

Remarks by Robert England

for

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***The Challenge of Global Aging***

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Good morning. It is a pleasure to be here with you today.

I want to take you on a time trip into the next 50 years and give you a little taste of future shock, with apologies to Alvin Toffler. He famously defined future shock this way: “the shattering stress and disorientation that we induce in individuals by subjecting them to too much change in too short a time.”

The exotic new worlds that futurists envision today are quite dazzling and perplexing: designer babies, space travel, the merger of life and non-life forms. The futurists often miss, however, one of the most profound changes that are coming – the aging of the populations the world.

Global aging will have a huge impact over the coming half century, as it transforms human society. Take the case of Italy. Census projections show that by 2050, there will be more Italians over 80 than years old than under 20. This is quite a change, when you consider that in Italy today there are roughly 6 people under 20 for everyone over 80.

Japan and virtually all of Europe, east and west, face similar challenges. The developing nations will follow – in Asia and Latin America.

The future I'm going to show you is one that will occur if all government policies remain in place and if businesses, asset managers, and individuals do nothing to address the challenges of aging.

So, let's fast forward to the year 2022 and the economic news keeps getting worse.

The collective GDP of Europe hasn't grown for a decade. Shrinking working-age populations and sluggish productivity growth mean that it may soon begin contracting—permanently. The *Economist* uses the term “Permanent Aging Recession” to describe the phenomenon.

France raises payroll taxes for the fifth straight year. Business leaders warn that the tax hike will mean even slower growth. But as *Le Monde* explains, the ruling Social Security Party has no more room to maneuver than its German and Italian counterparts. Most non-retirement spending (defense, highways, bridges, R&D and so forth) has already been zeroed out.

Japan, the world's largest debtor, asks the IMF for another bailout. The IMF refuses, citing Japan's repeated failure to close its social security deficit. According to the *Financial Times*, the decision was made after Beijing threatened to cancel IMF funding.

Leaders in the developed countries can avoid this future, but only if they act soon and take the appropriate measures.

The world stands on the threshold of a great demographic revolution. It's called global aging—and when it has run its course, nothing will be the same.

Global aging is on track to overburden government budgets. It threatens to usher in an era of widespread labor shortages and slower economic growth. It could destabilize global financial markets. And it may even overturn the geopolitical order.

This presentation looks at the forces behind global aging, the challenges it poses, and the steps the developed countries must take to avoid the gathering crisis.

Let's consider two alternative futures for East Asia. If the developed nations fail to confront their aging challenge, East Asia will face a future of slower growth, widespread capital shortages, declining export markets, and rising protectionism.

If the developed countries enact timely reforms . . . East Asia and the developed countries both reap huge benefits from the growing integration of their economies.

The whole world is aging—and today's developed countries are leading the way. By mid-century, 27 percent of the developed world's population will be aged 65 or older – nearly double the levels of today. And that's just the average. In Japan and some European countries, the elder share will be shooting past 35 percent. The developing world will follow this aging pattern, but, for the most part, at a slower pace – except in East Asia, which will see very rapid aging.

By 2050 East Asia will have a median age older than the United States – which will then have a median age of 40.7.

By 2025, South Korea, Taiwan, Hong Kong, and Singapore will be older than the U.S. By 2050 China and Thailand will join that list. Trailing behind by only 3 to 4 years will be Vietnam, Myanmar, Indonesia, Malaysia, the Philippines, North Korea and even India.

There are two forces behind global aging. The first force is falling fertility. People are having fewer babies—and this shrinks the relative number of younger people in the population.

Worldwide, the average number of lifetime births per woman has fallen from 5.0 to 2.8 since the mid-1960s. In the developing world, it has fallen from 6.0 to 3.1. In the developed countries, it has fallen even further—all the way to 1.6. A generation ago, every developed country was at or above the 2.1 “replacement rate” needed to maintain a stable population over time. Today, every developed country is below it—some far below it.

The second force behind global aging is rising life expectancy. People are living longer—and this enlarges the relative number of older people in the population.

Worldwide, life expectancy has risen by about 20 years since World War II—a greater gain over the past 50 years than over the previous 5,000. In the developing countries, it has risen from just over age 40 to just over age 60. In the developed countries, it has risen to nearly 80.

A historic transformation is approaching. Throughout history, the age structure of the population has resembled a pyramid, with many young people at the base and a few old people at the top. Global aging is about to turn the age pyramid on its head.

This is what the pyramid for the developed world looked like in 1950. Now watch the transformation. This is what the pyramid looks like today. This is where we're heading. And this is where we will be in 2050.

Global aging poses five fundamental challenges for today's developed countries:

The fiscal challenge of rising retirement costs. The labor challenge of a graying and shrinking workforce. The growth challenge of stagnant or declining markets. The financial challenge of asset devaluation and capital-flow swings. The geopolitical challenge of demographic power shifts and tight defense budgets.

Global aging is pushing the developed countries toward fiscal meltdown.

