

Interview with Minsuk Kim, Economist at the Regional Studies Division in the Asia and Pacific Department, International Monetary Fund

Demographic Transition in Asia — How to Mitigate Its Possible Impacts on the Economy?

By Japan SPOTLIGHT

The IMF published its “Regional Economic Outlook: Asia and Pacific” on April 17, 2017. Its subtitle is “Preparing for Choppy Seas”. Though the Asia-Pacific economy seems to be on a trend of stable growth, there are some challenges and impediments emerging today. The aging population is one of those challenges and there is an emerging risk of Asian countries’ growing old before becoming rich. We had an interview with Minsuk Kim, an economist at the Regional Studies Division in the Asia and Pacific Department of the IMF, who has worked on analyses of demographic transitions in Asia.

(Interviewed on June 28, 2017)

Self-Introduction

JS: I had a chance to hear your recent talk at the IMF office in Tokyo when your outlook was published and I was very impressed by your thoughts and excellent analysis. Could you first of all introduce yourself briefly?

Kim: I am currently an economist in the IMF and my major responsibility is monitoring economic developments in the Asia-Pacific region. The project I am currently working on is identifying cyclical economic drivers of Asian countries’ exports.

Asian Nations’ Rapid Aging

JS: Aging in Asia is our main subject today. According to your analysis, how quickly do you think this will affect the economy?

Kim: Aging is a very long-term trend. But it is also very predictable. Given the birth rate and life expectancy today, you can predict to an extent how it is going to play out. Some economic impacts will materialize as the population gets older later, but there can be other influences on our economies even today to the extent that people are forward-looking. For example, in a fast-aging economy firms will be reluctant to make new investments that require a young workforce or consumers will become more cautious in spending because of the need to save for retirement, especially if the public pension system is



Minsuk Kim, Economist at the Regional Studies Division in the Asia and Pacific Department, International Monetary Fund

not sufficiently strong. In Japan, for example, the inflation rates can become more easily entrenched because people are forward-looking. In our latest Regional Economic Outlook, we find that many Asian countries are at risk of growing old before becoming rich, which has importantly to do with the rapid speed of aging. From a policy perspective, this chart implies that many Asian countries will likely face high fiscal costs of aging without sufficient income.

JS: In particular in Asia, the role of women is drastically changing. Is that perhaps part of the reason we have a changing aging situation?

Kim: We didn’t focus on the role of fertility rates in our study. That said, historical data show that as women become more educated and participate more in the labor

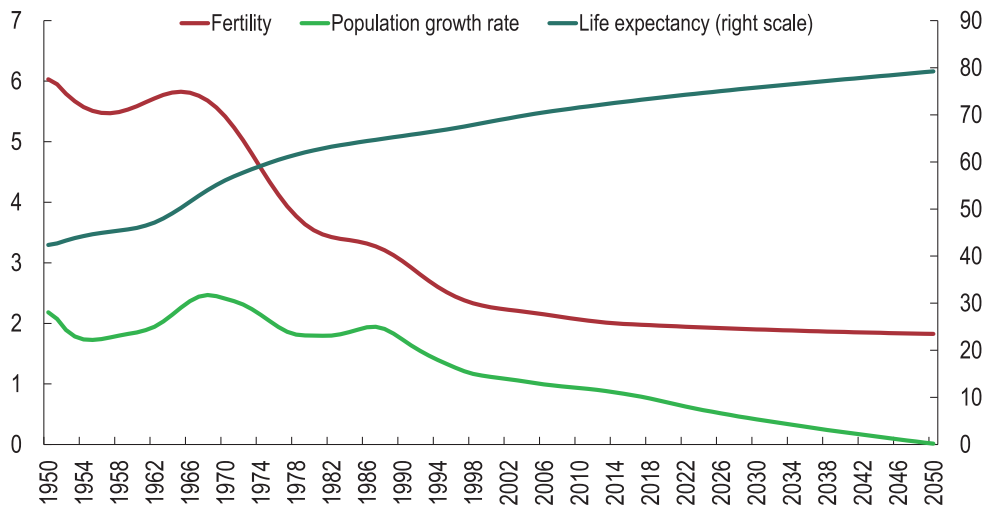
market the fertility rate tends to decline. But there are measures you can take to mitigate the negative impact on growth through the demographics channel. For example, expanding child care facilities; becoming more lenient with maternity leave.

