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Perspectives on the Old Age Crisis

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Summary: Panelists address a wide variety of issues concerning the problems of aging populations, including income security, health, and long-term care. Presentations range from pension reforms around the world to futurism. Panelists provide a mix of current developments, personal and professional observations, and visions of the future.

Mr. Robert M. Katz: I'm going to introduce three panelists, all of whom have very interesting and different perspectives on the old age crisis.

What we've done is just assemble three people whose jobs and interests are, in one way or another, involved with the old age crisis. The first speaker is Dimitri Vittas. Dimitri is a pension and insurance advisor at the World Bank and is now working in the capital markets.

To say he is world renowned, I think, is an understatement. He has devoted his career at the World Bank to helping many countries examine and reform Social Security systems. He will be speaking about the worldwide perspective.

Our second speaker is Anna Rappaport, who, of course, is the incoming president of the Society of Actuaries (SOA), and who has already been very outspoken about

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her views on the old age crisis, and, particularly, long-term care issues and the role of women.

Our third speaker is Tom Hughes, who is the chairperson of the Futurism Section. He's going to give us a completely different perspective on the old age crisis out of the future, so that we'll get a different look at that.

Mr. Dimitri Vittas: I am going to talk very briefly about the pension reform policy aspects encountered by the World Bank, mostly in developing countries. Perhaps some of the lessons we have learned and some of the issues that have come up are also relevant for developed countries, as well as for the U.S. I'm going to focus on recent developments and policies used. Basically I will cover what is happening around the world, such as the factors motivating pension reform, the role of the World Bank, and the policy issues that we are facing.

For those of us who work in the area of pension reform, 1997 has been a breakthrough year. In Latin America, three more countries, Mexico, Bolivia, and El Salvador, started implementing pension reform systems, joining the other countries that had already reformed the systems. We know of eight countries in Latin America that have implemented systemic pension reform, and part of that is the development of private pension funds. If we add Brazil, which has no pension reform, but has a very large private pension fund sector, we have nine countries in Latin America that are building a large presence in the area of private pension funds.

Thus, 1997 is the breakthrough year because, for the first time, we have three countries in Eastern Europe and Central Asia that have also passed legislation for systemic pension reform. These countries are Kazakstan, Hungary, and Poland. Those countries have not yet implemented this system. They're now working and preparing for the latest regulations and other aspects that are needed to start the new systems at the beginning of 1998 or mid-1998 if there is some delay. Nevertheless, they have made the big decision, and they have gone through parliament to change their pension systems.

There are many other countries around the world that are making progress in preparing for systemic pension reform. In Latin America, I can say that most of the countries are now working on such reform. In Eastern Europe and Central Asia, there are countries like Russia, Slovinia, Croatia, the Baltic countries, and a couple of other Central Asia Republics that are also very advanced in their work. Also the Middle East and North Africa, East Asia and the Pacific countries, and countries from Southern Europe are facing serious problems with their present Social Security system and are more or less advanced in the work they do preparing for systemic pension reform.

Why are so many countries interested in pension reform? There are many different reasons, but in the developing countries where we specialize, there are basically three reasons. First is design faults. The systems that they used to have, or they still have, suffer from many design faults: low retirement ages, high deflation rates, high payroll practices, and widespread evasion. This works to make the old systems untenable. Demographic aging is a factor all over the world, but it is not that important in the countries that we're dealing with. Even in Eastern Europe, the societies are not as aged as they are in Southern Europe or Japan and East Asia.

But one problem that these countries have in common is that by giving early retirement pensions, by having low retirement ages, and by having very widespread evasion, the ratio of pensioners to contributing workers in that system is twice what it should be if only the demographic factors were at play. So they have a crisis in the system even though they're not that old in relative terms. All of these developing countries suffer from very high administrative costs and very low investment return. All of this stuff is combined to push the pension reform.

The reform programs that have been adopted in different countries are by no means uniform. No two programs are identical. There are some important differences. For instance, in Chile there is an implicit public pillar. In Argentina, the public pillar is explicit. In Chile and Peru, the government has recognized contributions to the old system by issuing so-called recognition bonds. Argentina and Bolivia are recognizing them through the payment of what is known as compensatory pensions—pensions that are paid after people retire, not when they retire in one lump sum.

There are also differences in countries that apparently have similar systems. Kazakstan has decided to follow the Chilean experience and have an implicit public pillar. There are big differences between Kazakstan and Chile in the sense that in Kazakstan they are allowing for a state pension fund to play a very big part at the beginning. They are also allowing for corporate pension funds, which do not play a part in the Chilean system.

And then there are differences between Hungary and Poland in the structure of the first pillar. Hungary has relatively flat benefit that has been paid from the first pillar. In Poland, they want to use the notional accounts approach, the new development that started from Sweden.

What is the role of the World Bank in all this? Basically, we have three roles. The first is to create an awareness of the need for pension reform. I can claim that we have been successful in that area. We published a book in 1994 that was widely read and commented upon and studied by policy makers around the world. In that work, we have emphasized the importance of restructuring and downsizing the public pillar, not eliminating and privatizing Social Security completely. We have also emphasized the importance of promoting a private pillar so that we have a multiple pillar system following the precedent that has been established many decades ago by the Swiss, which follows the situation that exists in the U.S., the U.K., and the Organization of Economic Cooperation and Development (OECD) countries. If I may say so, most of the reform programs that have been adopted so far have one thing in common. There is a downsizing of the public pillar and a promoting of the private pillar.

The second role of the World Bank is to provide technical assistance. Once a country decides they want to prepare for pension reform, we offer assistance from within and outside the bank; we hire consultants, specialist lawyers, actuaries, economists, regulators, and other professionals to prepare for the reform. Once a country starts implementing a new pension system, we provide finance to help the transition costs, which are always high whenever pension reform is undertaken.

I put this item third. Although money is very important, in my view, it really doesn't matter to our role in the end. The countries can borrow for any reason from the World Bank. Money is tangible. Where we really have an influence is in the policy discussion when we shape the system that is going to be produced. It is not necessarily a matter of whether we lend $0.5 billion or $1 billion because we could have easily lent the same amount of money for another project for the particular country.

