Economy in 2046

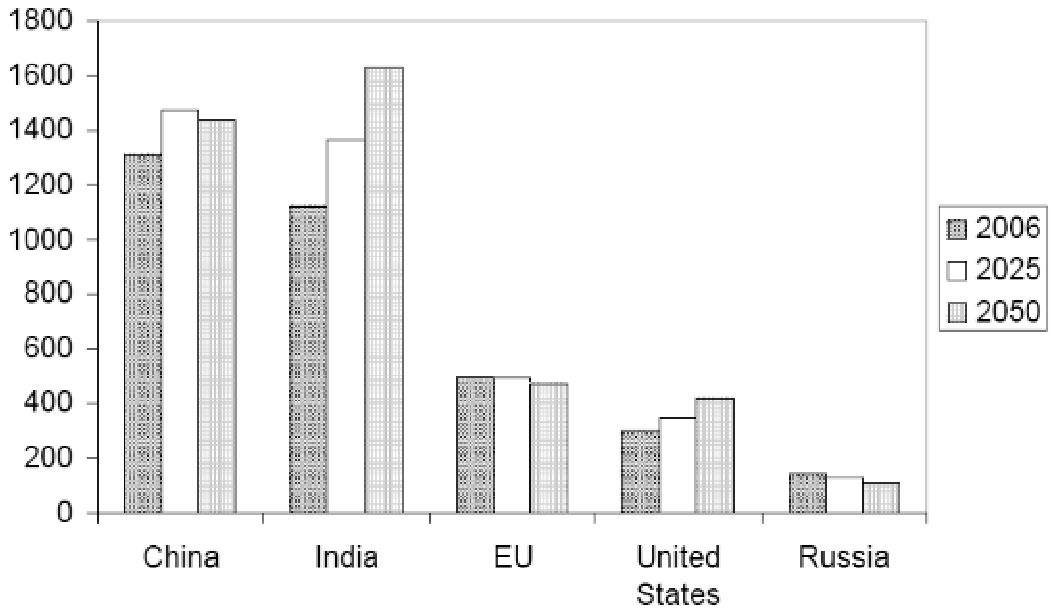
Based on a speech by Richard Laming, member of the UEF Executive Bureau and Director of Federal Union, at the Hertenstein seminar, 23 September 2006.

"Prediction is very difficult, especially about the future." Niels Bohr, the Danish physicist was not wrong when he said this, and in fact thinking about the future of the economy is doubly difficult. Not only is the economy uncertain, but how it unfolds depends on how different people interpret and react to that uncertainty. Success in the marketplace depends on guessing not the future, but on guessing what other people will guess about the future.

However, it has also been remarked that the future does not come from nowhere. It is derived from trends and facts that might well be apparent now, if only we knew where to look. This presentation will therefore outline some of those trends and facts, in the hope that they might form a basis for thinking ahead.

It is worth noting that, in the context of this discussion, there are changes ahead both for Europe and also for the Europeans who live in it. The extent and nature of these changes need to be considered carefully and separately – although they are of course in many ways connected – if a useful picture of life in Europe in 2046 is to be developed.

Population



The first and probably most important factor to consider is the size of the population. Figure 1 shows that China and India will remain the most populous countries in the world. China, with an autocratic system of government, is however likely to restrain the rate of growth of its population with rather more success than democratic India is expected to have (1,311 million in 2006 to 1,437 million in 2050 for China, 1,122 million to 1,628 million for India). The population of the EU27 will fall slightly (from 493 million to 475 million) as the population ages and the birthrate falls (of which more later), while the population of the

