

INTRODUCTION

HISTORY IS LITTERED WITH THE WRECKAGE OF GREAT POWERS THAT FAILED TO ADAPT TO REVOLUTIONARY CHANGE.

- ◆ **ANCIENT CHINA SEALED ITSELF OFF FROM FOREIGN INFLUENCE ONLY TO BE RUDELY AWAKENED CENTURIES LATER BY POWERFUL EUROPEAN NATIONS SHARPENED BY INTERNATIONAL COMPETITION.**
- ◆ **MANY DEVELOPING WORLD NATIONS ARE STILL CATCHING-UP AFTER STAYING WITH AGRICULTURE-BASED ECONOMIES AFTER OTHER NATIONS INDUSTRIALIZED IN THE 19TH CENTURY.**
- ◆ **THE SOVIET UNION DISSOLVED LARGELY BECAUSE IT EXERCISED TOTAL GOVERNMENT CONTROL OF POLITICAL AND ECONOMIC ACTIVITY, LEAVING IT UNABLE TO COMPETE WITH FREE MARKETS AND FREE ELECTORATES.**

AS WE ENTER A NEW MILLENNIUM, REVOLUTIONARY CHANGE IS ALL AROUND US. INFORMATION TECHNOLOGY HAS FOSTERED RAPID COMMERCIAL INNOVATION.

BUT WITH RESPECT TO ANOTHER, EQUALLY DRASTIC RESHAPING OF HUMAN SOCIETY—POPULATION AGING THROUGHOUT THE DEVELOPED WORLD—THE UNITED STATES IS AT RISK OF JOINING ITS ALLIES IN A DIRE POSITION.

THE ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD) PROJECTS THAT THE COMBINED SHARE OF GLOBAL GROSS DOMESTIC PRODUCT (GDP) PRODUCED BY THE UNITED STATES, JAPAN, AND THE EUROPEAN UNION WILL DECLINE BY ROUGHLY 40 PERCENT FROM ITS CURRENT PROPORTION BY THE MIDDLE OF THIS CENTURY.

THE PRINCIPAL REASON FOR THIS DECLINE IS UNRELATED

TO ANY FUNDAMENTAL ECONOMIC FAILURE – IT IS INSTEAD THE DRAG ON NATIONAL PRODUCTIVITY RESULTING FROM INCREASES IN THE ELDERLY POPULATION.

COUNTRIES WITH INCREASING NUMBERS OF ELDERLY CITIZENS COUPLED WITH A DECLINING PROPORTION OF THEIR POPULATION IN THE WORKFORCE WILL FACE SPIRALING SPENDING COMMITMENTS TO RETIREES. THIS WILL SLOW ECONOMIC GROWTH UNLESS PRODUCTIVITY ACCELERATES MARKEDLY.

REFERRING TO GLOBAL POPULATION AGING AS A “PROBLEM” MISREPRESENTS THE SITUATION. LONGER, HEALTHIER LIVES ARE GOOD NEWS FOR THE DEVELOPED WORLD AS ARE PERMANENTLY SUSTAINABLE LEVELS OF POPULATION GROWTH.

WHAT IS TRULY AN “OPPORTUNITY” WILL BECOME A

“PROBLEM” IF THE DEVELOPED WORLD DOES NOT ADAPT ITS STRUCTURES TO NEW REALITIES. WAYS MUST BE FOUND TO TAP THE PRODUCTIVITY, KNOWLEDGE, AND DESIRE FOR WORK OF THE GROWING SENIOR POPULATIONS OF THESE NATIONS. MEANS MUST ALSO BE DEVELOPED TO PROVIDE PENSION AND HEALTH CARE COMMITMENTS THAT DO NOT GROW MORE RAPIDLY THAN UNDERLYING ECONOMIES.