Whenever I speak about pension reform, I never want people to lose sight of the fact that the basic objective of any pension system is to pay adequate, but affordable and sustainable pensions. The other things that may happen as a result of the reform are second order effects. The purpose for pension systems is clearly to pay pensions.

However, one could correct any design force in the pay-as-you-go Social Security system and still maintain the defined-benefit nature of that system. That would not remove the many disincentives, and distortions that affect the labor markets when you have complete reliance on pay-as-you-go, defined-benefit systems.

The second objective of any reform is to remove those distortions or minimize them. One can achieve this by introducing a defined-contribution system, which is unfunded as the Swiss have proposed recently and the Italians and the Latins are in the process of implementing. If you do that, you may remove those distortions from the economic incentives, but you will not generate long-term savings and promote the development of long-term capital markets. In order to achieve that objective, you need to have a system where part of the structure is based on funded pension systems managed by the private sector. I will come back to why it is important that this be managed by the private sector. An important consideration here is that when you have a multi-pillar system, you are not going to have a worse result than if you have only one pillar in the system. You can naturally discuss that, but to control it, the results will be at least as good and probably better if the private markets operate efficiently.

One of the benefits of doing pension reform the full way, by including private pension funds, is the generation of long-term savings. The question of whether creating funded pension schemes increases the rate of savings in the economy is open to debate. It is not clear. Even if there is a positive effect, it is bound to be small and transitory. However, there is no doubt whatsoever that there is a benefit from a pension system reform that would incorporate the creation of a private pillar in the generation of long-term contractual savings.

Right now, around the world, there are 20 countries where contractual savings exceed 50% of the gross domestic product, (GDP). In fact, there are five or six countries, including the U.S., the U.K., the Netherlands, Switzerland, and South Africa, where it exceeds 100% of GDP. There are a quite a number of others that exceed 50% of GDP, and one of those countries is Chile, which introduced a new pension system in the early 1980s. There are other developing countries like Malaysia and Singapore that have had funded schemes for a long time.

Generating all this long-term savings is bound to have a positive impact on the financial markets. There are three main financial market benefits. First, if you have new players in the market, like the pension funds and the institutional investors, you're bound to have more competition and more efficiency in the system. You are also likely to stimulate financial innovation and the modernization of capital markets. The experience of New York, London, and Toronto shows that when you have institutional investors, the markets do get modernized and innovation does take place.

These changes have occurred because the institutional investors become a countervailing force to the dominant role that commercial banks and banks in general play in the developing countries. Having institutional investors is a very important element in modernizing the financial system, improving the allocation of capital, and promoting economic growth.

But there are also some concerns. There are some issues and questions regarding the performance of the markets. One important one has to do with the conflicts of interest between the managers of the pension funds and the corporate sector. If you have high market concentration, that will give rise to more concern on this issue. The second one is the high marketing and operating cost of private systems, especially ones like the Chilean system, which are based on long-term mutual funds run by independent companies and not by corporations. And the third one is the importance and the impact of regulation. You cannot have a well-run financial system or a well-run pension fund industry if you don't have effective regulation. You must have the right types of rules and the ability to implement them, so that they are not an empty article in the law.

When one addresses this question of pension reform, there are also policy issues for the overall system structure that one has to face. A basic question that comes up in any country is whether funding is the answer to the problem of aging. I belong to the group of people who do not think that funding is the answer. The only answer I can see to aging, especially rapid aging, is either to save more, get less in pensions, retire later, or a combination of the three. I do not think that pre funding is the answer here, and I believe there are many actuaries that have the same view, although there are many economists who think otherwise.

Why do we favor a multipillar system? The reason is to diversify across providers. If I am a financial system specialist, and if I feel the financial system could actually deliver high pensions in the long run, then I would not insist on maintaining the first pillar based on the redistribution principles. It isn't that I still favor multipillar systems because I do not simply know enough about the performance of financial markets for a long period of time to justify taking a view that only privatized fully funded pension funds are what we needed. I heard the stock market went down today by 270 points before lunch. Although we cannot make these decisions on the basis of one morning's performance, it does reinforce the argument.

What is the role of public agencies? There are many countries around the world where public agencies with funded schemes have played an important part in the financial system. However, the experience is almost, without exception, a negative one. First, the money might be completely wasted. The best example of that is in Egypt where the rate of return in real terms during the 1980s was –12. At that rate, if you start with 100, you end up with 20 at the end of the decade. In other countries, such as Sweden where the performance was not that bad, the public agency has not contributed as much as private pension funds can contribute to the modernization of capital markets and to nationalization.

There are some people who say that public agencies could do a decent job if they invest completely in indexed funds; therefore, eliminating all the problems of pressuring the public agency to support social projects or other low-yielding assets. The problem I have with that is that it is fine if the public agency represents 20% of the market. I cannot see it working if you represent the totality of the market. You cannot have a system where 100% of all the investment follows an indexed-passive management approach. Even if you can, there has not been any experience in the past, and we cannot recommend policy advice on the basis of some speculation about what might happen in the future. Rather, we must look at what has worked around the world.

There are policy issues that we face regarding coverage and social protection. There is a very big question in Chile and Argentina and most of the countries that we're dealing with where participation and compliance are very low. Simply passing a law and making it mandatory is not going to increase compliance. One possible instrument you can use in addition to compliance is to offer tax incentives. I found myself in this area. I cannot go into detail because of lack of time, but I find, in my personal view, that the most effective tax incentive is the government co-contribution. A co-contribution is what the government promises to pay to the savings account once an individual or his employer has committed to save a certain amount. That is a very strong incentive, and also it is very good in the long run because the government money is added to the account and this incentive generates more long-term savings. However, any use of tax incentives has to be decided in the context of the whole budgetary approach because there is a cost for the budget, and there are alternative uses of government money. So one has to be very careful when one proposes the use of tax incentives.

