than with the other calling for the "production" of more kids. (I myself have three of them, so I think, I am out of obligo).

Improving human capabilities is the central political question, because an adequate answer would ease the distributional problem uno actu. There are, however, not many indicators, that national policy so far has recognized the importance of this key to future problems.

As to distributional questions I could agree that overlapping intergenerational models may give some insight into the dynamics of redistributional needs. I, however, see the limits of such models; e.g. assigning the use of societal goods and services to particular cohorts. That leaves me not only with the conclusion that we have to try to get much more comprehensive insight into generational value developments.

But also with two final remarks:

- *First*, I am inclined to follow Nicholas Barr (The Welfare State as Piggy Bank, Oxford 2001) in arguing, that the demographic challenges before us do not call for a dismantling of the welfare state. To the contrary, they ask for a reinforcement of the state in the sense, that only the democratic state is legitimated to an authoritative and fair balance between the interests of succeeding generations and between social groups.

- *Second*, I doubt that our measure of welfare (GDP per capita) is adequate to think of the possible developments of well-being in our countries under the influence of ageing. I rather think that ageing will bring about - in the medium- and long-term - fundamental shifts in relative values: the trade-off between labor and leisure, between environment and production, between national and global interests, between the state and the civil society. Such developments will not be adequately assessed by the standard economic measure of welfare. Instead, I think, we have to try to enlarge our analyses to wider degrees of freedom in the option before us.