Gray Dawn: The Global Aging Crisis

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DAUNTING DEMOGRAPHICS

THE LIST of major global hazards in the next century has grown long and familiar. It includes the proliferation of nuclear, biological, and chemical weapons, other types of high-tech terrorism, deadly super-viruses, extreme climate change, the financial, economic, and political aftershocks of globalization, and the violent ethnic explosions waiting to be detonated in today's unsteady new democracies. Yet there is a less-understood challenge—the graying of the developed world's population—that may actually do more to reshape our collective future than any of the above.

Over the next several decades, countries in the developed world will experience an unprecedented growth in the number of their elderly and an unprecedented decline in the number of their youth. The timing and magnitude of this demographic transformation have already been determined. Next century's elderly have already been born and can be counted—and their cost to retirement benefit systems can be projected.

Unlike with global warming, there can be little debate over whether or when global aging will manifest itself. And unlike with other challenges, even the struggle to preserve and strengthen unsteady new democracies, the costs of global aging will be far beyond the means of even the world's wealthiest nations—unless retirement benefit systems are radically reformed. Failure to do so, to prepare early and boldly enough, will spark economic crises that will dwarf the recent meltdowns in Asia and Russia.

How we confront global aging will have vast economic consequences costing quadrillions of dollars over the next century. Indeed, it will greatly influence how we manage, and can afford to manage, the other major challenges that will face us in the future.

For this and other reasons, global aging will become not just the transcendent economic issue of the 21st century, but the transcendent political issue as well. It will dominate and daunt the public-policy agendas of developed countries and force the renegotiation of their social contracts. It will also reshape foreign policy strategies and the geopolitical order.

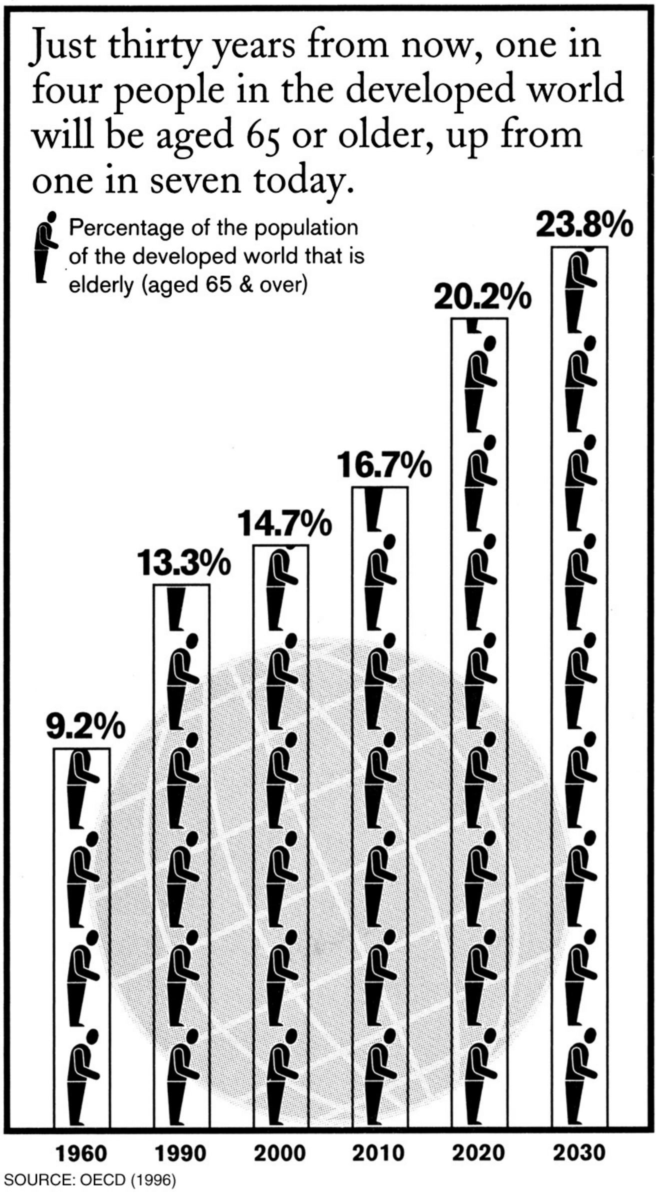
The United States has a massive challenge ahead of it. The broad outlines can already be seen in the emerging debate over Social Security and Medicare reform. But ominous as the fiscal stakes are in the United States, they loom even larger in Japan and Europe, where populations are aging even faster, birthrates are lower, the influx of young immigrants from developing countries is smaller, public pension benefits are more generous, and private pension systems are weaker.