Falling fertility and rising longevity translate directly into a lower "support" ratio of taxpaying workers to retired beneficiaries. A lower support ratio in turn translates into a higher cost rate for pay-as-you-go retirement programs. The developed countries only have a limited number of options, none of them popular: They can enact large tax hikes; they can enact large benefit cuts; or they can let the public debt explode. Voter reluctance to confront the difficult trade-offs is already resulting in growing political paralysis.

The resulting growth in retirement costs is staggering. Today, the total public cost of pensions and elder health benefits consumes an

average of 10.9 percent of GDP in the developed countries. By 2050, the official OECD projections say this cost will rise to 17.8 percent of GDP. And this may be optimistic. According to new projections from the Center for Strategic and International Studies, total public retirement spending will grow to an average of 23.4 percent of GDP. The increase—12 percent of GDP—is the equivalent of 30 percent of workers’ payroll on top of payroll tax rates that often exceed 30 percent already.

Beyond the fiscal challenge, there’s the labor-force challenge. Declining birthrates may lead to widespread labor shortages. In several developed countries, including Italy and Japan, working-age populations are already shrinking. Within a decade, they will be shrinking in most developed countries, the major exception being the United States. Workers will not only be scarcer, but older—possibly reducing the innovation, mobility, and risk-taking that underpin today’s “new economy.”

Both of these trends—a shrinking and a graying workforce—will generate intense pressure to step up immigration. Stepped-up immigration will in turn increase the potential for political backlash—and not just in the destination countries. Some worry about a “new colonialism” in which an aging developed world

siphons off the best-educated and most ambitious workers from younger developing countries. One way or another, businesses will be looking for ways to tap into the developing world's surplus labor. If they can't import the workers, they'll export the jobs.

Make no mistake: The potential labor shortages are large. Within 50 years, there will be 28 percent fewer working-age Germans than today, 36 percent fewer working-age Japanese, and 42 percent fewer working-age Italians.

Slower labor-force growth will mean slower economic growth.

By the 2010s, total employment in Japan and Europe will be falling by 1.0 to 1.5 percent per year. Unless productivity rises at least as fast as employment falls, real economies will begin contracting as well—not just during cyclical downturns, but decade in and decade out. Rates of savings and investment may also decline as societies age, further dragging down GDP growth. By the 2030s, the OECD projects that private savings rates in the developed world could plunge by 50 percent or more.

Businesses will have to adjust to the new realities. Shrinking economies will mean falling demand for infrastructure and capital

goods like highways, houses, and steel mills. Markets for consumer goods in the developed countries will also contract—with ominous implications for the global economy. In many industries, chronic overcapacity may lead to declining profits. To the extent they depend on exports to the developed world, the crisis could engulf the developing economies as well.

However you look at it, the developed countries face a daunting economic challenge. Consider the long-term growth prospects for Italy: a stagnating, then imploding economy, even assuming that productivity rises at a steady 1 percent per year. The projections are similar for Japan and many other countries in continental Europe.

Global aging may also usher in an era of greater instability in world financial markets.

As retiring Boomers begin cashing out assets, some economists predict that the markets will experience a “Great Depreciation.” At the same time, government borrowing to finance retirement benefits could put government finances in a bind. Widening pension deficits may shatter regional economic and monetary

entities like the European Monetary Union. They could also trigger large and destabilizing swings in global capital flows—not just among developed countries, but between the developed and developing worlds.

Focus a moment on the potential magnitude of the financial challenge. Left on autopilot, the public pension systems of the developed countries would by the 2030s be running deficits large enough to consume the savings of the developed world. Long before then, aging developed economies would become dependent on younger and higher-saving developing economies to maintain minimum levels of investment. No one knows how the balance of power may shift if countries like Japan become large borrowers and countries like China become large lenders. Here too global aging is pushing the developed world into uncharted waters.

Ever since the ancient Greeks, historians have observed that the rise and fall of civilizations is closely linked to demographic trends. Throughout history, contracting populations have given way militarily, economically, and culturally to expanding ones.

A demographically expanding developing world may be a politically unstable one. Much of Africa, Central Asia, and the Middle East will be rocked by “youth bulges” that could destabilize established regimes and trigger local and regional conflicts. Meanwhile, East Asia and Latin America will be translating population growth that is faster than the developed world into faster economic growth—and perhaps even into global leadership.

Even as new challenges arise, global aging will place new constraints on the ability of today’s great powers to meet their security commitments. Defense budgets will be under intense pressure from rising retirement costs. Armed forces may experience chronic manpower shortages. Elder-dominated electorates may also become more risk averse, shunning decisive confrontations in favor of ad-hoc settlements.

If demography is destiny, global leadership may pass from the first to the third world. Fifty years ago, six of the world’s twelve most populous nations were developed countries. Today, just three are developed countries. Fifty years from now, only one currently developed country will remain on the list: the United States—

although, China may join the moderately developed country club by then.

There is a window of opportunity to prepare for the aging challenge, but it is narrow and about to close.

Over the next decade, the developed countries must **focus on raising productivity and therefore real wages.** As workforces shrink, productivity growth will become the only source of economic growth in most countries. Larger gains will mean a larger GDP—and more resources available for all goals, public and private.

