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# Prologue

The foundation of our Empire was not laid in the gloomy age of Ignorance and Superstition, but at an Epoque when the rights of mankind were better understood and more clearly defined, than at any former period. . . . At this auspicious period, the United States came into existence as a Nation, and if their Citizens should not be completely free and happy, the fault will be intirely their own.

—George Washington, “Circular to State Governments,” June 8, 1783

## 2030—A Different Odyssey

Find a comfortable couch, lie back, and close your eyes. Take slow, deep breaths. Go deeply into the peaceful calm that separates your inner soul from the world around you.

Let your mind wander toward the future. Move, slowly, to the year 2030.

Now open your eyes.

What do you see?

You see a country whose collective population is older than that in Florida today. You see a country where walkers outnumber strollers. You see a country with twice as many retirees but only 18 percent more workers to support them. You see a country with large numbers of impoverished elderly citizens languishing in understaffed, overcrowded, substandard nursing homes.

You see a government in desperate trouble. It’s raising taxes sky high, drastically cutting retirement and health benefits, slashing defense, education, and other critical spending, and borrowing far beyond its capacity to repay. It’s also printing tons of money to “meet” its bills.

You see major tax evasion, high and rising rates of inflation, a growing underground economy, a rapidly depreciating currency, and more people exiting than entering the country. They're leaving because they're sure things will get still worse.

You see political instability, unemployment, labor strikes, high and rising crime rates, record-high interest rates. You see financial markets in ruin. In short, you see America plunging headlong toward third world status.

"No way," you'll say, as we snap our fingers and bring you back to earth. "Things can't get that bad."

Lots of people, particularly those running for reelection, would agree. Their tranquilizing view runs like this:

"Yes, the nation will be older, but our fiscal affairs and the economy will be just fine. The country's deficits are modest relative to the size of the economy and will decline through time. Sure, Social Security has some problems, but the system is close to seventy-five-year actuarial balance. The same holds for Medicare. The government can always cut fat. Technological change will bail us out. And we can always bring in more immigrants to pay our bills.

"Aging also brings economic benefits. First, we won't have so many unproductive kids to support. Second, people will be healthier and work longer. Third, old people own most of the economy's machines, factories, and other productive capital. Thus, having more oldsters around means there will be more capital available for workers to use in producing goods and services. So, yes, we'll be short on workers, but each will be more productive."

These and other purported ways of resolving the nation's aging dilemma are comforting—but they suffer from two problems: They are either wrong, or they are small potatoes when set against the fiscal imperatives of 77 million baby boomers' outstretched hands. In truth, there is no economic or demographic magic wand we can wave to make everything right. Bad things do happen to good countries, and we are heading into one God-awful fiscal storm, the full dimensions of which are hard to fathom.

To make matters worse, our captain has lost his bearings; he's got us pointed right at the storm and is gunning the motor. We've got

one chance left to turn the ship around, batten down the hatches, and escape the worst, but we need to act decisively, and we need to act now.

The first step is understanding the true size of the problem. Most people realize the country is getting older and that paying for the elderly will be expensive. What they don't realize is just how old and just how expensive the elderly are going to be. Ignorance here is anything but bliss. Nor is it innocent. The public doesn't fully know what's going on for two reasons. First, the government's compass really is broken. It's using the amount of official federal debt to measure our fiscal position, when the true liabilities facing the nation are twelve times larger. Second, the government has been working overtime to either fudge or outright conceal this fact.

This book delivers a demographic and fiscal reality check, and in ways you've probably never seen before. This isn't a Stephen King novel, but what you'll read in the first two-thirds of the book will scare you, make you angry, and send you running for cover. But keep reading. Help arrives in the last part of the book in the form of new government policy proposals and personal financial moves that can save our nation and protect you from the worst-case scenario.

We're going to scare you, but we aren't trying to. We're not doom-sayers. We don't sell gold coins, supplies of dehydrated food, or equipment for recharging your .357 shells. We don't have a newsletter that tells you where to make your fortune or how to keep your money safe. We're an economics professor and a financial journalist who have been watching this problem get worse year after year. We feel an intellectual and moral obligation to discuss it and offer some public policy as well as personal solutions. Our deepest motivation is very simple: we're fathers. We love our children and worry for their sake and for the sake of all of America's children about the future.