Aging has become a truly global challenge, and must therefore be given high priority on the global policy agenda. A gray dawn fast approaches. It is time to take an unflinching look at the shape of things to come.

The Floridization of the developed world. Been to Florida lately? You may not have realized it, but the vast concentration of seniors there—nearly 19 percent of the population—represents humanity's future. Today's Florida is a demographic benchmark that every developed nation will soon pass. Italy will hit the mark as early as 2003, followed by Japan in 2005 and Germany in 2006. France and Britain will pass present-day Florida around 2016; the United States and Canada in 2021 and 2023.

Societies much older than any we have ever known. Global life expectancy has grown more in the last fifty years than over the previous five thousand. Until the Industrial Revolution, people aged 65 and over never amounted to more than 2 or 3 percent of the population. In today's developed world, they amount to 14 percent. By the year 2030, they will reach 25 percent and be closing in on 30 in some countries.

An unprecedented economic burden on working-age people. Early in the next century, working-age populations in most developed countries will shrink. Between 2000 and 2010, Japan, for example, will suffer a 25 percent drop in the number of workers under age 30. Today the ratio of working taxpayers to nonworking pensioners in the developed world is around 3:1. By 2030, absent reform, this ratio will fall to 1.5:1, and in some countries, such as Germany and Italy, it will drop all the way down to 1:1 or even lower. While the longevity revolution represents a miraculous triumph of modern medicine and the extra years of life will surely be treasured by the elderly and their families, pension plans and other retirement benefit programs were not designed to provide these billions of extra years of payouts.



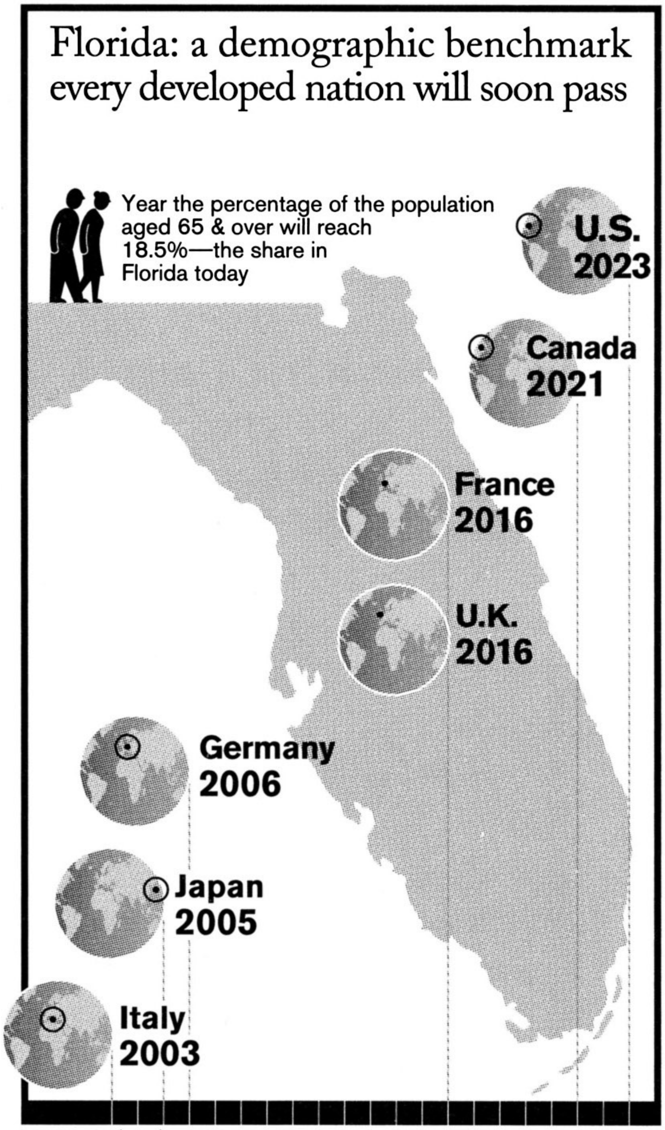
SOURCE: OECD (1996)

