The Coming Generational Storm: What You Need to Know about America's Economic Future

Authors: Laurence J. Kotlikoff
& Scott Burns
Publisher: The MIT Press.
2004, ISBN: 0262112868.

Reviewer: Sherman D. Hanna
Ohio State University

The authors of this book predict a bleak economic future. Is their role similar to the mythic Cassandra, daughter of the King of Troy, who was given the ability to predict the future by Apollo, but after she rejected his advances, was rendered unable to persuade anyone to heed her warnings? The authors' predictions in *The Coming Generational Storm* are accepted by many Americans, but political considerations have prevented Congress from taking any action related to them.

Before accepting their pessimistic analyses, however, consider some other predictions of doom and gloom. In the 1980s, many people thought that the "Twin Towers of Debt" would lead to economic ruin (Roberts, 1992). Roberts noted:

> The twin towers of debt were budget and trade deficits, and the implication was that only Americans were burdened with these ills. As the result of them, we had been rendered economically uncompetitive, hopelessly in debt to foreigners, and at their mercy. The day the Japanese stopped buying our Treasury bonds, interest rates would skyrocket, and our economy would plunge over the precipice. Moreover, federal irresponsibility had encouraged corporate and household debt to explode as well. Wherever one looked, the U.S. was smothered in debt (Roberts, 1992).

Throughout the 1980s, many were predicting that the 1990s would be filled with economic disasters in the United States. Instead, the decade was a period of prosperity, though not because of any policy prescriptions suggested by the pessimists. The fears of the 1980s were very similar to the fears expressed predictions in *The Coming Generational Storm.*

Predicting the future is a risky business, though many who do so seem incapable of embarrassment. The worst example is Paul Erlich, who in 1968 in his book *The Population Bomb* predicted worldwide starvation in the 1970s and 1980s (Hayward, 1999). Some bad predictions do not have important consequences. Consider this one from 1974:

> Housing economists predict that 50 percent of the United States population will live in some form of condominium housing within 20 years. Statistical trends support that prediction (U. S. Department of Housing and Urban Development, 1974).

In fact, less than 5% of year-round occupied housing units are currently condominiums (U.S. Department of Housing and Urban Development, 2002, Table 1A-1). Presumably, the inaccurate prediction in 1974 did not cause much harm, other than for builders to might have become too optimistic about condominium prospects in some markets. However, even predictions such as Erlich's can lead to bad decisions, such as people who might otherwise have wanted children deciding not to bring any into a world of famine. Predictions about running out of energy led some people to build stuffy underground homes or install expensive features that were inefficient given the past 20 years of energy prices.

I have made a number of predictions that were published and as with many prognosticators, I prefer to remember only my better ones. In a 1979 housing textbook, in discussing some futurists vision of most people living in megastructures, we mentioned the possibility of terrorists with a small nuclear device causing chaos for megastructures (Lindamood & Hanna, 1979). We also predicted that most people would live in "… some version of the single-family home on its own lot." After more than 30 years of study of economic trends, I feel reasonably confident in evaluating the predictions in *The Coming Generational Storm*.

Kotlikoff and Burns predict economic disaster for the United States unless we change course by reducing the benefits for Social Security and Medicare. Europe and Japan face much worse disasters because their populations are aging faster than the U.S. population and Europe has a more generous social welfare system. I agree that sooner or later, and preferably sooner, the benefit structure of Social Security pensions will have to be modified, but I believe that a gradual reduction of the replacement rates will probably be sufficient. With economic growth, the purchasing power of Social Security pensions should not decrease, but there would be a greater drop relative to previous wages. Medicare will need tighter controls on spending, and obviously that will be a substantial challenge. There are real problems for some workers with any increase in the minimum age for collecting Social Security benefits, but given that some people retiring at 62 will spend 38 years in retirement, shifting the retirement age up a few years seems reasonable.

The authors' prescriptions include a new federal sales tax, which is politically impossible. Even the more modest suggestions I listed above are politically difficult. Ideally, a popular president near the beginning of his or her second term would persuade Congress to start necessary reforms, but I will not hold my breath for that.

The authors' prescriptions for individuals are interesting, starting with staying away from financial planners. Since I train financial planners, I am ambivalent about that idea, though I agree that there are lot of financial planners who are a waste of money or worse. Even good advisors can be a drain on returns, but some people need comprehensive financial planning advice, so could receive a net benefit. The authors point out that in planning for retirement, one should consider pessimistic projections of investment returns. This is excellent advice, even if you only have money in low cost index funds. It is even more important if you have high cost actively managed funds, where you could do much worse than the historic average returns.

The authors tout the benefits of homeownership as important for a safe retirement, which is reasonable, but also develop an example purporting to show how much better you would be with your mortgage paid off. One assumption is that you could not obtain a higher net return from your money than you could from paying off your mortgage faster, which may be true for conservative investors, but is not likely to be true for more risk tolerant long-term investors, even with pessimistic projections. The other assumption is that you will adjust your income to match your needs, which is possible for planning purposes, and therefore, a complete cost comparison between paying off your mortgage faster or not should include the extra taxes you would have to pay on your extra income. I realize that this may make sense for some, but I will be happy enough to keep making mortgage payments until I am 80 or so.

The authors suggest that you should save until it hurts. Obviously this is good advice for many Americans. One first step is to pay off all credit card debt. When my students work on financial plans for friends or relatives, I am always amazed at how many of the clients have substantial high interest credit card debt. I always tell the students that paying off high interest debt is the best investment in the world.

I suspect that one motivation for the authors presenting an extremely bleak picture of the next 50 years is to try to motivate both Congress and individuals to take action. Telling a smoker that he will die 10 years early unless he quits today might help, even though a more nuanced message would be more accurate. There is no question that many individuals are not thinking clearly about their personal financial futures. As for Congress, the already limited ability to consider the future has been made worse in the past 10 years by the steady increase in partisan fights.

I am confident that Congress will never pass the main policy prescriptions presented in this book, and anything that passes will be modest reforms in retirement ages and replacement rates. As for the authors' suggestions for personal finances, presumably financial educators will meet the challenges of persuading people to adopt better habits.

I think that extreme economic disaster is unlikely for the United States. It is true that some prosperous countries, such as Argentina, have gone into permanent decline. Japan has had a long slump, though people in most of the world would love to have the standard of living of the average Japanese. Individual Americans certainly should not rely too much on Social Security pensions for a comfortable standard of living, but that is already obvious. Americans who are not thrifty or lucky will have to work past age 62, but that will not be a disaster. As for the macroeconomic picture the authors paint, it is more likely than an asteroid wiping out civilization in the next 50 years, but I am not going to lose any sleep over either possibility.

References

Hayward, S. (1999). Doomsday is cancelled until further notice: A review of predictions and prophecies for the year 2000. Remarks at the Pacific Research Institute's 20th Anniversary Policy Workshop. Retrieved July 26, 2004 from http://www.pacificresearch.org/pub/sab/enviro/doomsday.html.

Lindamood, S. & Hanna, S. D. (1979). *Housing, Society, and Consumers*. St. Paul, MN.: West Publishing.
Roberts, P. C. (1992, August 31). Debt, lies, and inflation. *National Review Online*, retrieved July26, 2004 from www.nationalreview.com/ reagan/roberts200406101413.asp.
U.S. Census Bureau. (2002). *American Housing Survey for the United States: 2001*. Current Housing Reports, Series 150. Retrieved from www.census.gov/prod/2002pubs/h150-01.pdf.
U.S. Department of Housing and Urban Development. (1974). Questions about condominiums, June 1974.

