Mountains are thrown up by colliding tectonic plates, but the forces at work in their creation are hidden from view and were, for a time, ill-understood. In advanced societies in recent decades, we have seen striking changes in work, investment and income distribution, yet central bankers and ministers of finance, among others, have failed to grasp the underlying forces that brought them about. In “The Great Demographic Reversal,” Charles Goodhart and Manoj Pradhan, both Britain-based economists, vividly document past demographic changes, along with their broad effects, and outline the strikingly different changes that, in their view, are soon to come. Not only is their book well argued, but it is bold as well. It defies the conventional wisdom that inflation will not be a problem in the near future.

The authors begin by focusing on a critical event: the opening up of an urbanizing China—as well of other, smaller countries, especially in Asia and Eastern Europe—and the insertion of many millions of low-paid workers into the global trading system. This increased workforce sharply increased the production of goods and services, which put downward pressure on global prices. But the wages of workers in advanced countries fell even more as employers moved production offshore or made credible threat to do so. Unskilled and semi-skilled workers bore the brunt of the wage shift, and income inequality rose accordingly.

The ramifications of this positive supply shock, as Messrs. Goodhart and Pradhan show,
were wide-ranging. With domestic wages flattened or lowered, and offshore investment beckoning, domestic investment in new plant and equipment stagnated, and income was distributed ever more unequally. The combination of rising global supply and falling domestic demand also had financial effects: With inflation suppressed, interest rates fell to historic lows. This is the world we see around us now. In the U.S., at the moment, the 10-year Treasury yield is less than 1%; the European Central Bank charges commercial banks for holding deposits with it; and there are now around $17 trillion of bonds worldwide offering a negative rate of return.

As convincing as their portrait of past trends may be, Messrs. Goodhart and Pradhan, in “The Great Demographic Reversal,” are intent on arguing that things are going to change again. Indeed, they note that the new trends are already becoming evident. Urbanization in China is slowing, and its working-age population is shrinking. In advanced countries, the ratio of “dependents” to workers is rising sharply as baby boomers retire. Retirees are not only living longer but are increasingly prone to dementia at older ages. As the need for caregivers intensifies, there will be fewer workers available for other work.

A rising dependency ratio, Messrs. Goodhart and Pradhan explain, is inherently inflationary, since “dependents” consume but do not produce. Meanwhile, workers are likely to consume more as a shortage of labor pushes up wages, and investment will rise in advanced countries as companies substitute capital for more expensive labor. In short, demand will rise even as supply potential falls. While new technology could increase productivity enough to offset the shortage of workers, the authors (quoting conflicting views by respected experts) refuse to assume that it will.

Extrapolating from these prospective developments, Messrs. Goodhart and Pradhan foresee income inequality narrowing—and inflation and interest rates going up. To some, like poorer workers and soon-to-retire savers, these shifts will obviously be good news. But they could well cause severe problems for governments as well as for agents in the private sector that, under the influence of low interest rates, have taken on outsize debt. Messrs. Goodhart and Pradhan ponder various approaches to a debt overhang without endorsing any one policy: e.g., debt restructuring and, for governments, higher or new taxes (e.g., taxes on land and carbon).

It’s hard not to conclude that the authors expect inflation to be a significant part of the solution, since it is easier to pay back loans in dollars that are worth less.

Undoubtedly “The Great Demographic Reversal” identifies crucial if overlooked forces that may lead to an inflationary future and higher interest rates. But there are other forces at work to which the authors might have given more attention. A complementary narrative might emphasize, for instance, the role of central banks. They have helped to
bring us to our current state, by an excessive reliance on monetary stimulus and debt expansion, and their future policies might yet lead us into a world quite different from the one that Messrs. Goodhart and Pradhan project.

In recent years, central banks, instead of letting prices fall “naturally” in response to demographic shifts, have resisted such a price decline with ever more aggressive monetary expansion. Moreover, the resulting borrowing has gone toward consumption more than productive investments. Debt, both public and private, had hit record high levels even before the pandemic and had been recognized as a “headwind” constraining economic expansion. The economic effects of the pandemic had to be met with still more expansion, adding to the debt-overhang problem. Worse, easy money and easy access to credit can, over time, threaten the stability of the financial sector as the “search for yield” draws investors to riskier creditors. Should these conditions culminate in another financial crisis, a debt-deflation spiral might follow—not inflation.

Even if Messrs. Goodhart and Pradhan are right to predict an inflationary future, inflation might hit much higher levels than the authors suggest. Indeed, history shows that high inflation is a common outcome when large government deficits are increasingly financed—as they are now—by central banks. Still, “The Great Demographic Reversal” provides an instructive glimpse of a possible future and a reminder of the forces that have brought us to this point. No one can say we haven’t been warned.

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Appeared in the December 8, 2020, print edition as “The Perils Of Aging.”