

## Overview

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The discussions here have covered a tremendous range of issues that normally central bankers are not exposed to or deal with. As Chairman Greenspan mentioned, one can forecast that if the average age of a group is 35 and unless there are fundamental changes in the inflow and outflow from the group, then the next year we can agree the average age will be about 36. But we didn't really go only into short-term forecasts. We had a fantastically courageous forecast from Kazumasa Iwata, who joined Maltose, who told us that in 800 years the last Japanese baby will be born. We had an enlightening and encouraging remark by John Helliwell, who took us to a different territory and basically said that what we really need to find are situations that will make us happy, that will make us feel part of the whole, that will make us involved, and that will make us committed. I could not resist remembering what the difference is between being involved and committed. I do not eat ham and eggs, but I am told that in the ham and eggs food, there is a basic distinction in which the chicken is involved but the pig is committed.

Coming back to the substance, we have heard that demographic issues are key, they are there, and they are covering the globe. We did have a very succinct description in the developed world, in the developing world, and we also saw that there are some differences between

them in one way or another. Whereas we heard the OECD description this morning, we heard yesterday Anne Krueger focusing on the developing countries. In the group we heard this morning, Rakesh Mohan was telling us where Asia really differs. We checked the implications on the budget, on the capital markets, on rates of return, on mobility, on productivity, on pensions, and we even dealt with or touched on how one deals with the challenges where all there is is the taxation. One should not use taxation that reduces labor supply. One should do anything that is needed to lengthen the time in which individuals spend in their workplace. We were also reminded that the incentives that are given in this regard, especially in Europe, are exactly the opposite.

Anne Krueger told us about a situation in Turkey and elsewhere that we do have a policy challenge that is not yet fully addressed. The question is: Is it really important? And why isn't it addressed? I will come back to it again and again to remind each time of the third box of the three boxes that Joel Mokyr put on the table yesterday. The third box, which contains the things that we do not know that we do not know, is getting filled up continuously.

We started yesterday on a journey into history. David Canning and David Bloom, joined by Joel Mokyr, took us there. We saw that it is a global matter. We are living longer. We are healthier. Productivity is higher. Fertility is lower.

Of course, there are some regional issues. Roger Ferguson reminded us about the HIV/AIDS and things of that type. But, by and large, there is a global issue. So, it is not just that one country or one region has to face it, but it is really global. What did I take from that discussion?

First, as David Canning told us, demographic changes are not just accounting. He says they may lead to fundamental changes in the behavior of markets, structures, institutions, and the like.

Will they be successful in doing it? This brings us to the next issue, which is that the countries with bad policies are likely to waste the opportunities and the countries with the right policies—countries that are open to trade, that have structural measures, and the like—will not waste these opportunities.

Therefore, what is the key? Develop the capital markets and the like. How do we go about doing it? There are two strings: one that focused on the slowly grinding democratic process—elections, voters that are getting older and they are voting, they change things, they change institutions. By and large, they will eventually do to us what we were told by Adair Turner—increase the retirement age. The IMF may push a bit harder without Article 4, but those are still issues that take a long time.

The question is: Why don't we find a quicker way, a faster way? This is the question that Arminio Fraga kept asking time and again. I am not sure we got an answer, but I think we will need to come back to it again.

Are the capital markets showing the severity of the issue or not? Well, we saw that the numbers are relatively small, some basis points. Of course, they can be large—30 basis points or larger—if interest rates are low. They are a bit less if interest rates are high. By and large, several predictions that come from standard models where it is the life cycle and the decumulation just do not show themselves in the behavior of that matter.

Why not? Of course, Axel Börsch-Supan reminded us that there are some regressions that show some evidence. But why aren't the markets showing the severity of the issue? This is the question that Morris Goldstein posed yesterday in a different context.

Why are markets more impressed from large budget deficits than from large actuarial debt? Why does the Maastricht Treaty focus on 60 percent debt to GDP ratio without giving due regard to the

actuarial issues? Why do the rating agencies not put this up front? There are a lot of “whys.”

Michael Mussa spoke about the incentives we must give to individuals so as to enable them to choose the right things. The problem is: Do we have enough incentives given to or imposed on the politicians to bring it about? I don't think we have the right motivation.

You know the story about motivation. The guy was condemned to die, was taken to the electric chair, was very overweight, and did not fit the chair. He was sent home and told, “Come back in a month.” He came back after a month and was hugely overweight. “Didn't we tell you to lower your weight?” “Yes, I did not have motivation!”

The real issue is the motivation imposed on the politicians. I think that Vittorio Corbo and Leszek Balcerowicz gave us a clue. Basically, we really need to make much more of the successful cases of the real benefits that come to the population. If we did not have Chile, we would have to invent it as a profession just to give the case of what it takes if you do the right things.

People have said that demography is like glaciers. They are huge, but they move very slowly. Let me ask you: If I told you that we are entering the era of global warming, would you also think that they are huge and move very slowly? Or would you think about it?