But we didn't write this book simply to assuage our consciences. We feel we have some unique insights into the demographic and economic problems facing our country based on our own research and that of other economists and financial analysts. Our goal is to leave you with a real sense of what's coming, why it's coming, when it's coming, and where national and personal economic salvation does and does not lie.

Although we take lots of shots at those politicians who put us in our current mess and are doing their best to make matters worse, we don't mean to sound partisan. Every postwar administration has passed the generational buck when it comes to paying for what it spends, so there's plenty of blame for both parties to share. But passing the buck needs to stop here, with our generation.

In the end, this book is not about politics, and it's not about which politician did exactly what exactly when. It's fundamentally about ourselves and our children. It's about how we adults, whether Republican, Democrat, Libertarian, Green, or independent, let our leaders systematically ignore, conceal, and minimize the huge dangers that lie ahead. But it's also about our desperate need to earn our titles—to act like adults by taking charge, at long last, of a very dangerous situation and beginning the serious task of protecting our beloved progeny.

Here's a guide to what lies ahead.

### From Strollers to Walkers

We start by describing the tidal wave of baby boomers that is moving inexorably from changing diapers to wearing them. In particular, we discuss the boomers' numbers, their dilatory mating patterns, their meager rate of procreation, their romance with divorce, their plans to be retired *for as long as most people lived only a few centuries ago*, their prospects for an isolated, childless old age, and the protracted delay in their departure to the next world.

When it comes to aging, we also point out that the United States is not alone. The entire developed world and large parts of the developing world, including China, are in the process of getting much, much older. This won't be a one-time event. The United States and its very best buddies will not only be getting old; they will be staying old. The population shares of the old (those over age 65) and the very old (those over age 85) will grow year after year throughout the entire twenty-first century.

These remarkable demographic changes are unique in human history. They are also unstoppable. They will transform our world at the per-

sonal, national, and international levels. In particular, they will exact a fiscal toll that will shake our economy and those of Japan and Western Europe to their very foundations.

### Truth Is Worse Than Fiction

Conventional politics is an unending argument about Haves and Have-Nots. Are the Haves getting more? Is it too much? Why isn't there more sharing with the Have-Nots? The Have/Have-Nots argument works to completely obscure another discussion: the Nows and the Laters. We're the Nows; our children and grandchildren are the Laters. Decade after decade, the Nows have taken from the Laters. Unfortunately, this fiscal child abuse, like the psychological kind, is hard to spot. But measure it we can, and measure it we will using a relatively new method, called *generational accounting*. Doing so leads to the following bottom line: *Unless we adults make very large sacrifices very quickly, our kids will face lifetime net tax rates that are twice those we face!*

Yes, you read that right. On each dollar earned, our kids will be faced with taxes, net of the benefits they receive, that are nearly twice what we currently pay. If you think Uncle Sam is ripping you off, imagine how your children will feel.

Another way to characterize the findings is to calculate the immediate and permanent federal personal and corporate income tax hike needed to achieve *generational balance*—the equalization of lifetime tax rates facing current and future generations. Brace yourself. *The requisite tax hike is a whopping 69 percent!*

It would be nice if we could tell you that we've calculated these numbers. Then you could say, "These guys are nuts," and discard the book. But our very own government has calculated these figures. The fact that you haven't seen these findings, which were prepared through the fall of 2002 by top economists, statisticians, actuaries, and fiscal analysts at the Department of Treasury, the Office of Management and Budget, and the Federal Reserve, is no accident. They were yanked from publication in the President's FY 2004 Budget within a couple of weeks of the budget's release for fear they would undermine President Bush's proposed third major tax cut.

## Driving in LA with a Map of New York

Unfortunately, throwing out generational accounting is choosing to fly blind. The alternative guidance system—the size of the government’s official debt—is worse than useless when it comes to understanding the fiscal burden we are leaving our kids. Indeed, from a scientific perspective, government debt is entirely content free. It tells us nothing about a country’s fiscal policy. On the contrary, the size of a nation’s official debt is purely a function of how the government labels its receipts and payments—what words it uses to describe the monies it takes in and pays out. With one set of words, the country will report one size deficit. With another, it will report a different size deficit. Indeed, with the proper choice of words, governments can make their deficits as large—or as small—as they’d like.