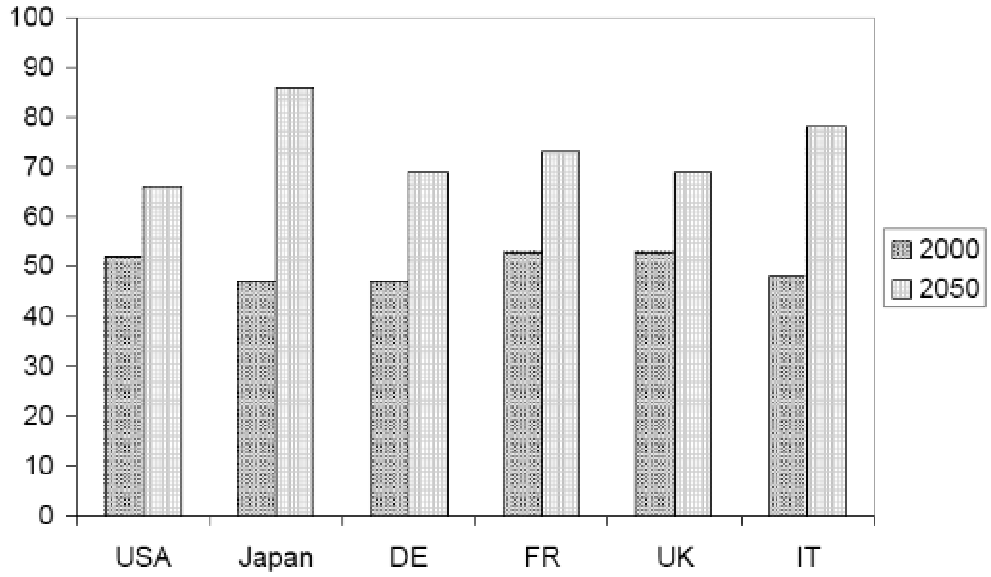
United States will grow (from 299 million to 420 million). Russia faces a potentially catastrophic fall in its population, with a projected decline of 23 per cent from 142 million in 2006 to 110 million in 2050.

Uneven population growth

While the population of the EU will remain, in total, broadly stable between now and 2050, this does not reflect a consistent pattern across the continent but is rather the sum of several different trends (Figure 2). In northern Europe, with its family-friendly policies and a profound commitment to gender equality, the population is projected to rise by around 15 per cent. Western Europe, too, will see a rise, but of a smaller scale, perhaps 5 per cent. Across Mediterranean Europe, the population is projected to fall by a similar proportion, but eastern Europe stands out: the projected change there is a fall of up to 15 per cent. Romania and Bulgaria are the extreme cases, with a 30 per cent decline forecast.

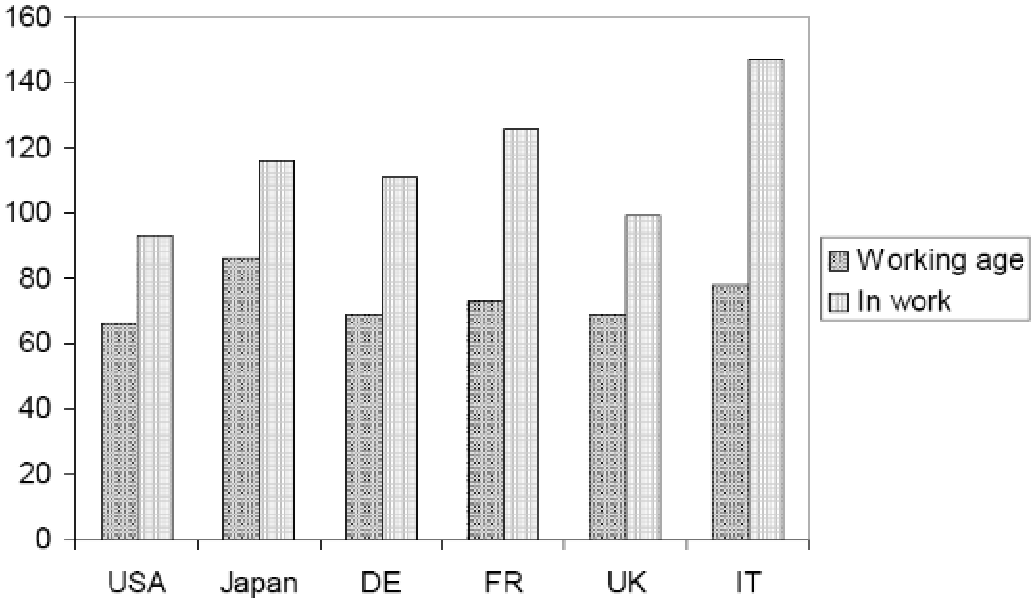
The political consequences of the Yalta agreement were overcome with the EU enlargement of 2004 and the economic effects are being reduced as the eastern European economies grow more rapidly than the western ones. However, it seems that the consequences of communism will live on demographically. The last time the population fell by so much across such a large part of Europe was in the 14th century at the time of the Black Death. That comparison shows the scale of the disaster that communism wrought on Europe.