The aging of the aged: the number of "old old" will grow much faster than the number of "young old." The United Nations projects that by 2050, the number of people aged 65 to 84 worldwide will grow from 400 million to 1.3 billion (a threefold increase), while the number of people aged 85 and over will grow from 26 million to 175 million (a sixfold increase)—and the number aged 100 and over from 135,000 to 2.2 million (a sixteenfold increase). The "old old" consume far more health care than the "young old"—about two to three times as much. For nursing-home care, the ratio is roughly 20:1. Yet little of this cost is figured in the official projections of future public expenditures.

Falling birthrates will intensify the global aging trend. As life spans increase, fewer babies are being born. As recently as the late 1960s, the worldwide total fertility rate (that is, the average number of lifetime births per woman) stood at about 5.0, well within the historical range. Then came a behavioral revolution, driven by growing affluence, urbanization, feminism, rising female participation in the workforce, new birth control technologies, and legalized abortion. The result: an unprecedented and unexpected decline in the global fertility rate to about 2.7—a drop fast approaching the replacement rate of 2.1 (the rate required merely to maintain a constant population). In the developed world alone, the average fertility rate has plummeted to 1.6. Since 1995, Japan has had fewer births annually than in any year since 1899. In Germany; where the rate has fallen to 1.3, fewer babies are born each year than in Nepal, which has a population only one-quarter as large.

A shrinking population in an aging developed world. Unless their fertility rates rebound, the total populations of western Europe and Japan will shrink to about one-half of their current size before the end of the next century. In 1950, 7 of the 12 most populous nations were in the developed world: the United States, Russia, Japan, Germany, France, Italy, and the United Kingdom. The United Nations projects that by 2050, only the United States will remain on the list. Nigeria, Pakistan, Ethiopia, Congo, Mexico, and the Philippines will replace the others. But since developing countries are also experiencing a drop in fertility, many are now actually aging faster than the typical developed country. In France, for example, it took over a century for the elderly to grow from 7 to 14 percent of the population. South Korea, Taiwan, Singapore, and China are projected to traverse that distance in only 25 years.

From worker shortage to rising immigration pressure. Perhaps the most predictable consequence of the gap in fertility and population growth rates between developed and developing countries will be the rising demand for immigrant workers in older and wealthier societies facing labor shortages. Immigrants are typically young and tend to bring with them the family practices of their native culture—including higher fertility rates. In many European countries, non-European foreigners already make up roughly 10 percent of the population. This includes 10 million to 13 million Muslims, nearly all of whom are working-age or younger. In Germany, foreigners will make up 30 percent of the total population by 2030, and over half the population of major cities like Munich and Frankfurt. Global aging and attendant labor shortages will therefore ensure that immigration remains a major issue in developed countries for decades to come. Culture wars could erupt over the balkanization of language and religion; electorates could divide along ethnic lines; and émigré leaders could sway foreign policy.



SOURCE: OECD (1996); author's calculations

GRAYING MEANS PAYING

OFFICIAL PROJECTIONS suggest that within 30 years, developed countries will have to spend at least an extra 9 to 16 percent of GDP simply to meet their old-age benefit promises. The unfunded liabilities for pensions (that is, benefits already earned by today's workers for which nothing has been saved) are already almost $35 trillion. Add in health care, and the total jumps to at least twice as much. At minimum, the global aging issue thus represents, to paraphrase the old quiz show, a $64 trillion question hanging over the developed world's future.

To pay for promised benefits through increased taxation is unfeasible. Doing so would raise the total tax burden by an unthinkable 25 to 40 percent of every worker's taxable wages—in countries where payroll tax rates sometimes already exceed 40 percent. To finance the costs of these benefits by borrowing would be just as disastrous. Governments would run unprecedented deficits that would quickly consume the savings of the developed world.

