

**Europe's Population Pauperism:  
Long-Term Economic Consequences**

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# Europe's Population Pauperism: Long-Term Economic Consequences

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## Overview

In late August 2008, readers of the International Herald Tribune woke up to the startling headline: “Europe sets date when deaths overtake births: 7 years.” The stark wording brought home the harsh reality that the European population is about to contract. The source of this disquieting news item was Eurostat, the official statistical agency of the European Union, which had just released its latest long-term population projections. My research is based to a large extent on data compiled by Eurostat as well as by the Population Division of the United Nations for purposes of global comparison.

The goal of my study was to examine primarily the economic aspects of the EU’s demographic dilemma while also touching upon the social aspects with which they are intertwined. The below replacement fertility rates of the past four decades and the rapidly aging population have already set in motion trends that eventually will result in a setback to economic growth prospects extending through the middle of the century and the European Commission has confirmed this in its forecasts. Not all countries will be affected equally as some are showing signs of population revival. But the EU is set to lose the challenge for global economic primacy. The United States population, whose fertility rate has been at or close to replacement since 1990, will continue to grow faster, positioning the US to enhance its economic well being, prosperity and power.

## Introduction

The 27 member countries of today’s EU currently have a population of just under 500 million compared with somewhat more than 300 million for the United States. The older members (the EU15) number about 390 million. The average EU27 fertility rate of 1.51 in 2005 contrasted with the 2.1 replacement level of the United States. If current baseline United Nations demographic projections stay on track, the US population will have surpassed the more prosperous EU15 countries by 2050, a development that carries with it implications for global economic standing. Moreover, Germany, the largest and most prosperous EU member today, may witness a 10% population decline by mid-century.

Demographically, the EU appears to be “burning the candle at both ends” – both the decline in fertility and the increase in longevity are unprecedented in European history! Fewer children being born and a growing group of older citizens will have significant macroeconomic consequences which now are beginning to unfold. Fertility rates fell below replacement in the mid 1970s. Data for 2007 show that deaths exceeded live births in nine EU countries and eight countries experienced a decline in population. Net inward migration was nearly four times the natural population change and therefore accounted for most of the overall population increase. This has been the case since 1992.<sup>1</sup>

According to the latest biennial UN population compilations, in 2005, the top 10 countries in the world with the *oldest population* were all European nations, with the sole exception of Japan, which headed the list. Italy and Germany were next in rank, followed

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<sup>1</sup> Eurostat, *Population in Europe 2007: first results*, Statistics in Focus #81/2008.

by Finland, Bulgaria, Croatia, Belgium, Sweden, Slovenia, and Switzerland.<sup>2</sup> At the other end of the population spectrum, the countries with the *lowest birth rates* were nearly all European, according to the Central Intelligence Agency: The EU as a whole ranked 194 out of 224 countries/areas covered.<sup>3</sup> Japan, Germany and Italy preceded Hong Kong which was dead last!

### **The factors of production**

To place the EU population problem in perspective, basic economics comes into play. Economists speak of “the factors of production” which are simply land, labor and capital. Countries need all three in order to have economic growth – just as a stool needs three legs to stand.

There is a need for **land** in order to farm, set up a factory, build an office, and provide housing. People work to produce food, goods and services.

**Labor** or the labor force constitutes “the working age population” which is generally defined as that segment of the population, between the ages of 16 and 64, that supports others who are not normally employed: children, the elderly and the infirm. Workers are the net producers and savers, young people are net consumers and the elderly are somewhere in between.<sup>4</sup>

Finally there is the third leg of the stool, **capital**. While generally referring to money – earned or borrowed – capital is needed for investment to start or expand a business. Capital is also required to finance operations and pay workers.

But there is also “**human capital**,” including intellectual capital – the hands and brains of the labor force needed to make products or provide services that will be sold in the marketplace. The more educated and skilled is the labor force, the better the standard of living, the quality of life and the ability of a country to stay competitive.

A country’s greatest resource is its population – to till the fields or toil in industry. Economic well-being and prosperity cannot exist without *enough* people who work. According to one report by the European Commission:

“Never before in history have birth rates fallen so far, so fast, so low and for so long.”<sup>5</sup>

This strong conclusion has raised the question: Will there be enough manpower to meet the needs of a growing economy and sustain an ever increasing number of older persons or will economic decline set in? As the European Commission acknowledged in a “Green Paper” in March 2006:

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<sup>2</sup> United Nations Population Division, *World Population Prospects: The 2006 Revision. Highlights*.

<sup>3</sup> Central Intelligence Agency, *The World Factbook*, 2007.

<sup>4</sup> Federal Reserve Bank of Kansas City, Symposium on *Global Demographic Change: Economic Impacts and Policy Changes*, August 26-28, 2004.