Dependency ratio



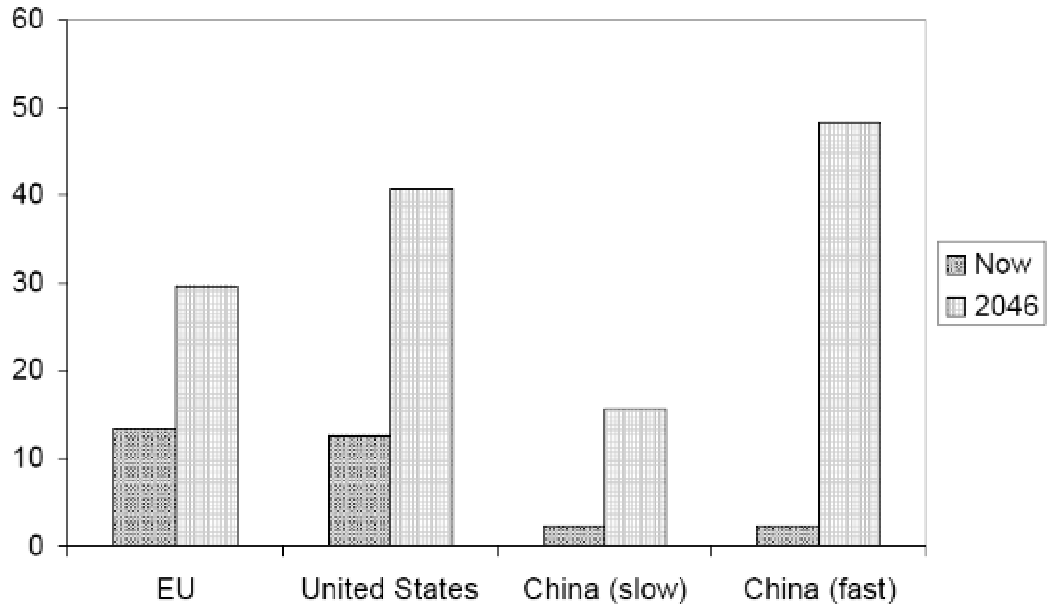
Even if the absolute size of the population does not matter, the age structure within the population most certainly does. Figure 3 depicts the dependency ratio of a number of European countries in 2000 compared with projections for 2050 (the USA and Japan are included for comparison). The dependency ratio is defined as the number of people aged below 15 or above 64 for every 100 people between those ages. It shows how many children and pensioners will depend on each person of working age, and that number is set to grow substantially. Italy, for example, faces an increase of 63 per cent, from 48 per hundred to 78.

Effective dependency ratio



The dependency ratio arises directly and unavoidably from the age structure of the population. The effective dependency ration, which is based not on the number of people of working age but on the number of people actually in work, is also related therefore to the regulation of the labour market. Figure 4 shows the comparison between the two ratios in 2050: in each example quoted, the effective dependency ratio is much worse. The gap between these two ratios shows how much scope there is for policy changes that encourage more people into work or to work longer. Every 100 Italians in work will have to support 147 non-workers, so policy changes of this kind may well be very desirable.