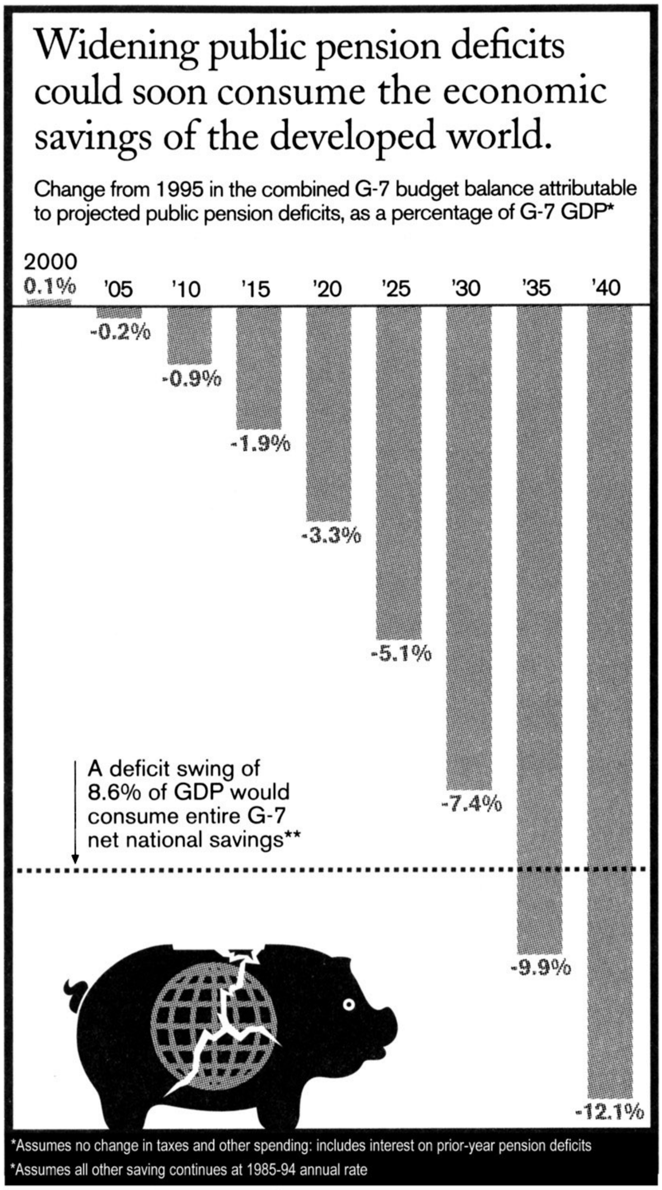
And the $64 trillion estimate is probably low. It likely underestimates future growth in longevity and health care costs and ignores the negative effects on the economy of more borrowing, higher interest rates, more taxes, less savings, and lower rates of productivity and wage growth.

There are only a handful of exceptions to these nightmarish forecasts. In Australia, total public retirement costs as a share of GDP are expected to rise only slightly, and they may even decline in Britain and Ireland. This fiscal good fortune is not due to any special demographic trend, but to timely policy reforms—including tight limits on public health spending, modest pension benefit formulas, and new personally owned savings programs that allow future public benefits to shrink as a share of average wages. This approach may yet be emulated elsewhere.

Failure to respond to the aging challenge will destabilize the global economy, straining financial and political institutions around the world. Consider Japan, which today runs a large current account surplus making up well over half the capital exports of all the surplus nations combined. Then imagine a scenario in which Japan leaves its retirement programs and fiscal policies on autopilot. Thirty years from now, under this scenario, Japan will be importing massive amounts of capital to prevent its domestic economy from collapsing under the weight of benefit outlays. This will require a huge reversal in global capital flows. To get some idea of the potential volatility, note that over the next decade, Japan's annual pension deficit is projected to grow to roughly 3 times the size of its recent and massive capital exports to the United States; by 2030, the annual deficit is expected to be 15 times as large. Such reversals will cause wildly fluctuating interest and exchange rates, which may in turn short-circuit financial institutions and trigger a serious market crash.