The next question on social protection issues is the minimum pension and how well it is integrated with the social assistance pensions in the country. I don't know any country that has actually so far managed to integrate the two very well, although there are so many people working on these issues now that I have no doubt that soon a way will be found to integrate the two things. What we need is a system where the government promises a minimum pension that does not act as a disincentive for people to work and save. One has to combine the two aspects in an effective way.

There are policy issues for the financial markets in addition to what I mentioned before. There is a question of regulation in the detail. How draconian should the regulations be? People who are familiar with the Chilean system know that the regulations that they apply in Chile are very strict and widespread. I used to work in London before I joined the World Bank. I could never imagine any manager of a pension fund in London ever accepting the regulations that they impose in Chile because that would take London back 20 years, if not more.

But it is essential for a developing country that starts without a financial system to use draconian regulations at the beginning. It is also a guarantee against failure. The biggest failure that can happen in a new pension reform is that the managers have the opportunity to steal the money and go to Brazil, Cyprus, Indonesia, or wherever, so there has to be a very effective regulation system to prevent this from happening.

There's the question of whether you are imposing investment allocation rules and whether you are allowing international diversification or not. For a country that starts a new pension system with no experience in well-developed capital markets, investment rules should be imposed, but they should aim for maximum limits, not for minimum limits, in order to ensure adequate diversification. The same thing applies to international diversification. I have no problem with some limits being imposed, even zero at the beginning. However, over time, those rules should be relaxed to allow for more freedom to the private sector in this area.

There is the role of state guarantees and benchmark portfolios and minimum profitability rules. Again, I see a role for such use at the beginning because one needs to protect the individual worker from any abhorrent behavior by the manager. A better way needs to be found than what is being used now in Chile.

There are policy issues for insurance markets. One thing that few people realize at the beginning of pension reform is that the main beneficiaries of pension reform are the insurance companies and the consultants who advise the various countries and the various companies on how to set up pension funds. They benefit because there is bound to be greater demand for life and disability insurance and for annuities. In order to meet that demand, what developing countries need to do is to open the markets to foreign expertise, make the markets contestable, and stimulate product innovation.

There is a lot of concern about the offer of annuities when pension reform is first introduced. I often argue that this is premature. Whenever you have a new system, the likelihood that there will be many pension plans in the first ten years is very small—ten years is a long enough period to develop new products, provided you allow the foreign expertise to come into the country. Clearly, what I'm suggesting has no relevance to the U.S., Canada, the U.K., and other advanced countries. For most of the countries where the World Bank is involved, it is one of the most important features.

Whenever I go to a country and discuss pension reform issues, I put forward three essential preconditions before we start talking about pension reform. First, there must be a strong commitment by government. They must really be committed to implementing the reform. Second, implement rules for safe custody, which prevents the stealing of the money, as I mentioned before. The third is openness to foreign expertise. This is very important because if you don't have the local expertise, it is not easy to offer those services.

Let's discuss the implication of pension reform for international markets. Many people who work for these big investment banks and stock brokering firms obviously support pension reform around the world. There are some things they have to do to support the reform in countries. First, they must avoid fiscal illusion. Just because the deficit is going to be put above the line because countries recognize that the pay-as-you-go system has an implicit deficit, they should not raise the rate of interest they charge on those countries when they borrow in international markets. That's one thing. In fact, my second point is that the financial market should reward reforming countries by lowering the risk premium they charge these countries because they are committed to improving the overall efficiency of the economy. I am pleased to say that recently we have seen a positive reaction from the markets. The risk premiums that are charged on a country such as Hungary have gone down.

The third aspect is to help finance the transition course. Not only should the World Bank be prepared to provide finance, (after all, the resources of the World Bank are limited), but the private markets and the international markets should also be willing to provide this support.

I know I have gone quickly through a wide range of very complex issues. I wanted to give you a flavor of what we are facing in every country where we discuss the possibility of pension reform. Contrary to the impression that some people may have, we at the World Bank do not have a blueprint that we try to sell to every country. We try to tailor the advice we give to fit the circumstances in the country. For instance, I have done a lot of work for Middle Eastern and North African countries. Based on the meetings I had there, these countries are not ready to implement a reform in the style of Latin American countries. In those cases, we recommend changing an existing pay-as-you-go system into a well-rounded, well-managed provident fund. It would still be a defined-contribution system, but it would be under public management. Then it would gradually allow for privatization through outsourcing, following the example of the U.K. where privatization has taken place over a long period, and has worked very well.

Mr. Katz: I think that was a wonderful introduction to what's going on at the World Bank. Let me just say that the economists beat the actuaries to the punch in publishing *Averting the Old Age Crisis*. That's the work to which Dimitri referred. I'm sure many of you are familiar with and, hopefully, are knowledgeable about what the economists have suggested. I'd like to see if the actuarial profession is going to issue something of the same magnitude that could be of similar significance to the world as a whole. Anna Rappaport will now focus more on the U.S.

Ms. Anna M. Rappaport: I'm actually going to focus on the U.S. from of a microperspective in that I'm going to talk a lot about the individual point of view. Our objectives for this session are to focus on the stakeholders. Who are the different groups of people who might be involved in thinking about these issues? I'd like you to understand the key issues. As Bob said, this is more of a U.S. perspective. It's certainly true that the data are U.S. data, but you could replace the data with data from a number of countries other than the ones Dimitri mentioned and reach the same conclusions. So you can view this as more of an advanced industrialized country perspective rather than a U.S. perspective.

We then want to try to define a framework. What are the things that we need to think about in dealing with this from an individual's perspective? What are some of the challenges facing different stakeholders?

I'd like to have you leave this room and, in some way, change at least one thing about the way you deal with one of these issues or the way you do work. Maybe you'll say, "Here's one extra issue I need to focus on." I want you to say, "I got something valuable out of it, and my client or my company did something differently and better because I was here."

We're going to start out with an introduction and then a quick overview of the current situation with some data, the framework and issues, and challenges. What are the forces pushing us to a new look? What are the perspectives of the kinds of countries I'm talking about? Who are the stakeholders and what are the problems they face?

