Are There Enough People?

In many countries around the world, governments are concerned about demographic ageing. This is happening in Asian countries such as Japan and China. In Europe, countries such as Italy and Hungary face the same trend, as do Germany and the Netherlands.

In many of these countries, governments are calling for policies to address this perceived issue. Young people are increasingly encouraged to have more children. Economists and politicians fear a shrinking population much as they fear falling prices: help, the population is declining, productivity is weakening, and economic growth will slow.

What should be done? The answer is that the best approach is to leave this to the free market. The mechanisms of prices and interest rates offer a solution to this “problem”. How does this work? Suppose a population grows older. Older people consume relatively more, paid for by their pension arrangement and past savings, and save less for the future. After all, for them, the future has long since begun, now the time has come to benefit from past savings. This has two consequences:

1. Interest rates will rise.
Interest rates depend on people’s time preference. In an on average older society, older people prefer having a higher amount of money available now instead of in the future, compared to when they were young. They require a higher compensation to forgo that amount of money in the present. This implies a higher interest rate. So, a lower supply of savings leads to higher interest rates. The relatively smaller group of savers will need to be enticed by higher returns in order to invest.

2. Prices adjust to society’s preferences.
An older population will demand relatively fewer fashionable goods such as games and dance events, and more services such as elder care and healthcare. Put bluntly, the prices of services such as elder care will rise relative to the prices of games and XTC pills.

With a declining population, there will be little or no economic growth as measured by indicators such as Gross National Product (GNP). That is not a problem: with fewer people, fewer goods are needed. Thanks to productive innovation and technological progress, GNP may still grow, but this is not necessary. What matters most is that people’s well-being improves. For an older population, that will probably mean something different from what it means for a younger one.

The production structure will adapt to the preferences of the population. Investment will flow to where profits can be made. If elder care is expected to become relatively more attractive due to the changed subjective preferences of people in this society, the prices will rise compared to products and services where there is less need. Capital will flow into that sector where prices are relatively highest, as this is where most profit can be generated. As a consequence, wages and employment will develop in these sectors relatively favourably. Investors will seek out technologies to organise elder care efficiently and to meet this urgent consumer demand.

Politicians want more people

Politicians and economists often regard growth in GNP as more important than improvements in people’s well-being. A shrinking population could imply less “economic growth”. Government representatives will claim elder care is unaffordable and ask “Who will take care of our elderly?”.

Instead of leaving the allocation of resources to the free market and accepting a possible economic contraction, they push society into "growth mode". There must be more people; there must be "growth" to pay for elder care.

The growth they advocate is nominal growth. The economic and monetary policies of virtually all countries are aimed at stimulating "economic growth", regardless of the population's composition. This often leads to monetary easing, lower interest rates, and persistently high or even worsening debt levels. Everything is sacrificed for the sake of a growing economy.

An important question is this: if the population shrinks, should the money supply also decline?
The answer is no. Interest rates and prices adjust automatically to the changing preferences of the population. A higher interest rate fits naturally with an ageing and shrinking population. And even if the answer were yes, how would that be achieved? Monetary tightening would push interest rates up even further. They would then rise beyond what is necessary to sustain a harmonious society.

Conversely, if a population grows, should the money supply increase?
Again, the answer is no. A relatively younger and growing population will naturally save more for the future; its time preference corresponds to a lower interest rate. Relatively more will be invested in the production structure, in capital, and in prosperity than would be the case with an older population. It is often assumed that the money supply should grow in line with the population or with economic activity. However, if money growth accelerates because of monetary easing, interest rates will fall even further than is necessary for a balanced society.

Loose monetary policy does not push all prices upwards to the same degree. Some prices rise more than others. As a result, the signalling function of prices for investors weakens, and the structure of production is shaped less effectively by the preferences of the population.

Loose monetary policies pushes interest rates down below where it would be if purely based on people´s time preferences. Due to the lower interest rate money flows into projects for which there is in fact less need. The projects that are truly needed have already been funded. The additional money, offered at even lower interest rates, finds its way into investments that previously did not appear profitable. As a result, the newly created money does not generate the required real returns, keeping up with rising prices.

Through this political pursuit of growth, society places enormous pressure on itself. Rising prices and misguided investments weaken purchasing power. We keep on working hard, exhausting ourselves, as is seems there is never enough economic growth. And this does not even begin to account for the strain placed on natural resources and on nature itself. Much is sacrificed to the growth ambitions of politicians and economists.

So, are there enough people? The answer is: leave that question to people themselves and let society take shape according to their preferences. Prices and interest rates are well able to cope with any societal development. The less intervention, the better for our well-being. This also applies to how or if we want to grow our population.