GDP

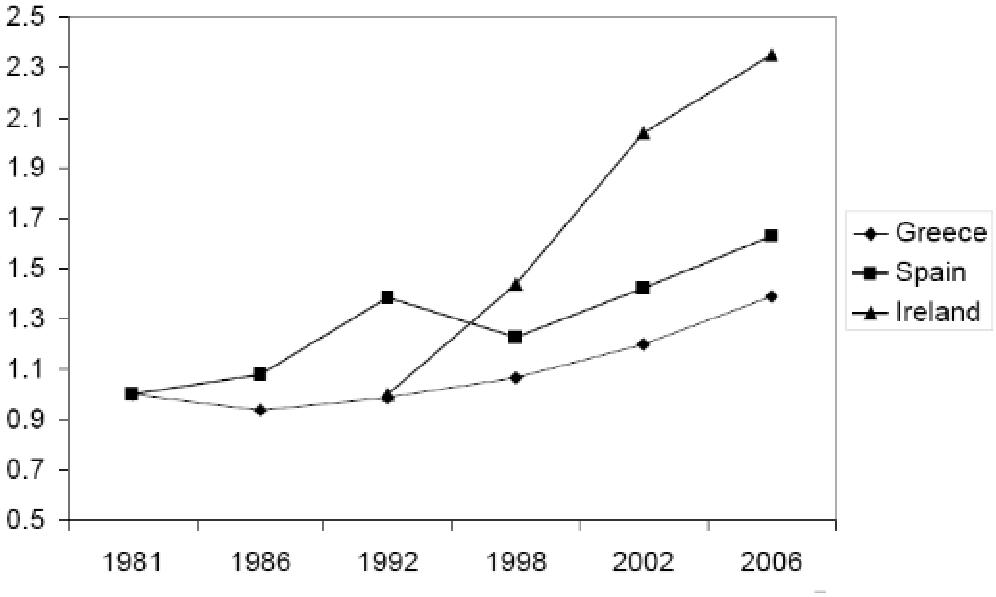


GDP is a broad measure of the size of the economy: a higher GDP represents more economic activity and therefore more economic power. Figure 5 is based on GDP at current market prices and compares the EU, the United States and China. At present, the EU ($13.4 trillion) has a slightly larger economy than the United States ($12.5 trillion) and a much larger economy than China ($2.2 trillion). However, projections of growth between now and 2046 (based on average growth rates over the past 25 years) show that the US will overtake the EU; the possible future trajectory for Chinese growth is very uncertain, but it is likely that the Chinese economy will be at least comparable by then. (Using market price GDP enables a comparison of external economic power; the alternative, purchasing-power-parity model is better if one wishes to compare domestic living standards, because it allows that the same goods and services might be cheaper in poorer countries, but that is not the subject of this article.)

Relative growth rates

The first five sections of this article attempt to make rough predictions of Europe and the world 40 years hence, based on demographic and economic facts and trends. For the next four sections, making predictions of this kind is impossible: the factors that might determine the future are much more subject to political influence, and that is indeed why they are interesting. If there is a broad background of demographic and economic change on the way,

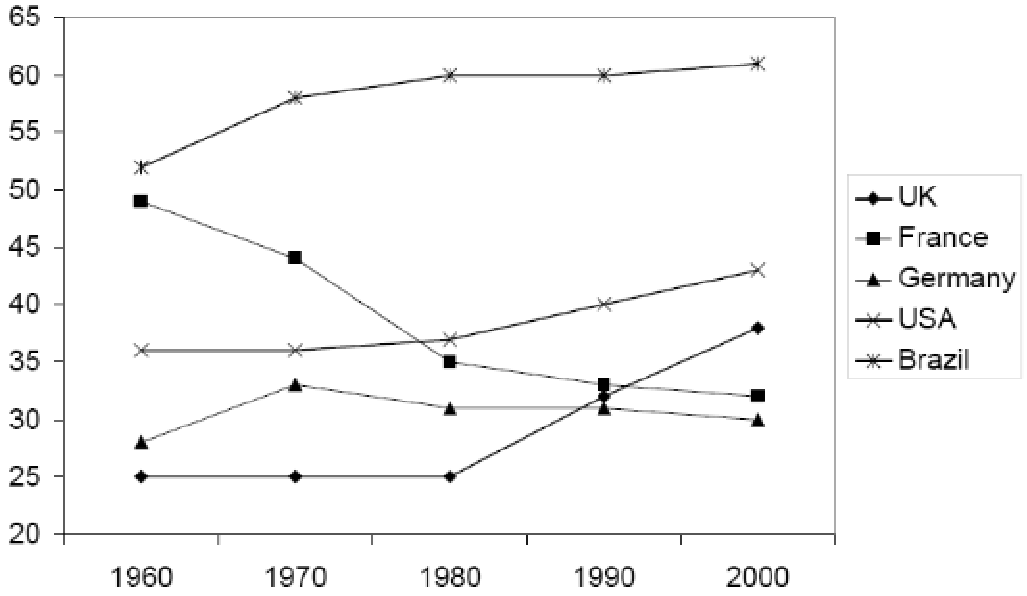
there is a range of political and consumer choices to be made in how to react to them. The best guide to those choices is to look at what has happened in the past.