<sup>5</sup> European Commission, *Reproductive Health Indicators in the European Union: Health Monitoring Program*, August 2003, page 7.

“Never in history has there been economic growth without population growth.”<sup>6</sup>

### **The population components: youth, workers, retirees**

The population of any given country can be divided into three segments: youth, workers and retired persons. **Youth** covers individuals under the age of 16, essentially infants and adolescents growing up and going through the basic schooling years. Indeed, many young persons do not enter the labor force until they are much older, having opted for additional education and better preparation.

As young people become adults, the vast majority enters the labor force to become **workers** or productive members of society. The labor force is defined as the portion of the population aged between 16 and 64, both employed and unemployed. The employment rate of this segment of the population in the EU27 in 2007 stood at 65.4%, below that of the United States. Actual employment totaled 218 million persons.<sup>7</sup>

The normal population distribution in any economy has a majority of people in the working age group and in employment, a large segment of the population in the youth category up to age 15, and the smallest portion in the age 65 and over group. When expressed as a diagram, the picture portrayed is that of a “population pyramid.” However, current trends in Europe, after approximately four decades of declining fertility rates, have distorted this image considerably.

When there is a low fertility rate the percentage share of youth to total population shrinks over time implying fewer new entrants into the labor force in the near future.

At some stage, most workers opt out of the labor force and become **retirees** with age 65 generally considered the norm. The ratio of persons aged 65 or over as a percent of those of working age constitutes the old-age dependency ratio. In the EU, the ratio is expected to drop from 4-to-1 currently to 2-to-1 by 2050. A situation where two persons are working and paying taxes for every one retiree is considered unsustainable.

### **The vanishing Europeans: declining fertility rates**

The EU cannot escape the fact that its fertility rate, the average number of children per woman, has been below the 2.1 replacement level for about four decades, perhaps a legacy of the population control movement. In 2005, the EU27 had a fertility rate of 1.51.

Rates ranged from a high of 1.92 for France to a low of only 1.24 for Poland. The Scandinavian countries showed fertility rates well above the EU average as did Ireland. Among the larger countries, the United Kingdom was above the average while Germany,

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<sup>6</sup> European Commission, *Green Paper - Confronting demographic changes: a new solidarity between the generations*, Brussels, 16 March 2005, page 5.

<sup>7</sup> Eurostat, *European Union Labor Force Survey – Annual results 2007*, Data in Focus, Population and Social Conditions, #27/2008.

Italy and Spain were all below average. The lowest rates were recorded in the eastern European member states, perhaps reflecting their harsh communist past and their high rates of emigration.<sup>8</sup>

The European Commission, the Organization for Economic Cooperation and Development (OECD) and individual countries have examined the declining birth and fertility rates in the major countries and are now searching for family friendly policies and policies to deal with a large aging population.

The EU basic blueprint for dealing with aging and natality are found in the European Commission's communication: "**The demographic future of Europe – from challenge to opportunity**" which has given rise to much discussion, including the first of what is to become a biennial "European Demographic Forum" to compare policies and determine best practices among the member states.

At the first of these fora, in October 2006, the challenges were laid out:

1. The number of older workers (aged 55 to 64) will increase by 14 million between 2005 and 2030.
2. The number of people aged over 80 will rise from 19 million today to 34 million in 2030.
3. The EU's total working age population (15-64 years) will fall by 20 million between 2005 and 2030.
4. The populations of Hungary, Latvia, Lithuania, Estonia, Slovakia, and the Czech Republic have already started to decline.
5. Of the six most populous states, only the United Kingdom and France will witness a rise in population between 2005 and 2050, by 8% and 9.6%, respectively.<sup>9</sup>

A number of factors influence the decision to have children. Other than strictly personal considerations, what comes into play can include any of the following: tax incentives, availability and length of parental leave, flexible work hours for mothers returning from maternity leave, paternal leave for new fathers, adequate and affordable child care facilities, extended families to provide support, and more.

In examining the factors behind the fertility rates of a selection of European countries a variety of incentives, practices and even historical considerations are germane.

**France** has the highest fertility rate in the EU. According to data compiled by the French official statistics institute INSEE, the rate was 2.0 in 2006. This was the highest level in

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<sup>8</sup> Eurostat, *A statistical illustration of the situation of women and men in the EU27*, News release #32/2007, 5 March 2007.

<sup>9</sup> European Commission, *The demographic future of Europe – from challenge to opportunity*, Brussels, October 12, 2006

thirty years.<sup>10</sup> The rate rose from the 1.92 rate reached the year before, although 2007 preliminary results indicate a small setback to 1.98.