This message, delivered in chapter 3, is pretty radical. After all, every country in the world uses the government deficit to assess its fiscal performance. International lending institutions like the International Monetary Fund and the World Bank also use it routinely to determine whether a country qualifies for loans and other assistance. Indeed, fiscal policy discussions virtually anywhere in the world treat the deficit as the central measure of fiscal performance.

Deficit delusion has given our government (and other governments) tremendous license to expropriate future generations by taxing them to cover its unpaid bills. Most of this expropriation has occurred under the cover of “budget balance” through pay-as-you-go Social Security systems. But as chapter 3 shows, countries can report massive surpluses while simultaneously shifting huge future liabilities onto the next generation that never show up in the “official” government debt, figures that fail to show the huge cost of future commitments like Social Security and Medicare.

## Popular Tonics, Snake Oils, and Other Easy Fixes

By the time you reach chapter 4, you’ll be ready for a miracle cure, so we tried to find you one. We asked whether the boomers could expect

to get bailed out by technological progress, the sale of government assets, a growing economy, foreigners investing in the United States, their parents, their employers, a delay in their retirement, immigration, or the elimination of wasteful government spending.

Unfortunately, the answers are no, no, no, no, no, no, no, no, and no. Technological progress will raise government expenditures by more than government receipts; selling government assets would be a wash; the economy will suffer a capital shortage; foreigners will be pulling their assets out of our country; the boomers can't expect particularly large inheritances; employers are cutting back on their retirement plans; a delay in retirement age large enough to matter is not in the cards; immigration costs almost as much as it saves; and wasteful government spending is just a drop in the bucket.

### Going Critical

History is replete with examples of what happens when countries can't pay their bills. They raise taxes to exorbitant levels, default on their explicit and implicit obligations, and begin printing money like mad. This triggers inflation, drives interest rates through the roof, and sends exchange rates down the tubes. Businesses go belly up, and banks shut their doors. The result is financial and economic meltdown.

Argentina is the latest country to go critical. Brazil appears to be next on the list. Precisely when the United States will take its turn at fiscal suicide is hard to say for reasons discussed in chapter 5. But the date is close at hand unless the country miraculously changes course—not by swallowing sugar pills, but by undergoing radical surgery.

The real danger in going critical is that the country will get stuck in what economists call a bad *steady state*—one featuring ongoing and economically suffocating liabilities, sky-high tax rates, recurrent bouts of high inflation, widespread tax avoidance, capital flight, and a brain drain as the nation's most talented workers seek their fortunes on distant shores. If this happens, our kids won't be crying just about taxes as they pack their bags. They'll primarily be crying about the awful state of the economy.

## **Changing Course**

Chapter 6 charts a new policy course for our nation by proposing bold, meaningful, new reforms of Social Security and Medicare, the two big entitlement programs that are driving us broke. Since each of these programs is serving a vital function, no reform will be accepted if it throws the baby out with the bath water. Our proposals for reforming these programs are simple, straightforward, and geared to attract support from both political parties.

## **Grab Your Life Jacket**

Unfortunately, if history is any guide, the reforms we suggest won't be enacted for the simple reason that they require immediate and major sacrifice. Baby boomers can thus look forward to a retirement marked by extremely high taxes, substantially reduced retirement and health care benefits, very high rates of inflation, and an ailing economy. We provide examples of how this is happening—already.

## **Securing Your Future**

Staying above water in the ensuing environment means rethinking now how much to save, where to save it, and how much to pay the professional retirement-investment complex for help. The fact is that we all need to start saving like crazy. But how we invest our savings will make a big difference. We don't want to be withdrawing lots of money from our 401(k) plans precisely at the moment the government starts raising taxes on those withdrawals. Nor do we want to be clipping fixed dollar coupons on long-term bonds when the purchasing power of that income is being eroded by inflation. This chapter shows you how to reorganize your conventional portfolio, why home ownership is likely your best investment, and why holding unconventional assets is the trick to coping with future inflation.

## **Epilogue**

We close by recapping the size, speed, and direction of the coming generational storm, stressing the need for immediate and dramatic policy change, repeating the precise changes needed, assessing the likelihood of such change, and reviewing the steps you should take to limit your own downside risk.

## **A Safety Warning**

Before you read on, we recommend you get into a comfortable chair, loosen your collar, and take your antidepressants.