What is the global warming in our context? It is the capital markets. It is globalization. It is more sophisticated investors. This is the global warming of demography. We need to put it up front.

The question that Armenio posed regarding why the long run isn't addressed today is a very similar question that we asked some years ago. Why aren't structural policies used in the right way? An answer we gave there was: “Why would politicians do things that they will not be around to reap the benefits?”

It is such a slow process. Well then, speed it up. Move into a fast-forward. Capital markets have done wonders to speed up the results of future policies of future results. The issue is how we find the analog here.

Let me move very quickly to another topic, which is the issue of migration. The perspective that Ralph Bryant put in the crosshairs—the consequences—is a very important perspective. I completely agree with the perspective that John Taylor, Michael Mussa, and others have put on the table, which is: At the end of the day, migration is not to be analyzed just as in the old days the brain-drain story.

All roads, in principle, are not one-way roads. Societies that have enjoyed the benefits of migration occasionally have sent the benefits back to the home countries—that is the remittance—and have attracted tourism. The statistics that speak about education mean that we have to focus on that.

Stanley Fischer told me that when Franco Modigliani was always looking for an example, he said, “Well, let me tell you an example about any country. Choose Italy.” So, let me do the same. Let me give you an example from any country. Choose Israel. I can tell you that looking at the economic development of Israel, basically a martian coming down to earth, not knowing what happened when, would recognize two turning points in Israeli economic performance. One has to do with the early 1950s; one has to do with the early 1990s. Both are periods of huge mass immigration into the country, especially the one in the more recent episode, which did wonders to an economy.

First, of course, is the human capital element that was mentioned here. I think it changed much more. It is very difficult to go to a country that is very rigid, highly unionized, and has rigid labor markets—the things we teach what not to do—and to change it gradually. There is nothing more effective in introducing flexibility in the labor market than flooding the labor market with a huge amount of labor that basically makes minimum wage an irrelevant issue, that makes the unions that prevent the employment of those who want to

be employed an irrelevant issue. In no time, that influx of immigrants has changed the character of labor markets, has reduced unionism, has supported capital market reform—because that is the only way you could have generated foreign direct investments that would provide a support for employing the labor that came in—has highlighted the benefits of globalization, has stimulated budget consolidation, and has stimulated the recognition of the benefits from price stability. It is all as one went into the notion of saying: “There is such a big influx that how does one absorb them?” So, if there is anything to our economic theory that says that is what good economic policy is about, then this laboratory experiment, which really forced it, means you do not need to go through the conviction and the intellectual level. You needed to get the conviction through your lags, as we say. That is exactly where it came about.

Frankly, in my reading of the history of the early 1990s, it even forced national priorities to put more attention to the peace process, which at the time became another move. What I am trying to say is that immigration is a major factor changing the faces of society. It is not just a one-way street, as was mentioned here. It is really changing it in a complete way. This is where nonlinearity comes in. It is very difficult to do an extrapolation in demographic trends and very easy to be discouraged and say the big changes will happen in Never Never Land. We do have big changes that may even be steps to bigger changes. They cross a threshold, they shake the tree, and create new initial conditions and new market settings.

I can say that in our case, it definitely brought about, for the first time in 1991, other changes. Suddenly, budget policy was set in a multiyear setting and monetary policy was set in a multiyear setting with inflation targets—all not because of the intellectual conviction, but the realization that somehow if the prime priority is the right employment for the right immigrants, you had better create the environment. A small footnote to this is China. If the prime priority is to make sure that there is employment in China, then don't kid yourself.

The Chinese authority will not bring about an appreciation of the currency and a very strong landing.

Let me make one remark about monetary policy. I did listen to Charlie Bean and, of course, like all central bankers—you know, once a central banker always a central banker. There is only one thing that nobody can take away from you: the title of former governor. I still have great sympathy to what he said. When I saw the title and Craig Hakkio told me, “You don’t have a problem speaking. Just say what the implication is to monetary policy.”

I said, “My goodness, I hope I will not be dragged into the debate we had in Israel in 1991-92.”

Everyone said, “You know, we have massive national objectives. We have to absorb the immigrants. Why don’t you use monetary policy to accomplish this?”

For a hammer, everything looks like a nail. And for monetary policy, the only thing is interest rates. So, how do you contribute to absorbing the immigrants? The presumption is low interest rates. Do all the nice things, especially for people who think they are the only ones with a heart on the left side.

Let me tell you, if the reason overburdening of monetary policy that was there in the late 1980s dealing with or trying to be tempted to deal with fiscal deficits, there is no more dangerous monetary policy than to deal with a demography, unless you are doing what Charlie Bean said—namely, be more vigilant and make sure that those demographic changes come against the background of price stability, financial market stability, developed markets. Do all the nice things we were told to do and even more so.

This is my take on monetary policy.