The actual number of births in France – 783,500, was one of the EU's largest last year. Foreigners or immigrants contributed to this outcome too. The proportion of births to women with a foreign nationality increased from 9.6% in 1997 to 12.4% last year according to INSEE.<sup>11</sup>

French services, benefits and other support for families are among the most extensive of any country. According to an OECD compilation, the government spends nearly 4% of GDP on families including cash, services and tax breaks. France has a vast state sponsored child care program that not only encourages having children but stresses having a *third* child. Evidence indicates that highly educated, professional women are taking advantage of the system. French experience shows that very rich families tend to have many children, as do the poor and immigrant families. The baby dearth is mostly in the middle class.

There is a parental leave of up to 26 weeks and special subsidies for families of at least three children. Income taxes are framed in a way that more numerous families are taxed less. There is a monthly allowance for families with at least three children, which rises when they reach 11 years of age. There are incentives for women to remain at home to take care of newborns for up to three years. A cash payment is available for up to three years, the amount depending on family income. In 2006, the plan was modified so that higher monthly payments became available for women who want to take this allowance in one year in order to return to work sooner.

For women who return to work, child care facilities are available on a full-day basis and low cost preschool is based on ability to pay. There are subsidized summer camps too. There is also a special tax deduction for families that hire help to do household chores.

France provides numerous family friendly benefits such as the *carte famille nombreuse*, or large family card, which gives discounts of as much as 30% on train travel and half off on metro transportation.

Accommodating French family policies have to be seen in a historical perspective. The French are aware of several periods in their history when there were serious setbacks to their population. At the time of the French Revolution, for reasons historians cannot quite explain, the birth rate fell precipitously and the population, which had been the largest in Europe, fell below that of Britain and Germany in the 19<sup>th</sup> century. Then there was a massive loss of life during the Spanish influenza epidemic and the World War I years in the early part of the 20<sup>th</sup> century, followed by additional losses during World War II. It was clear to the French that to survive as a nation they needed to have the numbers!

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<sup>10</sup> Institut National de Statistique (INSEE), *Bilan démographique 2006: un excédent naturel record*

<sup>11</sup> Institut National de Statistique (INSEE), *Bilan démographique 2007: Des naissances toujours très nombreuses.*

Every year the French government, regardless of party in power, has a “family conference” to review family policies.

According to UN estimates, the French population could rise from 62 million in 2006 to over 68 million by 2050, greatly narrowing the gap with Germany, whose present 82 million is projected to fall to 74 million by mid-century.

**Germany** has one of the lowest fertility rates in the EU. According to EU data for 2005, it is tied with Italy and Spain at 1.34. Germany’s rate has been falling longer than in other countries. Indeed, in 2005 some 30% of German women had never had children. Unlike the French, the Germans do not have much in the way of family friendly policies, although that is changing somewhat.

With a change in government in late 2005, the coalition government headed by Christian Democrat Angela Merkel, the first woman Chancellor, shifted focus. Although married and childless herself, she appointed a pro-family Minister for Family, Ursula von der Leyen,<sup>12</sup> a medical doctor and mother of seven children. For the first time in the post World War II period, the natality issue was moved to the front burner.

Certain measures were adopted in 2006 which focused on financial considerations. The so-called *Elterngeld* or parental allowance was amplified to pay two-thirds of income to a working mother who has a child – up to 1,800 euros net per month for 12 months. The leave can be extended for an additional two months and applied to the father – assuming he has been at work while the mother cared for the newborn at home – if he at that point decides to stay home to take care of the child. In addition, the federal government is allocating funds to the Länder (states) and municipalities to expand child care benefits at the local level.

For reasons that are not fully clear, in the first part of 2007 doctors and hospitals throughout Germany noted a sharp increase in births. To explain this, some observers pointed to the previous summer, when Germany hosted the World Soccer Championship Games, an event that created a great deal of euphoria and well being among the locals. Did such good feelings influence last year’s fertility rate? The evidence is in and the German Federal Statistical Office reported that the rate rose to 1.37 in 2007 – the highest rate in 17 years – from 1.33 the year before. In addition, for the first time since unification, both East and West Germany had the same fertility rate. Whether last year’s outcome signaled a turning point remains to be seen!

While the latest news may be encouraging, the effects from the fertility rate that had been falling since 1965 already has led to an actual population decline, notwithstanding migratory movements. According to official data, Germany’s population fell last year to 82.22 million from 82.32 million in 2006 due to an excess of deaths over births and a

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<sup>12</sup> Her full title is Minister for Family Affairs, Senior Citizens, Women and Youth.

decline in immigration.<sup>13</sup> UN projections show that Germany's population is expected to decline to 74 million by mid-century.

