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Fiscal Implications of an Aging Population
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pg. 100

which Western Europe relies mainly on the free-market perspective, while The Netherlands chooses to revitalize the coordination perspective.

Secondly, a different choice could have been made concerning the particular topics that are elaborated upon and other, perhaps equally important, ones that are left almost undiscussed. For example, little attention is paid to financial developments.

However, emphasizing such criticism on 'details' would do not justice to a study that covers such a broad field of interesting topics and which is, furthermore, obviously innovating in its methodology.

Nevertheless, the study carries a risk with it. Paraphrasing the words of Wallace Stevens, there is a risk that readers will get stuck in a fantastic world without being able to return to the real world. For, in practice, policymakers do not always seem to feel the need to review all kinds of possible scenarios and then formulate no-regrets policies. Instead, they will perhaps find it more attractive to single out certain elements of the study to adstruct the views they already have. Depending on their purpose, they will pick out the one scenario they think of as the most probable, the most appealing or, in some cases, even the most frightening in order to stress their point. The study is not intended to be used like that. What's more, The Netherlands are fully interweaved in the Western European economy as well as in the world economy and no domestic policy could bring about the most favourable scenario or prevent a less attractive one from becoming reality.

I hope the study will be used in the way it is meant to be used, *i.e.* for the purpose of formulating no-regrets policies for The Netherlands in the years to come. Therefore, I would recommend readers to first read section 5.3, dealing with the use of the study; it starts off with a warning about the way in which the study should not be used.

Finally, I consider *Nederland in Drievoud* to be a study of great value. Its influence on economic policy making in The Netherlands could be substantial. To illustrate, on June 19, 1992, only eight days after the study was published, the Dutch government requested the Social and Economic Council (SER) to give its opinion on the direction in which economic policy should develop n the 1990s, in view of the ongoing international economic integration, especially within the EC. In its letter to the SER, the government extensively referred to the analyses in *Nederland in Drievoud.*

Rob J. Mulder

Dieter Bös and Sijbren Cnossen (eds.), *Fiscal Implications of an Aging Population*, Series on Population Economics, Springer Verlag, Berlin, 1992. Pp. x + 191.

The aging of populations in the industrialized world poses a challence to Keynes' 'mad men in authority.' The relevant issues arise from evolution in tax bases, demographics (*e.g.*, fertility and morality, household types, number of ethnic minorities), pension premiums and benefits. Aging poses more questions than a general economist, even Paul Samuelson or Robert Solow, can ever hope to answer. Still, one is well advised to start asking some of these questions now, before it is too late. The awareness that aging may cause large welfare losses is gradually growing. Dieter Bös and Sijbren Cnossen have compiled a number of articles on the fiscal implications of aging populations that were

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presented earlier at a conference of the *International Seminar of Public Economics* (ISPE) in Vaalsbroek. Many experts in the field of population economics were present to discuss the issues of an aging population. The papers that finally ended up in the volume varied from highly theoretical to detailed empirical work.

In their contribution to the volume, Eric Drissen and Frans van Winden present a general equilibrium model that gives some insights into the possible political and economic consequences of an aging population. Their ambitions are rather high in modelling the fiscal consequences of aging. They distinguish between six social groups in society (workers, capital-owning entrepreneurs, disabled individuals with and without capital, and retirees with and without capital). The fiscal consequences of aging are gauged by paying attention to changes in the number of retirees, the capital endowments of retirees, the political influence of retirees and the altruistic feelings in society for the retirees. The last two effects led to ambiguous conclusions and I will not linger on the intricacies of these results. In general, the ambiguity of comparative statics is to be expected since the model is highly interdependent. There is, however, an interesting and to a large extent unambigous effect: an increase in the number of retirees *with capital* gives rise to public and private output increases and both public pension benefit and premium decreases. The general tax rate is not affected. To trust their conventional-wisdom bashing one would like to see a full-fledged dynamic model. Although the authors give their readers the impression that one can interpret the results as such (see p. 4), I have my doubts. To give just a simple example, in a dynamic model it makes a lot of difference whether an increase in the number of retirees arises from an increase in life expectancy or in ealry retirement, whether the economy is dynamically efficient. The dynamics can certainly be found in the paper written by David Wildasin. He stays closer to standard models of overlapping generations as he looks into the question of the possible deadweight losses of aging. Some of the innovations that he introduces are public educational expenditures, individual expectations about social security benefits, and a general utility structure. Perhaps on account of the simple nature of his model, Wildasin derives rather strong conclusions. Under moderate assumptions about the future demographic state of the U.S., the cost to workers of the increase in social security benefits will double by 2025–2050. The consequences are aggrevated or mitigated by varying the labor supply elasticity and the population decline scenarios.

The issue of public pension finance is again highlighted in contributions by Blanchet and Kessler, Boadway, Marchand and Pestieau, and Peters. The big selling point of the analysis by Didier Blanchet and Denis Kessler is that one gets an impression of the sensitivity of normative financial policy implications with respect to the intertemporal substitution elasticity, the degree of aging of the population and the manner in which expectations are formulated in deriving conclusions about optimal pension funding. For instance, the formation of a trust fund receives low justification with a welfare function which assumes a high substitutability between consumption of the successive cohorts. Moreover, unlike numerous other pension studies, the property of constant factor prices is not assumed but rather endogenized.

The paper by Robin Boadway, Maurice Marchand and Pierre Pestieau is, despite its conventional set-up, very informative. They examine the optimal pay-as–you-go social security scheme in the face of a changing demographic structure. The reason that their paper is an innovation is that they use a time-dependent (but exogenous) population growth rate which they exploit in a transparent manner, a feat not easily accomplished

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in the wide-ranging literature on overlapping generations models. One gets an idea of the extent of resource smoothing in a closed economy *vis-a-vis* a small open economy.