One of the forces pushing a new look is population aging. If you look at the demographics, the issue of an aging population is true in many different countries, particularly the western countries. It's especially true in Japan. In Japan, the population is aging even faster than it is in this country.

There are constraints on resources. Retirement might come from public programs; it might come from employer programs; and, it might come from what we do for ourselves, but there are constraints on all of those resources. We have a concern over unfunded and unrecognized obligations. That's mostly a public employee issue, but the issue exists too for people who work with negotiated plans, such as certain corporate plans. We also have challenges in social insurance programs.

Who are the stakeholders? The individuals. You, me, and our families. Why our families? What happens if we reach old age and we don't have the resources to take care of ourselves? Our children and our family members are the first people we're likely to turn to.

Employers are stakeholders and governments are stakeholders. I would contend that even employers that say, "It's not my problem; I'm not going to do anything about that," are stakeholders as well. Why? Find an employee who's age 58 and has been at his company for 27 years. He can't afford to retire, but wants to retire. I'd rather have him retire. Is that a problem? You bet it's a problem. So employers are stakeholders whether they want to be active participants in this or not.

What are the problems? One is government programs. Social Security and Medicare funding, as structured today, won't quite cover the benefits. How big the gap is depends on how you measure it, and people disagree about the size of the gap, but there is a gap. Other public programs will also cost more. And when we add all of the other programs into this equation, we clearly have issues of program design and resources. Individuals are not saving enough, and they frequently don't have the authoritative information they need. If they have the information, they don't have the motivation. We talk about retirement education. I say, if you haven't saved any money, investment education doesn't help. The first thing you have to do is save some money; then you need to know about how to invest it.

Employers really aren't ready to increase their roles. Women are often alone with very limited resources in older age, and there's no rational long-term care system in the U.S. I think this is true in many places, and we need to think about that within the framework of both service delivery as well as financing. Instead of saying long-term care, we need to say system-to-care for the frail and elderly, which is a broader way of thinking of it.

Let's now focus on the current situation. I'm going to give you some key facts and some data supporting them. The population is getting older, but most of us know that. The elderly population is heavily female. Most of you might have known that. But in your everyday work, do you think about the consequences of that? Females are more likely to live alone. Many need assistance of one sort or another. They can't function 100% independently. They're not as well off as males, and benefits have facilitated early retirement programs.

We're at 3 million people over the age of 85, and it is projected to be almost 18 million in 2050. No matter which scenario you look at, the number of people at the very old ages is projected to increase dramatically.

Robert Friedland has been doing a study coordinated with the Commonwealth Fund about what America is going to look like when there are twice as many elderly people in the country. Think about the whole country's population looking like Florida's.

If we look at the number of elderly men per 100 women by age, using 1990 data, we have at ages 65–69, about 81. By the time we get up to age 95 and older, there are only 27 elderly men per 100 women. At ages 85–89, it is 42. How many people here have a parent, a grandparent, or an aunt in some kind of a retirement community or assisted living facility? Quite a few. When you go to visit, who do you find there? Women, lots of women. Right. That's important because if we're thinking about people's financial security, we have to think about how they are going to pay for it, and what they need.

Let's now discuss marital status by age and sex as of 1994. This is in terms of program design. I view this as very, very powerful data. What do people need as they age? Let's focus on age 65–74 males and females and age 75 and older males and females. There are more females than males, which is what we expected in each group. There are more widowed females and less married females in both groups. Now, you might be wondering, whom are they married to? The males are married to younger women.

If you think about couples where one is sick and needs care, as long as you have a couple, and only one person is sick, the one who is well can take care of the sick one. When you have a person living alone, there's no longer a caretaker unless the person's children will do it. Then there is the group that's most likely to need support and does not have a family member available to do it. At the same time, those are the people who are most likely to be poor or near poor. At time of widowhood, our data show us that many people suffer a decline in economic status, which means that there is great opportunity for those of you in the life insurance business.

Let's look at some data from Great Britain. The reason I like this data is because they show the percentage of the population needing care in Great Britain in 1985. Rather than just focusing on one situation with regard to disability, the data show it gradually in four stages of disability. It shows low, moderate, regular, and continuous. There's the percentage of people age 60 and over needing assistance, and there's also the 16–59 age group. Of course, there are many more disabled in the elder population. It's something for us to think about.

Those of us who have been dealing with things like long-term care typically think of the most severely disabled people. If you think more about the frail elderly, you know that is a lot of our experience. What if Mom can't drive the car anymore, or she can't take care of the house or the garden? She has to move. It's not that one day people are healthy and suddenly they need long-term care. There are many steps along the way.

One of the challenges that I see for us in the next few years, and for other people interested in this, is to do a much better job of defining the health stages. How would we define the different health statuses and the movement between them, and how can we define data? It seems to me that would be a first step to being able to think about both redesigning the system to deliver care and the financing of it. The system to deliver care is redefining itself within housing options as we speak.

What about the median income of those age 55 and over? Let's discuss some data that was published by the Employee Benefit Research Institute (EBRI) in a book that I recommend*, Retirement In The 21st Century Ready Or Not.* There are two messages here. Males are better off than females, and married couples are better off than unmarried individuals. You could find lots of other data as well, but that's usually the story.

The last piece of data I wanted to share with you relates to the issue of early retirement. Our benefit programs, both our government and our private programs, have encouraged early retirement. If you look at any long-term trends, you'll see labor force participation rates dropping. These are at age 60–63. There is a dramatic change between 1970 and 1980.

The last issue of the *Public Policy and Aging Report*, which is a publication that Robert Friedland's organization puts out, says that the early retirement rates are turning around a bit. It also shows some data. I would advise all of you to subscribe to that publication. It's a great publication.

All of these are U.S. data except for the one table on the U.K. While this is a U.S. perspective, there are similar issues in many other countries, particularly the western countries. I would say that there's a high level of awareness among most people about the aging population aspect. I'm not sure about the level of awareness of the male/female part and the living status part. There's disagreement about how to address it, and there's a reluctance to make tough decisions, so it's not easy on you.