**The United Kingdom** had a fertility rate of 1.8 in 2005, tied with Finland and Sweden for third highest in the EU. Like Sweden, the United Kingdom has a high percentage of resident foreigners. Family policies are not as extensive as in some other countries but incentives include child tax credits, paid maternity and paternity leave, and the right of working mothers with small children to ask for work flexibility.

The United Kingdom's population is now the third largest in the EU, after Germany and France, at close to 61 million according to UN estimates. In the United Kingdom there has been a natural increase in the population every year since 1901, with the sole exception of 1976. More recently, since the late 1990s, net migration from abroad has added more people than the natural increase to the national population.<sup>14</sup>

In **Italy**, according to the National Statistics Institute, ISTAT, the population exceeded 59 million the end of 2007 due mostly from the net inflow of immigrants but also from the excess of births over deaths. On January 1, 2008, foreigners residing legally in Italy numbered over 3.4 million, up nearly a half million in a year, and comprised 5.8% of the population.<sup>15</sup> There was an increase in the fertility rate as well, from 1.35 in 2006 to 1.37 last year, thus confirming the trend of a gradual rise after a record low of 1.19 in 1995. While this is a positive trend, ISTAT pointed out that foreigners residing in Italy accounted for 10.3% of live births in 2006, up from 1.7% in 1995.

From more extensive definitive data for 2005, ISTAT determined fertility rates of Italian versus foreign women. The results showed that Italian women had 1.24 children while foreign women had nearly double or 2.41. Between 1995 and 2005, the birth rate rose 13.3% overall, but for Italian women only 4.2%.

Not all countries disaggregate births as to mothers who are nationals from births of foreigners/immigrants, but Italy does as does France. The concept of dealing with foreigners who reside in Italy is rather unique: Children born of foreigners resident in Italy are designated "foreigners born in Italy – second generation."

Returning to explanations why Italians have a low birth rate, people cite a long list of complaints. Raising a child properly is considered costly. Child care facilities are virtually nonexistent in Italy. Family members traditionally take care of each other: In that vein, some working women delay having children until their mothers have stopped working (usually in their late fifties) and can take care of grandchildren. In addition,

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<sup>13</sup> Federal Statistical Office of Germany, *Smaller population despite more births*, Press release #229, June 26, 2008.

<sup>14</sup> Office for National Statistics, *Population Estimates: UK population grows to more than 60 million*, statistics.gov.uk, 24 August 2006.

<sup>15</sup> ISTAT (Istituto nazionale di statistica), *Bilancio demografico nazionale: Anno 2006*, Comunicato stampa, 5 luglio 2007; and *La popolazione straniera residente in Italia all'1° gennaio 2008*.

Italians complain that proper housing is expensive and in short supply. Mortgages are not as common as in other developed countries.

**Spain** in 2005 had the same low fertility rate of 1.34 as Italy and Germany, but the demographic scenario evolved in a very different manner. Spain experienced a later and longer baby boom period, due to the heavy population loss (about three million victims, or over 10% of the population) during the years of the Spanish Civil War (1936-39).

While the boomer generation usually includes those born between 1946 and 1964, in Spain the baby boom extended into the early 1970s. The longer-than-average baby boom period contributed to Spain's strong economic growth over the past decade. As the late boomers married and started families, they created a strong demand for housing, contributing to a construction boom to such an extent that construction spending as a percentage of GDP became one of the highest of any major country.

Women's greater participation in the world of work from very low levels initially contributed to the decline in fertility but this did not affect overall population growth since Spain became a magnet for immigrants.

Spain has received a large number of immigrants, many from South American countries. As Spanish speakers, the latter have no linguistic problem and that enhances their employability and productivity. Similarity in language, culture and religion has made for easier assimilation too. Spain's population increased from 40.5 million to 44.7 million between 2000 and 2006. The estimated foreign share of the population rose from 2.3% to 9.3% over the same period. To gauge the magnitude of migrant flows, in 2005 alone, Spain was second after the United States in receiving permanent new immigrants, according to OECD statistics on international migration.

The International Monetary Fund, in its annual economic assessment of the country stated the following:

"... strong employment growth allowed the absorption of exceptionally large immigration flows: the Spanish economy generated more than 60 percent of all new jobs in the euro area in 2005 and unemployment declined to historic lows."<sup>16</sup>

Spain became an economic success story. The Spanish economy expanded at an average annual rate of 3.4% since 1995, one of the highest growth rates in the EU and one of the longest expansionary growth periods. However, with the incipient recession job losses picked up in 2008 and the government began offering bonuses to immigrants to return to their country of origin.

**The Scandinavian** countries have fertility rates that are higher than the EU average but government spending on families also is high. Denmark and Finland were at 1.80 in 2005 while Sweden stood at 1.77 – above average but still below replacement levels. In these

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<sup>16</sup> International Monetary Fund, "*Spain – 2006 Article IV Consultation. Preliminary Conclusions of the IMF Mission*," March 21, 2006.

countries, noted for their extensive social benefit policies, there seem to be many family incentives, especially concerning parental leave, which can be shared by mothers and fathers. Also, child care facilities are well established.