The paper by Wolfgang Peters is perhaps too conventional because it is hard to detect a novel insight. Peters analyzes the optimal public pension finance question for economies that encounter population decline and low birth rates. In that respect it is a stroke of bad luck for Peters to be included in a volume with the above cited papers. There is too much overlap. But then again one could argue that it is the responsibility of the author to bring forward new results.

The microeconomic consequences of aging are considered in the contributions by Burkhauser and Duncan and by Börsch-Supan and Stahl. Richard Burkhauser and Greg Duncan discuss some empirical results on the poverty rate among the aged in the U.S. and the impact of public policy in cushioning demographic (widowhood, divorce) and work-related events (labor disability, retirement and unemployment). They base their results on data from the Panel Study of Income Dynamics (PSID) which covers the period from 1968 to 1986. Although their results confirm my hunches about the American social security system, they are still striking. Although the U.S. system does a satisfactory job in preventing severe financial harship from most work-related events, it is less effective in cushioning the hardship from such events as death of a spouse and divorce, especially for women. In general, women of all ages have a higher risk of poverty than the men, and the risk is highest at older ages.

Axel Börsch-Supan and Konrad Stahl add more economic theory to their results than Burkhauser and Duncan do. They try to explain an intriguing irregulatiry in West German consumption patterns. The life-cycle theory of consumption predicts that consumers save when they work and they dissave when they retire from the work force. Based on the West German Income and Expenditure Survey they observe the following pattern: net savings are lowest between the ages of 35 and 45 and then savings increase to a peak at the retirement age. This peak is followed by a massive decline after the retirement age. And then the irregularity appears; net savings increase again to reach a life-time maximum at the oldest age category. Examination of both expenditure patterns and asset accumulation leads to the same conclusion: the life-cycle theory has to be adjusted to account for this aging phenomenon. Börsch-Supan and Stahl try to account for this by paying attention to age and health-related consumption constraints. Other explanatory elements of a theory like cohort effects, mortality risk, an operative bequest motive and precautionary savings are discarded by them as not being relevant for the West German data.

The labor market implications of aging are examined in two papers by Zimmermann and Apps. Klaus Zimmermann employs the latest econometric techniques, such as cointegration, in order to detect regulatities in the West German labor market data. Specifically, he tries to find out whether generation size and structure are of importance in understanding German unemployment time series. The inspiration for his work can be found in the American labor market literature where larger cohorts seem to have depressed earnings conditions on entry in the labor market. In a dynamic setting, the effects of cohort size and structure may set in motion a cycle of earnings and fertility. Individuals born into a small cohort have a high relative income compared with individuals born into a large chort, affecting their fertility decisions more positively. Zimmermann does not find sufficient evidence that in the long run young cohorts experience higher unemployment rates if their cohort size is relatively large. However, in the short run there is a positive impact of relative cohort size and age on unemployment.

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Finally, Patricia Apps shows how reforms to the Australian tax-benefit system affects the income distribution and the male and female labor supply. The paper is an excellent example demonstrating the importance of distinguishing between male and female economic behavior. The tax reform boils down to a greater reliance on proportional taxation and a welfare system that is targeted more stringently on combined family income in order to cut government expenditure. The reform is likely to cause the tax burden to shift to lower and middle-income households with a second earner and it produces negative labor supply effects. Projecting the reformed tax system into the future of aging populations it turns out that working married women contribute disproportionately to the rise in government expenditure on retirement incomes. Although the setting is Australian, I think the lessons are more or less applicable to any developed country.

In conclusion, the volume of Bös and Cnossen contains a rich menu of economic analyses of aging. For those who dislike 'foreign' food for thought there are a number of standard and straightforward analyses. For economists who like spicy surprise the volume offers papers by, for instance, Börsche-Supan and Stahl, and Blanchet and Kessler. The empirical papers are all, without exception, theory-provocative, *i.e.* they challenge received theory or opinions. For those inspired by empirics there is enough material to construct models that do more justice to the intricacies of aging populations. Some contributions are, however, not as palatable as one would like them to be because of their style, their unneccesary complex nature, and the fact that some papers only touch tangentially on the fiscal implications of aging. This is a drawback that one encounters quite often in the high-brow economic journals and this indigestion is not caused because the reader is not used to high protein food. The most important ideas in economics are simple (*i.e.* analytically tractable) and therefore well-understood. The economics of aging populations can be made simple. Some contributions in the Bös-Cnossen volume are indeed simple and increase our knowledge of the fiscal implications of aging populations considerably. The most important contribution of the authors of this volume is in stimulating further thought on the economic analysis of aging. What more can one ask of a series on population economics?

Hendrik P. van Dalen

Matthew B. Canzoneri, Vittorio Grilli and Paul Masson (eds.), *Establishing a Central Bank: Issues in Europe and Lessons from the US*, Cambridge University Press, Cambridge, *etc.*, 1992. Pp. 307. £29.95

This book is the outcome of a conference 'Designing a Central Bank' that was held in May 1991. This timing (before 'Maastricht') implies that information in some papers is outdated. Much of the analyses presented are, however, still very worthwhile reading. The book contains an introduction by the editors and eight papers which come under three headings: the design of a central bank, the transition from national central banks to a European central bank and fiscal policy requirements of a common currency area.

The first paper by Barry Eichengreen provides a concise history of the evolution of decision-making within the Federal Reserve System. In the beginning decision-making reflected conflicting regional preferences of the 12 district reserve banks that all issued

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