I'd like to shift to what we've been calling the framework and some of its issues. There is a project that the Society's Committee on Retirement Systems Practice Area Advancement is working on that I think is going to be a very exciting project on retirement planning. They want to really help us focus more on understanding what happens after people retire, and help us to do a better job at identifying retirement planning needs. We need to replace our preretirement income when we retire. Maybe we'll put in a little inflation factor and not think too much else about the postretirement period. I say there's much more going on, and we need to think about that with a lot more clarity. Let's think about the needs of the elderly. How do they change over time? What are the issues in pension plans and retiree health after the death of a spouse? What about long-term care of the frail and the elderly? How is the responsibility split? What's in the minds of the employers?

What are the needs of the elderly and, for that matter, the needs of any group of people? What about income? We know we need money, which might come from assets that we already have or the earnings of our current income. Another issue is medical care and financing for it. If we are not able to do anything ourselves, we may need special assistance with specific tasks, and we may think of that as long-term care. We need to find a better word for that because I think long-term care doesn't really describe what we're thinking about here. How might these needs change over time? What if we retire at age 62 and live to 95? Inflation is another factor. Actuaries understand these things.

Next is housing. Many people live in a big house for their children's benefit. When the kids grow up, we don't need the big house anymore, and we can move into a less expensive and smaller house. Does everybody do that? Not everyone. Some people also live in a high cost area. We could move to Arkansas. There are many retirees in Arkansas, so it's frequently possible to scale down housing cost at retirement.

On the other hand, we might want to be in the suburbs, and we might want to increase our housing cost because we need two houses now. That's a time of retirement. If you look again at a previous issue of the *Public Policy and Aging Report*, you'd find out that there's considerable integration going on between housing and delivery of services. There is not so much medical care, but personal assistance. There's a lot of development of new assisted living facilities. I can tell you a personal story about my mom. I'm sure many of you could tell us a personal story. Those places are very expensive. So there are various stages. We might have the potential for lower housing cost at the time of retirement, but find significantly higher costs later.

The loss of a spouse creates a discontinuity, which is a big issue. Data shows that we do have a decline in well-being from a financial point of view in many cases. There is loss of functionality. We need help. We have changing health care needs and different special interests. We might retire and want to travel. That might be soon after we retire, but not later on.

What are some of the retirement plan issues that we would think about if we're trying to design a retirement plan? One is the allocation of our dollars between different participants and the individual and the provider. Another is the allocation of risk and responsibility. These issues apply to whether we're talking about a public plan or a private plan.

This gets us to thinking about defined-benefit plans and defined-contribution plans. Again, there are public and private plans. In the private sector, within the U.S. framework, some of the trends point to what we call a cash-balance plan. From the participant's point of view, a cash-balance plan is one that looks like a defined-contribution plan. From the employer's point of view, it looks like a defined-benefit plan.

The cost increase is moderated for retiree health. The people are predicting that they're going to pick up again and grow faster. Plans have been changed to manage the liability. There have been many changes. There's a new Government Accounting Office (GAL) study that documents the history of plan changes. There's also a Carter Foundation study that documents the changes that take place in the previous weeks. There's relatively little prefunding of these benefits anywhere, and certainly in the U.S. there's little prefunding. An exception might be in a few public utilities where there is some prefunding.

Employer changes have to link to Medicare, and we're probably on the verge of a whole new round of changes because of the recent Medicare changes, but that hasn't really shaken out yet. We have to pay a lot of attention to the supplements and HMOs.

After the death of a spouse, security comes from survivor income benefits, life insurance, assets, and long-term care coverage. These are some of the sources.

I took a shot at the people in the life insurance industry, because they haven't been doing their jobs in terms of this protection. But that's true of all of us and our systems. The issue is that Social Security survivor benefits don't maintain the preretirement living standard. It's true for the elections that people make in their private pensions as well.

In the area of long-term care, we have a spectrum of needs. If we think about the frail and elderly, which is why I like the U.K. data, long-term care is used in the most extreme cases only. I've been quite interested in looking at the frail elderly. Look at what percentage of the situation you can get covered under long-term care insurance. Are we talking about a quarter, or a half? How much? How do we do anything about that? Most care today is provided informally at home by family members and neighbors. We don't really have an integrated system of either providing care or financing it.

Medicaid is the biggest payer by far. There's a potential for Medicaid cuts though, and that's going to create a problem. In the U.S., you have people who are in the very low income bracket on Medicaid. The people at the top have money. It's the people in the middle on this particular issue who frequently have been crushed, and the employers have not played much of a role. Some employers offer voluntary benefits. And even employers who are very concerned about the problem might offer a voluntary benefit, but the practical reality is they are probably not going to get a very big sign-up. It will still be a good thing to do.

What about the role of government? What about the role of the employer, the individual, or the family? These are the issues that we're all going to be grappling with in the next few years. Employers are asking what their responsibility is as an employer? Is it to provide benefits, to offer opportunities to stay employed, or to provide education and retirement planning? How should we allocate spending? What about career and long-service employees? Should we emphasize putting our dollars there? With traditional defined-benefit plans linked heavily to average pay, we were putting a great deal of money toward career and long-service people. Was that bad? No, it's not bad. It depends on what you were trying to do. If your goal is to provide benefits to people that stay a long time, it is very efficient. Historically, those same people do not want to provide benefits to early leavers. Many organizations have changed their goals. The critical thing is understanding goals.

How important is portability? For some plan sponsors, portability is critical. They're very concerned about that. I heard a very powerful story. I talked to an employer in an organization who still had a traditional defined-benefit plan and a matched savings plan. The human resource (HR) person said, "We do a lot of acquisitions here, and every time we do an acquisition, one-third of the employees leave. I want to be fair and square with those people if they have to walk out of here any day during their career." He was selling a change to a plan that offered much more portability and much more of a benefit to early leavers, not because he didn't believe in the traditional values, but because he knew that there would be people who he had no control over. They were perfectly good performers who would be losing their jobs.