In **Sweden** parents are allowed 18 months leave each for a new child. The leave is paid for by the government. Child care centers abound and are also government subsidized. Part time work and flexible hours for mothers make it possible to find a balance between family and work responsibilities.

In looking at **Norway**, which is not a member of the EU, new mothers are covered under the National Insurance Act adopted in 1956 and their maternity leave is financed through taxes so employers do not foot the bill. The system allows for 10 or 12 months leave with 100% or 80% of pay. There is also paternity leave; fathers must take at least four weeks off. Mothers must take the first six weeks as maternity leave, but the parents can share the rest of the time among themselves if they so desire.

Finally, the mother is protected by law regarding job retention and status so that there is no employment discrimination on account of pregnancy and childbirth, while the father cannot be penalized for taking his share of paternity leave. The incentives for childbearing, in covering both parents, stem from government policies to assure joint parental responsibility as well as gender equality.

The gender equality aspect of some European policies may be one way of reconciling work and family life as women try to balance their combined roles of family caretaker and career person. With more women who become mothers but who are well educated, working at various professions, earning decent salaries, and making a contribution to economic advancement, perhaps fathers, through paternity leave, are given the opportunity to understand better what mothers of small children face when they are at home. This better integrates the roles of fatherhood and motherhood into parenthood.

### **Women's education levels and the impact on fertility: Scandinavian records**

According to data published by Eurostat, Scandinavian women are the most educated in Europe, a larger proportion of them work outside the home and they have above EU average fertility rates. Data for 2006 for the EU27 indicate that almost 24% of women had degrees (slightly higher than the 23% share for men), but the EU's highest rates were achieved by women in Finland at 42%, followed by Denmark at 39% then Sweden with 37%.<sup>17</sup>

Women in the same three countries also had above-average employment rates: The EU27 employment rate for women was 57% of the female labor force in mid-2006. Denmark had the highest women's employment rate in the entire EU at 73%, followed by Sweden at 71% and Finland 68%.<sup>18</sup>

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<sup>17</sup> Eurostat, *A statistical illustration of the situation of women and men in the EU27*, News release #32/2007, 5 March 2007.

<sup>18</sup> Idem.

The combination of well educated women working and having children contributes to national economic well being in many ways: There are more workers producing goods and services of higher value added and, the more children these women have, the better educated they are likely to be, thus assuring a highly qualified labor force for the future.

The Scandinavian experience contrasts significantly with low fertility countries such as Italy and Spain where the female labor participation rate is among the lowest in the EU at 47% and 53%, respectively. Many women in these two countries neither work nor have children even though they stay at home.

It does seem to make a difference if governments play a role in family support. Government spending on family-related matters, according to an OECD study shows a low of 1.1% and 1.2% of GDP in Spain and Italy compared with more than 3.5% in Luxembourg, Denmark, France, Norway, and Sweden.

### **The preferred number of children**

A survey taken in 2006 by the EU's official opinion gatherer, Eurobarometer, entitled: "Childbearing Preferences and Family Issues in Europe" posed a series of questions relating to family formation and turned up a startling revelation. One question asked about the "personal ideal number of children." The results were surprising: 50% answered "two" and 21% answered "three." Only 8% considered "one" as a preference. The responses averaged 2.36 for women and 2.21 for men. Since almost three-fourths answered 2 or 3, it would appear that the population replacement rate would be within reach. The results beg the question: "Why are actual fertility rates as low as they are?"

Mindful of the above results, when Germany held the rotating presidency of the EU in the first half of 2007, the German Family Minister, Ursula von der Leyen urged the European Economic and Social Committee (EESC) to draw up an opinion on family issues. The result was the call for a "European Pact for the Family" announced on March 15, 2007.

"The European Council, the European Parliament and the European Commission are urged to adopt strong measures to encourage the Member States to sign a **European Pact for the Family**. This pact should include an affirmation of Member States' desire to pursue policies that meet people's expectations regarding the number of children they would like to have as well as a plan to establish a **fixed threshold for public funding for family**. Furthermore, the Committee calls for Member States to commit themselves to ongoing and sustainable measures to support children and families – because the long-term stability of these policies is the key to their success."<sup>19</sup>

After so many studies, finally the European Commission in October 2008 offered a proposal to increase the minimum maternity leave from 14 to 18 weeks as part of a general package to promote work-life balance.

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<sup>19</sup> European Economic and Social Committee, *EESC calls for European Pact for the Family*, Press release N° 21/2007, 15 March 2007.

