

GROWTH CHALLENGES

Preventing 'Retiree Overhang' from Destroying Prosperity

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Five years since the onset of the financial crisis most Western economies are still struggling to return to healthy growth and employment levels. This week Kishore Mahbubani, Dean of the Lee Kuan Yew School of Public Policy, asks whether Europe and Japan will indeed ever recover their “animal spirits”[1]. He goes so far as wonder if they may even have given up hope of doing so, despite having fuelled world growth for so many decades till now.

This piece proposes that the persistence of that sluggishness in those countries may be linked to distorted wealth accumulation and expectations *between* generations. In particular, it raises the idea as to whether the wealth, pension and intellectual over-representation and future entitlements of the now retiring Baby Boomers in those economies are a direct cause of the sluggishness itself. A case of ‘Ashes to Ashes – Boomers to Bust’ in which a relatively fortunate demographic, the Baby Boomers, may almost be serving to retire their economies along with their own retirement. A few policy ideas for merging the gap between generations are suggested.

A baseline reference point is the established challenge facing Chinese policy makers in being confronted by an economy that is ‘old before rich’. This refers to the fact of China’s high birth rate after 1949, combined with its one-child policy since 1980, meaning the country is now home to over 200 million people aged over 60. This now equates to five workers for every retired person. By 2035 the ratio will fall to just two to one. Japan, South Korea, Singapore, Taiwan and Hong Kong, alongside most Western economies are facing similar demographic time bombs, but these economies in having first accumulated high per capita wealth. It may however turn out, that long-run and contrary to long-standing debate that Chinese policy

makers might actually face a less, or at least very differently challenging set of circumstances.

1. A Story of Generational Change in Fortunes

“Young people today haven’t got a chance of buying a house at a reasonable price, even with rock bottom interest rates”, says *The Guardian* of the situation in the UK[2]. The once sufficient 25-year long mortgage meantime is morphing into a 40-year enterprise. Amid calls for a cap on the rate of growth of housing to 5%, at best capital gains for today’s new home owners will be a shadow of those accrued to the generation before, likely with or without the cap. With first time buyers all but priced out of sustaining the traditional market cycle, instead of allowing market correction, the home-owner voting wealthy older majority are instead finding foreign buyers. The story is little different across the ‘advanced’ economic world.

Amid falling real wages, sluggish buy-to-live capital gains and the rising cost of a university education leave young persons in the UK and elsewhere in developed countries with far less hope for their economic future than was offered to persons of that age a generation ago. This contrasts markedly to the post-War era and policy context afforded to their parents’ generation: a housing price boom (one in five British Boomers own at least two residential homes), comparatively easy access to credit, final salary pension schemes, state privatisation shareholder society windfalls, demutualisation of building societies, free university tuition, bull market equities, council house sales – all leading to wealth: the Boomers for example own more than 80% of the wealth in Britain. [3]

In the persistently sluggish post-financial crisis era, the young of the US and across most of Europe and Japan in contrast, are lucky to have an unpaid internship, let alone a pensionable permanent contract offering spending power anything close to what their parents enjoyed. And yet, on the back of that struggle rides a generation of largely pension-entitled, home owning, even landlord Baby Boomers, chasing their dreams of creating a ‘third age’. What of the consumption habits of a semi or fully retired cashed up generation having never experienced systemic difficulties in accessing credit? Are they responsive to macroeconomic policy? – Probably less than income-earning and more active investors. Beyond the standard globalisation arguments, could this also help to explain why economic policy appears to be less effective than before? Is there even a need for a new retirement macroeconomic policy

basket? One that seeks to sustain the struggling active younger economy in their wake might be productive.

And this scenario from the UK is all the while being repeated across the West and in Japan. Detroit presents a classic tale, if seeming extreme could rather merely be ahead of the curve. And it's true that not all Boomers are wealthy and many did work hard. Nonetheless the cost of their intended retirement entitlements has simply not been adequately saved for. Furthermore, in this case of bankrupt Detroit, some pension-invested Boomers there are fighting for rights to a retirement income not far short of \$100k over several decades – within an environment where many of the young around them are unemployed and with limited prospect of any job at all let alone coming close to accumulating this type of extraordinary accrued future benefit. Pension promises of a few decades ago today almost seem to have been signed into law in a fantasy era of optimism that did not accurately predict its own sustainability going forth.

