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Special Report: AGE WAR IN 2011?



2011 is 1946 plus 65. In other words, it is the year that the first members of the 90-million strong post World War II North American baby boom generation will reach retirement age. It is also the year in which the same retirement benefits they helped fund for their parents' generation are likely to be suddenly withdrawn from them.

When a few thousand people share an opinion or buy a product, it may amount to a curiosity, or even a trend. But, when 90 million do so, it's a revolution.

This time, the revolution will shake North American society to its foundations because an age war will break out between the generations. The early battle lines are already being drawn, and the issue will be, who will benefit and who will pay.

If you were born between 1946 and 1964 and aspire to a comfortable and leisurely

retirement, chances are you are a member of a doomed generation. But, even if you are already in your 50s or 60s, you will still be the victim of reduced benefits.

Retirement will be neither comfortable nor leisurely. In fact, it may not even be possible.

CRISIS ON A TIMETABLE

But, unlike the typical disaster, which strikes without warning, this one is absolutely predictable. That is because it is an inescapable result of three demographic trends which have no precedent in modern times.

The first of these trends, as we have noted, is the aging of the baby boom generation. Its numbers account for fully one-third of the North American population. Its sheer size has made it a society-transforming influence at every turn.

The second trend is the rapidly increasing number of senior citizens. Since 1900, average life expectancy has increased by 28 years. Two-thirds of all the men and women in the entire history of the world who have lived beyond age 65 are alive today.

Because of continuing advances in healthcare, older folks are also healthier and more active than any other older generation in history. There have been many baby booms throughout the course of human events, but never before a senior boom.

The third trend is the so-called birth dearth. In 1986, the fertility of North American women (defined as the number of children each woman would have in her life if the present rate of birth continued) declined to 1.8.

TWO-THIRDS OF ALL THE PEOPLE WHO HAVE LIVED BEYOND THE AGE OF 65 IN THE ENTIRE HISTORY OF THE WORLD ARE ALIVE TODAY. BPM LOOKS AT PENSION FUTURES IN 2011.

That's less than half the rate of their mothers, 27% lower than the rate in 1970, and less than one-fourth the rate in 1900. It's even lower than the replacement rate - which is 2.1. In fact, it's the lowest fertility rate ever recorded.

Fertility has been steadily declining since the turn of the century. As a consequence, the rising number of elderly is not being offset by increasing numbers of children.

EXPLOSIVE EFFECTS

Taken together, these three demographic trends make an extremely explosive mix.

Lengthening life expectancy and the birth of fewer children add up to an increasingly aging society. In July, 1983, for example, the number of U.S. citizens over 65 surpassed for the first time the number

of teenagers. By 2025, seniors over 65 will outnumber teenagers by 2-to-1.

This undermines the fundamental assumption on which the so-called “pay as you go” retirement schemes sponsored by governments are based - namely, that there will always be a relatively large working-age population to support a relatively small number of retirees.

For every American who retired in 1940, there were more than 40 workers to support Social Security benefits through their payroll taxes. But, by 1950, there were only 17. In 1990, only 3.4. By 2020, there will be only 1.78. And, though the numbers in Canada are different, they tell the same story.

Living longer, while having fewer children, means boomers will be the first seniors unable to draw on the financial support of a much larger number of younger North Americans. With fewer than two workers for every retiree, merely maintaining the present level of benefits will create a crushing burden for those still employed.

AGE WAR IN THE 21ST CENTURY

That burden will set the stage for an age war, the likes of which no one has ever seen. Boomers today are paying record portions of their income to support today’s retirees. After having made these sacrifices, they will scarcely relinquish similar benefits for themselves without a fight.

Of course, controversies are nothing new to Canadian and U.S. politics. But what will make this one especially nasty is that the debate will inevitably become polarized along ethnic and racial lines.

One interesting demographic side effect of the birth dearth is that today’s children more and more tend to be members of minority groups. For example, in the United States, almost 20% of the population under age 15 is Hispanic. Of those over 65, only 11 % are Hispanic.

As a result of this trend, seniors by the year 2011 will have almost no blood relationship to the younger working-age population on the other side of the retirement debate.

Worse, there will be an unavoidable tendency to equate age and ethnicity. For example, concerns about infant mortality or pediatric health will be labelled a Hispanic problem, or retirement issues an Anglo problem.

The impending battle over who will pay for retirement benefits is likely to make today’s raging debate over abortion seem genteel in comparison.