How should risk be allocated? One of the things that we find is that chief financial officers (CFOs) typically are afraid of some of the risks until they realize that reward comes with risk. They realize that companies have done well with their investments. When they really take a look at it, they decide that maybe this is not such a bad payoff.

What about postretirement and medical? We must conclude with challenges. There are some challenges for employers, for employees, for public plan sponsors, for actuaries, and for you and me. The challenges to employers are limits on resources. There is a spectrum of needs. Employers must allocate resources well and support the business needs. Employers have a variety of different company needs and transition can be very difficult.

An organization that starts out looking one way and ends up looking very different needs to have a different retirement plan. In retirement plans, remember that you must walk and talk the culture of the company. An organization that needs a very different retirement plan may have a very hard time making a good transition.

The challenges to individuals include saving enough and using retirement assets well. One of the critical issues for many families is that they have good assets at the time of retirement, but they may not have the knowledge to do the things that they have to do to use them well in retirement. Plan for that postretirement period and balance the needs of family members.

What are the challenges to public sponsors? How do they deal with limits on resources? What about their unfunded pension, and retiree health liabilities? Changing the plan is a public policy venture. How do you amend the plan? You get a law passed. Think about that.

I have an interesting story because I would have never believed this could happen. We were in a situation a few years ago in which a group of public sector participants saw their benefits being threatened. We were hired to help an organization that was working with those employees. We said, "Do you have money? How are you going to pay for this campaign you're going to put on?" They said, "We'll write the participants and they'll send money." We responded, "You're going to write the participants and they'll send the money?" The participants sent hundreds of thousands of dollars, and they had their campaign. It's interesting.

Some of the public sector employees are very concerned about their benefits, and they will support efforts. The politics is a whole different thing, and the transitions can be difficult and expensive.

The challenge to us in the actuarial profession is that all the stakeholders need better information, and that's what we're about. A group representing any set of stakeholders might need its own actuary. If I want to understand this stuff, I need an actuary to help me. Participate in the public debates by working with different stakeholders as individuals and by supporting your actuarial organizations. In North America, support the AAA, the CIA, and the appropriate organizations in Mexico. Help them get a better long-term care system and financing for it. Create the authority for a retirement planning framework. My view is that we, as actuaries, should have such good data and such a good retirement planning framework that anybody that's building products for retirement will look to us as the source of that information. Benefit patterns are often out of date when compared to the needs of the organizations that offer them.

Part of my agenda, as President of the SOA, is to get more people focused on these issues, and particularly to get the people who are interested in these issues to look at the demographic segments. We should be looking at men and women separately, looking at different family structures, and seeing what the implications of their decisions will be.

Mr. Katz: Last year, when Anna delivered her address as the new President-Elect, the first words out of her mouth were old age crisis. I thought that the one thing I could do in organizing programs is give her a forum. I just want to say that I hope all of you feel the way I do. This is really great stuff, and we really should get involved. Now Tom Hughes will give us the futurism perspective.

Mr. E. Tom Hughes: I'm the member of the panel who is going to do something different. If you read the description of this program, you'll notice references to the future three or four times; certainly, far more than you might expect. That's because Bob Katz was trying to weave my topic into this overall program.

I'm here representing the Futurism Section of the Society. While I spend a good deal of my professional life in the pension business, I don't profess to be an expert on the old age crisis. I do profess that futurism, or studies of the future, can help us deal with the old age crisis. One way that can happen is by identifying possible future states that may influence current perceptions of an issue; thereby affecting actions that can be taken now in advance. In other words, future studies can allow advanced planning and anticipation of future possible outcomes.

Second, and perhaps what is more important, visions developed as a result of studying or thinking about the future can be embraced and support can be given to them now. There are usually little or no hard facts to support visions of the future, which often represent newly emerging trends, plausible or possible outcomes, and the futurist's personal desires. I would add that futurism can be a satisfying discipline as there are no right answers. We are developing possible futures without predicting them, or assigning a probability they may or may not come about. In this respect, futurists are not unlike economists, stock market analysts, and investment advisors.

The other presenters have given you facts and figures on both the scope and depth of the world's old age crisis. Projections based on predictable variables show that our social insurance systems are being increasingly stressed as the world's population ages. The options available to us, in many instances, are limited, and, in many cases, are quite painful.

Now, without detracting from those analyses in any way, I think it would be interesting and, perhaps helpful, to list some possible future states that might help mitigate the affects of the aging crisis. In other words, we should explore emerging trends or possible outcomes that may help us deal with the old age crisis. We do need help, and looking for potential allies seems worthwhile. I'm not here to predict that these future states will actually come about, but there's reason to believe they might. If they're possible, then we can support and feed these visions or emerging trends.

I, like you, realize I could have produced a similar list of possible future states in which the old age crisis is bleaker than it has been portrayed. My purpose here is to illustrate how future studies may help us prepare for the future. By focusing on positive outcomes, we can at least see those ideas that we ought to nourish and support.

The first of these often overlooked concepts that I want to bring to your attention is that of retirement itself. Perceptions of retirement vary from society to society and change over time. In much of the western world, retirement didn't exist as a formalized process until the latter part of the 19th century.

Prior to that, most societies were agricultural, and work was a way of life. People worked as long as they could. With the onset of industrialization, family-run businesses gave way to corporations, and work became a means to an end; an income on which to live rather than a way of life. Retirement was introduced as a practice to make way for younger workers and a response to the unemployment problems of the Great Depression. While those motivations still exist, they're not nearly so strong now as they were then.

In the U.S. and most of Europe, age 65 was chosen as a normal retirement age because the term of life after 65 was relatively short, and public retirement plan costs would be more manageable. There is currently anecdotal evidence, and Anna made reference to parts of it that occur in the U.S., of an increase in and a tendency for second and third careers for older workers. Such people are apparently beginning to work well past 65, not merely to provide income supplements, but for personal satisfaction in terms of the feeling of worth and involvement. This is a powerful need for many humans.