Amid under-funded entitlements and a rising sense of scarcity, it would be counter-productive if the main Boomer reference point for their own sense of legitimate entitlement were other Boomers, with future generations and the sustainability of prosperity full stop displaced to near irrelevance. While economists have long been aware of the challenges in getting old before getting rich – the unique demographic challenge of China – it might also be in the end that the challenges of getting old after getting rich hold a differently difficult face all of their own. As *The Guardian* noted on July 2013, no one can expect taxpayers to indefinitely support a two-tiered retirement system, where they foot the bill for people to live better than they themselves will.[\[2\]](#)

Interestingly, in China, where the old mass have only been exposed to wealth if they are fortunate in their older years, the problems are reversed. China's government in contrast is being forced and is able to implement laws that force the relatively rich young to care for their ageing and on average relatively poorer (certainly in terms of lifetime prospects) parents. Different policy challenges appear to apply to managing the embedded excesses of the relatively fortunate generation – whether young or old.

2. The Bigger Macroeconomic Picture

In his latest book, soon-to-be nonagenarian godfather of Singapore, Lee Kuan Yew, expresses his views on the link between demography and country destiny: “Demographics determine the destiny of a people. If you are declining in population, as a nation, you are declining in strength. Old people do not change their cars and television sets, “.

Developing the point further one can arrive at the notion that steady state of growth over decades might rather even hinge on the relative balance of disposable income between generations, as much as on the static reality of old people not replacing their electricals. These possible effects may furthermore be magnified in democracies where the greater tendency of Baby Boomers to vote and their own demographic dominance makes the ‘grey vote’ effect potentially very powerfully prohibitive in terms of all but ruling out policies that seek to swing the economic balance more equitably toward the young.

And it is even early days yet, for the Baby Boomers, born between 1946 and 1964, have not yet reached their entitlement or non-working peak. While little is published of the true gap between savings and entitlements going forth, an earlier World Economic Forum report quotes Daniel Hofmann, Chief Economist for Zurich Financial Services, “Under a proper accounting framework, most advanced economies would be fiscally insolvent.. in the absence of far-reaching structural corrections, there will be a high risk of sovereign defaults”. In America national debt is already as large as the entire GDP – what room for emerging bankrupt councils, cities, and states even? Is Detroit just the tip of the iceberg?

Bringing this piece back to continued sluggish growth in the West and Japan, the macroeconomic concept of debt overhang might here be a relevant means of linking the two ideas of demographic booms after wealth, and persistent low growth. Debt overhang is a paralysing economic situation recently only associated with developing countries. It arises when a debt is so large that further borrowing is dis-incentivised even in the case of viable projects, thanks to the need to divert all profits to fund prior borrowing.

Given the scale of public debt in rich countries today, together with shrinking workforces, greater competition from emerging markets, falling real wages, and a mass of Boomer

entitlements to be paid out over coming decades, might this itself be forming an inter-generational economic overhang that serves the same effects as debt overhang did in the 'third world'? Moreover, if an atypical share of wealth and aggregate disposable income lies among new retirees and soon-to-retire Boomers, given their relatively fixed income trajectory is unlikely they will be highly responsive to policy stimulus – potentially another factor in the inability of policy makers to use economic policy to lift economic activity.

All the while, it seems that the Boomers are happy to draw up the social contract ladder behind them. As one Boomer said in conversation with me, "Me and my husband will be alright. The real problems will come after we've gone". At the other extreme, the new King of the Netherlands said in his inaugural speech to parliament: "The classical welfare state is slowly but surely evolving into a 'participatory society'," he continued – one, that is, where citizens will be expected to take care of themselves, or create civil-society solutions for problems such as retiree welfare.^[4] Since retracting established benefits to a demographic boom is not an electoral possibility, does this thus mean that 'evolving' literally means that as and when the Boomers have dried out the benefits system the ladder comes up, and the door closes to the societal principles that were among the only fruits of two world wars?

While this piece indeed is not a quantitative study that can prove any causality of the associations being made, in general relatively little such work or journalistic commentary has been published on the topic. Could it be that this lack of analysis may itself be a problem of the very challenge being faced? That is, that the leading voices of the economic and political commentariat comprise a potentially disastrous moral hazard problem in that since they themselves are Baby Boomers beneficiaries of a system appearing to crumble *after* them, it is not in their interests to write about the situation? Together with the "grey vote" undermining the willingness of politicians to make hard choices, the potential for this concept of 'retiree overhang' to produce not just a Japanese-style lost decade, but a lost generation, a lost century, is striking.

