



SEVEN REVOLUTIONS

“An initiative to promote strategic thinking on the key issues of tomorrow.”

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“NAMING NAMES”: AGING AND VULNERABILITY

You and most of the other recipients of this *Seven Revolutions FYI* communication are pre-retirement, pre-pension professionals located in the developed world—most of you in the prime of your successful careers. Apart from your contributions to professional life, however, you also play another critical role—financing the retirement of the generations ahead of you.

As each year passes, that role becomes more difficult. Soon, for the next generation of successful professionals, it will become unmanageable.

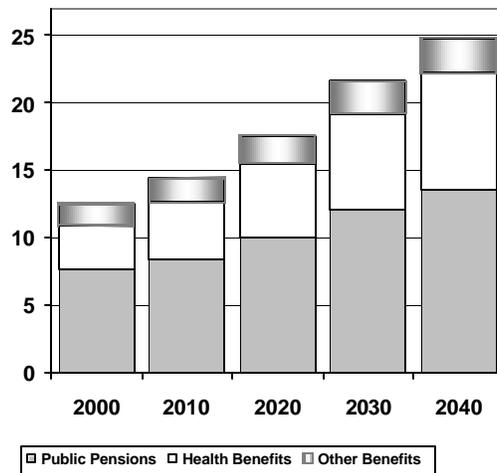
For every 100 of us who are working-age adults in the developed world, there are now 30 pension-eligible elders who are ready to retire. The next generation will have an even more pronounced burden. **By the year 2040, by the time many of us now shouldering the retirement system are ourselves ready for retirement, there will be 70 retirees for every 100 workers.**

If all that seems like a daunting proposition to Americans, it is all the more overwhelming to a number of European countries and Japan, which have old-age dependency ratios even higher than the developed-world average. **The fastest-aging countries—Japan, Italy, and Spain—face the agonizing prospect that they will have as many retirees as workers.** One to one.

The forces are irreversible—at least in the near term. The story is rather straight-forward. Start with longer life expectancy. Then slam the brakes on fertility so

that the national rate falls well below replacement level (Italy, Spain and large parts of central Europe now have levels of 1.2, compared with a replacement rate of 2.1). Sprinkle on social welfare systems with unsustainably generous pension benefits. The result is stressed social welfare systems, strong negative fiscal pressures, slowed macroeconomic growth, new inter-generational tensions, and political polarization on issues ranging from health care to immigration.

**DEVELOPED COUNTRIES:
ESTIMATED PUBLIC BENEFITS TO
THE ELDERLY, 2000-2040 (% GDP)**



Looking out the next 25 years, the operative question is what countries in the developed world are most

“vulnerable” to these demographic forces.

To answer that question, a research team from the Global Aging Initiative at CSIS has developed an “aging vulnerability index” consisting of measures relating to four categories.

First, they examined the demographic fundamentals—the “public burdens” in the various countries presented by dependency ratios. Second was the “fiscal room for maneuver”—the possibility that governments might respond to demographic realities by raising taxes, cutting public spending, or

borrowing. Third, they incorporated measures of “benefit dependence”—how dependent the elderly are, and might become, on public benefits. The final category was euphemistically called “elder affluence”—how much clout the specific age-cohorts have to influence future transfers.

The results were telling. **Highest on the vulnerability index were Spain, Italy and France.** Why? Key common factors for the high vulnerability score were severe demographic pressures, lavish benefit formulas, early retirement systems, and heavy elder dependence on pay-as-you-go public support.

Spain tops the charts because it had the most pronounced results in each of the three public-burden indicators in the index. **Italy** earns second place because of its high dependency ratio. In 2040, it will hit the one-on-one level—one dependent person for every working-age adult. The number-three ranking assigned to **France** is primarily due to the lavish public pension system and the high level of dependence of the elderly population on public support.

Next came a middle group of “**medium-vulnerable**” countries of **Belgium, Netherlands, Germany, Japan, Sweden and Canada.** Each country here faces heavier old-age dependency burdens. Belgium and the Netherlands top this group because of their generous and unreformed benefit systems. Japan, despite expectations that it will have the highest old-age dependency ratios by 2040, has a relatively small exposure on public benefits. Germany and Sweden have taken reform steps, which explains their lower levels of vulnerability.

The least vulnerable tier—the United States, the United Kingdom, and Australia—have limited vulnerabilities for different reasons. From the standpoint of the index, the **United States** has the most favorable future as far as demographic fundamentals are concerned. The **United Kingdom** received the best ranking in the “public-burden” and “fiscal room for maneuver” categories. Finally, **Australia** managed to develop a negative score as a result of its public-burden and fiscal room for maneuver scores.

What does all this imply as we survey the next 25 years and beyond?

This titanic shift in the center of “aging gravity”—from a majority of “pre-elderly” (less than 60 years) to a majority of “elderly” (60+) in the developed countries will have wide-ranging secondary effects far above and beyond the categories covered in the CSIS index, as significant as they are:

- ❑ A corresponding shift in consumer preferences is at the top of the list. Look for the “modern maturitization” (*Modern Maturity* is the flagship publication of the AARP, with more than 20 million recipients) of many key areas of consumer markets and buying patterns.
- ❑ Because so many EU member states are on the vulnerability list, we can expect to see increasing pressure on the attempts by Brussels to reinforce the Growth and Stability Pact—especially the fiscal discipline component. How these process plays out will have important implications for the Central and Eastern European candidate countries that are set to join the EU in 2004.
- ❑ We can expect to see more cross-border capital flows to markets with higher economic vitality. This implies a potential change in the risk-return calculus—and serious questions about the pricing of risk premiums associated with various higher-growth countries.

See Richard Jackson and Neil Howe, “Preliminary Results from the CSIS Aging Vulnerability Index,” CSIS unpublished paper, November 15, 2002. The link is: http://www.csis.org/gai/aging_index.pdf.