As they age, some nations will do little to change course, while others may succeed in boosting their national savings rate, at least temporarily, through a combination of fiscal restraint and household thrift. Yet this too could result in a volatile disequilibrium in supply and demand for global capital. Such imbalance could wreak havoc with international institutions such as the European Union.

In recent years, the EU has focused on monetary union, launched a single currency (the euro), promoted cross-border labor mobility, and struggled to harmonize fiscal, monetary, and trade policies. European leaders expect to have their hands full smoothing out differences between members of the Economic and Monetary Union (EMU)—from the timing of their business cycles to the diversity of their credit institutions and political cultures. For this reason, they established official public debt and deficit criteria (three percent of GDP for EMU membership) in order to discourage maverick nations from placing undue economic burdens on fellow members. But the EU has yet to face up to the biggest challenge to its future viability: the likelihood of varying national responses to the fiscal pressures of demographic aging. Indeed, the EU does not even include unfunded pension liabilities in the official EMU debt and deficit criteria—which is like measuring icebergs without looking beneath the water line.



SOURCE: OECD (1996); author's calculations

When these liabilities come due and move from "off the books" to "on the books," the EU will, under current constraints, be required to penalize EMU members that exceed the three percent deficit cap. As a recent IMF report concludes, "over time it will become increasingly difficult for most countries to meet the deficit ceiling without comprehensive social security reform." The EU could, of course, retain members by raising the deficit limit. But once the floodgates are opened, national differences in fiscal policy may mean that EMU members rack up deficits at different rates. The European Central Bank, the euro, and a half-century of progress toward European unity could be lost as a result.

The total projected cost of the age wave is so staggering that we might reasonably conclude it could never be paid. After all, these numbers are projections, not predictions. They tell us what is likely to happen if current policy remains unchanged, not whether it is likely or even possible for this condition to hold. In all probability, economies would implode and governments would collapse before the projections ever materialize. But this is exactly why we must focus on these projections, for they call attention to the paramount question: Will we change course sooner, when we still have time to control our destiny and reach a more sustainable path? Or later, after unsustainable economic damage and political and social trauma cause a wrenching upheaval?

A GRAYING NEW WORLD ORDER

WHILE THE fiscal and economic consequences of global aging deserve serious discussion, other important consequences must also be examined. At the top of the list is the impact of the age wave on foreign policy and international security.

Will the developed world be able to maintain its security commitments? One need not be a Nobel laureate in economics to understand that a country's GDP growth is the product of workforce and productivity growth. If workforces shrink rapidly, GDP may drop as well, since labor productivity may not rise fast enough to compensate for the loss of workers. At least some developed countries are therefore likely to experience a long-term decline in total production of goods and services—that is, in real GDP.

Economists correctly focus on the developed world's GDP per capita, which can rise even as its workforce and total GDP shrink. But anything with a fixed cost becomes a national challenge when that cost has to be spread over a smaller population and funded out of shrinking revenues. National defense is the classic example. The West already faces grave threats from rogue states armed with biological and chemical arsenals, terrorists capable of hacking into vulnerable computer systems, and proliferating nuclear weapons. None of these external dangers will shrink to accommodate our declining workforce or GDP.

Leading developed countries will no doubt need to spend as much or more on defense and international investments as they do today. But the age wave will put immense pressure on governments to cut back. Falling birthrates, together with a rising demand for young workers, will also inevitably mean smaller armies. And how many parents will allow their only child to go off to war?

With fewer soldiers, total capability can be maintained only by large increases in technology and weaponry. But boosting military productivity creates a Catch-22. For how will governments get the budget resources to pay for high-tech weaponry if the senior-weighted electorate demands more money for high-tech medicine? Even if military capital is successfully substituted for military labor, the deployment options may be dangerously limited. Developed nations facing a threat may feel they have only two extreme (but relatively inexpensive) choices: a low-level response (antiterrorist strikes and cruise-missile diplomacy) or a high-level response (an all-out attack with strategic weapons).