Further, some futurists see future work patterns that will extend well into old age with work beginning later in life, and with one's work life punctuated by significant periods of education, sabbaticals, and part-time work as a matter of choice. I would also point out that working later in life is a pattern well attuned to the information age, which is well upon us. There is a reduced need for travel, commuting, and physical labor that the aged are not nearly well suited for. The overall improvement in the state of the aged's health is yet another factor contributing to their ability to work later in life.

Finally, the notion of retirement at a fixed age, 65 for example, ignores the significant improvements in longevity that the aged are incurring. A number of public retirement systems are planning to index the normal retirement age to reflect the increases in longevity. One principle suggested as a means to establish the rate of indexing is to keep the benefit payment period at a roughly constant proportion of one's average lifetime.

The desirable vision of the future of retirement could be characterized in three ways: (1) Individuals have the freedom to choose the age at which to withdraw from the compensated labor force, and an increasing number choose to retire later in life than currently; (2) There's an absence of the concept of a normal or usual retirement age; and (3) In formal public and private pension plans, the age at which full benefits become payable is indexed to reflect increasing longevity.

You all realize that such a vision would first apply to the more developed economies of the world. Less-developed countries would likely evolve to such states at a later date. From our perspective, it is fortuitous that many developing countries have a younger population and, perhaps, can learn how to deal with their population's aging problems by watching how today's modern mature economies handle theirs.

Another plausible scenario that could act positively in the aging crisis is worker migration. Migration of workers between economies is happening in many parts of the world today and is expected to continue, and perhaps, increase. People migrate to find work, and it is plausible to expect to see growth in the number of older workers from mature economies migrating to growth economies in developing countries. Such older workers would be valued for their experience in more advanced economies. To attract such older workers, the developing countries would provide not only work, but also social insurance benefits, including retirement income credits.

In a similar fashion, younger workers from developing countries are finding work in mature economies that are suffering from a shortage of labor in certain occupations. Such new entrants can increase the ratio of workers to retirees in the mature economies' social insurance programs, potentially lessening the financial burden for those supporting such programs.

The third trend I'd like to draw your attention to that's consistent with the theme of working later in life is the increasing emphasis on self reliance in many of today's societies. Numerous countries have been reversing decades of practices of increasing the level of coverage of the social insurance programs. The cause of the problem may or may not be age related. The common problem is that many such plans simply cannot be afforded. Furthermore, in countries where employment-related benefits are significant, the same trend is evident.

In the U.S., employers have been taking steps to control costs by passing along benefit cost increases to employees and eliminating contributions for less-than-essential benefit programs. In addition, instead of being solely a funding agent for employment benefits, U.S. employers, at least, are increasingly serving as a convenient outlet through which employees can select benefits that they themselves pay for. As a result, work site marketing of a product designed for purchase by individuals is now a growth industry for the U.S. insurance companies.

The theme is clear. Employers are controlling their financial commitment to employee benefits, but providing workers the opportunity and incentive to purchase benefits at attractive rates.

Employers are reducing their cost in other ways. Instead of underwriting the cost of defined-benefit pension programs, employers are fixing their cost by installing defined-contribution plans. Rather than being designed to provide an adequate retirement income, such plans are designed to provide a fixed level of employee contribution. There has been a very dramatic shift to the defined-contribution type of retirement plan in the U.S. We can plot on a graph the number of participants in defined-benefit versus defined-contribution plans from 1975 projected out to the year 2000. The more than two-to-one ratio of the defined-benefit to defined-contribution plans has reversed. We now have more than 40 million defined-contribution participants versus more than 20 million defined-benefit participants.

This shows up, also, in the assets. As a matter of fact, this year, the crossover point for the assets under U.S. private defined-benefit plans has been equal to and surpassed by the assets in defined-contribution plans. Clearly, there is a change in this type of plan that relies on the concept of self reliance. This shift to defined-contribution plans is prevalent in other advancing countries, although it is not nearly so prominent.

As I said, one clear message associated with these trends is that of self-reliance in which the individual is expected to take on more of the responsibility for his or her own destiny. The shift in defined-contribution plans illustrates the concept vividly. The employer provides a given contribution toward the employees' retirement needs. The employee is expected to make up the difference between what is needed for an adequate retirement income and what is provided by the social insurance plan and the employer's contributions. In this environment, employer-provided plans are also typically providing the facility for employees to save on their own behalf through various types of voluntary contribution accounts.

In the U.S., there's a significantly increased emphasis on the individual taking much more responsibility for the adequacy of his or her retirement benefits. This is in response to the well-known problems of Social Security and Medicare; the lessened financial support from employers and the promotion of self-reliance by these groups; and the financial services industry in the U.S., which sees a significant marketing opportunity. Virtually every financial institution has a program to estimate the savings one needs to achieve a desired level of financial outcome or retirement income. Educating employees on how to invest their own savings as well as pension plan money set aside for them by their employers becomes yet another growth business in the U.S.

All of this should lead to increased levels of retirement benefits provided by individual savings; thus reducing, to some extent, the need for public financing of such benefits. We have only limited evidence that this is happening. Survey results show an increase in the number of respondents indicating they are saving for retirement; it has gone from 74% up to 83% in the years 1991–95, which shows an increasing trend. But people are notoriously overreporting the extent and level of their savings. At least the trend is positive, and we are focusing on positive trends.

Another factor that bodes well for dealing with the old age crisis is the growth of private sector methods of providing retirement income. A thriving retirement income industry will clearly reduce the burden placed on the public sector. In the U.S., the private retirement savings industry is well developed, generally profitable, and growing.

The U.S. private sector retirement savings plans for 1989, 1994, 1999 (projected) show a 9% annual growth rate. There are new plans forming and new net contributions in defined-contribution plans. This subtracts a lot of interest in terms of money managers and what not.

Similar trends occur in other countries, although they are not nearly such well-developed markets; those being Australia, Canada and the U.K. There is fairly significant growth of the same kind of magnitude exhibited in the U.S.

A growth pattern such as these and capital pools such as these attract entrepreneurs who are and will be successful by providing creative and effective approaches to retirement planning and savings. Furthermore, an active retirement savings industry promotes itself by promoting retirement planning to the public; thereby increasing awareness of the subject and positively influencing consumer behavior, i.e., better planning, increased savings, and better investment results. An effective private sector source of retirement income clearly complements the public sector's floor of protection.