JS: Given that there is a diversity among the aging populations in Asia, would it not be possible to create a complementary relationship between the aging countries and those still enjoying the benefits of a young population through immigration? I have the India-Japan relationship in mind.

CHART 1

Asia: Fertility, Life Expectancy, and Population Growth

(Percent on the left scale; Year on the right scale)



Source: IMF staff estimates based on United Nations, *World Population Prospects: 2015 Revision* (medium-fertility scenario).

Kim: It's a very good point. You mentioned immigration and you are talking about the flow of labor. There can be also a complementary relationship in terms of capital flows as well. But let me first talk about the labor flows. Our study shows that immigration can play a meaningful role in mitigating the negative impact of aging on growth. Countries such as Australia and New Zealand have always enjoyed significant migrant growth into their economies. In the case of Australia, we project that the impact of aging on growth would have been negative without migration. But because of their immigration policy we expect their growth impact to be on the positive side: about 0.7% points per year over the next three decades. From a capital flow perspective, the diverse demographic trends in Asia can also offer rich opportunities for cross-border risk sharing and financial integration. For example, savings in relatively old countries seeking a higher return could be used to finance the large infrastructure gaps in relatively young countries.

JS: We often say in Japan that we have to raise total productivity given our aging society and depopulation. You take a different point of view.

Kim: Raising productivity is an important priority in every country, especially in an advanced economy such as Japan where other sources of growth are relatively limited. At the micro-level, studies show that the impact of aging on productivity could differ across the profession. For example, if you are a manager or a professor or a doctor your productivity could actually go up as you get older and accumulate more knowledge. But if you are a construction or a

factory worker, where jobs are physically more demanding, the impact of aging on productivity is likely to be negative.

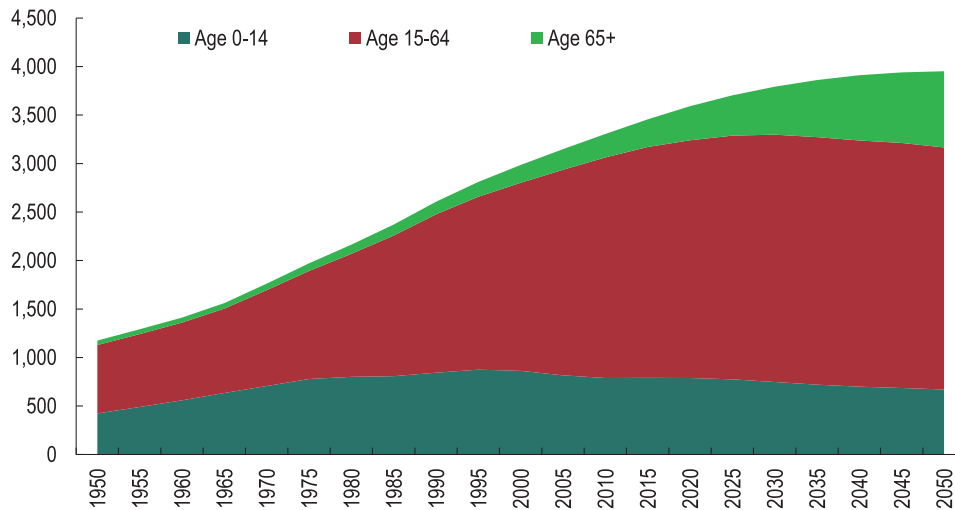
JS: You've said that aging in Asia is rapidly under progress and the economy is growing old before becoming rich. However, many economists say that economic growth in Asia is much higher than in other countries – by more than 5%. Could you comment on these two phenomena? (Charts 1-4)