## The parlous employment situation in the EU

Recent employment trends have shown that the EU has experienced generally higher jobless rates than the United States, a less than optimum use of the existing work force and the appearance of skilled personnel shortages.

“GDP per head in Europe is around 65% that of the United States and the main reason for this gap is the relatively low labour utilisation in European countries. In particular, Europeans work 13% less hours on average than Americans do.”<sup>20</sup>

Employers are burdened by costly benefits which in some countries are nearly double the wage rate. There is limited flexibility in hiring and firing, and unions in some countries are very powerful and place undue pressure on the private sector and on political leaders

The EU is proud of its social protection system and often criticizes the American free market model. Yet, some labor market strategies are yielding some hybrid solutions, including one called “flexicurity.” The idea, generated in Denmark, attempts to combine a more flexible labor market with incentives to secure a smooth worker transition to new job opportunities while discouraging long term joblessness.

The EU27 annual average jobless rate ranged between 7% and 9% from 2000 through mid 2008, but with an economic downturn now gathering momentum, the rate was 7.5% at the latest reading. Over the same time span, the US unemployment rate fluctuated between 4% and 6.5% in October 2008.<sup>21</sup> The numbers suggest that Europe currently has enough slack before “full employment” is reached. But here and there labor shortages have appeared as, for example, engineers and skilled technicians in Germany.

Despite longer life spans, in Europe there is a tendency to retire early. For many years, women have been allowed to retire earlier than men – even though women live longer than men. Clearly if people live longer and enjoy good health, they should be given the option to work longer years, either full time or on a part-time basis, in their current employment or in less demanding positions.

According to Eurostat, persons aged 65 or over numbered nearly 85 million in 2008 equal to 17% of the EU population, up from 15% ten years earlier. The highest share was accounted for by Germany and Italy, both with nearly 20%. Taking into account current trends, EU projections indicate that the overall number of the over 65 population could rise to 148 million by 2050, or 29% of the population.<sup>22</sup>

Employment of older persons in 2005 was very low across the board. Eurostat estimated that the employment rate of persons aged 60-64 was 27% of that age bracket while that of 65-69 year olds was only 8%. The preference for retirement is strong given that benefits

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<sup>20</sup> European Central Bank, *European Women: Why Do(n't) They Work?*, Working Paper Series, N°454/March 2005, page 5.

<sup>21</sup> European Commission, *Statistical Annex of European Economy*, Spring 2007.

<sup>22</sup> Eurostat, *From 2015 deaths projected to outnumber births in the EU2*, News release #119/2008, 26 August 2008.

are generous and the tax burden is much higher (than in the United States) so many Europeans question why they should go on working and continue to pay a large share of earnings as taxes.

### **The productivity dilemma**

With a looming labor shortage, EU workers will have to be more productive and work longer years to maintain their standard of living. In an aging society, the labor force becomes older too and this can be a drawback to the discovery of new processes, products and disciplines that can contribute to productivity gains. Anecdotal evidence would suggest that people past their prime are not as innovative as younger workers. However, the wisdom accumulated from having been in the work force a long time does contribute to productivity through discipline, experience, efficiency, dedication – in short: a good work ethic!

Also, physical and mental capabilities vary by individual, and dementia is not in prospect for all who make it to the “*quatrième age*,” as the French call the very old (80+). An excellent example is the Italian Nobel Prize winner Dr. Rita Levi-Montalcini, a neurobiologist, who commemorated her 99<sup>th</sup> birthday in April 2008! A prolific scientific writer, she had just published another book. Notwithstanding her age, she remains active in a number of prestigious scientific associations including the Pontifical Academy, the US National Academy of Science and the Royal Society, and is president of a foundation she established in 1992 to promote education for women in Africa. Truly she is an inspiration to those who know about her, and a shining example of how to remain engaged for a lifetime.

### **Europe’s experience with immigration**

In addition to possible productivity gains, the working age segment of the population could benefit from increased immigration. There were approximately 25 million non-nationals living in the EU25 member states in 2004. Their numbers increase by close to 1.5 million per year.

Population shifts have occurred throughout European history and today is no different. Acceptance, acculturation and adaptation are key ingredients to successful immigration. Intra-European migration has been facilitated by the Schengen Agreement. It allows for the free movement of persons across borders. But intra EU migration only subtracts population from one member country to add it to another. Indeed, large numbers of eastern Europeans, particularly from Poland, moved to more prosperous EU countries after May 2004.

It is worth noting that, while the majority of non-nationals are from non-EU countries, often the largest single group is that of another EU member state as a result of cross-border migration that took place within Europe in the post World War II period, from the poorer areas to the more prosperous and faster growing countries. For example, the largest non-national group in the United Kingdom is from Ireland – and vice versa, the

largest group in Belgium comes from Italy, in France the largest foreign presence is from Portugal, and the largest group in Sweden comes from Finland.<sup>23</sup> This was the case in 10 of the 25 EU members in 2004.

