Implications of an Aging Society

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Fact: The world is getting older. In virtually all academic research on global demographics there is uniform agreement that people are living longer. Additionally, the fertility rates in developed nations, and to a lesser extent developing nations, are also trending down over time. The real world implications of these two simple statements are astounding. The reason to understand and discuss these outcomes, is that they will likely have a direct impact on the financial well-being of you, your family, your country, and the global economy. This paper will outline some of the implications, possible outcomes, and potential remedies. We hope it will serve as an informative piece that generates thought and discussion.

Fact: Everybody who will be age 65 in 2025 has already been born. What this demonstrates is that the current demographic momentum is immutable and certain. Even if everyone in the U.S. started having more children this instant, those children would not enter the work force for 2 to 3 decades. Thus, unlike many social sciences where outcomes can be somewhat nebulous, in the field of demographics, barring pandemic plague, or a life extinction event like a comet hitting the planet, these demographic trends are certain to unfold over the next 20-40 years.

To understand the magnitude of the issue, consider this research: "Today's developed countries stand on the threshold of a stunning demographic transformation. Throughout most of history until well into the Industrial Revolution, the elderly (aged 65 and over) comprised a tiny fraction of the population – never more than 3-4 percent in any country. In the developed world today, they comprise 16% of the population. By 2030, the share is projected to rise to 23% and by 2050 to 26%. In some fast-aging countries of Western Europe, it will reach 35% by 2050- and in Japan it will approach 40 percent." [1] So, we have a problem that is unprecedented in history which represents an average 6 fold increase in elderly populations vs. the historic norm over the next 30 years or so.

The problem, however, does not end there. Due to the composition and timing of the various birth cohorts, commonly referred to as baby boomers, echo boom generation, gen x'ers, millennials etc., "Most developed countries will not only have aging populations, but also stagnant or declining ones. By around 2015, working age populations (aged 20-64) in almost every developed country will cease growing and in many cases begin to contract, the only major exception being the United States. By 2050, there will be 27 percent fewer working-age Germans than today and 39 percent fewer working-age Japanese." [2] In actuality, many countries will face absolute declines in their total populations, in addition to the reduction in working populations.

For example, Russia has a nasty combination of extreme below-replacement fertility and generally high morbidity partially due to

[1] The Graying of the Great Powers by Richard Jackson, Neil Howe, Center for Strategic and International Studies, 2008, page 7.

[2] The Graying of the Great Powers by Richard Jackson, Neil Howe, Center for Strategic and International Studies, 2008, page 7.

AIDS, a poor health system, and excessive per capita alcohol consumption. The result is an expected decline of 31% in total population from 2005-2050, from 144 million to 99 million people. The geopolitical implications of this single fact alone merit significant discussion, mostly beyond the scope of this paper. The wide ranging nature of demographic impacts, however, makes it worth a small digression for illustrative purposes

In the context of a discussion on the future economic and security needs of his country in 2006, President Vladimir Putin said that Russia's declining birth rate is "the most acute problem facing our country today." [3] Some potential negative consequences of depopulation could include economic malaise caused by eroding growth and declining tax bases, the closing of schools and businesses, and reductions in community size and vigor. When coupled with higher dependency rates of an older population upon a smaller supporting population, the overall productive capacity of the country will likely decline. Additionally, Putin may be concerned about a shift in the composition of the Russian ethnic population. Due to differentials in birth rates between the majority Orthodox Slav population and the large Muslim minority, over time, Russia will become less ethnically Russian. Demographic forecasts suggest that the Muslim share of the Russian population will grow from around 14% in 2005 to circa 25% by 2050. [4]

[3] "Vladimir Putin on Raising Russia's Birth Rate", Population and Development Review 32, no. 2 (June 2006)

[4] World Population Prospects: The 2006 Revision (New York: UN Population Division, 2007)

Michael Manville wrote in the Washington Times that same year, "Some projections are much higher, and at least one expert predicts that Russia will be majority-Muslim by mid-century." [5] When leaders of a country recognize that their geopolitical ambitions may be threatened, they may act unpredictably. Similarly, when an ethnic group feels imperiled, they may galvanize around an aggressive orientation towards others. According to a 2007 survey by the Pew Research Center, "Twice as many Russians (63% vs. 27%) say that a "strong leader" is more important for solving the country's problems than a democratic government." [6] In this case, the twin impacts could lead towards a nationalist neo-authoritarian regime with destabilizing actions in the region - think Ukraine.