RELATIVE TO ITS ALLIES, THE UNITED STATES IS MORE FAVORABLY SITUATED TO GRAPPLE WITH THE CHALLENGES OF POPULATION AGING. ITS FISCAL POSITION IS GOOD, AND IT STILL HAS ENOUGH TIME TO PREPARE, TO PROVIDE ADVANCE FUNDING FOR ITS ELDERLY-CARE PROGRAMS, AND TO LESSEN THE MAGNITUDE OF ITS UNFUNDED LIABILITIES WITHOUT CAUSING UNDUE HARDSHIPS FOR ANY GENERATION OF WORKERS OR RETIREES.

SO FAR HOWEVER, THE UNITED STATES HAS BEEN

HAMSTRUNG BY POLITICAL FAILURES. TOO MANY PUBLIC OFFICIALS DEFEND EVERY DIME OF UNSUSTAINABLE SPENDING COMMITMENTS.

SELF-AVOWED CONSERVATIVES WHO PROMISE TO LEAVE CURRENT DEFINED-BENEFIT COMMITMENTS UNTOUCHED EVEN AS NEW METHODS ARE INCORPORATED TO FINANCE THEM ARE ALSO AT FAULT.

GLOBAL DIMENSIONS OF POPULATION AGING

THE RATIO OF WORKERS TO RETIREES IN THE UNITED STATES WILL PLUMMET IN THE NEXT 30 YEARS. CURRENTLY THE WORKER:RETIREE RATIO IS 3:1. THAT RATIO IS SCHEDULED TO DROP TO LESS THAN 2:1 BY 2030. THE OECD PROJECTS THAT THE UNITED STATES WILL HAVE AN ELDERLY-DEPENDENCY RATIO OF NEARLY 40 PERCENT BY 2035.

THIS FIGURE SHOULD JOLT POLICYMAKERS IN THE U.S. AND ESPECIALLY ABROAD. JAPAN WILL PASS 50 PERCENT IN 2035 AND FRANCE 60 PERCENT. GERMANY WOULD BE ALMOST AS HIGH AS FRANCE, AND ITALY IS PROJECTED TO FACE A WHOPPING 100 PERCENT DEPENDENCY RATIO IN 2035—MORE RETIREES THAN WORKERS.

THE IMPACT OF THESE CHANGES ON CURRENT ELDERLY-CARE SYSTEMS WOULD BE EXTRAORDINARY. BY 2030, THE UNITED STATES WOULD HAVE TO IMPOSE AN INCREASE IN

FEDERAL TAXATION LARGER THAN THE PAYROLL TAXES THAT EMPLOYERS AND EMPLOYEES TOGETHER CURRENTLY PAY TO THE U.S. GOVERNMENT.

ONCE AGAIN THESE FIGURES ARE EASILY SURPASSED BY OUR EUROPEAN ALLIES. KEEPING DEBT LEVELS CONSTANT, TAXES IN FRANCE WOULD HAVE TO BE ROUGHLY 7 PERCENT OF GDP, 9 PERCENT IN JAPAN AND GERMANY, AND 11 PERCENT IN ITALY.

DESPITE THESE FACTS, THE MYTH PERSISTS THAT FASTER ECONOMIC GROWTH SIGNIFICANTLY AMELIORATES THIS SITUATION. ALTHOUGH FASTER ECONOMIC GROWTH WOULD PERMIT A LESS NEGATIVE PROJECTION OF SOCIAL SECURITY'S "ACTUARIAL SOLVENCY," THIS IS SIMPLY AN ARTIFACT OF A CALCULATION THAT BEARS LITTLE RELEVANCE TO THE WAY THAT ANY PAY-AS-YOU-GO SYSTEM WORKS.

SOCIAL SECURITY BENEFITS ARE FINANCED SOLELY BY TAXING CURRENT WORKERS. HIGHER GROWTH TODAY MEANS MORE REVENUE TODAY AND THUS MORE CREDITS ON THE REVENUE SIDE OF THE SYSTEM'S "ACTUARIAL BALANCE." BUT THERE IS NO CURRENT MEANS OF SAVING ANY ADDITIONAL REVENUE PRODUCED BY SUCH GROWTH. NOT ONE PENNY OF TODAY'S REVENUES CAN BE USED TO MEET TOMORROW'S BENEFIT OBLIGATIONS.

