

## [Comment] Procreation or Perdition?

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EUOBSERVER / COMMENT - Europe's population is shrinking. By 2050, we are told, there will be 7 million fewer of us. Politicians want us to work longer and accept lower pensions because of the 'demographic time-bomb'.

Many EU countries are now offering couples monthly allowances to stay at home to look after their babies in the hope that this will entice them to have more children. In a recent book entitled 'Minimum', the author and publisher Frank Schirrmacher laments what he sees as the disastrous social consequences of population decline. Should we be so worried?

### The benefits of population decline

In its simplistic version, the argument that population decline leads inexorably to national decline smacks of the sort of nationalism one might have heard in the 1930s. Since the Second World War, economists and demographers have generally agreed that the rate of population growth should be controlled.

One reason is that too many people put a strain on limited resources; a planet populated by 15 billion people would be much more at risk than it is with 7 billion today. Another is that a high growth rate of population reduces 'prosperity' (GDP per person). If GDP grows at 3% per year and population growth is zero, each of us is better off. But if annual population growth is also 3%, the increment in GDP must be devoted entirely to feeding and clothing more children and GDP per person remains unchanged.

China, India and other developing countries recognised these realities many years ago and introduced family planning. In Europe and certain other parts of the world, high levels of industrialisation and urbanisation had already undermined the traditional rural imperative of producing as many hands as possible to help with work and to provide support in old age. In general, population growth rates have been declining in much of the world as fertility falls.

The richer we become, the fewer babies we want. Indeed, at present, the total fertility rate (TFR) in every EU member state has fallen below the figure of 2.0 that is required to keep population constant.

### The cost of population decline

The problem is that population decline increases the dependency ratio; ie, the ratio of people who are either too young or too old to work to those of working age. Two generations ago in Europe, a 65-year old might expect to live until his or her early 70s---today the average person lives a decade longer.

Fewer babies today mean fewer workers tomorrow. By 2050, instead of the average retiree being supported by the four active workers, only two will be there to do the job. In short, the main factors undermining the EU's generous pension provisions are decreasing fertility and increasing longevity.

A remedy much favoured by centre-right politicians is privatisation. Unfortunately, privatising pension provision does not reduce the overall cost but merely displaces it. Instead of the state carrying the debt, private firms do. They reduce their pension costs by covering fewer people (eg, contracting out to low-paid workers who tend to have no coverage at all) while shifting from final salary based pensions to defined benefit schemes.

### Four Choices

Basically, there are only four ways of dealing with the pension crisis: (a) reducing pension benefits; (b) increasing retirement age; (c) reducing the dependency ratio by adding to the workforce, and (d) increasing productivity. The first two tend to be resisted strongly and are difficult to implement; moreover, the burden of meaner state pensions and more years of work falls disproportionately on the less well-off.

Adding to the workforce can be achieved by increasing domestic population either through immigration or by having more children. Having more children increases the workforce in the medium term, but in the short term raises the dependency ratio. In either case, the solution is not permanent since the extra workers will one day become extra pensioners.

Adult immigrants achieve the same objective at lower costs since the costs of raising them to adulthood is mainly borne elsewhere, but for politicians, the injunction to 'have more babies' is less contentious than to



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'open the borders'.

### **An optimal solution?**

The best solution would be to raise labour productivity; ie, to raise income per head, putting away part of the increase for a rainy day. Even a low rate of productivity growth, when compounded over many years, provides sufficient extra income to support more pensioners. This is what governments do when they tax workers (and employers) and use the proceeds to build up extra pension funds.

But here is the crunch: nobody wants to pay the bill. Employers complain that globalisation is squeezing their profits. Workers join the growing middle class clamour for lower taxation.

At the end of the day, the 'pension crisis' cannot be laid at the doorstep of immigrants who allegedly scrounge on our welfare, or on mothers who are allegedly too selfish to have babies or even blamed on member states' failure to meet the Lisbon targets. In essence, the problem is one of how the annual increment in GDP is to be distributed between rich and poor as well as between jam today and jam tomorrow. Within a generation, an extra 2% of GDP will be needed to fund the pension gap.

If we are to retire at a decent standard of living, governments must bite the bullet and increase taxation on those who can best afford to pay.

A quick glance at the income distribution figures should quell the doubters. The USA, the world's richest country in terms of GDP per capita, last year grew at just over 3%. According to the US Census Bureau, the entire increment in national income was absorbed by the top 10% of income earners.

These are the very people who will retire to private affluence well before they reach 65, and much the same trend is visible in Europe. Some of these good burghers refuse to face the tough choices; instead, they write books warning us that our pensions are too generous and that low birth rates are leading us down the road to perdition.

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