Ireland offers an example of how a combination of policies can lead to an economic success story. After having lowered corporate taxes, promoted foreign investment inflows and developed new industries that could take advantage of its well-educated labor force, Ireland's double-digit jobless rate rapidly dwindled in the 1990s.

As Ireland suddenly faced previously unheard of labor shortages, it looked overseas for workers. Its government investment promotion agency, the Ireland Development Authority (IDA) came up with the idea of recruiting in the United States, targeting first the Irish who had earlier emigrated, then the more educated generation of Irish Americans who could be tempted to return to the land of family roots under economically viable circumstances. Successful recruitment efforts abroad were one element contributing to Ireland's prosperity as its economic growth rate soared into double digits. Today, Ireland's per capita income is higher than that of the United Kingdom – and has been for a decade.

The example of Spain's large Latin American immigration mentioned previously may be an exceptional case in terms of assimilation. In the case of France, the large number of immigrants from North African countries may know enough French, but culturally they have proven hard to integrate as widespread civil unrest in November 2005 pointed out.

Although targeted recruitment from outside Europe could help fill the future worker gap, it is worth recalling that Europe has no tradition of a "melting pot" as does the United States. Even today with so much ado about immigration, few European countries exceed the influx noted in North America. Migrants as a percent of population were highest in Switzerland (23%), Ireland (14%), Sweden and Germany (12%), and Spain (11%). In contrast, the migrant share was 19% in Canada and 13% in the United States.

While net migration tends to be inward, given certain labor market rigidities, there is an growing outflow of skilled European professionals in search of more unfettered markets in which to work: They are emigrating from such countries as Germany and Sweden to the United States, Canada and Australia. This further aggravates EU labor prospects.

### **Population challenges to fiscal sustainability**

As pensioners, retirees and the entire elderly segment of the EU population becomes larger and comprises an expanding portion of the overall population, these older persons will place a growing burden on their countries' fiscal system. Official pension outlays already are high. Most EU governments have budget deficits and high tax rates. Tax revenues, including social contributions, were 45% of GDP in 2007 in the EU27. In the United States, the comparable ratio was 28%.

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<sup>23</sup> Eurostat, *Non-national populations in the EU Member States*, Statistics in Focus, Population and Social Conditions, 8/2006.

As workers retire, they begin to collect pensions from government social security systems, former employers or private pension schemes. Pension systems have not fully kept up with population dynamics. For example, in Sweden, when the official pension system was adopted in 1913, the pension age was set at 67 even though the average life expectancy was 55 years for men and 58 for women. Today they are 78 and 83, respectively.<sup>24</sup>

Germany enacted changes effective in 2007 that increase the full retirement age over time to 67. Other countries are considering both equalization (retirement for men and women at comparable ages) and delaying retirement with full benefits.

Today, life expectancy in the EU27 is approximately 82 years for women and 76 years for men.<sup>25</sup>

Given that there is a tendency to live longer and retire earlier, actuaries are devoting more time to analyzing a relatively new branch of insurance: longevity risk. If people live longer their pensions have to earn more. Higher returns usually are associated with higher risk and that risk has to be insured and minimized.

In many European countries (and Japan too) centenarians are the mostly rapidly increasing population segment. While, in general, Europeans save more than Americans, there is increasing concern that people may outlive their savings – and that pension systems will be overburdened with payments.

Some EU countries, like France introduced a 50-year government bond in 2005. These bonds are being used primarily to fund pension systems. In the United States, individuals were given tax incentives to open private savings schemes to save for their old age. In the EU, only the United Kingdom and the Netherlands have significant private pension arrangements.

Managing different types of retirement schemes, whether private or public, involves trillions of dollars. The OECD recently estimated that there are over one million occupational pension funds in its 30 member countries linked to private employment alone and they managed more than \$18 trillion in assets at the end of 2005.<sup>26</sup> Governmental social security systems undoubtedly handle considerably more.

Demographers estimate that life expectancy since the 1960s in Europe and the United States has risen by about one year per decade. Indeed, life expectancy has risen faster than forecast in the past century and could expand more quickly in the future if cures are

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<sup>24</sup> *Changing age structures of populations and their implications for development*, Statement by H.E. Ms. Ulla Ström, Ambassador and Deputy Permanent Representative of Sweden at the United Nations, to the Commission on Population and Development, Fortieth Session, 10 April 2007.

<sup>25</sup> Eurostat, *A Statistical illustration of the situation of women and men in the EU27*, News release #32/2007, 5 March 2007.