TO THE CONTRARY, THE CURRENT SOCIAL SECURITY SYSTEM IS CONFIGURED TO PROVIDE HIGHER BENEFITS IF HIGHER WAGE GROWTH IS ACHIEVED, IN WHICH CASE TOMORROW'S OUTLAYS WOULD GROW ALMOST AS MUCH AS TOMORROW'S REVENUES. THUS LITTLE OF CONSEQUENCE CAN BE ACHIEVED THROUGH FASTER ECONOMIC GROWTH AS LONG AS THE SYSTEM CONTAINS NO FUNDED SAVINGS MECHANISM.

THE DEVELOPED NATIONS OF THE WORLD ARE ALL ON A

COURSE TOWARD A MASSIVE INCREASE IN EITHER TAX RATES OR INDEBTEDNESS, AND MANIPULATING THE ECONOMIC VARIABLES DOES NOT CHANGE THIS PROJECTION SIGNIFICANTLY.

ACTION, RATHER THAN RE-ESTIMATION, WILL BE NECESSARY TO MAINTAIN THE POSITION OF ADVANTAGE THAT THE DEVELOPED WORLD CURRENTLY ENJOYS.

PROVIDING PENSIONS AND HEALTH CARE WITH OUTMODED MODELS

MANY WESTERN NATIONS RETAIN A PAY-AS-YOU-GO ENTITLEMENT STRUCTURE THAT TIES BENEFITS TO ECONOMIC GROWTH. THIS ARRANGEMENT MAKES IT IMPOSSIBLE TO GROW ONE'S WAY OUT OF THE FINANCIAL PROBLEM OR TO USE NEAR-TERM SAVING TO REDUCE LONG-TERM OBLIGATIONS. THIS LATTER PROBLEM IS ONE REASON WHY SO MANY POLICY EXPERTS HAVE ENDORSED "ADVANCE FUNDING" OF PUBLIC PENSION SYSTEMS WORLDWIDE.

THIS PAY-AS-YOU-GO STRUCTURE MANDATES THAT EXPENDITURES RISE DRAMATICALLY AS RETIRED POPULATIONS INCREASE. FOCUSING ON "ACTUARIAL SOLVENCY" OBSCURES RATHER THAN ILLUMINATES THE NATURE OF THE FINANCING CHALLENGE.

IN THE UNITED STATES, THE FINDING THAT SOCIAL SECURITY IS "ACTUARIALLY SOUND" ENABLES VARIOUS

POLICY EXPERTS TO DECLARE THAT THERE IS “NO PROBLEM” FOR THE NEXT 35 YEARS, EVEN THOUGH AN EFFECTIVE TAX RATE INCREASE OF MORE THAN 50 PERCENT IS PROJECTED TO BE REQUIRED WITHIN 30 YEARS.

RELUCTANCE TO COMMUNICATE THESE REALITIES TO THE ELECTORATE UNDERMINES THE PUBLIC’S WILLINGNESS TO CONFRONT THE COST OF THE CURRENT SYSTEM AND OF PROPOSED REFORMS TO IT.

PRESIDENT BILL CLINTON, AFTER A YEAR OF “DISCUSSION” OF SOCIAL SECURITY, CHOSE INSTEAD TO ENDORSE A FRAMEWORK THAT IMPROVED NOTHING ABOUT THAT PROGRAM’S LONG-TERM FINANCES OTHER THAN ITS ACTUARIAL ACCOUNTING—THROUGH INFUSION OF A SERIES OF TRANSFERS TO THE SOCIAL SECURITY TRUST FUND FROM THE GENERAL REVENUES OF THE FEDERAL GOVERNMENT.

ONLY PROPOSALS THAT ARE STRAIGHTFORWARD IN REDUCING FEDERAL UNFUNDED LIABILITIES WHILE PROVIDING NEW FUNDED ACCOUNT BENEFITS AVERT THE FISCAL MELTDOWN.