Kim: The issue is that Asia has been the world champion of growth for the past several decades. In many countries they are enjoying the benefits of high growth including on the fiscal side. The question is how far we can prolong this strong growth, especially given the demographic trends. As the population gets older, the government will need to spend more on social security, health care, pensions and other aging-related areas. The important challenge will be making sure our fiscal positions remain sustainable over the long term while meeting these spending needs. The point we want to emphasize is: let's act early, let's not be complacent, let's focus on investment in growth areas, including strengthening the social safety net. Many Asian economies have large informal sectors, which don't provide much protection after retirement. They are not covered by formal pensions. The government should stand ready to protect these vulnerable people and do so on a sustainable basis. This would require investing in education and core infrastructure; making sure revenue remains sufficient by undertaking needed fiscal reforms. And by providing support to the vulnerable aging population on a

CHART 2

Asia: Population by Age Groups

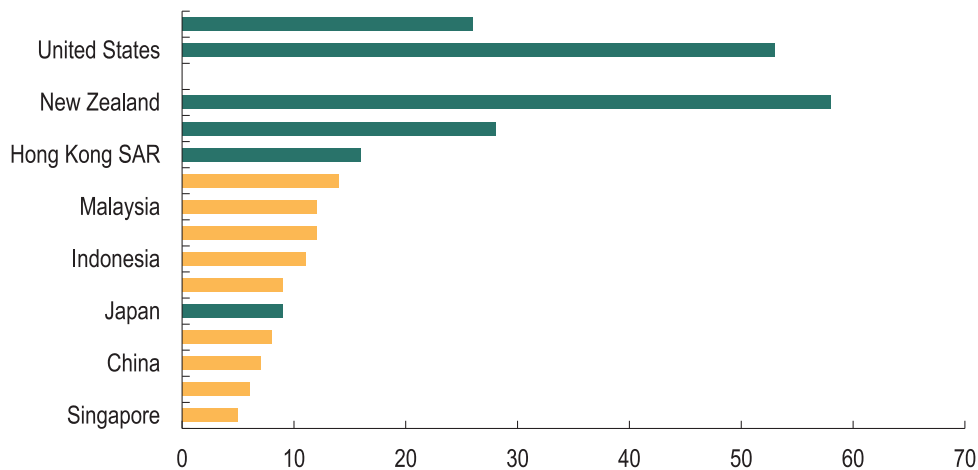
(Millions)



Source: IMF staff estimates and projections based on United Nations, *World Population Prospects: 2015 Revision* (medium-fertility scenario).

CHART 3

Number of Years for the Old-Age Dependency Ratio to Increase from 15 Percent to 20 Percent



Source: IMF staff calculations based on United Nations, *World Population Prospects: 2015 Revision* (medium-fertility scenario).

Note: The old-age dependency ratio indicates the population 65 years and older as a share of the working-age population (15-64 years). Countries in green reflect historical data, while countries in yellow reflect projections.

sustainable basis, we can also give confidence to consumers today by reducing the need to save for precautionary purposes.

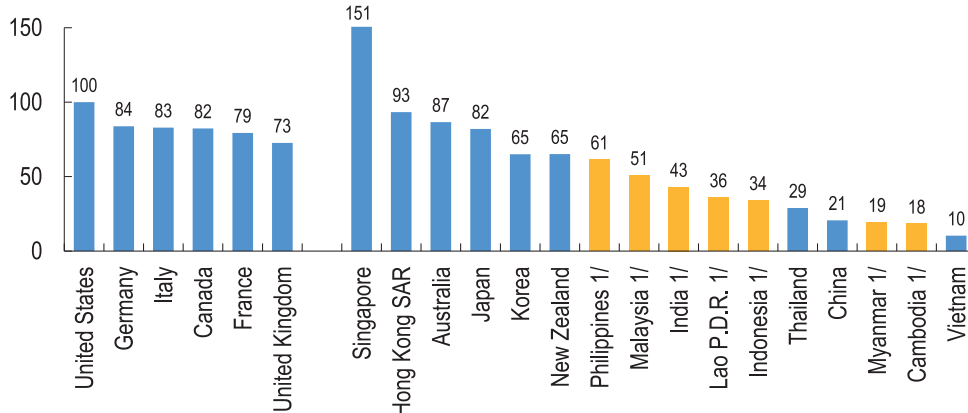
Possible Prescriptions to Mitigate Impacts of Aging

