

“The Next US (Retirement) Revolution”

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The US is now entering the much-discussed era of the retirement of the baby boomers, the generation born after World War II. The big issue now is whether it will be able to pay for their retirement. If not, what happens to them and the US?

It's pretty clear that the US Social Security system won't be able to cope if things stay as they are. If the current retirement age and benefit levels don't change, the system runs out of money after 2037. However it's worse than that. It starts going cash-negative by 2015.

And there is another factor that isn't included in these calculations. That is that pension funds for public sector workers are also running at a massive loss that will increase over time because of the same problem of the retirement of the baby boomers. So on the surface things look pretty bad.

But as always, there's another side. We can't just look at a retirement system like an accountant would, even though it's a good place to start. What drives the solvency of retirement systems is not accounting factors, but demographics, politics and behavior. And looking at each of these shows other trends at work.

Let's look at demographics. I'm going to assume for a moment that the statisticians have correctly extrapolated past trends. But of course, they can't predict the future.

No doubt they have included past immigration rates. The US also benefits from illegal immigration which keeps bringing in younger, more fertile people who help reverse the aging of the US and create lots of babies in big families.

Right now the Republicans in particular are anti-immigration. But illegal immigrants keep on coming because the US is a wildly attractive place to come for them in comparison with the awful conditions in their home countries south of the US border.

Right now the US is within walking distance of a country that has 110 million people, the majority of whom hate to live there and can and do walk to the US. That country is Mexico.

Of course they are stopped when they get here. But the worse the problems in Mexico become, the more they will come. As Mexico's crime, social, governance and corruption problems get even worse, if that is possible, Mexicans have an ever-greater incentive to get out of there to come to the US no matter what it takes.

Unless the US adopts a shoot-to-kill policy on its southern borders with Mexico, which it will never do, then we can expect the US dependency ratio to be more favorable than that predicted by the statisticians because of this constant flow of desperate people. That means a better outcome for the US retirement system because it adds younger, more hardy workers who also pay tax, as virtually all illegal immigrants do.

What about politics? As we said, the retirement system in the US isn't just the Federal social security system; it's also the pension systems of public and private sector workers. The private sector is in pretty good shape. Of course it's the public sectors systems that are a shambles. That has been caused by public sector unions getting politicians, mainly Democratic, to provide retirement benefits that will be impossible to pay for.

But a new confluence of events will soon address that issue. The State and local governments in the US have just run out of money and even the Democratic politicians are being compelled to address the issue. The Republicans are too, particularly because of the Tea Party.

Over the next two years the Republicans' new majorities in politics will enable them to shift electoral systems throughout the US in their favor. We can expect a big movement to the Republicans in the 2012 Presidential election even if Obama wins re-election. That will reduce the power of the unions; in fact this is already happening in the US following the Republican victories in the mid-term elections of 2010.

One key indicator: Obama is already moving to the center as we have seen with his new economic appointments and shifting away from union priorities, as we saw with the South Korea Free Trade Agreement. He needs to do this to win re-election. We can expect to see gradual improvements in the area of public sector retirement system solvency as this movement unfolds.

This political shift will also help a nascent move towards US federal deficit reduction. It now appears that both parties understand that this will have to occur and that the health and retirement systems will have to be restructured. This will take some time, but we can expect some changes in the next 3-5 years which will change things like social security retirement ages and benefits, so as to result in lower net outlays.

And how about behavior? We have to remember that there is a fundamental difference between the retirement behaviors of people in the US and Europe. In Europe retirement and vacations are taken very seriously. It has been the practice to take these at very early ages by US standards and with very good retirement packages.

This has never been the case in the US. US workers take far less vacation and have never been as oriented to early retirement as the Europeans. Many of the US population are upwardly mobile, hard-working immigrants who don't trust government to fund their retirement anyway. If the US retirement system doesn't work, many of these people will support each other through their extended families.

In the US it is illegal to force people to retire (except in the military and the FBI). If they can get jobs, older people can take them. It is clear that older people are now working longer, and retiring later. As the health of older people improves this has become more possible. This shift has not yet been factored into retirement systems predictions because it is a fairly new phenomenon and no-one really understands it very well.

But for most Americans, the idea of retiring at age 55, 60, or even 65 is no longer realistic and for many, not even desirable. Many older people in the US want to work as long as they can, even into their 80s.

As a fact many of them are retiring much later than retirement systems planners had accounted for. If retirement systems dictate later retirement ages than at present, which it is certain they will, most of these people have already anticipated that and are retiring even later than the planners actually planned.

Of course, this may and probably will mean that real wages for older workers will decline, but that's OK. It just means that instead of getting really low retirement benefits they will get somewhat higher wages, albeit still not generous. But that's not the same as living on no money at all or living on retirement benefits that are totally inadequate.

And we haven't addressed one other hugely important issue in the equation. That is, the capacity of the US to innovate and grow which will bring in more taxes to fund the social security system.

It is currently fashionable to see the US as just being on a one-way street downhill to mediocrity and national weakness. Certainly there are some disturbing trends but you can't rule the US out yet.

Facebook is 7 years old and has almost 600 million members and it is still growing. It's just been valued at over \$50 billion and is now worth more than most of the top companies in the world. Groupon, the newest Internet company sensation, is growing even faster than Google or Facebook did. Silicon Valley is on a roll. The US innovation machine is roaring back again. Yes, there are still a lot of challenges, but the US is hardly alone in that.

And, to come back to demographics and immigration, there's one other thing. Immigrants tend to be the most innovative and economically vibrant sectors of a population and this is very true in the US. Much of US growth and vibrancy has come from immigrants from all quarters of the globe who have brought with them amazing and innovative ideas.

Think of Sergey Brin of Google who came from Russia or Pierre Omidyar of eBay who was born in Paris to Iranian parents. How will another 10-15 million immigrants from Mexico and other countries impact the growth and innovation prospects of the US in the next 20 years? Pretty positively we can expect.

So will the US retirement system cope? Probably, but who knows; the US governments, Federal, State and municipal, like governments everywhere, are hugely inefficient and cumbersome. But it looks like finally they are on the move.

But will the US economy, society and the behaviors of its citizens cope? There is no doubt of that. The private sector is already swinging back into action. The behaviors of its citizens are changing rapidly in a positive way. The American growth machine is back into action. I certainly wouldn't bet against the US yet.

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