THE TWO DIRECTIONS ARE NOT CLOSE IN THEIR EFFECTS. ONE LEADS TO PERMANENT AND UNSUSTAINABLE DEBT, AND THE OTHER TO PERPETUAL SURPLUS. THE FORK IN THE ROAD FOR THE UNITED STATES MUST BE ANALYZED AND CONFRONTED NOW, OR VERY DIFFERENT FUTURES AWAIT.

CAPITAL SHORTAGE

RATHER THAN REDUCING THE COSTS OF FEDERAL ENTITLEMENTS BY LIMITING SPENDING, THE CLINTON ADMINISTRATION SAYS THAT ALL CURRENT BENEFIT PROMISES CAN BE KEPT IF THE GOVERNMENT RUNS SURPLUSES OF SUFFICIENT SIZE TO PAY OFF EXISTING FEDERAL DEBT BY 2014. THIS WOULD ENABLE THE GOVERNMENT TO BETTER BORROW THE NECESSARY FUNDS WHEN IT FACES SEVERE DEFICITS IN THE MID-2010'S AND BEYOND.

SUCH AN APPROACH WOULD NOT GUARANTEE THAT THE BENEFITS OF SAVING WOULD FLOW DIRECTLY TO SOCIAL SECURITY, AS WITH PERSONAL ACCOUNTS, BUT ASSUMES THAT THE INDIRECT BENEFITS STEMMING FROM INCREASING NET NATIONAL SAVINGS RATES WILL DO THE JOB.

GLOBAL AGING TRENDS PROVIDE EVIDENCE THAT SUCH AN APPROACH CANNOT WORK. THE SIMPLE REASON IS THAT

THE UNITED STATES WOULD THEN BE DESPERATELY SEEKING ADDITIONAL FUNDING AT THE SAME TIME THAT THE REST OF THE DEVELOPED WORLD IS STARVING FOR IT.

A RECENT GAO REPORT PROJECTS THAT THIS APPROACH WOULD STILL ULTIMATELY RESULT IN UNSUSTAINABLE FEDERAL DEBT WITH THE BORROWING BEGINNING IN EARNEST IN 2040.

USING THE MORE TENABLE BUT OPTIMISTIC ASSUMPTION THAT WASHINGTON WILL PRESERVE THE ENTIRETY OF THE SOCIAL SECURITY SURPLUS, BUT TAP INTO THE NON-SOCIAL SECURITY SURPLUS TO FINANCE SPENDING AND TAX RELIEF, GAO'S PROJECTIONS ARE THAT THE PRESIDENT'S PLAN WOULD REQUIRE A RESUMPTION OF NEW BORROWING BY 2020.

ONE MUST ASK WHERE THIS NEW CAPITAL WILL COME FROM. THE UNITED STATES PROJECTS A NEGATIVE NATIONAL SAVINGS RATE BEFORE 2030. ASSUMING EVEN SIGNIFICANTLY

HIGHER PRIVATE SAVINGS RATES, THE MEDIAN PROJECTION FOR JAPAN'S NET-SAVINGS RATE IS ALSO NEGATIVE, PRIMARILY BECAUSE GOVERNMENT DEBT SOAKS UP ALL PRIVATE SAVING AND THEN SOME. THE SAME IS TRUE OF GERMANY AND ITALY. A RANGE OF PROJECTIONS FOR FRANCE'S NET SAVINGS RATE IS COMPLETELY NEGATIVE, AS ARE THE UNITED KINGDOM'S.

ALL OF THESE COUNTRIES WILL BE SEEKING CAPITAL AT THE SAME TIME, AND NONE OF THEM CURRENTLY CAN PROJECT FINDING A SUFFICIENT AMOUNT AMONG PRIVATE DOMESTIC CREDITORS.