Will Young/Old become the next North/South fault line? Historically, the richest industrial powers have been growing, capital-exporting, philanthropic giants that project their power and mores around the world. The richest industrial powers of the future may be none of these things. Instead, they may be demographically imploding, capital-importing, fiscally starving neutrals who twist and turn to avoid expensive international entanglements. A quarter-century from now, will the divide between today's "rich" and "poor" nations be better described as a divide between growth and decline, surplus and deficit, expansion and retreat, future and past? By the mid-2020s, will the contrast between North and South be better described as a contrast between Young and Old?

If today's largest low-income societies, especially China, set up fully funded retirement systems to prepare for their own future aging, they may well produce ever larger capital surpluses. As a result, today's great powers could someday depend on these surpluses to keep themselves financially afloat. But how should we expect these new suppliers of capital to use their newly acquired leverage? Will they turn the tables in international diplomacy? Will the Chinese, for example, someday demand that the United States shore up its Medicare system the way Americans once demanded that China reform its human rights policies as a condition for foreign assistance?

As Samuel Huntington recently put it, "the juxtaposition of a rapidly growing people of one culture and a slowly growing or stagnant people of another culture generates pressure for economic and/or political adjustments in both societies." Countries where populations are still exploding rank high on any list of potential trouble spots, whereas the countries most likely to lose population—and to see a weakening of their commitment to expensive defense and global security programs—are the staunchest friends of liberal democracy.

In many parts of the developing world, the total fertility rate remains very high (7.3 in the Gaza Strip versus 2.7 in Israel), most people are very young (49 percent under age 15 in Uganda), and the population is growing very rapidly (doubling every 26 years in Iran). These areas also tend to be the poorest, most rapidly urbanizing, most institutionally unstable—and most likely to fall under the sway of rogue leadership. They are the same societies that spawned most of the military strongmen and terrorists who have bedeviled the United States and Europe in recent decades. The Pentagon's long-term planners predict that outbreaks of regional anarchy will occur more frequently early in the next century. To pinpoint when and where, they track what they call "youth bulges" in the world's poorest urban centers.

Is demography destiny, after all? Is the rapidly aging developed world fated to decline? Must it cede leadership to younger and faster-growing societies? For the answer to be no, the developed world must redefine that role around a new mission. And what better way to do so than to show the younger, yet more tradition-bound, societies—which will soon age in their turn—how a world dominated by the old can still accommodate the young.

WHOSE WATCH IS IT, ANYWAY?

FROM PRIVATE discussions with leaders of major economies, I can attest that they are well briefed on the stunning demographic trends that lie ahead. But so far they have responded with paralysis rather than action. Hardly any country is doing what it should to prepare. Margaret Thatcher confesses that she repeatedly tried to raise the aging issue at G-7 summit meetings. Yet her fellow leaders stalled. "Of course aging is a profound challenge," they replied, "but it doesn't hit until early in the next century—after my watch."

Americans often fault their leaders for not acknowledging long-term problems and for not facing up to silent and slow-motion challenges. But denial is not a peculiarly American syndrome. In 1995, Silvio Berlusconi's *Forza Italia* government was buffeted by a number of political storms, all of which it weathered—except for pension reform, which shattered the coalition. That same year, the Dutch parliament was forced to repeal a recent cut in retirement benefits after a strong Pension Party, backed by the elderly, emerged from nowhere to punish the reformers. In 1996, the French government's modest proposal to trim pensions triggered strikes and even riots. A year later the Socialists overturned the ruling government at the polls.

Each country's response, or nonresponse, is colored by its political and cultural institutions. In Europe, where the welfare state is more expansive, voters can hardly imagine that the promises made by previous generations of politicians can no longer be kept. They therefore support leaders, unions, and party coalitions that make generous unfunded pensions the very cornerstone of social democracy. In the United States, the problem has less to do with welfare-state dependence than the uniquely American notion that every citizen has personally earned and is therefore entitled to whatever benefits government happens to have promised.

How governments ultimately prepare for global aging will also depend on how global aging itself reshapes politics. Already some of the largest and most strident interest groups in the United States are those that claim to speak for senior citizens, such as the American Association of Retired Persons, with its 33 million members, 1,700 paid employees, ten times that many trained volunteers, and an annual budget of $5.5 billion.