So, by now you might be wondering what all this means and how it could affect you? Here are some of the conclusions and implications:

1) An aging population implies more retired people. Everyone knows that this will impact the US Social Security System. Alan Greenspan, then Chairman of the US Federal Reserve Bank, acknowledged as much in 2003 during his testimony before the Special Committee on Aging, U.S. Senate when he stated, "As you know, the aging of the population in the United States will

[5] Michael Manville, "Muslim Birthrate Worries Russia; Majority seen by Midcentury," The Washington Times, November 21, 2006

[6] "World Publics Welcome Global Trade – But Not Immigration," Pew Global attitudes Project, Pew Research Center, Oct. 4, 2007, page 65

have significant effects on our fiscal situation. In particular, it makes our Social Security and Medicare programs unsustainable in the long run, short of a major increase in immigration rates, a dramatic acceleration in productivity growth well beyond historical experience, a significant increase in the age of eligibility for benefits, or the use of general revenues to fund benefits." [7] So the elephant in the room is in plain sight, yet, our politicians continue to postpone making any lobbying entities in the country today with an annual budget in excess of $1 billion dollars. Fully 30% of our population will be aging into eligibility for our entitlement programs over the next decade or so. How do the politicians take the politically repugnant but necessary actions to fix the system and still retain their jobs? The solutions probably imply some sort of means testing for eligibility, almost certainly an increase in the eligible age to receive benefits, increased taxation, and possibly tying benefits to a demographic indicator like CPI for inflation today. For the affluent elderly today who will likely have their benefits grandfathered, the key questions might be: Have I done proper estate planning? Have I established Trusts to tax efficiently pass my assets to my heirs? Have I helped educate my kids and grandchildren about the importance of savings and investment? For the middle aged and their children, the direct implication is that you might have to work longer, save more, earn more, or both, in order to offset the reduced eligibility requirements. The same type of financial planning conversations should be central in your thoughts about your future financial well-being. Adding risk reduction techniques in the form of various types of insurance products, while sometimes costly, may add to the security of your wealth and standard of living during retirement.

2) If Social Security is the elephant in the room, then healthcare- consisting of Medicare, Medicaid, and the Affordable Care Act - is the giant dinosaur sitting next to it. Greenspan further stated in his testimony, "While the prospect of a shortfall in social security is reasonably certain given the changing composition of the population, the range of possible outcomes in Medicare is far wider. Rapidly advancing medical technologies, essentially inelastic demand for medical services for the elderly, and a subsidized third –party payment system have created virtually unconstrained demand." [8] According to the Heritage Institute when commenting on the federal

[7] Testimony of Chairman Alan Greenspan, Aging Global Population, Before the Special Committee on Aging, U.S. Senate, February 27, 2003, Federal Reserve Website, Archives.

[8] Testimony of Chairman Alan Greenspan, Aging Global Population, Before the Special Committee on Aging, U.S. Senate, February 27, 2003, Federal Reserve Website, Archives.

