Population Aging, Debt and Economic Growth
Comments on Goodhart

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Issues

1. Will real interest rates rise?
2. What is the debt problem?
3. What does all this imply about inequality?

Will Real Interest Rates Rise?

- Paper suggests so, in spite of an increasing old-age dependency ratio
  - Standard thinking: Higher OADR $\rightarrow$ higher ratio of capital to labor and hence lower interest rates
  - Goodhart: with old-age benefits holding steady, less need to save and less ability to
  - Simulation results (Krüger-Ludwig, 2009): if benefits are preserved in a PAYG system, smaller fall in interest rates than if tax rates preserved; note: does *not* predict an interest rate increase

Will Real Interest Rates Rise?

- But there may be further upward pressure on interest rates from government borrowing
  - Governments may borrow to maintain benefits, rather than raising taxes
  - This is what they have been doing
- A simple way to think about interest rate effects: how large is government debt, both explicit and in the form of implicit liabilities to the elderly?
  - Both forms of borrowing contribute to crowding out of productive capital and higher interest rates

Will Real Interest Rates Rise?

- Will capital flows offset this prediction?
  - Not likely, even with differential patterns of population aging and development (e.g., Börsch-Supan, Ludwig and Winter, 2006)
- A separate issue: risk premium, with a larger share of private assets held by the elderly
  - Could this cause safe yields to fall?

What is the Debt Problem?

- Paper: a focus on business debt
  - Supports Mirrlees Review proposal for an ACE, to balance incentives for use of debt and equity
- Does this address recent debt problem?
  - Overleveraged households and housing
  - Undercapitalized financial institutions
  - Governments with rapid increases in explicit and implicit national debt

What is the Debt Problem?

- Corporate tax reform would be a good thing, in itself
  - But, international tax reforms more pressing
- Some progress already in addressing the debt problems of households and financial institutions
  - But many governments still face major fiscal imbalances, especially taking account of implicit liabilities (Auerbach, BIS 2011)

What is the Debt Problem?

- Example – the United States
  - Beginning of 2015: publicly held national debt = \$13 trillion
  - But unfunded liabilities of old-age pensions and health care system, as estimated (optimistically) by the government: \$69 trillion
- Current 75-year fiscal gap (Auerbach-Gale, 2016): 4.5 – 6.4 percent of GDP

Implications for Inequality

- Paper's focus on capital vs. labor, and rates of return vs. wages
- But much of the increase (within countries) in inequality has been attributable to wage inequality
  - Higher returns to skill (technology, globalization)
  - (Maybe) higher capture of rents by top earners
- If there is additional capital deepening, what will the impact be?
  - Worsening with capital-skill complementarity

Summary

1. Interest rates may rise – because of government fiscal imbalances
2. Going forward, debt problem is a government problem
3. Aging provides no obvious offset to rising intra-country inequality