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The Global Challenge of Retirement Security

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Speech to the Henry Jackson Society

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As Prepared for Delivery

Thank you for that introduction, and thank you to the Society for offering me this opportunity to speak tonight. It is a privilege to be in this historic Palace and to address this distinguished audience, under the auspices of a society dedicated to the legacy of a great American statesman, Senator Henry M. Jackson.

In 1984, when posthumously awarding him the Medal of Freedom, President Reagan observed that Henry Jackson "absorbed within himself…a love of freedom [and] a will to defend it."

My theme tonight is one that surely would have intrigued Scoop Jackson. It is the global challenge of retirement security—that is, providing securely for an aging population.

The challenge is well-known.

Many of its implications are rarely, if ever, discussed.

In a narrow sense, retirement security is a natural topic for me as CEO of the Investment Company Institute. In the United States, mutual funds are considered essential tools in planning for a secure retirement. Funds hold one-quarter of Americans' retirement assets.

Earlier in my career, I was a senior aide to President Reagan and a leader of his National Security Council staff in the White House. So my interest in this theme is broader.

That's because "retirement security" means so much more than just pension coverage or income security—particularly in the context of a global population that is rapidly aging.

For a nation to provide retirement security, it must provide for the needs of its elderly population—without shortchanging the prospects of generations still in their working years, and those yet to come.

Retirement security means overcoming the economic drag of slow labor force growth. It means finding ways to provide for retirees while mobilizing the investment capital required to create jobs and opportunities for the workforce.

And it means finding solutions to the intergenerational competition for resources that is putting strains on public expenditures, including national security budgets. This is especially important for the United States and the United Kingdom, who have borne the burden of maintaining the global security system. We must have the resources necessary to sustain that system, even as we care for our aging populations.

How serious is the issue of global aging? Demographic trends unfold slowly, and the prospect of graying nations may seem remote. It is not. It is a reality that has already begun to define the 21st Century.

The Greek financial crisis, for example, was triggered in part by the unsustainable promises made by Greece's public pension system. The government's response included proposals to increase the average retirement age—by just two years, from 61 to 63. Even that modest proposal helped spark widespread civil unrest.

In mid-October, France was shaken by strikes and demonstrations that drew as many as 3-1/2 million people into the streets. Their cause was opposition to a law—later enacted—that will increase the minimum retirement age for the French state pension system from 60 to 62 over the next eight years.

In Spain, too, tens of thousands took to the streets last spring, outraged by an increase in the retirement age from 65 to 67.

Now, my own country has not been immune. But in our case, the protest has been at the ballot box, not the barricades. In America's recent elections, voters turned control of the House of Representatives over to the Republican Party, and sharply reduced the majority held by Democrats in the Senate. The Republicans now hold their largest majority in the House in more than 60 years. They made historic gains in state legislatures and governorships as well.

This abrupt course correction was particularly pronounced among the one-third of the electorate that describes itself as "independent" of the two main parties. Independent voters flipped from an eight percentage-point majority for President Obama in 2008 to a 15-point advantage for Republicans this year.

The electoral results were fueled in no small part by conservative activists who affiliate with a loose movement they call the "Tea Party"—a reference to the Boston Tea Party. That milestone on America's march to independence may be remembered somewhat differently in Westminster than in Washington.

Today's Tea Party is not as well organized or clear in purpose as were the Sons of Liberty in Boston Harbor in 1773. But one common theme unites today's activists—a deeply felt concern that the federal government has been imperiling America's future.

How?

With current and projected budget deficits far in excess of anything we have seen since we were fighting beside you in World War II.

This concern was ignited by massive economic stimulus packages and public bailouts of private institutions. It was fueled by a significant increase in discretionary government spending. It was stoked by the government's colossal attempt to remake health care, a sector that accounts for one-sixth of the American economy, through a legislative process that brought disrepute on today's fractured and partisan Congress.

This spending spree followed on the heels of the recession, which reduced federal revenues to their smallest share of the economy since 1950. All told, these events drove the federal budget more than $1 trillion into the red.

At the same time, state and local governments scrambled to close growing budget gaps. And many states face unfunded promises for workers' pensions totaling in the trillions of dollars.

Together, these trends have threatened to bury our country and our economy in debilitating debt—and to do so even before the impending retirement of the Baby Boom generation accelerates spending on the income and health needs of America's own aging population.

As a result, Tea Party activists—and millions of other Americans—turned on the party in power. They sent a powerful and unmistakable message to Washington:

"Get this under control."

At the Investment Company Institute, we have every reason to share the concern that government get this under control. Our members serve as investment professionals managing $11 trillion in assets on behalf of more than 90 million shareholders. But it requires no financial sophistication to understand that U.S. government debt rising to such levels will spell disaster for investors, for financial markets, for the economic standing of the United States, and for its leadership in the world.

Greece, France, Spain, the United States—these are straws in the wind signaling the powerful effect that the demographics of an aging population will have on the economic and political future. Let's look at what's driving that future.

