

General Discussion: Demographic Changes and International Factor Mobility

Chair: Martin Feldstein

Mr. Feldstein: There is an interesting forthcoming NBER working paper that touches on the first issue that Alan Taylor showed us in his graphs: the change in international capital flows from an earlier period to today. The paper looks at what happened when Teddy Roosevelt decided to expand the Monroe Doctrine to declare that the United States had the right to intervene militarily in Central America when countries defaulted on their obligations. It turned out that we did not do much of that, but the spread on interest rates in those countries fell immediately by a very substantial amount. That may help explain why when gunboat diplomacy went out of fashion, the capital flows also began to shrink.

Mr. Balcerowicz: My question is about the politics of pension reform, which was raised earlier. I have an impression there was a note of hopelessness that nothing can be done because pensioners dominate the voting process, etc. However, there are a number of countries that have reformed their pension systems. So, there is sort of a natural experiment that should allow us to compare what the politics were behind those countries that have reformed and those that did not reform. It would be a fruitful empirical study. I doubt whether those countries that reached reform have a lower ratio of pensioners to other voters, on average, than the countries that did not reform. But

this is an empirical hypothesis. Among the countries that reformed are central European countries, including my own: Poland. I can tell you from experience that this reform did not provoke much resistance, certainly much less than some privatizations—the deregulation of labor markets or cutting current expenditures. The question is: Why? In the Polish case, and I suppose we were not unique, there were certain conditions that were met.

First, this pension reform was a bipartisan endeavor. Second, there was a bipartisan leadership. There was a very good public relations campaign. And lastly, the future pensioners were addressed—not the current pensioners but the future pensioners. Thanks to this campaign, the picture was presented that without reform of the pension system they would not have any pension. So, they supported the pension reform.

Mr. Crockett: I would like to congratulate the Kansas City Fed for inviting John Helliwell to give a talk at this stage. It makes us much more encouraged than we would otherwise be, because it reminds us that we are dealing with the consequences of things that in themselves are very good. Everybody is living longer and healthier lives. And people have a greater opportunity to choose the size of their families.

We have allowed those good things to create some economic problems. But it should not be impossible to find solutions to those problems that would leave us much better off. As Helliwell pointed out, given that people are living longer and healthier lives, they can easily work to an older age. There is no physiological reason why the dependency ratio should rise, or at least rise by as much as we are now projecting. Moreover, Helliwell is telling us that if people would only accustom themselves to the idea of working longer and being more “engaged,” they would actually be happier and therefore would not resist later retirement in the way we now observe. So the issue is: How do we get people to want what we believe they would end up liking?

I would like to ask John Helliwell, since he is the one who is trying to leave us in a more happy frame of mind, if he could speculate a little bit on what economic measures, or educational measures, or public relations measures could encourage people to think more positively about the benefits that would flow from this longer working life. If people would work longer, and they now can work longer, not only would we deal substantively with a large part of the fiscal problem, but maybe we would even deal with the happiness problem too.

Mr. Dugger: A number of people have raised the question of politics as a solution. A number of important observations have been made about it. Let me report on some discussions that are going forward with board members of AARP, the National Council on Aging, and other senior groups in Washington. Those discussions, when they involve thoughtful people on both sides, are certainly from the senior side resulting in questions about the range of entitlements that are on the table for discussion. This is clearly an example of how John Helliwell's engagement concept or maybe an older idea of just benefit gains from trade. What seniors are saying back to representatives of senior groups is that if a benefit authorized under law is on the table and the issue is long-term growth, why are not all benefits provided for under law on the table? They have specific references to a number of hard-to-justify corporate entitlements, other kinds of tax expenditures, etc. The list is fairly long. From my standpoint, it is very clear that the senior advocacy community in the United States is completely aware of everything we have been talking about. They are open to all of the IMF-type adjustments with respect to pensions. They are open to more imaginative proposals with respect to Medicare, which is a much more serious problem, such as not offering benefits to a generation. That is, they would assign their last year life benefits—they were open to a discussion of this—and allocate it to young people, if they thought that none of that money was going to be allocated elsewhere in ways that do not contribute to long-term economic growth. Politically, these discussions are going forward. They involve increasingly an insistence that all benefits provided

under law should be on the table and the long-term economic growth should be the objective against which these benefits are considered.

Ms. Swonk: Alan Taylor referred to the issue of taking very low-skilled workers and getting them a productivity boost when they go to the host country. For example, if you walk into McDonald's restaurant in much of the Chicago area, there are icons on the cash register so employees do not need to actually read English to take the customer's order. You can just push the icons that have pictures of hamburgers or whatever you are ordering. The machine also tells you what to give back in change.

