



# The Coming Generational Storm

What You Need to Know about America's Economic Future

by Laurence J. Kotlikoff and Scott Burns MIT Press © 2004 274 pages

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# Take-Aways

- The U.S. population of people older than 100 will rise from 60,000 to 600,000 by mid-century.
- The "pig in the python" effect describes the bulge caused by the baby boom generation.
- Demographics show that America is becoming "one big retirement community."
- Our culture is essentially shopping with the credit cards of our children, running up huge debts that they will have to repay.
- Generational accounting measures the debt burden that one generation leaves the next.
- Accumulating huge government debt and social security entitlements amounts to fiscal child abuse.
- To cover the gap in revenue, payroll taxes will need to rise permanently by at least one-third.
- Technology will not solve this problem.
- It has been suggested that the U.S. conduct a national yard sale to sell off assets to pay for the debt. This won't work.
- As the government inflates the money supply to reduce its debt burden, gold may again become an attractive shelter for capital.

Rating (1	0 is best)		
Overall	Applicability	Innovation	Style
9	8	9	10



### Relevance

#### What You Will Learn

In this Abstract, you will learn: 1) The problems presented by the mass retirement of the baby boom generation; 2) Its financial impact, including the future burden of "fiscal child abuse;" 3) What the government could do; and 4) What you should do to protect your assets.

### Recommendation

This volume is infinitely more thoughtful than most of the books that point to the expected insolvency of the Social Security system and pronounce that the fiscal sky is falling. After all, the U.S. economy has weathered plenty of fiscal crises before, but those in power have barely addressed this one. Authors Laurence J. Kotlikoff and Scott Burns ask you to realize that the government is saddling your children with unbearable debt. One by one, they strip away all the supposed answers to the demographic bulge and economic bust that characterize the impending mass retirement of the baby boom generation. They demonstrate that the dwindling number of working-age citizens simply will not be able to support the coming onslaught of retirees. The python has eaten the rabbit, but will it be able to swallow? Kotlikoff's "generational accounting" explains that government is running up charges on our kids' credit cards. And like any bill that doesn't get paid, this one will keep getting bigger. getAbstract.com recommends this nicely crafted book to all responsible citizens.

# **Abstract**

#### **Generational Tsunami**

Forget Bob Dylan's classic "Forever Young." Based on America's graying demographic, the new ballad ought to be "Forever Old — at least for the foreseeable future." The times they are a changing, and a tidal wave of aging baby boomers is about to slam down on our economy. Consider one statistic. Today, some 60,000 U.S. citizens are 100 or older. By the mid-century, there will be 600,000. Just to house the centarians, you would need a city slightly larger than current-day Washington, D.C. (population 567,000). Carefully consider the economic challenge presented by this aging population.

#### The Tip of the Age-berg

Why is the economy facing a coming generational storm? These facts help explain:

- If you were born in 1900, your life expectancy was 47.
- Your chance of living to age 65 or older was less than one in 20.
- Now, life expectancy is 76, and gains in life expectancy appear to be accelerating.
- By 2000, 12.4% of Americans were older than 65.
- The nation's population reached 76 million in 1900, doubled to 151 million by 1950 and nearly doubled to 286 million by 2000. Projections are it will pass 300 million in 2006. (Editor's note: A share of that growth does not come from births but from immigration.)

Countering this, family sizes are shrinking. In several European countries, the fertility rate is low enough to cause eventual shrinkage of the population. In the U.S., just enough babies are being born to hover near the population replacement rates. The result is the

#### "This book delivers a demographic and fiscal reality check, and in ways you've probably never seen before."

"The public doesn't know what's going on for two reasons. First, the government's compass really is broken. It's using the amount of official federal debt to measure our fiscal position, when the true liabilities facing the nation are 12 times larger."



"Second, the government has been working overtime to either fudge or outright conceal this fact."

"Every postwar administration has passed the generational buck when it comes to paying for what it spends, so there's plenty of blame for both parties to share."

"But passing the buck needs to stop here, with our generation."

"The tidal wave of baby boomers...is moving inexorably from changing diapers to wearing them." familiar "pig in the python" effect: baby boomers are aging and fewer workers will be available to fund their retirements.