But, unlike the unborn, the old can speak for themselves. As the boomers age, the activism they displayed in the Sixties will explode again in a powerful, organized defence of their entitlements. Already, the

leading U.S. lobby for the aged, the American Association of Retired Persons, is 30 million strong. And, unlike young people, seniors all vote.

On the other side of the issue, early battle lines are also being drawn. In 1985, an organization called Americans for Generational Equity was established. According to its literature, one of its missions is “to prevent young families from being sold into financial slavery.”

WHAT TO DO

Despite their numbers and political clout, today’s boomers will not be able to avoid being cruelly short-changed by today’s government-sponsored retirement schemes. That is, they cannot hope to get back in benefits what they paid in along the way. That makes it absolutely imperative that they begin early to take steps to fund their own retirement. That means putting away the maximum amount possible in IRAs, RRSPs, and other voluntary pension schemes.

It also means taking full advantage of every legal means of allowing your savings to accumulate tax free.

One pitfall to avoid is counting on the appreciated value of a house in the suburbs to finance your retirement. As we have repeatedly noted, the inflation adjusted value of single family homes is more likely to substantially decline than significantly appreciate during the next 10 to 20 years.

Because time is short and retirement is expensive, you will have to seek the highest return on your savings that a reasonable level of risk will allow. However, the single most important thing the reader can do is get started early. As Ralph Waldo Emerson once observed, “Tobacco, coffee, alcohol, hashish, prussic acid, and strychnine: all these are weak dilutions. The surest poison is time.” ■

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COMMENTARY

BY ISMO HEIKKILA

Financial education will continue to be a key component in achieving financial goals. There is too much short-term tactical action being taken by individuals without having a longer-term strategic financial plan.

Rationalization and an optimistic outlook are far too often a substitute for candid examination of personal goals and establishing a consistent financial discipline.

There is a belief that government and employers will provide financial support in

the future. The reality is that each individual is responsible for building the net worth required to generate an income for the rest of his or her life.

It is possible that the baby boomers will inherit billions of dollars and then have to give some of it back to the government to help support others less fortunate. ■

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COMMENTARY

BY MARTIN DEN HEYER

Most Canadians will depend on a variety of sources for their retirement income and security – government plans and programs, company sponsored plans, and RRSPs and other forms of private savings, including home ownership. This article counsels us not to depend on government plans at all and claims that baby boomers who will start to retire in 2011 “will not be able to avoid being cruelly shortchanged by today’s government retirement schemes.”

The scenario is that of an American “age war” starting some time after the year 2011, between Anglo seniors and impoverished young members of minority groups. It is an “inescapable result” of three current demographic trends – the aging of current baby-boomers, increasing life expectancy, and declining birth rates. And it is presented as a North American scenario, so one must assume it includes Canada.

But, should this scenario really be taken seriously and used as a frame of reference for making current investment decisions? The answer is an emphatic “No.”

Since first being studied by the Reverend Thomas Malthus in the 18th Century, human beings have been haunted by the infrequent tendency in nature for population to outstrip all possible means of subsistence. The article’s “age war” scenario is just one more variation on this theme, with the predicted default of our government pension plans being the inevitable application of “lifeboat ethics” as our population ages.

But, so-called “Malthusian models” have found only limited validity in the field of human endeavour – primarily in third world environments where productivity, technology, and social and political systems remain relatively static. Thus Malthus’s own gloomy outlook for England has not (at least, not yet!) come to pass because of all the unanticipated changes set in motion by the Industrial Revolution.

The article ignores all of the current non-demographic trends that will surely impact the final outcome. So, most long-term projections that do take these other

factors into account aren't nearly as pessimistic. The most we can conclude from demographic trends is that we shouldn't stake our retirement security entirely on pay-as-you-go government plans. That's why you don't hear much these days about expanding the Canada Pension Plan.

However, even if we could devise a model that included all current trends in demographics, political and social systems, technology and productivity, we still wouldn't end up with an "inescapable" single scenario for 2011 and beyond.

That's because, according to recent developments in a branch of mathematics called "chaos theory," some phenomena cannot be represented by a stable model. In chaos theory, a minute change in the initial input, or some minor, unanticipated development between now and the year 2011, could produce a dramatically different future.

Now, this merely confirms what our everyday common sense tells us – we can't predict our own future with any certainty. Therefore, no single prediction about our future can possibly be "unavoidable" or "inescapable."

