

# **Demographic Change, Relative Factor Prices, International Capital Flows, and Their Differential Effects on the Welfare of Generations**

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## Policy Abstract

This study focuses on the relationships between demographic trends, international resource flows and macroeconomic changes across countries, and across generations within countries. As the working age population declines, for example, labor will become scarcer, relative to capital, real wages will increase and real rates of return to capital will decrease. The welfare implications of changing factor prices differ across generations, as younger generations gain from wage increases, and older generations lose from lower capital returns. The goal of this project is to quantify these effects in an international context, accounting for international flows of resources across countries. The study finds that the rate of return to capital decreases by roughly 80 to 90 basis points if capital is allowed to flow freely across regions. The simulations indicate that capital flows from rapidly aging regions to the rest of the world will initially be substantial, but that trends are reversed subsequently. In terms of the generational welfare effects, the simulations suggest that for younger households with few capital assets, increases in wages will dominate the decline in rates of return on capital. For example, abstracting from social security and its reform, the cohort born in 2005 will gain about 0.6-0.9 percent in terms of lifetime consumption. Older, asset-rich individuals, on the other hand, tend to lose because of the decline in interest rates on capital.