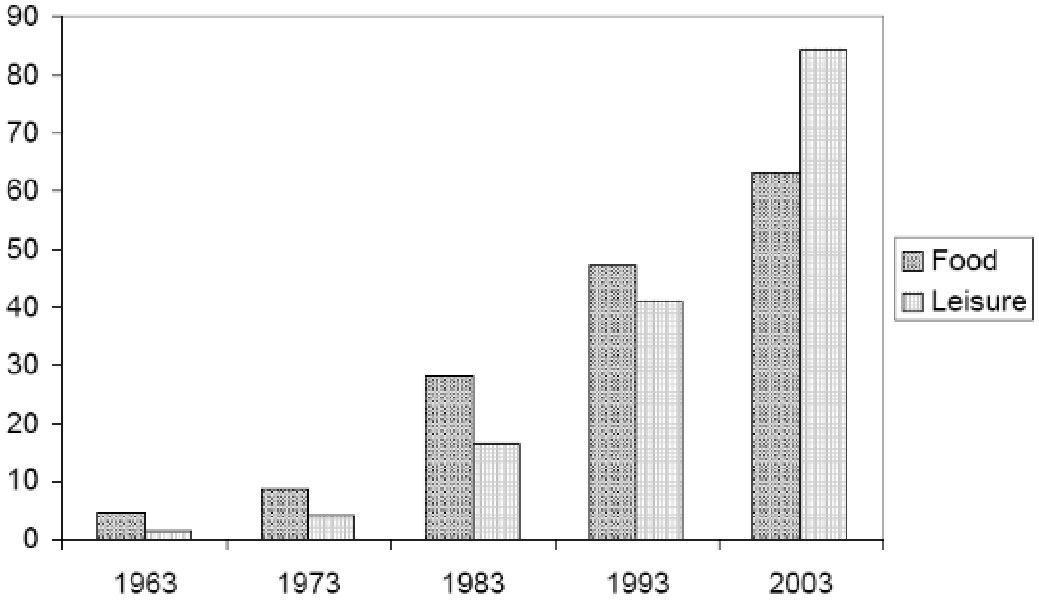
The first of these choices concerns the extent to which the different national economies of the EU might converge in their performance in the future. Figure 6 compares the growth rates of three relatively recent member states – Ireland (which joined in 1973), Greece (1981) and Spain (1986) – with that of Belgium. The aim is to show the rate at which new members might converge with the mainstream. The graph shows that the three member states, although they all have had similar benefits of cohesion funds and access to the single market, have experienced very different results. The Irish economy has grown spectacularly, the Spanish less well, the Greek slower still. The reason for these different experiences lies in the domestic policy choices made by each country. It is not the purpose of this article to outline what those policy choices were, still less to say what they should be in the future. It is necessary to realise, though, that there are policy choices to be made: it is down to each member state of the EU how much of a success it makes of its membership.

Income inequality

A further demonstration of the effects of policy choices can be seen in the distribution of income. The Gini coefficient measures inequality, with a higher coefficient indicating a more unequal distribution: in the case of Figure 7, the distribution of incomes is shown. As with growth rates, the picture in Europe is mixed. The UK took a considerable turn towards a more unequal income distribution from 1980 onwards (the United States did the same). France, on the other hand, has over a period of 40 years become a much more equal society in terms of income. In Germany, the position has stayed broadly constant. (The example of Brazil shows the extreme case of how unequal the distribution of income can become.) Faced with globalisation, is it inevitable that the level of inequality must grow, too?