Senior power is rising in Europe, where it manifests itself less through independent senior organizations than in labor unions and (often union-affiliated) political parties that formally adopt pro-retiree platforms. Could age-based political parties be the wave of the future? In Russia, although the Communist resurgence is usually ascribed to nationalism and nostalgia, a demographic bias is at work as well. The Communists have repositioned themselves as the party of retirees, who are aggrieved by how runaway inflation has slashed the real value of their pensions. In the 1995 Duma elections, over half of those aged 55 and older voted Communist, versus only ten percent of those under age 40.

Commenting on how the old seem to trump the young at every turn, Lee Kuan Yew once proposed that each taxpaying worker be given two votes to balance the lobbying clout of each retired elder. No nation, not even Singapore, is likely to enact Lee's suggestion. But the question must be asked: With ever more electoral power flowing into the hands of elders, what can motivate political leaders to act on behalf of the long-term future of the young?

A handful of basic strategies, all of them difficult, might enable countries to overcome the economic and political challenges of an aging society: extending work lives and postponing retirement; enlarging the workforce through immigration and increased labor force participation; encouraging higher fertility and investing more in the education and productivity of future workers; strengthening intergenerational bonds of responsibility within families; and targeting government-paid benefits to those most in need while encouraging and even requiring workers to save for their own retirements. All of these strategies unfortunately touch raw nerves—by amending existing social contracts, by violating cultural expectations, or by offending entrenched ideologies.

TOWARD A SUMMIT ON GLOBAL AGING

ALL COUNTRIES would be well served by collective deliberation over the choices that lie ahead. For that reason I propose a Summit on Global Aging. Few venues are as well covered by the media as a global summit. Leaders have been willing to convene summits to discuss global warming. Why not global aging, which will hit us sooner and with greater certainty? By calling attention to what is at stake, a global aging summit could shift the public discussion into fast forward. That alone would be a major contribution. The summit process would also help provide an international framework for voter education, collective burden-sharing, and global leadership. Once national constituencies begin to grasp the magnitude of the global aging challenge, they will be more inclined to take reform seriously. Once governments get into the habit of cooperating on what in fact is a global challenge, individual leaders will not need to incur the economic and political risks of acting alone.

This summit should launch a new multilateral initiative to lend the global aging agenda a visible institutional presence: an Agency on Global Aging. Such an agency would examine how developed countries should reform their retirement systems and how developing countries should properly set them up in the first place. Perhaps the most basic question is how to weigh the interests and well-being of one generation against the next. Then there is the issue of defining the safety-net standard of social adequacy. Is there a minimum level of retirement income that should be the right of every citizen? To what extent should retirement security be left to people's own resources? When should government pick up the pieces, and how can it do so without discouraging responsible behavior? Should government compel people in advance to make better life choices, say, by enacting a mandatory savings program?

Another critical task is to integrate research about the age wave's timing, magnitude, and location. Fiscal projections should be based on assumptions that are both globally consistent and—when it comes to longevity, fertility, and health care costs—more realistic than those now in use. Still to be determined: Which countries will be hit earliest and hardest? What might happen to interest rates, exchange rates, and cross-border capital flows under various political and fiscal scenarios?

But this is not all the proposed agency could do. It could continue to build global awareness, publish a high-visibility annual report that would update these calculations, and ensure that the various regular multilateral summits (from the G-7 to ASEAN and APEC) keep global aging high on their discussion agendas. It could give coherent voice to the need for timely policy reform around the world, hold up as models whatever major steps have been taken to reduce unfunded liabilities, help design funded benefit programs, and promote generational equity. On these and many other issues, nations have much to learn from each other, just as those who favor mandatory funded pension plans are already benefiting from the examples of Chile, Britain, Austria, and Singapore.

Global aging could trigger a crisis that engulfs the world economy. This crisis may even threaten democracy itself. By making tough choices now world leaders would demonstrate that they genuinely care about the future, that they understand this unique opportunity for young and old nations to work together, and that they comprehend the price of freedom. The gray dawn approaches. We must establish new ways of thinking and new institutions to help us prepare for a much older world.

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