The other issue is one that John Taylor and I brought up yesterday, which does not seem to be in the conversation. It deals with global capital flows and the remittance issue. There are two issues there. One of the benefits is—John cited a \$100 billion number bigger than foreign-direct investment in many of these countries—there is a benefit to the home country of the immigrants leaving. There is also a huge benefit, looking at it from a banking industry's perspective—Citigroup has started to move in this direction—if you can capture those remittances within the financial system, you can also bring people into the financial system more effectively and perhaps increase their returns to the society where they are living, an increase in liquidity. That is another issue I wanted to get John Helliwell and Alan Taylor's opinion on.

Mr. Turner: I wanted to also pick up John Helliwell's challenge to think about this in welfare terms and to point out, as Andrew Crockett has already said, that actually we are talking about things as a problem, which in many ways are very good things. It is not just aging, which is a very good thing. World population stabilization is a very good thing for all sorts of reasons to do with the environment, the preservation of wild spaces, etc. And world population stabilization is also the inevitable consequence of other good things because, as I said yesterday, if we achieve reasonable economic growth

throughout the world, it is highly likely that we will have world population stabilization.

If eventually the whole world achieves world population stabilization, then immigration cannot be a solution for the whole world's pensions system challenge. But it is a potential transitional solution for some countries. But it is an intermediate solution with a consequence, which is that you will eventually have to deal with the problems of population stability but at a higher population level and higher population density.

And population density in itself has certain congestion externality costs.

It is an observable fact that the acceptance of immigration as a solution is much greater in America than it is in Europe. What I would like to suggest is that this is not simply an arbitrary conservatism on the part of Europe, but it is the rational response of Europe to a higher level of population density. If you fly over Denver and look down on Denver, you have a completely different attitude about the idea of population expansion, new housing development, and the benefits that will give of a larger tax base to support your pay-as-you-go system than if you fly over London, where you believe that further housing development around London is going to destroy valued countryside. Or that, if housing development does not occur, it is going to make housing increasingly a positional good, so that the benefits of those extra workers to support your pay-as-you-go system are offset by the fact that we are all frantically competing for a small supply of nice houses in pleasant locations. Europe has a population density, if you take the whole of Europe including Scandinavia, about three or four times that of the United States' lower 48 states. So Europe's doubt on immigration may be rational welfare maximization when we take a wider perspective than simply thinking about the benefits to dependency ratios that come from immigration. That is not to say that Europe should exclude immigration—it should have some. But simply that if people are rational welfare maximizers,

Europe will have less immigration than the United States has and that is not simply arbitrary conservatism.

Mr. Feldstein: Regarding the point about whether more immigrants would help our pay-as-you-go system, there are two aspects that are not helpful.

First, the immigrant who comes at age 40 and works until age 65 and then retires, even if he or she earns the average earnings in the U.S. population, which typically they do not, for Social Security purposes they would be classified as a low-wage worker. Why? Because the way we calculate the formula, we would add in all the zeros for the years they did not contribute and average them in. Then we would provide a replacement rate based on that average, which would give them, given the structure of our benefits, a substantially higher replacement rate than a middle-income worker in the United States who had worked a full lifetime.

The other thing is, of course, we have a system that is not structurally sound and is losing money. If we add more people, we will lose money on more people. So, unless we are prepared to reform the system, that is not going to be a solution at all.

Mr. Sinai: This question is for John Helliwell. Regarding outsourcing, there are a couple of pages in the paper about offshore outsourcing. Do you have any idea of the magnitudes involved and do you have an opinion on how big a phenomenon that might be? And second, I see why anecdotally I am observing so many foreign-born workers in the United States from your point number 6, which talks about a foreign-born percentage of the entire U.S. population rising from about 8 percent to 11 percent over the decade of the 1990s. That is really quite a big increase. What is the latest percentage for 2004 on foreign-born workers in the United States? Are there other cities than the ones you mentioned where there are such a large percentage of foreign-born workers relative to the national average?

Mr. Fischer: Regarding the capital controls, Alan Taylor's chart shows the developing countries are now at the point where the industrialized countries were at in 1994 in terms of the amount of capital controls they have. This seems quite astounding. Do you believe that?

Ms. Woodall: John Helliwell and others have mentioned that China is aging as rapidly as OECD countries and is not that far behind. Therefore, it cannot be seen as part of the solution to OECD countries and indeed has problems of its own. I wonder if looking at the crude dependency ratio in China is slightly misleading. In China, you have a very high proportion of underemployed workers. About 60 percent of the population is still in rural areas. Many of those in effect have a marginal product close to zero. Over the coming decades as they join the more formal workforce, will that offset part of the aging process, so in fact if you look at the effective population of working age or the effective labor force that will not fall as a proportion of the population by as much?