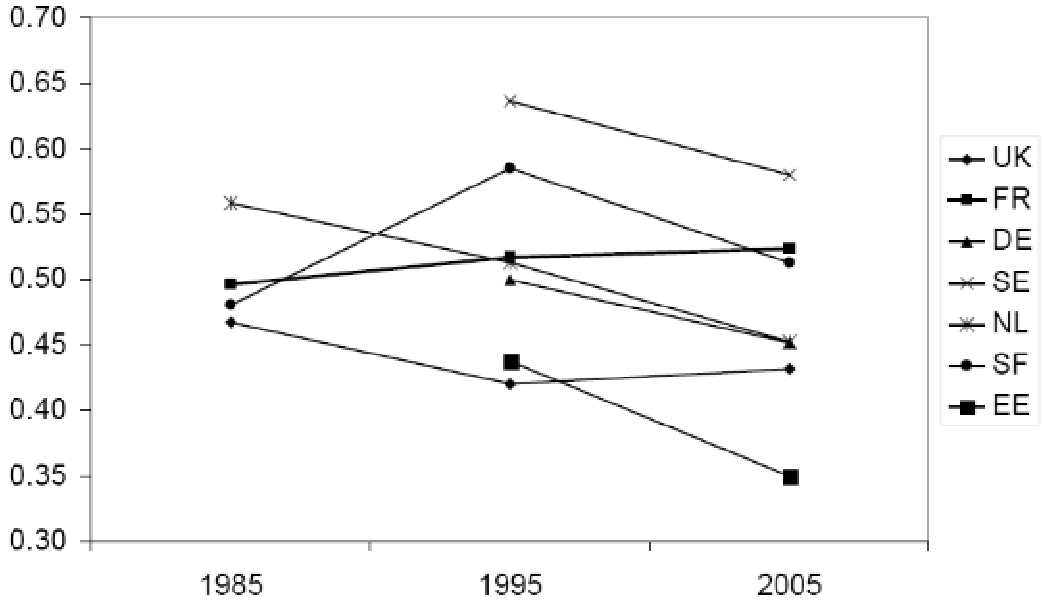


Necessities vs luxuries



As consumers become richer, they have more opportunity to make choices about how they spend their income. Figure 8 demonstrates this, using data that shows the growth of household spending on necessities (symbolised by food) and luxuries (symbolised by leisure). The household spending shown is that of the UK over the past 40 years, so we can be sure that the expenditure on food has not been a source of pleasure. In a richer future Europe, how will consumers choose to spend their income? Perhaps they will take it in the form of shorter working hours, or increased environmental protection, or in other ways that improve their quality of life rather than their material living standards.

Size of the state



Lastly, there is a simple demonstration of the changing role of the state in the economy (Figure 9). Different European countries over the past 20 years have each had a different balance between the public and private sector, and in each country that balance has changed in a different way. As an illustration of the first point, compare Estonia and Sweden: in Estonia today, the state takes up 35 per cent of national GDP; in Sweden it is 58 per cent, almost twice as high. The difference in the way that balance has changed in different countries is shown by comparing Finland, France and the Netherlands. There appears to be a broad downwards trend now, but it is by no means universal (in the UK, the public sector is growing, for example) and the rate of change varies considerably.

Conclusion

The preceding examples show both the scale of the changes ahead – in terms of population and economic growth – and also the range of choices available. The role of Europe in the world is set to change considerably; the role of Europeans may well change even more.

No particular economic future is inevitable. It lies in the hands of Europe and the Europeans to shape their own future – to a considerable extent, perhaps – if they wish to do so. Whether they will wish to do so is matter not of economics but of politics, and that is something which that requires the future attention of us all.

Notes

Figure 1 - Population: figures are millions (source: Population Reference Bureau)

Figure 2 - Population growth in Europe to 2050: percentage change between now and 2050, by region (source: Population Reference Bureau)

Figure 3 - Dependency ratio: the number of children and pensioners per hundred people of working age (source: Economist, "World in figures", quoted in Niall Ferguson, "The Cash Nexus", Penguin, 2001)

Figure 4 - Effective dependency ratio in 2050: the number of children and pensioners per hundred people of working age in work – this is compared with the dependency ratio in 2050 (source: as above, plus McMorrow and Roeger "Economic consequences of ageing populations", quoted in Niall Ferguson, "The Cash Nexus", Penguin, 2001)

Figure 5 - GDP: growth estimates for EU and United States are based on average growth rates over last 25 years, Chinese slow growth is 5 per cent, fast growth is 8 per cent, figures are trillions of dollars, at current market prices (source: IMF)

Figure 6 - Relative growth rates in different countries: GDP in each country compared with the GDP of Belgium (indexed, 1981=1, source: Eurostat)

Figure 7 - Income inequality within countries: Gini coeffients – the higher number, the more unequal the income distribution (source: United Nations)

Figure 8 - Necessities vs luxuries: UK household expenditure on food and leisure: figures are GBP billions (source: National Statistics)

Figure 9 - Size of the state: proportion of GDP accounted for by average of government income and expenditure (source: Eurostat)

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