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KALEIDOSCOPE

Broader Investment Horizons for an Aging World

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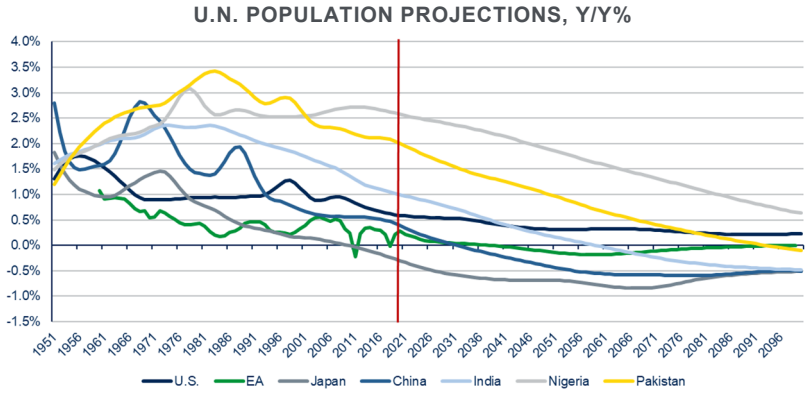
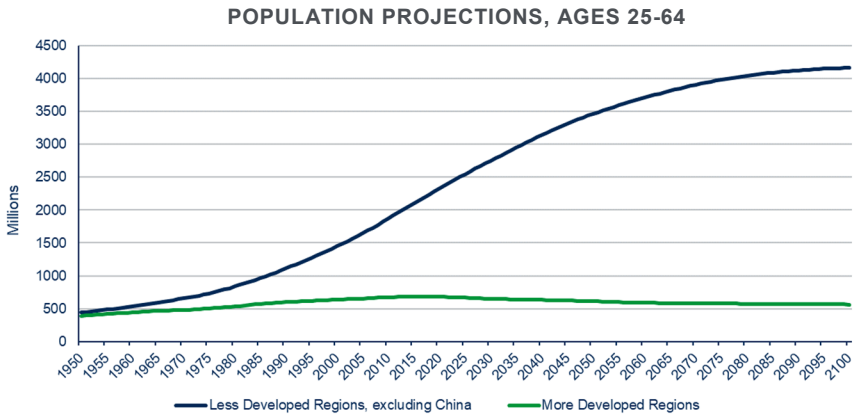
In a deeply uncertain world, there is one certainty. Young, booming populations in emerging markets (EM) have started outpacing those in aging, rich countries and might provide just the opportunity needed to fill job openings, support growth and even—finally—overcome the barriers that are keeping capital from flowing towards EMs. These accelerating and diverging trends will likely result in a shortage of workers in advanced economies, forcing firms to find workers and support growth in poorer, less-developed but younger regions. If older, wealthy countries need higher returns for their retirements and more workers to employ, and dynamic emerging economies need more capital to grow, perhaps at long last there's a deal to be done.



Source: Our World in Data and the United Nations. As of February 22, 2022.

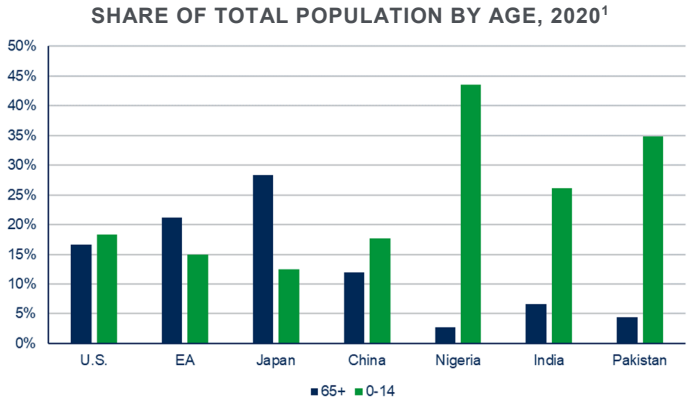
Younger, Fast-Growing EM Populations will Account for More of the Global Potential Labor Force

Developing economies will make up an increasingly greater share of the world's potential workforce. Projections from the United Nations suggest that, by 2042, less-developed regions (excluding China) will account for 70% of the world's working age population between the ages of 25-64, compared with just 56% in 2010.