<sup>26</sup> OECD, *idem*.

found for cancer and other deadly diseases that would drive down mortality rates. According to one bank study:

“While an undeniable blessing to the world as a whole, increasing longevity has also had a more worrying impact on those whose business it is to provide for old-age income.”<sup>27</sup>

### **The impact on economic growth**

In early 2006, the European Commission issued a major report reviewing and analyzing the principal economic variables related to EU population pauperism. The report presented a bleak growth scenario for the long term.

“As a result of these employment trends and the agreed assumptions on productivity, potential GDP growth is projected to decline in the decades to come. For the EU15, the annual average potential GDP growth rate will fall from 2.2% in the period 2004-2010 to 1.8 % in the period 2011-2030 and to 1.3% between 2031 and 2050. An even steeper decline is foreseen in the EU10 [those joining the EU in 2004], from 4.3% in the period 2004-10 to 3% in the period 2011-30 and to 0.9% between 2031 and 2050. This is not only due to unfavourable demographic developments, but also to the underlying assumptions for these countries which assume productivity growth rates coming closer to those of EU15 countries as they complete the convergence process.

In addition, the sources of economic growth will alter dramatically. Employment will make a positive contribution to growth up to 2010, become neutral in the period 2011-2030, and turn significantly negative thereafter. Over time, labour productivity (due to the progress of technology) will become the dominant, and in some countries the only, source of growth. If the projected rise in productivity and in the employment rate will not materialise in the future, the potential growth may fall even more.”<sup>28</sup>

More recently, the demographic realities underlying EU-US comparisons were best synthesized by the President of the European Central Bank (ECB), Jean-Claude Trichet, who has been one of the few prominent Europeans to raise the population question – and contrast it with the United States.

“... let us not forget the demographic change occurring on both sides of the Atlantic. Indeed, Europe’s long term growth performance has also been constrained by the low rate of increase of its population and the ageing of its society. Since the mid 1990’s, population in the euro area has been growing at a rate of just 0.4% compared to 1.1% in the US. This aggregate result should however not cover the important role immigration has had in supporting economic growth in some euro area countries. However, what is worrisome is that at the same time, the gap in population growth has been even larger with regard to growth in the working age population [the working age population grew on average by 0.3% in the euro area over the period 1996-2006 compared to 1.4% in the US], which manifests that Europe has a more acute problem of population ageing.”<sup>29</sup>

<sup>27</sup> J.P.Morgan Securities Ltd., Global Market Strategy, *Longevity: a market in the making*, July 2,2007.

<sup>28</sup> European Commission, Directorate General for Economic and Financial Affairs, *The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050)*, European Economy, Special report n° 1/2006, p.9.

<sup>29</sup> “*The need for structural reform in Europe*”, Speech by Jean-Claude Trichet, President of the European Central Bank. The Jean Monnet Lecture to the Lisbon Council, Brussels, 4 June 2007.

The ECB President summarized as “disappointing” Europe’s performance over the past decade and proposed such structural reforms as getting more people to work, increasing competition, unlocking business potential, and supporting an innovative environment.<sup>30</sup>

### **Europe as an economic power...?**

The EU’s economic challenge for global dominance will not succeed in surpassing the economic might of the United States. Europe’s population pauperism over the past 40 years will compromise its future economic potential as the European Commission has stated unequivocally. The United States is poised to admit an adequate cohort of youth to its labor force while the Europeans will be trying to squeeze every ounce of production from a dwindling labor force that has to support a costly, rapidly aging population.

Whereas now the EU boasts a larger population than that of the United States, a feat accomplished by adding new members,<sup>31</sup> based on past trends the United States is on track to exceed the population of the more prosperous EU15 by the middle of this century. The UN projections to 2050 are 402 million for the United States, versus 398 million for the EU15.

One final set of data: According to a UN ranking of countries by population size over time, the United States ranked third in 1950 with 158 million people, stayed in third place in 2007 with 306 million and continues to remain number three in global population projections in 2050 with 402 million. Among the more populous European countries, there were six countries among the top 20 in 1950, only one (Germany) in 2007 and none in 2050. (India and China occupy the top two spots throughout.)<sup>32</sup>

While the negative consequences of past population pauperism will unfold through the middle of this century, the very latest data do seem to offer a ray of light and hope for Europe as fertility rates have started to move up in some EU countries. If the trend continues, then there is the possibility of a turning point in population growth and better economic performance for the second half of this millennium!

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<sup>30</sup> *Idem.*

<sup>31</sup> The 10 countries that joined the EU in May 2004 added 25% to the EU’s population but only 4% to GDP, thus impoverishing the per capita income of the bloc.

<sup>32</sup> United Nations, *World Population Prospects, The 2006 Revision. Highlights.*