

Comment on “Demographics and the current account” by Joschka Gerigk, Miriam Rinawi, and Adrien Wicht

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Demographics matter a lot. There are almost no areas in economics – and many other disciplines – that are not impacted by changes to the age distribution. A large number of research papers offer empirical or theoretical insights of how demographics affect outcomes.

Some of the effects are straightforward – social insurance schemes, as well as tax and transfer systems, depend directly on the relative number of elderly and younger citizens and taxpayers. The direct link between demographics and fiscal policy allows for an easy identification of the potential problems. But demographics themselves are an also obstacle to reform. Often, changes have to be approved in the political process in which the weight of the elderly has increased dramatically in recent years.

Other effects are more subtle. The demographic composition has an impact on within-country inequality, and it affects the income and wealth distributions between countries. Less well known is that demographics have an effect on innovative capacity and – ultimately – growth. A recent paper by LIANG, WANG and LAZEAR (2018) shows that older workers in society slow entrepreneurship, as they block younger workers from acquiring relevant skills or climbing up in hierarchy. Older societies not only have lower rates of entrepreneurship overall, but also in every single age group.

One important underlying cause for the importance of demographics is that individuals behave differently at different stages of their life even if their preferences stay the same (which is often not the case). They acquire skills when young; as their income increases, they build up savings which they then slowly (ideally) run down after retirement. Fiscal policy adds twists, and not all individuals are perfectly rational. But Modigliani and Brumberg’s life-cycle model is able to capture most important moves and still forms the backbone of many micro-based macroeconomic models.

Obviously, the life-cycle decisions of the population add up and, as a consequence, impact macroeconomic variables as well. Demographics are bound to matter even in the international context, especially if the age distributions of countries differ. If the middle aged save but the old and the young run down assets (their own or those of their parents, respectively), the current account will mirror these

decisions. Countries with a large share of prime-age workers save more than they currently “need”, while for older societies it is the reverse. This is exactly where the paper by Gerigk, Rinawi and Wicht fits in. The authors try to quantify the effect of demographics on the current account of countries over time. Given the current political tone, this is an important exercise for sure.

A quantification is not straightforward – a simple plot between dependency ratio and the current account shows no obvious relationship between the current account and dependency ratios. To shed some light on the importance of demographics, the authors borrow an empirical strategy from an earlier paper on the relationship between demographics and macroeconomic by FAIR and DOMINGUEZ (1991). An age polynomial offers a parsimonious way to tease out the link between the age composition and the current account, which also allows us to forecast the future evolution of the current account based on demographics.

The authors find a positive association between the current account and the share of prime-age individuals, and a negative association with the share of the elderly. Not surprisingly, the forecast also mirrors the demographic changes to come – in most industrialised countries, population ageing will decrease the current account balance in the near future.

The analysis by GERIGK, RINAWI, and WICHT is an interesting exercise, but I wonder (a) whether there are alternative (and preferably more recent) ways to include age distributions in empirical macroeconomic models; and, more importantly, (b) whether Fair and Dominguez’s strategy can be directly implemented in an international context. One important feature of the current account is that general equilibrium feedbacks are important. Positive current accounts in some countries must be balanced by deficit(s) in others. It is unclear to me whether the empirical implementation forces such an equilibrium.

As the coefficients on the demographic variables are hard to interpret, the authors compute a combined effect of demographics in the magnitude of 1-2% of GDP, albeit with large confidence bands. At first sight, these numbers seem reasonable. But would a calibrated general equilibrium model come up with similar estimates? A simple check could be to sum up the effects – the sample covers most of the important countries in trade – and see whether the demographic impacts roughly cancel out.

In sum, this is an interesting paper on a hotly discussed subject not only in academia, but also the political arena. The paper provides important insights on the link between demographics and international trade, but it is probably too early to use it for policy recommendations. We will not see the governor of a central

bank or a trade minister justify policy measures in view of a large positive current account with the words "It's the demography, stupid".

References

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LIANG, JAMES, HUI WANG and EDWARD P. LAZEAR (2018), Demographics and Entrepreneurship, *Journal of Political Economy* 126 (S1), pp. 140-196.