Perhaps the future trend that should be most heartening to us in viewing the aging crisis is that while we earthlings are getting older, we're also getting wealthier. Moreover, the distribution of wealth is expected to become more even between countries. A distribution of wealth by groups of countries in 1990 shows that the so-called rich countries have 14% of the population and own 59% of the world's wealth. Thirty years later, by the year 2020, the nonrich countries will own 59% of the wealth. Their share by then is projected to be $4 trillion, or almost four times their current wealth in constant dollars.

With increased wealth comes a number of positive benefits pertinent to the old age crisis. You can expect an increased level of education, which is usually associated with a reduced level of population growth, which in turn implies more resources available to the older segments of the population. An increased level of education also brings with it an improved ability for people to be self reliant.

Second, an increasing level of wealth, we believe, funds a growing and healthy private sector. We believe the private sector brings creative approaches to retirement needs, and can share with the public sector the burdens of the aging crisis. This growth in wealth won't solve all their problems, and it will not be here tomorrow, but clearly such resources will go a long way toward solving problems upon which societies and individuals choose to spend this increased wealth.

That brings me to the final point about the environment in which we will face the old age crisis. That point pertains to the level of awareness that exists now at virtually all levels of society regarding this issue. People in societies tend to spend their resources on issues of interest to them, and people can't be interested unless they're aware. If you think back five, or even two years ago, this issue was visible only in special circles to actuaries, demographers, and social planners. It's in full public view in the U.S., and perhaps, to a comparable extent, elsewhere. When talk shows feature spokespersons on the subject, and when local newspapers lead the Sunday news section with a special feature that warns of problems to come in Social Security and Medicare, then we have the discussion where it ought to be. The public is informed and involved and asking questions.

We face many challenges in dealing with the old age crisis, and there are many factors working against us, but there are a number of positive facets of the future environment that I believe will help us deal with this problem, and I'm pleased to have had this opportunity to talk to you about them.

Mr. Abraham Hazelcorn: I've been very much encouraged by what I heard about the foundation, but I want the assembled group to realize something about the recent volunteer effort. I've been reading all sorts of reports lately. I was amazed to read about the 1995 White House Conference on Aging. There was not one mention of an actuary or an actuarial association, whereas all kinds of other organizations were mentioned. You're looking to the future, but I think we ought to realize what has happened in the very recent past.

Earlier this year, the Administration on Aging in the Department of Health and Human Services had a paper on pension counseling. There was mention of the difficulty lawyers have in explaining pensions. No mention was made of the SOA. In one sort of unrelated side issue, the American Society of Pension Actuaries (ASPA) was mentioned. I think we have to make ourselves more visible.

Mr. Ian M. Charlton: I have a concern that has been bothering me for some time, and it comes from two sources. First, are we really measuring savings? In the old days when we had defined-benefit plans, in many cases it seemed as though our salaries were being reduced because of these benefits. We could have gone to a different job at a higher pay with no benefits and looked at savings.

I have never been able to evaluate the situation, but I considered the money that my employer was putting into a defined-benefit plan to be, in effect, my savings. So I wonder if our data are correct.

Second, I think what bothers me more is the investment responsibility. Under the old defined-benefit system, the employer was employing the services of an investment specialist and an actuarial consultant. Now the individual is going into a

401(k) or a defined-contribution plan, and the employer is giving him or her some options as to where to put his or her investments, but no advice. The employer should not give advice for the problems that exist.

I'm wondering, are we better off now with people putting their own savings under their own investment expertise, which is practically nil? Are we better off now, or were we better off before?

Mr. Hughes: Well, this is consonant with this trend toward self-reliance. It's clear that once I'm more responsible for my own retirement benefit adequacy, I have to learn what my employer performed before. Whether an employer performed them more or less ably is a question we can only speculate about. Many talented people are spending a lot of time determining how best to teach the American public, at least, about how to make these investments.

The federal government is involved. The Labor Department underwrote a fairly significant effort here, at least in the form of brochures, to teach people about the basics of investments: what's a stock, what's a bond, how do they perform, what are the dangers, the risks, etc.? There is an enormous amount of education going on. Personally, I think it's the way to go, but there's always a mix here. You don't have to do everything on a defined-contribution basis. You want some things to be less dependent upon your personal success.

Mr. Charlton: Some less-educated people don't have the faintest idea of what to do. They would love to have somebody hold their hands. They don't have the ability or are not exercising the ability to obtain that information

Mr. Hughes: We're still in transition. Corporate America has human relations departments that are becoming more skilled at that. They won't tell you what stocks to buy or what funds to choose. But you can get from most well-run personnel departments a good primer on what factors ought to be reflected when you make your personal investment choices.

Ms. Rappaport: Tom, I'd like to disagree with you in one sense. I agree that corporate America is making an effort. However, we have many Americans who you might say are financially illiterate and don't have the basic skills and necessary vocabulary. If you have people who don't understand how compound interest works, it's very difficult to explain the implications of the different kinds of investments. We need to solve these issues before they ever get to the workplace.

Mr. Hughes: I can't argue with that.

Mr. Vittas: A very brief comment. Empirically, it is very difficult to tell whether the previous system was better than the new system because some employees could be lucky and work for a very well-run corporation that respects the defined-benefit plan in full, and gives good returns to its workers. But in other corporations, they may terminate or take this plan over or do all the things that corporations used to do before ERISA. In those cases, the employee would not get as good a return.

If you remove the "tontine" principle from the company benefits that used to exist, then corporations will not be as interested in offering a defined-benefit plan as they used to be. If you take that as a given, the only way is to follow what Mr. Hughes has been saying, which is to educate the public more. There is very simple advice that you can give to workers now if you really are interested. You can direct them to invest in indexed funds. If they invest in indexed funds, they don't need to understand compounding. They don't need to understand any of the other things. There are many people doing very well at very little cost. If they do not know what to do, they should go into indexed funds.