Life expectancy is rising. This, of course, is good news, marking mankind's enormous progress over the last century against the ancient scourges of disease and hunger. The author Ted Fishman, in his new book Shock of Gray, notes that the world's 6.7 billion people will live, on average, 37 years longer than their ancestors who lived just a century ago.

Most of those gains came through sharp reductions of childhood mortality. But life expectancy has risen at every age. Today, a 65-year-old American is five times more likely to see an 85th birthday than his or her counterpart a century earlier.

At the same time, people all over the world are having fewer children. Since the early 1960s, the number of births per woman has fallen by almost half, to two-and-a-half children today.

Close to half of the world's population lives in countries with fertility rates below the replacement rate of just over two births per woman. That includes virtually all developed countries, and many developing nations as well.

Rising life expectancies and falling birthrates are the jaws of a demographic vise that will squeeze retirement systems in particular.

According to the United Nations, the ratio of working-adults to elderly in the developed world may be cut in half from the year 2000 to 2040.

These same trends form a fiscal vise as well—that of stagnant government resources, on the one hand, and rising demands of the elderly, on the other.

And here is where the global security issues to which I alluded before come in. Aging brings broader concerns as well. Consider the effects of population change on three countries of importance to us all—Japan, Russia, and China.

- At 83 years, Japan has the longest average life expectancy in the world. At the same time, it has suffered one of the steepest drops in fertility. As a result, demographer Nicholas Eberstadt predicts Japan is on track for, as he puts it, "a degree of aging thus far contemplated only in science fiction"—including a 17 percent drop in its working-age population by 2030. Just two decades ago, Japan was the economic superpower of Asia. Over the next two decades, Japan will be sorely challenged to emerge from its current sluggish growth. What do its demographic trends mean for the world economy and for East Asian security?

- Russia offers a striking contrast to the global upsurge in longevity. Average life expectancy in 2009 was lower than in 1961. Death rates have doubled among working-age men. Russia's working-age population is projected to shrink by one-fifth over the next 20 years. What then will become of the Kremlin's ambitious targets for a return to superpower status fueled by strong economic growth? And if Russia falls short of those ambitions, what will be the response of an autocratic government with a still-massive army and the world's second largest nuclear arsenal?

- China is another anomaly—the world's first country to grow old even as it grows wealthy, a product of its "one child" policy. The Center for Strategic and International Studies predicts that China's working-age population will peak and start to decline before 2030, while its elderly population doubles, to 240 million.

But China will have another potentially destabilizing force: a gender imbalance—six young men for every five young women. This is likely to result in what Eberstadt calls a huge pool of "unmarried, underprivileged, and, quite possibly, deeply discontented young men."

Here, too, aging trends could play havoc with expectations of rapid growth and development. How will the world cope with the loss of China's savings, as the Chinese cash out their global investments to support an aging population? More broadly, will these stresses of a population so imbalanced make China turn inward? Or will they make China ever more assertive in its region, more avid for the resources of Africa and Latin America, and more adventuresome globally?

That is a plausible vision for the future. Plausible, and not very appealing.

Even leaving these extremes aside, an aging world will have significant effects on global economics and security.

- What new powers will arise as the developed world shrinks—from almost one-quarter of the world's people in 1950, to just one-tenth by 2050?

- Will aging countries open their borders, using immigration as a competitive advantage? If so, what will be the effects of lost human potential and increased remittances on the developing countries that emigrants leave behind?

- How will all these trends influence future patterns of economic growth, productivity, and trade?

- How will the competition between the needs of the elderly and the needs of security squeeze the developed nations? In particular, will the aging of the West—the nations that since World War II have been the mainstays of the global security system—spell a decline in their commitment and means to influence global affairs?

So much is at stake—vast and urgent concerns that touch us all. Issues of wealth and poverty—but also of war and peace.

The questions are clear. The answers are difficult.

There is no historical precedent for the challenges we face. Each society will experience them somewhat differently.

With that in mind, let me offer some thoughts about my own country.

First, it's important to note that demographic forces in the United States are more favorable than those in many other developed countries. Fertility remains above the replacement rate. Immigration contributes a steady flow of younger workers. The U.S. Census Bureau projects moderate but steady growth in the U.S. working-age population over the next 20 years.

Still, we Americans face an especially severe problem of budgetary overreach. Even before the financial crisis, our position as the world's leading economy made us forgetful of basic principles of fiscal discipline—particularly the notion of balancing spending and revenues over the course of an economic cycle.

Now, after recession and a slow recovery, the result is unmistakable. We are hemorrhaging red ink.

Our federal budget deficit has topped $1.3 trillion in each of the last two years. It is expected to remain above $1 trillion this year. National debt held by the public has surged from 40 percent of U.S. GDP in 2008 to 62 percent now—that's growing by half in just two years.

And we still face the imminent retirement of the Baby Boom generation, whose oldest members will turn 65 come January. The burden of providing for income and health needs of retirees, now and in the future, has created a huge unfunded liability for America. The U.S. Treasury puts the present value of these obligations at $107 trillion.