The developed countries must **scale back pay-as-you-go benefits.** The late Herb Stein, the former chairman of the Council of Economic Advisors, was fond of saying that things which are unsustainable tend to stop. Most countries will be forced to make substantial cuts in public retirement benefits. The issue is not whether reform will occur, but whether it will occur sooner, giving people time to prepare—or later, in the midst of crisis.

The developed countries must **put in place funded alternatives—like individual retirement accounts.** At the macro level, funded systems can shield government budgets from demographic

pressures and help maintain adequate rates of savings and investment. At the micro level, they offer higher returns, higher benefits, and the security of ownership. Recent market developments remind us that the funding strategy is not without costs and risks. Over the long run, however, funded systems offer decisive advantages—which is why they are being embraced by countries as diverse as Australia, Germany, Mexico, Poland, Sweden, the UK and Kazakhstan.

The developed countries must also **encourage later retirement and longer work lives**. Moving beyond the three-box life cycle of education, work, and retirement would not only have enormous economic benefits, it would also, many gerontologists believe, be good for the elderly themselves.

The developed countries must **encourage more working-age employment**. The elderly aren't society's only neglected resource. More work by adults in the traditional working ages can also boost the size of the economy and tax base. Countries with few working women (such as Italy), low immigration (such as Japan), or high structural unemployment (such as Germany) would do well to consider this “American” strategy. Continental Europe, in particular, must rethink unemployment and disability schemes that are widely blamed for discouraging work effort.

The developed countries must **reward families for raising children**. Children are an aging society's most valuable resource. A number of developed countries—notably the Scandinavian nations and France—have a long tradition of generous public funding for “family allowances” and other pro-natal incentives. The tradition seems to be spreading.

At the same time, the developed countries need to recognize that global aging is a global problem requiring global solutions.

The potential advantages of the “globalization” strategy are enormous. Immigration and outsourcing can match jobs and workers, helping to ease labor shortages and boost economic growth. Cross-border investment can match savings activity and investment opportunities, allowing savers in older and more slowly growing economies to enjoy the higher returns available in younger and faster growing economies around the world.

Meanwhile, fears of a Great Depreciation may prove unfounded if more developed countries adopt or expand funded schemes. It will also help if savers in younger countries are permitted to buy stocks that trade in the developed country markets. If companies like GE and Citigroup are to become major employers in the developing

countries, they will have every incentive to ensure that their stocks trade there as well.

Globalization can also bring large advantages for the developing economies. Foreign savers can supply the capital emerging markets need to become engines of global growth. Foreign employers can be encouraged—or required—to invest in local communities. Even immigrants usually send home money, raising the living standards of those who stay behind. Remittances from the United States alone in 2000 totaled \$45 billion, vastly exceeding the foreign aid budgets of the entire developed world.

The globalization strategy must overcome real obstacles, including the lack of transparency and security in the capital markets of many developing countries. Still, it holds out the promise that young people can help support old people across international borders. As such, it is an essential strategy for an aging world.

Let's suppose the developed countries successfully address the aging challenge. They have cut back and controlled costs and set up more funded accounts. This drives up savings and frees capital for investment. If that capital is to flow into East Asia and other developing areas, more needs to be done.

East Asian nations should take more steps to ensure the security and transparency of their capital markets. **[click.]** They should guarantee property rights and the rule of law. **[click.]** They should invest in modern infrastructure and an educated workforce. And, finally, they need to prepare for their own age waves that loom just over the horizon.

Much of East Asia is now experiencing a birth dearth. You can see from this graph that the high birth rates that prevailed between 1965 and 1970 and dropped over the decades to the point that . . . in the period of 1995 to 2000 they are as low as or lower than many birth rates in the developed countries. These low birth rates mean fewer workers entering the work force in the coming decades, which will accelerate the aging of societies.

As a result, East Asia will soon age in its turn. The proportion of elderly will dramatically rise – jumping from 7 percent to 23 percent in China, and 7 percent to 29 percent in Singapore.

East Asia will enjoy some considerable advantages as it faces the aging challenge. Few of the countries in East Asia have

accumulated large unfunded liabilities for pay-as-you-go retirement systems. In China, for example, the most pessimistic estimate of the unfunded liability in the urban social security system is a sum equal to 145 percent of GDP. Given China's fairly low debt levels, the shortfall could be financed over a period of decades at a low annual cost to its budget. Many East Asian countries also have a tradition of funded retirement savings. Most have strong extended families that serve as care networks for the elderly. All have time to learn from the mistakes of their older and more affluent neighbors.

Some East Asian nations, however, have a big disadvantage. They will have to manage old-age dependency burdens rivaling those of the developed world. But, they will not have the benefit of the developed world's affluence. Of course, some nations like Singapore are affluent, as is Hong Kong. Others are already moderately developed, such as South Korea and Taiwan. China is on a path to become a moderately developed nation by the time it shoulders the burden of rapid aging – provided it addresses a number of challenges tied to its transition to a market economy.

We live in an era defined by many challenges, from global warming to global terrorism. But none is as certain as global aging. And none is as likely to have such a large and enduring effect on the shape of national economies and the world order.

Time is running out. We can engage the challenge constructively. Or we can wait for it to overtake us. But we cannot avoid it.

Thank you.