Mr. Taylor: In response to Stan Fischer's question, I did not discuss that figure. But if I had, I would have emphasized that it is more useful for showing the differences between the 1970s and today, rather than for making comparison across countries within periods; rather than the commonalities in the trends, I would emphasize the slower reduction in barriers in developing countries and I agree they probably have a way to go. It is a very crude index that goes from one to three and it has been averaged, it is derived from the work of Kaminsky and Schmukler. One can get more detailed data from Dennis Quinn. It is a very narrow set of criteria, so I do not think it applies to everything on both the current and capital account. Even if developing countries have lowered their controls on average, part of the risk premium and the obstacles or the barriers to capital movement is the probabilistic nature of capital controls. Are they going to be imposed in a crisis? Are they going to go on and off is still an issue, and this is not captured by the crude index. So, yes, I think substantial policy barriers remain.

Regarding Diane Swonk's point: Yes, there are multiple dimensions to the benefits of migration. She spoke about remittances back home. Also it creates labor scarcity in the sending country. One of my friends and colleagues, Kevin O'Rourke, has written on that for Ireland in the 19th century—immigration as a form of famine relief. In that sense, the neoclassical model is predicting some kind of equitable effects there. It should be bringing up the wage in the sending country, perhaps lowering the return on capital. This ties into some of John's Helliwell's discussion because there are some potential links here between the neoclassical and Heckscher-Ohlin models' predictions. The latter model suggests that trade and integration are going to have an impact distributionally, one which is likely more equitable in the developing countries, tending to raise wages and lower the return on capital (or raise unskilled wages and lower skilled wages).

Contrast that with the outsourcing-and-happiness story that John Helliwell told, which in some ways is a little bit like a cherry-picking story ironically, given what he had said. So, if you take a social capital or status gradient approach what is going on, then if the IT guy in Silicon Valley is suddenly paid less because his job has been moved to Bangalore, in California, that is happy news for the lower-paid Californians. We obtain a more even gradient in our society. But what has happened in India? We expect to see a rise in the wage of the skilled worker there, not an unskilled worker. That kind of outsourcing is rather like selective migration if it is only happening at the high-skill level. I am a little bit concerned about whether that example will exacerbate the kind of social capital or status gradient problems that have been discussed by Michael Marmot, Robert Putnam, and others. I am not completely sure which way that kind of outsourcing will go, but it could conceivably worsen rather than improve social capital in the poorer countries.

Mr. Helliwell: Picking up Alan Taylor's last point, I would agree that outsourcing has some features in common with migration. What I was suggesting was that some of these trade possibilities may have lower economic and social cost than the migration alternatives. It

seems plausible that the cherry-picking effects will be less in the outsourcing case, since the export-oriented Indian IT workers remain embedded in their local communities. That remains to be studied. Regarding Allen Sinai's point, how big is this outsourcing now? Not very big, in part because if it is going to be successful it has to rely on the sorts of slowly built reputational intermediation that I described in my paper. I attended a recent IT outsourcing of people in the industry, and discovered that they see themselves now, in the Indian conglomerate Tata and other firms, as corporate-level reputational intermediators. They also think they may be ready to move to a larger scale, building bridges in a bigger way. For the reasons Alan Taylor notes, governments in India will want to ensure that these activities are facilitated in ways that allow communities to be strengthened rather than fractured. Just as the payments back to the home countries of foreign workers can help the community from which they came, so the high pay of the people who are working on these outsourcing jobs in India can be put to the benefit of those communities. The more cohesive those communities are, the more likely it is that redistribution takes place naturally rather than coercively. Alan Sinai also asked for the latest numbers on the foreign-born population. The data from the 2003 Current Population Survey (published in August 2004) place the foreign-born share of the U.S. population at 11.7 percent. The more detailed 2000 census shows that the foreign-born share is much higher in urban areas, and especially in the gateway cities for Hispanic immigration. There were six cities (with populations exceeding 100,000) in 2000 with foreign-born shares exceeding 50 percent. Of these four were in California and two in Florida. The fact that immigration—and this returns to Adair Turner's point—is predominantly, almost overwhelmingly, urban now means that the size of your Outback is irrelevant compared with how life is being lived in the cities and countries where immigrants are going. The real question is: What is happening to city life and city densities? You have to get back to the quality and nature of life in those places.

If I am to leave you on a high note, I have to answer Andrew Crockett's query about possible ways of getting a positive spin on later-life engagement. I say, let us start broadening the way we think of this engagement. The well-being results show us that it is the engagement and a sense of efficacy that make people want to contribute and help others. It is not the salary. Regular commercial-type employment becomes a smaller and smaller share of what people want. It is the flexibility and to deal with people they trust. Doing something valuable to help others is increasingly the kind of thing people are going to want to do. Whether done through community organizations, sports organizations, families, or more formal groups, such activities help fill the gaps in the welfare system as well as the gaps in people's lives. If that kind of activity can be facilitated, it not only lowers the cost of official dependency-supporting programs, but also strongly increases the life satisfaction of the contributors. That will run hand in hand, I forecast, with more extended and more flexible involvement in the paid workforce, but the paid involvement will be the lesser part of the total if the total is well-designed.