Put another way, the Congressional Budget Office projects a likely scenario in which Treasury debt held by the public will soar to 185 percent of America's gross domestic product over the next 25 years.

Now, as the late economist Herbert Stein was fond of saying, "If something cannot go on forever, it won't."

And in the wake of the election, Washington now seems willing at least to discuss putting the brakes on our fiscal profligacy.

Since our election, we have seen the unveiling of serious, substantial plans designed to reduce the federal budget deficit and limit the soaring trajectory of public debt.

One plan was issued by the co-chairs of the National Commission on Fiscal Responsibility and Reform, former Clinton chief of staff Erskine Bowles and former Republican Senator Alan Simpson. In their proposal, they observe bluntly, "America cannot be great if we go broke."

The co-chairs boldly tackled the twin pillars of retirement spending—health-care costs and income security. And they issued a call for a sweeping overhaul of the U.S. tax system. Their plan would, for example, very gradually increase the Social Security retirement age by two years, to 69, while tilting benefits more toward lower-income retirees and subjecting more income to the payroll tax.

I think it is safe to say that neither their ideas nor others put forward to date have met with universal approval. But for once there are candid, clear-eyed assessments of the kind of steps necessary to stabilize our national debt. They already have helped to crystallize a debate that is badly needed as America—like other nations—looks ahead to meet the challenges of aging and retirement security.

In doing so, we have before us the example of Britain and the painful but necessary agenda of budget cuts and reforms it is implementing. The forthright way in which Britain is seeking to address its fiscal challenges sets a standard to which other countries should aspire—and that includes America.

Now, as the United States and other nations rise to meet these challenges, I modestly propose three guiding principles for policymakers and citizens. I believe these principles apply particularly well to my own country—but are applicable elsewhere.

First, we absolutely have to be candid about the extent of the problems and the consequences of choices. Too often, leaders have relied on wishful thinking and false promises in enacting policies without communicating—or even understanding—the long-term budgetary effects. The health-care legislation passed in the United States last spring, for example, promised "savings" from a variety of sources, such as cuts in physician payments, that have already proved politically difficult and unreliable. A stiff dose of realism and truthfulness is absolutely essential—and, I believe, would be welcomed by all of our publics.

Benjamin Franklin wrote in Poor Richard's Almanack: "Honesty is the best policy." On these vital issues, it should be the only policy.

The second principle is that the most promising solutions to fiscal problems will be multi-faceted and will require compromise.

Spending cuts alone will not set budgets right—but neither will tax increases. Both the public and private sectors must do their shares. Only if the burdens are widely shared will the benefits be as well.

It is essential to focus on policies that promise sound, long-term economic growth, by fostering productivity and entrepreneurship. In short, we must have a mix of reforms, including ideas that reach beyond government to rely upon individual enterprise and responsibility as well.

Here, perhaps, the American retirement system can offer a useful example. We have a robust system for retirement income that relies on multiple sources and provides great flexibility to workers and employers.

The bedrock of Americans' retirement income is Social Security. America's mutual fund industry recognizes that Social Security faces a long-term gap between funding and benefits. We believe, however, that this gap can be closed without changing the fundamental structure of the system.

Nearly half of retirement income for American retirees comes from private sources. In fact, the private sector is where the American system has proven its greatest flexibility and adaptability—particularly as defined contribution plans have taken on a larger role in providing pension coverage.

Defined contribution plans offer many advantages. They accommodate the labor mobility needed in today's fast-changing economy. They embody flexibility by giving workers individual control and choice over key decisions—decision like how to invest, when to retire, how much income to withdraw—the kinds of decisions that are made by formula or political fiat in other systems.

Other countries see the advantages of the defined contribution approach—although there are many, many variations on the theme. One such approach is the new National Employment Savings Trust, or NEST, created by the British government as part of a comprehensive strategy for boosting private-sector pension saving.

My third and final principle for dealing with the fiscal challenges of aging populations is that solutions must be equitable in the broadest sense.

It is clear that we will have to make adjustments to our health and income programs.

These adjustments must be fair to today's retirees, and to those who will retire in the next decade. They must take into account the interests of the young person just graduated from university and seeking a first job. They must take into account those of newborns, and of millions yet to be born. And they must preserve our willingness and means to safeguard the blessings of freedom for today's and future generations.

Candor, compromise, and equity—all are vital principles as we strive to provide securely for the needs of our aging populations.

No one should believe that meeting these needs will be easy. We are dealing, after all, with matters that—handled poorly—will stretch and strain the very fabric of our societies.

Still, I am confident that our countries can rise to these challenges—just as they have risen to meet historic challenges before.

Too much is at stake for us to be petty; too much for us to be shortsighted; and too much for us to devote anything less than the full measure of wisdom and energy required to succeed.

Those who come after us deserve nothing less.

Thank you for your time and attention.