JS: What do you suggest is needed in order to modify the negative impacts on growth?

CHART 4

Per Capita Income Level at the Peak of Working-Age Population Share

(Purchasing power parity based; in percent of U.S. per capita income at each country's peak year)



Sources: IMF World Economic Outlook database; and IMF staff calculations based on United Nations World Population Prospects: 2015 Revision (medium-fertility scenario).

Note: For the countries shown above, the working-age population (15-64 years) share of the total population has peaked, or is projected to reach the peak, in the following years: United States (2008), Germany (1987), Italy (1993), Canada (2009), France (1987), United Kingdom (1950 or earlier), Singapore (2011), Hong Kong SAR (2009), Australia (2009), Japan (1992), Korea (2014), New Zealand (2009), the Philippines (2056), Malaysia (2020), India (2040), Lao P.D.R. (2048), Indonesia (2031), Thailand (2013), China (2011), Myanmar (2027), Cambodia (2044), and Vietnam (2014).

1/ Based on IMF staff projection. For Malaysia, the income level relative to the United States is calculated from the April 2017 WEO projection for 2020. For the Philippines, India, and Indonesia, the income levels are calculated by applying the projected PPP per capita income growth rate in 2022, starting from 2023 and up to the year in which the working-age population share is projected to peak, respectively.

Kim: One option is promoting a higher labor force participation. For example, in Japan, expanding child care facilities under Abenomics has really worked well. That's a policy option that other countries could consider. Prolonging the retirement age could also help. But for this to be successful, it should be supported by other fundamental labor market reforms. These include: tackling the labor market duality between regular and non-regular workers; removing the gender gap in the labor market and helping boost the female labor force participation; and transitioning to a compensation system based on merit rather than seniority. These measures would help incentivize firms to hire more elderly people. You can't simply force firms to delay the retirement age.

JS: People in Asia have a stronger incentive to educate their children to help them get a good job.

Kim: It may have an impact on some Asian countries, especially where people put high value on education. But it's not universally true across all Asian countries. Some may have different cultural backgrounds, for one thing.

JS: Asia is supposed to have a very high growth potential. What is your candid view on this? You seem to believe that with an open competition policy to raise the market mechanism it is possible to overcome the demerits of an aging society.

Kim: Asia has been leading world growth for several decades. The challenge now is maintaining this growth potential; making sure that Asia keeps growing on a sustainable basis. That will require true policy efforts and many structural reforms. Creating a more business-friendly environment, streamlining regulations, cutting red tape, opening up domestic markets to invite more competition and also more investment from outside, will all help increase productivity and prolong the strong growth today. In emerging markets, increasing investment in secondary education is important to secure a well-trained workforce. In advanced economies, the priority would be more on augmenting the capacity to keep innovating, for example by ensuring the R&D spending is managed and investing in tertiary and higher education to make sure you have a workforce that meets the needs of emerging industries. Fiscal reforms aimed at enhancing debt sustainability today can also give confidence to the current population. Bringing in foreign labor can also help. It doesn't necessarily have to be in the form of immigration. Other countries have used, for example, guest worker programs that were targeted at specific skills or specific industries, inviting workers on a temporary basis. So there are alternatives to immigration and exploring these can be very important.

JS

Written with the cooperation of Ian de Stains OBE who is a writer and consultant.