WHO THEN WILL PROVIDE INTERNATIONAL CAPITAL AT THIS TIME? CHINA IS A GREAT UNKNOWN; ITS OWN DEMOGRAPHIC PROBLEMS BEGIN IN APPROXIMATELY 15 YEARS; ITS INTERNAL ECONOMIC SITUATION IS UNCERTAIN; AND MANY WESTERN NATIONS MAY BALK AT RELYING ON NON-

ALLIES SUCH AS CHINA FOR CAPITAL.

THERE IS NO FREE LUNCH AS FAR AS ELDERLY ENTITLEMENTS ARE CONCERNED. THE HIGHLY IMPLAUSIBLE ASSUMPTION THAT U.S. GOVERNMENTS WILL MAINTAIN THE FISCAL DISCIPLINE TO RUN HUGE SURPLUSES IN THE SHORT TERM SIMPLY DOES NOT JIVE WITH THE REALITIES OF GLOBAL DEMOGRAPHICS.

TO RETAIN ITS POSITION OF WORLD LEADERSHIP, THE UNITED STATES MUST MUSTER THE COURAGE BOTH TO REDUCE ITS OWN OUTLAY OBLIGATIONS AND TO INCORPORATE GREATER ADVANCE FUNDING AND ENCOURAGE ITS ALLIES TO DO THE SAME.

PRACTICAL APPROACHES

NATIONS NEED TO PLAN AHEAD AND TAKE STEPS TO CHANGE EXISTING POLICIES AND REVISE OLD MODELS. IN THE US, INDIVIDUALS MAY RECEIVE SOCIAL SECURITY BENEFITS AT AGE 62, BUT THEY ARE PENALIZED BY REDUCED BENEFITS IF THEY CONTINUE TO EARN WAGES.

SPECIAL INTERESTS AND LABOR UNIONS WORK HARD TO PREVENT CHANGES IN ELIGIBILITY, EVEN IF THEY AFFECT NO SENIORS CURRENTLY.

POLICIES IN MANY OF THESE PROGRAMS HAVE UNTIL NOW BEEN CRAFTED TO DRIVE INDIVIDUALS INTO RETIREMENT. IN THE U.S., THE RECENTLY REPEALED EARNINGS TEST WAS A WELL-KNOWN PENALTY.

IN THE DEVELOPING WORLD, THE EVIDENCE IS LARGELY THAT INDIVIDUALS RETIRE BECAUSE GOVERNMENTS PAY

THEM TO—WITH PREDICTABLE EFFECTS ON GOVERNMENT REVENUES.

BOTH POSITIVE AND NEGATIVE INCENTIVES NEED TO BE CONSIDERED FOR THEIR EFFECTS ON RETIREMENT DECISIONS THROUGHOUT THE DEVELOPED WORLD. PREDICTABLY, THE CARROTS—ELIMINATING THE EARNINGS TEST ON SOCIAL SECURITY BENEFITS—ATTRACT MORE POLITICAL SUPPORT THAN THE STICKS—GRADUAL CHANGES TO ELIGIBILITY.

THERE IS LITTLE REASON TO BELIEVE THAT PLUMMETING WORKER-RETIREE RATIOS CAN BE AVERTED SOLELY BY STILL MORE BENEFITS TO WORKING SENIORS.

THE FUNDAMENTAL CHALLENGE FACING EACH OF THESE NATIONS WILL BE TO REDUCE THE SCOPE OF UNFUNDED LIABILITIES TO NATIONAL PENSION AND HEALTH CARE PROGRAMS. AS LONG AS ANY SUCCESS IN REDUCING OUTLAY

OBLIGATIONS IS DEFINED IN POLITICAL PARLANCE AS A BENEFIT CUT, THERE WILL BE LITTLE LIKELIHOOD OF AVERTING SPIRALING COSTS.

PRUDENT CHOICES WOULD MAKE THESE PROJECTIONS VANISH. AS NOTED ABOVE, BIPARTISAN PLANS TO ADVANCE FUNDS AND RESTRAIN OUTLAYS WOULD ALSO MAKE THEM VANISH, NOT ONLY BY PROVIDING A SOUND SOCIAL SECURITY SYSTEM BUT ALSO ELIMINATING COMMENCEMENT OF AN EARLY TWENTY-FIRST CENTURY BORROWING SPREE.