Preventing not only America, but also Europe and Japan from being involuntarily retired, through such implicit hijack by their older post-war demography of the relatively wealthy voting majority appears to require formulation of a new policy will and creativity. Democracy itself may be at stake given the theoretical relative powers of autocratic governments to make

difficult and long-term change, and thus keep their economies on a more sustainable path than the old wealthy economies are at present.

A few relatively politically ‘safe’ policy ideas for their consideration might include the following:

- 1) Incentives for the employment of grandparental labour as all but if not full-time baby-sitters to free up labour among the working age population, especially those with skills in short supply such as teachers and medical personnel. It is incidentally standard in China such that young mothers can make the most of their productive years, and that grandmothers step in to support. The very active role of grandparents in China’s household labour is arguably left out of the labour statistics and ageing crisis reports.
- 2) A look at the progress of a new initiative in China’s far northern province of Jilin. In what might be an extraordinary public-private partnership innovation, the Changchun municipal government has signed an agreement with the Vanke Group to establish a one million square meters health retirement residential community and cultural and creative industries projects.^[3] The Vanke Group says the concept will be based on common development, with economic and social development side by side. Could it even be that by osmosis the old of the area will support, in small or big ways, the innovation and creativity of the young, directly and indirectly? Nascent an innovation yet, something to watch nonetheless – a blending generations within a creative compound could be the way of the ageing future. Volunteer cross-generational support services in nursing homes for qualified aspiring entrepreneurs and researchers? A re-teaching of the young how to sew, how to mend, and basic skills by the same process? Complicated legally perhaps, yet not impossible. Churches could also provide such venues.
- 3) Greater cooperation between rich and poor ageing societies alike. Denmark is one of the countries at the forefront here, with Health Minister having recently visited China with a health and aged-care services delegation in tow. Promising to help China with lessons from Denmark’s services for the aged, the two sides explored mutual opportunities for providing opportunities to the aged.

- 4) In an earlier piece I proposed ensuring the rate of increase of pensions be aligned with the real wage, to ensure a consistent wage increase for the active and post-active workforce. A policy in Britain has since been adopted that benefits change in line with the real wage rate – but not pensions. Aside from at the basic minimum standard of living level, this is arguably hard to justify. Pensioners too, where living above the minimum level, may remain more connected to the rest of society if also riding the highs and lows of the employed workforce.
- 5) Similarly keeping ageing populations sufficiently connected to the internet such that they can remain economically active in ways that retired generations previously may not have been expected to. A useful business model from Victoria, Australia, offers home cooked meals that are advertised online and picked up from the private kitchen when ready. Easily set up, this presents a way both to save the time of the working age population while also offering income streams to pensioners living a mostly local life.
- 6) A better system of monitoring intergenerational spread of resource allocation that may help to prevent possibly related swings and slumps in aggregate demand – least of all to protect the sustainability of democracy from relatively privileged voting lumps like the post-war boom. Some type of index that captured the potential scale of retiree over-hang – resources promised ahead of time to imminently retiring workers as some projected proportion of economic activity at the parallel time those payments are made, could help to prevent the scale of the entitlement burden that may now be part of the story of sluggish economic growth. If computed correction, this could also even be used as a benchmark for adjusting related benefits to ensure their sustainability, within that period and across generations.

The debate over how to sustain prosperity amid the rise of increasingly industrialised competition from China and the other BRIC countries – Brazil, Russia and India – is just beginning. The debate over how to manage the latter, in the presence of retiree overhang has not yet started. A thought for the new Governor of the Bank of England, for next year's G20 summit in Australia, and far beyond.

[1]

<http://smh.domain.com.au/real-estate-news/boomers-put-super-squeeze-on-first-home-buyers-20130601-2nihw.html>

[2] <http://www.theguardian.com/money/us-money-blog/2013/jul/23/detroit-retirement-pensions-problem>

[3] http://kuaixun.stcn.com/content/2012-08/14/content_6593487.htm

<http://www.project-syndicate.org/commentary/chimerica-and-global-prospects-for-prosperity-and-stability-by-kishore-mahbubani>

[1] <http://www.project-syndicate.org/commentary/chimerica-and-global-prospects-for-prosperity-and-stability-by-kishore-mahbubani>

[2] <http://www.theguardian.com/business/2013/jun/04/george-osborne-help-to-buy-moronic>

[3] <http://www.telegraph.co.uk/finance/economics/10171591/10-Baby-Boomer-entitlements-todays-youth-wont-have.html>

[4] <http://www.neogaf.com/forum/showthread.php?t=679737>