budget, "Three major budget categories –major health care programs, Social Security and interest on the federal debt –will account for 85% of nominal spending growth over the next decade." [9] According to the Office of Management and Budget, the estimated annual spending for total mandatory programs in 2014, which include healthcare, social security and net interest payments, was $2.54 trillion dollars. In 2013 the breakdown was 22% healthcare programs, 22% Social Security, and 6% net interest. Fully half of the current US budget is already mandated towards these programs. As the demographic wave hits, these costs are expected to more than triple. The Congressional Budget Office projects that the current 3% of GDP that is deficit spending will mushroom to 13% by2035, thus a quadrupling of our annual national deficit. Medicare spending is the single largest contributor to this growth as it is expected to double as a percent of GDP spending between now and 2050. The US debt is projected to breach the 100% of GDP mark around 2028 and reach 190% by 2038. [10] As we've stated many times in our quarterly updates, clearly, this is unsustainable. Once again, the impact to individuals is fairly obvious. Some combination of reduced entitlements via means testing, spending constraints, increased taxes, or healthcare rationing will be needed to curtail these programs. The longer it takes for the government to address the issue, the worse and more difficult becomes the fix.

3) The economic impacts can be fairly broad albeit more difficult to directly forecast. Additionally, the academic literature is less unanimous about the magnitude and timing of change. Generally, the conversation suggests that economic growth will slow, rates of savings and investment could fall, public sector deficits could rise, current account balances could turn negative, and the work force could become less mobile and entrepreneurial. These seem like fairly straightforward conclusions. Fewer people working and saving implies lower GDP. Older populations tend to spend down their savings during retirement. The composition of spending will change with probable increases in health care and leisure, while reducing the accumulation of material things. If populations are in absolute decline, businesses will need to invest less to maintain production capacity. We've already highlighted the public deficit issue. If governments, like the US, choose to postpone dealing with the issue, they will need to finance the

[9] The Unsustainability of Federal Spending, Edwin J. Feulner, PH.D., Jan. 8, 2015, The Heritage Foundation website

[10] Heritage Foundation compilation of data from Congressional Budget Office, 2014 Federal Budget in Pictures, www.heritage.org

excess spending. In this case, we are dependent and will become more so on foreign capital to finance our excess consumption. What happens when a foreign agent, say China, decides they want to influence US policy in the region by exerting pressure via manipulation of our debt markets? Obviously, the economic impacts and policy responses can and will affect the global geopolitical environment.

4) In terms of geopolitics, demographic research indicates a plethora of possible outcomes. These range in discussion from the changing of social moods, immigration policy, trade policy, and national security policy. We've already shown how the demographic calculus may be influencing the policies of Russia. One could analyze and write a paper on virtually every region in the world. In the US the State Department does just that. Some of the insights from the literature demonstrate that the US is relatively better off than other developed nations. US influence within the developed world will likely increase over time as other countries like Germany, France, England, and Japan go through more difficult demographic transitions than our country. That being said, the population and GDP of the developed world will likely decrease as a percent of world totals. In terms of Sub-Saharan Africa and some Muslim nations, due to large youth populations and differentials in timing of the demographic transition, they could remain chronically unstable for decades yet to come. Areas such as the Middle East, North and South Africa, East Asia and the Soviet bloc will face extreme changes with possible consequent issues of regional war, the rise of authoritarian regimes, civil strife, and continued ethnic and religious conflict. Who would have thought that an aging population could help create such issues?

Lest you read this and think all is bleak, it is not. The US is in much better shape than most of the world. There is still a lot of time for intelligent policy to be implemented to offset many of the fiscal issues. A comprehensive and open immigration policy could partially offset the decline in working populations, thus reducing the economic impact. Enhanced trade policy could mitigate some of the issues with respect to current account deficits, debt and trade flows. Aligning ourselves with countries that have positive demographic characteristics could help us share the fiscal and security burdens which are likely to come our way. Technological innovation, the US entrepreneurial spirit, and our competitive nature could all enhance productivity and thus reduce the economic slowdown. Pension policies, both public and private that force greater savings, can act as a buffer to the decline in capital and reduce the overall debt burden. At the individual level, understanding these issues and being proactive with your own financial planning should help to keep you on the right track for wealth preservation, growth, and achieving your objectives. So, while the analysis is sobering, and the challenge is great, the outlook can still be a positive one for our society and ourselves.

Regards,

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