Source: Our World in Data and U.N. As of February 22, 2022.

The average global fertility rate in 2019 was almost double in low-income countries, at 4.6, what it was in high-income countries.[1] Meanwhile, those age 65 and over comprise a much larger share of developed countries' populations. This means that developed countries will see a much smaller replacement rate, so these diverging trends between EM and Developed Market (DM) demographics are set to accelerate.



Source: World Bank. As of February 22, 2022.

Meanwhile, Aging DM Populations will Likely Lead to Worker Shortages

Headlines over the past year have highlighted shortages of workers in the U.S. and U.K., and population trends will likely exacerbate these strains in the future. As populations age and birth rates continue to fall, companies will need to look elsewhere to find workers.

A 2021 study by the Center for Global Development calculated that, without immigration, high- and upper-middle income countries will need an additional 667 million people between the ages of 20-64 to maintain the same dependency ratio in 2050 that they had in 2020. Meanwhile, low- and lower-middle income countries would have 463 million

[1] https://www.cgdev.org/publication/global-mobility-confronting-world-workforce-imbalance

more people in this age group than are needed to keep their dependency ratios constant over the same time period.

Mass immigration is an unlikely solution, particularly as political pressures lead more countries to turn inward and attitudes towards immigrants in many developed countries have been less welcoming in recent years. Companies in developed regions may just have to look beyond their borders to find workers and support economic activity at home.

Obstacles to Tapping into Developing Markets Growth

This is no easy task. Firms that engage with workers in less-developed economies will have to confront and address governance challenges, burdensome business climates, and unfamiliar regulatory environments. Employers will need to offer higher wages to attract and hire workers in developing countries. Education and skill levels also differ between and even within countries. All of these are reasons why advanced economies' corporates will likely find themselves making significant investments in less-developed economies to find, train, and pay the workforce they need to span a more global footprint.

Overcoming these hurdles would raise standards of living in developing countries, and rising incomes could support greater demand for housing, consumption, infrastructure, and technology. Meanwhile, these workers would also support growth and businesses in developed economies, as well as deliver higher returns on capital.

While theory has long suggested that capital should flow from rich to poor countries, so far this has not been the case in practice. Some possible reasons include:[2]

- Governance challenges, burdensome business climates, and less-competitive markets that create greater challenges for companies.
- Unfamiliar regulatory environments that add uncertainty and costs.
- A skills mismatch in less-developed economies makes it harder to fill the needed jobs without more investment.
- Central banks in developing countries have accumulated reserves to cushion the shocks of global financial crises.

Another reason may be that friction in either financial or goods markets prevents net capital transfers. Nicholas Ford and Charles Yuji Horioka[3] argue that net flows of capital cannot take place with transfers of financial capital alone, unlike gross flows of capital. Rather, they argue that net capital flows can only be achieved if global goods markets are also integrated. However, frictions in the global goods market have obstructed the net flow of capital.

Is Now the Moment?

If the imperative to expand workforces globally is strong enough, given the diverging demographic trends, could this be the catalyst to help reverse the capital flows

[2] https://carnegieendowment.org/2011/06/23/capital-flow-conundrum-pub-44798#:~:text=Economists%20and%20policy%20makers%20alike,simplistic%3B%20it%20is%20also%20dangerous
[3] https://www.nber.org/system/files/working_papers/w22081/w22081.pdf

conundrum and encourage companies and investors to target goods and infrastructure in developing countries?

Moreover, tapping into global labor forces provides opportunities for investment, such as education and upskilling workforces abroad, particularly given rapidly advancing technologies that would allow some of this to be accomplished remotely. However, if businesses in developed economies fail to find innovative ways to expand, upskill, or automate their workforces, they will face a future of tight labor markets, rising wages and slow growth given demographic trends.

Despite calls for countries to be self-sufficient in the wake of the pandemic and amid rising populist pressures, the global economy remains deeply interconnected—as today's oil markets remind us. With growth in developed market labor supply set to slow, younger and more dynamic populations in emerging markets provide new opportunities. Of course, some countries will be easier to tap into than others and there will be plenty of challenges on the way. But the logic of global demographic trends means that investors may have no other choice than to try.

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