UNDER MY PLAN WITH SENATORS ROBERT KERREY, JOHN BREAUX, CHARLES GRASSLEY, AND OTHERS, AND UNDER A SIMILAR KOLBE-STENHOLM PROPOSAL IN THE HOUSE OF REPRESENTATIVES, THE UNITED STATES WOULD STAND TO BE A NET CREDITOR THROUGHOUT THE TWENTY-FIRST CENTURY, AN ENVIABLE POSITION IN A CAPITAL STARVED WORLD.

ONE PROMISING OPTION IS TO EARMARK A PORTION OF THE BUDGET SURPLUS FOR RETIREMENT SAVINGS ACCOUNTS AND RELIEVE THE BURDEN ON FUTURE TAXPAYERS OF THE LONG-TERM LIABILITIES ASSOCIATED WITH SOCIAL SECURITY. WITH THIS SAVINGS, FORMALLY SHELTERED AND EARMARKED FOR RETIREMENT, THE SURPLUS CAN BECOME RETIREMENT INVESTMENT RATHER THAN A MEANS OF FINANCING FEDERAL CONSUMPTION TODAY.

THIS MOST IMPORTANT INGREDIENT IN THE WHOLE EQUATION IS THAT, AS PART OF THE EXCHANGE, BENEFITS BASED ON UNTENABLE GOVERNMENT PROMISES WOULD BE REPLACED BY ONES WITHDRAWN FROM FUNDED ACCOUNTS. THIS IS ONLY A “BENEFIT CUT” IF ONE BELIEVES THAT THE ONLY BENEFITS THAT COUNT ARE THOSE PAID FOR BY TAXPAYERS AT THAT TIME. THESE LIABILITY REDUCTIONS ARE THE CRITICAL ELEMENT OF THE SOLUTION TO THE PROBLEM; WITHOUT THEM, THERE IS NO WAY TO ACHIEVE LONG-TERM

SUSTAINABILITY.

WITH THE ELDERLY ON A MORE SELF-RELIANT BASIS IN THE TWENTY-FIRST CENTURY, DRAWING FROM THEIR OWN EARMARKED RETIREMENT FINANCES, AND WITH WORK INCENTIVES IMPROVED, THE U.S. WOULD BE PLACED IN A BETTER POSITION TO MEET CHALLENGES TO ITS SECURITY AND PROSPERITY THROUGHOUT THIS CENTURY.

ONE NEED ONLY REVIEW THE 20th CENTURY TO SEE THE IMPORTANCE OF PROSPEROUS, STABLE DEMOCRACIES TO THE FUTURE OF HUMANITY. THE POWER AND MIGHT OF THE WESTERN DEMOCRACIES WERE INDEED OBSTACLES FIRST TO GENOCIDAL FASCISM AND THEN TO TOTALITARIAN COMMUNISM, WITH ALL THE HORRORS EACH WOULD HAVE INFLICTED ON HUMANITY.

A CHALLENGE TO THE CONTINUED PRIMACY OF THESE

GREAT NATIONS LAY AHEAD, JOINED IN RECENT DECADES BY NATIONS SUCH AS JAPAN AND GERMANY. POSTERITY CANNOT AFFORD THE LUXURY OF OUR LOOKING BACKWARD. HISTORY ONLY REWARDS THOSE WHO RECOGNIZE NEW REALITIES AND PLAN FOR THEM.

IF WE WEAN OURSELVES FROM ONE-SIZE-FITS-ALL GOVERNMENT SOLUTIONS AND TAP THE POTENTIAL OF OUR LEADING FINANCIAL AND TECHNOLOGY RESOURCES, WE CAN BE JUSTLY CONFIDENT THAT IN THE TWENTY-FIRST CENTURY, AS IN THE TWENTIETH, FREE ECONOMIES AND ELECTORATES WILL STILL HOLD THE UPPER HAND.