## The Perfect Demographic Storm

In 1950, there were 16.5 workers per Social Security beneficiary. That ratio fell to 3.4 by 2000. By the time the last baby boomers retire in 2030, there will be only two covered workers per beneficiary. Obviously, workers' wages will no longer be sufficient to support the payments promised to those retirees. The aging American population is not a temporary phenomenon. The number of folks 65 and older will increase from 35.5 million in 2000 to 69.4 million in 2030, a trend that will continue through 2080. The Social Security Administration suggests that the population of elderly will rise to 96.5 million by 2090. You could hardly exaggerate the social and economic effects of this aging of America, which is becoming one rapidly expanding retirement community.

## The Buying Binge

American government today is shopping with our children's credit cards, amassing tremendous debts that the young will be unable to pay. They will be saddled with a huge economic burden, like a man in a rubber raft watching a tidal wave bear down. The American electorate probably would not permit this if they understood it. The solution is generational accounting, which sounds new but has been around for about 15 years. Some 30 countries already use it, including such far-flung examples as Argentina, Finland, Iceland, Korea and Israel. Generational accounting measures the daunting mountain of debt being left to future generations.

Inflation is the most common way to address debt. Inflation becomes a way to renege on debt, because it reduces the value of the debt by adding money into the money supply. Too much money creation diminishes the buying power of each dollar. The significance of the debt is diminished as well, as the government simply generates the money to pay its debts by increasing the money supply. This approach creates continually rising prices, which are socially and economically disruptive. The formula is very simple. When government runs up bills, whether due to the war on terror or social security entitlements, someone will have to pay — the current generation or future ones. No other alternative exists.

#### **Fiscal Child Abuse**

How serious is the debt being left for the future? To pay it off, upcoming generations face a lifetime net tax at approximately double today's rate, according to calculations by respected government economist Dr. Jagadeesh Gokhale, a senior economic adviser to the Federal Reserve Bank of Cleveland.

The figure commonly used to describe the Social Security system's fiscal shortfall is \$3.5 trillion. The <u>situation is actually much more serious</u>, if you look a little farther in the distance. An approximately \$10.5 trillion deficit looms according to figures in the Social Security Trustees Report, which indicates that the system is about three times worse than the public has been led to believe. Current discussions have suggested a permanent 2% increase in payroll taxes to cover future Social Security deficits. Instead, meeting the true costs would call for a hike near 4.5%. This amounts to raising the combined employer-employee Social Security payroll tax by about one-third. Of course, Social Security spending is only one aspect of the overall budget deficit that later generations will have to pay for, unless the current generation commits to doing something about it now.



"Like it or not, ready or not, everyone reading this book will experience the greatest demographic change in human history."

"If you forget its liabilities, the federal government is very rich."

"Two-thirds of our government's fixed assets are used in our nation's defense."

"The lesson here is that we can't be sure about technology and future economic growth. Actually, we can't even be sure about past economic growth."

#### **Snake Oil Cures**

Some of the popular myths that suggest ways to address the revenue gap include:

- Technology will solve everything As workers become more productive, fewer workers will be able to generate more income. This will equip future generations to carry more debt burden than seems feasible today. The first problem with this notion is the assumption that the economic results of technology's march will be smooth and positive. The dot-com bust suggests otherwise. Secondly, this concept overlooks the fact that the Social Security benefits system is structured in such a way that benefits increase as the economy grows. The entitlements increase is based directly or indirectly on the economy's performance. Thus, higher productivity would increase real wages and raise the cost of goods and services that the government buys. These factors suggest the U.S. cannot produce its way out of the deficit.
- The national yard sale The government has a lot of assets, and owns a lot of valuable land. In hard times, the government could simply sell some of its stuff. Unfortunately for this idea, most of the country's assets are not in a readily saleable form. Some 60% of the U.S.'s fixed assets provide for its national defense. And, the market isn't clamoring to buy aircraft carriers, even if the U.S. wanted to sell them.
- <u>Capital deepening</u> Capital deepening refers to the tendency of wage earners to accumulate capital over their lifetimes. Hence, this notion goes, future generations will have more capital, and will be in a better position to pay for government and Social Security. That is not the case. The likelihood is that future generations will have less capital, not more. The reason is taxes. As payroll and other taxes increase, future generations will save less. Many models suggest today's children will have 40% less take-home pay than their parents.
- <u>Direct contribution plans</u> Many employers match contributions employees make to private pension plans, thus encouraging workers to save vast sums for their retirement. So, this concept asks, can the financing of boomer retirement be privatized in whole or part, relieving the burden on the Social Security system? The error here is that when direct contribution withdrawals are eventually made, they are taxable. When the full effect of the deficit is felt, income taxes will go up. By the time boomers start to withdraw from pre-paid retirement accounts, they will face stiff tax rates. Employees are probably overestimating the benefits of these programs, even assuming that their assets are not in the form of stock investments in companies such as Enron. These investments can be very risky. If the company goes south, you lose your job and your nest egg.
- <u>Delayed retirement</u> Boomers can all simply keep working. Sadly, delayed retirement has a negligible effect. Workers who delay retirement often save less, because they have fewer retirement years to finance.
- <u>Let the immigrants pay</u> The U.S. can open its floodgates to immigrants, who will gladly come in and work, and their payroll taxes will finance the system. Not so fast: the U.S. already arrests more than a million illegal immigrants annually, and this prospect raises major homeland security issues. And, even immigrants who work and pay taxes may also need government services or benefits.
- <u>Privatization</u> There is growing talk of phasing in a plan encouraging participants to leave Social Security, in whole or in part, and invest in stocks. This overlooks the fact that stocks are a risky investment. You can also expect the government to increase the taxes to be paid on Social Security and other retirement benefits, in whatever form they may come.



"The measurement of economic growth is far from perfect, and some of what gets recorded as increases in national output is anything but a real and permanent gain."

"The 1990s was marked not only by lots of useless telecom investment, but by tens of billions of dollars of investment in Internet companies, like pets.com, that are now defunct."

#### **Solutions?**

If those answers don't work, what will? Well, the answer may be a three-pronged approach. The government could decide to tax more, to borrow and to incite sufficient inflation to water down the real value of the debt and, therefore, reduce its burden. The problem with this is that inflation is bound to rear its ugly head. With 10% inflation, everyone earns more and pays higher payroll taxes. On the downside, with inflation, money doesn't go as far or buy as many goods as it once did. Given that reality, the real question becomes, what can individuals do to weather the economic disruptions headed our way? How can you secure your future against the coming generational storm?

### Weathering the Storm

First, do not put much faith in the "<u>retirement-investment complex</u>." These are the bankers, brokers, mutual fund managers and financial advisers who purport to help you prepare for retirement, many of whom work diligently to separate you from your money. False promises, poor objectives and excessive fees all spell disaster for investors who rely too much on financial professionals to direct their future financial security.

Instead, save like mad, use investments that offer tax shelters and hold non-taxable assets. Based on the likelihood of inflation and a dubious Social Security system, consider these specific options:

- Adjust your standard of living Reduce now, to save more for the future.
- <u>Delay retirement</u> This increases your Social Security benefits and builds savings.
- <u>Downsize your home</u> Many seniors already trade in their big homes for smaller residences as they get older, using the capital difference to help fund their retirement. Be forewarned, however, that millions of other baby-boomers will be trying to do exactly the same thing within a relatively short time period. This may weaken the market for your old home, reducing the viability of this option unless you get smart and sell sooner rather than later.
- <u>Move in with your kids</u> This only works if your children will permit it and you can stand it. For many, it is not a solid alternative.
- Relocate Move to an area with a much lower cost of living.

Oh, and one other suggestion. Because the government is doing everything it can to stoke up the fires of inflation, consider the age-old shelter of investing in gold. It's an excellent hedge against an inflated dollar.

# **About The Authors**

Economist <u>Laurence J. Kotlikoff</u> is a professor of economics at Boston University and a Research Associate at the National Bureau of Economic Research. <u>Scott Burns</u> is a personal finance columnist with the *Dallas Morning News*. His work is syndicated nationally by Universal Press.