For these reasons, prudence dictates that investment professionals establish frameworks that recognize – and, more importantly, quantify – the possible impacts of various scenarios which generate uncertainty and risk. This approach imposes a discipline that is more likely to enable us to take advantage of opportunity and protect ourselves from risk as the future unfolds. ■

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COMMENTARY

By DON EZRA

Like an onion, this article has many layers. The outermost layer is its tone: disaster ahead!

Peeling that layer away reveals the next, the date of arrival: the year 2011, comfortably within our own lifetime.

And right inside that layer is the story: when the baby boom generation retires, it may not be able to rely on the working population for financial support.

Let's look at these layers in reverse order, starting with the story.

It isn't really news anymore. It was predicted about 15 years ago by Geoffrey Calvert in his "Pensions and Survival, The coming crisis of money and retirement." But it bears repeating because I sense that few members of the public realize its significance. Only financial executives and consultants seem fully aware of the impli-

cations – and politicians shy away from taking action.

Some facts are presented, especially the changing dependency ratios (worker-to-retiree ratios shrinking from 40:1 in 1940 to 1.78:1 by 2020) and the decline in fertility (at 1.8 children per woman of childbearing age, this is below the rate of 2.1 children required to replace parents, allowing for the fact that some children do not survive to childbearing age). I would have liked to see other facts added. How much more, for example, will contributions to Social Security (in the U.S.) and CPP and OAS (in Canada) have to increase for the plan's promised benefits to be supportable?

This critical omission permits the second layer of the story to appear. For the financial crisis will appear not suddenly but slowly. In fact, the strain is already present and it will increase both up to and beyond the year 2011. There isn't a dramatic increase in that year. Just as the approach of the crisis is predictable today, so, too, is its gradually increasing magnitude. This offers our politicians numerous occasions before 2011 to show their courage – but, of course, they'll need leadership from the voters first. And in the past, in Canada, as in the U.S., they have sometimes been prepared to change the plan's benefit and contribution structure and it is conceivable that they will do so again.

And so to the onion's skin, the scenario of war, ethnic and racial polarization, and society shaken to its foundations. Perhaps these angles have to be pandered to in order to drive home what is fundamentally a financial story – and maybe things really will turn out to be vicious. But one statistic about Hispanics doesn't do it for me. And readers don't have the opportunity to judge for themselves because the article is very short on facts. What if no action is taken for five years: how much will contributions or benefits have to change then? How about ten years? Only with this sort of information can a reader make an informed judgement.

To sum up, there's a genuine story here, one the public needs to understand, but it's hidden beneath a call for panic. ■

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COMMENTARY

By WILLIAM SOLOMON

As is mentioned in the preceding article, the aging of the so-called "baby boomers" should not have come as a surprise to any-

one, especially not to governments. In fact, it was the presence of this generation (i.e. those born between 1946 and 1964) that provided the tax base to fund the current retirement programs, both in Canada and the U.S. Demographers certainly knew about us, as did governments. We did not just "appear"!

For reasons stated, we will reach a "crunch" in 2011 when the first of those boomers seeks retirement benefits that he provided to his parents (through the tax system) some 30 years earlier. But, will there be funds available to pay him?

Focus, for a moment, on the Canada Pension Plan which began in 1966 with combined annual contributions from employees and employers of 3.6% of earnings on a wage base of \$5,000 per annum. A bargain by today's standards.

By the time the plan celebrates its 50th anniversary, the combined funding rate is scheduled to increase to at least 10.1 % of pay, which by then might be sufficient to finance the current (1991) benefit obligations of the plan.

Unfortunately, the CPP's well will have run dry long before my generation is able to dip into the trough. Not only is the anticipated outgo expected to exceed the inflow, it is uncertain how the shortfall will be financed. While the provinces were lent the money at favourable rates during the 1960s and 1970s, it is much more difficult for them to repay those loans from future taxpayers.

The article suggests one course of action: prudent savings for one's own retirement, while not relying exclusively (if at all) on governments to honour their commitment to us. In part, this is the direction in which we are being pointed.

The changes to tax laws covering retirement savings, which became effective in 1991, provide increased limits on tax-sheltered savings for retirement. For the majority of Canadians who do not enjoy any form of pension benefit from their employer, this is an opportunity not to be overlooked.

Yes, we shall continue to pay ever increasing amounts to the CPP, thereby postponing, but certainly not avoiding, the inevitable. The reality of the demographics is that, in the absence of mass immigration to Canada, there will not be sufficient contributors to meet obligations when the baby boomers put their deserving hands forward in about 20 years time.

For some of us, retirement may be a financial disappointment at best, and at worst a period of government-induced poverty. I can hardly wait to reach 65. ■

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