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# Perspectives

## The Hostile World: Part 2 - The Demographic Time Bomb



This past summer, the renowned Bernard Lewis visited Europe. For those of you who're not familiar with the name, Professor Lewis is one of the world's foremost authorities on Middle Eastern history, as well as the region's contemporary culture. If you want to make a commitment to understand what's playing out on the world stage right now, reading Bernard Lewis' work is a must.\*

So what happened this summer? Professor Lewis was interviewed by German newspaper *Die Welt* about Iraq, the Palestinian question and Al Qaida. And quite coincidentally, with the interview about to end, the topic of Europe came up. Could the European Union ever serve as a counterweight to the United States? Bernard Lewis simply said, "No." In time, China and India would be that, for sure. Perhaps even Russia. But Europe, the erudite professor dared, "will be part of the Arabic West...of the Maghreb."

### An Imploding Empire

One of the continent's politicians who took note was the Netherlands' Frits Bolkestein, an outgoing EU Commissioner. In a speech at the University of Leiden, he quoted Professor Lewis' remarks and warned his EU colleagues of something I've discussed in Perspectives quite often—the similarities between the European Union and the Austro-Hungarian Empire. Both entities expanded by absorbing ever weaker elements. And both grew by absorbing culturally incompatible populations. The confident Viennese took in 20 million Slavs, much as today's Europe has ingested 20 million Muslims. Once Vienna decided to allow the new subjects to preserve their culture and have autonomy, the empire imploded.

The formidable Mr. Bolkestein elaborated on this parallel. Once the EU allows Turkey in, he said, it will be difficult to bar countries far more European in character, like Ukraine and Belarus. And with that, the EU will create a degree of instability that it has neither the financial means nor the cultural solidarity to control.

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\*I highly recommend "Islam and the West", "The Middle East" and "What Went Wrong?" Published in the US by Simon & Schuster; in Europe by Oxford University Press.

At the heart of Mr. Bolkestein's fears are two things. He feels that EU immigration policy, which projects the addition of 83 million Muslim Turks to the EU's population base, will speed up the Islamization of Europe to the point where the continent will be turned into "an Austro-Hungarian Empire on a grand scale." Referring to Bernard Lewis' interview, Bolkestein concluded that, "The US will remain the only superpower. China is becoming an economic giant. Europe is being Islamicized."

## **Exploding Muslim Populations...**

If you feel this type of talk is far-fetched, consider the demographic projections:

-During the next 50 years, Germany will have no growth; even with immigration factored in, its negative birth rate will ensure that the country's population will stay at 80 million people. Little Yemen, in contrast—a mere speck on the Arab landscape—will grow from 18 million people to 85 million.

-Russia, another nation with a negative fertility rate, will shrink from roughly 150 million people to 100 million. Iran, now at 65 million people, is expected to have a larger population than Russia.

-Japan's population will fall to 110 million. Iraq and Saudi Arabia will each have more people than that.

-Italy will have shrunk from 57 to 45 million people, but the Afghans will more than make up for it: they'll grow from 21 million to 70 million.

How reliable are demographic projections? There are random factors that can interfere—civil war or pandemics are events even beyond the forecasting ability of demographers. But barring those, projections thirty or even fifty years out are reasonably accurate, because current birth patterns can predict future population trends with fair accuracy.

One reality, then, is that populations in the developed nations are generally stagnant or declining, while populations in the emerging economies are booming. A second reality centers on the clash between the Muslim world, which is on a sharp upward trajectory, and its immediate neighbors, Europe and Russia, which have a shrinking population base.

From a political viewpoint, these developments are explosive and will, within our lifetime, manifest themselves in many ways. Geopolitical flare-ups will give way to massive and lingering confrontations, as the uprising of the dispossessed Muslim masses takes its course. But geopolitics was the topic of my last issue—let me today focus on the economic consequences of these changes.

## **Shrinking Western Populations**

Some of you will have noticed Fed Chairman Alan Greenspan making increasingly frequent references to Social Security funding. The issue is pressing: will there be enough money as a wave of baby boomers starts claiming their share of benefits and far fewer people make contributions?

Mr. Greenspan makes no bones about his feelings: he says that politicians, forever short-sighted and intent on mollifying their electorate, aren't doing what's necessary. Such views don't earn him friends. After Greenspan spoke to Congress about social security earlier this year, politicians of every stripe publicly distanced themselves from him. Why? Because there are only few ways to fix the problem and all are politically unacceptable.

Here's what the government could do:

- Increase funding via higher taxes or a direct increase in social security premiums. But doing so would offend the young and middle aged, i.e. the part of the population who pays.
- Decrease benefits or raise the eligibility age. This alternative would be unpalatable for the elderly, who constitute an increasingly large voting block.
- Government could take money from other programs (education, health, roads, policing, etc.). But a great number of programs are themselves under-funded and, besides, program spending generates valuable benefits for politicians.
- Government could borrow to fund the shortfall. But by doing so it would drive up interest rates and starve the productive economy of capital.

Having said all this, I'll now surprise you by stating that the US demographic profile is far better than that of other developed nations. Yes, America's social security pool is quite inadequate to support future payouts, but crunch-time will arrive faster and be far more painful elsewhere. The reason is that the United States has a positive fertility rate, an advantage much of Europe, Japan and Russia don't enjoy. The table below shows you how the fertility factor will manifest itself in terms of changes to the working age populations of the three large developed economies. As you can see, the difference between the US on the one hand, and Europe and Japan on the other, is dramatic.

### How Working Age Populations will Change

	Today	2050	Change
European Union	232 million	187 million	-19%
Japan	79 million	49 million	-38%
United States	177 million	231 million	+31%

According to UN statistical forecasts, the support ratio of working age people to pensioners will deteriorate at a frightening rate. Currently, in the developed world on average, there are 100 working age adults for every 30 pensioners. In 35 years, the same 100 people will have to support 65 elders. By 2050, the UN demographers project, the support ratio will have reached disastrous proportions. In the most acute cases, each worker will have to support a pensioner!

### A Recipe for Social Dislocation

Imagine the implications. The young and middle aged will be increasingly angry at having to support so many old people, yet they won't be able to do a thing about it, because the elderly will have an overwhelming voting majority!

That alone is a recipe for major social dislocation. There will also be regional tensions: Britain's demographic profile is almost as solid as that of the US, but Italy's and Spain's are catastrophic. And there will be radical adjustments between the world's economic power blocks. In a refreshingly honest assessment of its grim demographic profile, the European Commission recently forecast how it thinks the share of the world's gross domestic product will change. The EU's share, it thinks, will fall from currently 18% to 10% in 2050. That of the United States will increase from 23% to 26%.

Let me now turn back to the remedies available to government. What will the politicians do when the baby-boom factor kicks in and how will different solutions impact the economy?

If governments decided to resort to taxation to pay for the social security imbalance, Europe's nations would use up more than 50% of their entire GDP in taxes; in some countries, the burden would exceed 60%. In the United States, the tax load as a percentage of GDP would go from 33% to 44%. Translated to the individual level, that would mean that the typical US tax rate of roughly 29% would rise to 38%. In much of Europe, where taxes are already sky-high, the personal tax rate would soar beyond 80%. Evidently, paying for social security deficits through taxes is not a politically feasible solution.

What about cutbacks in program spending? Again, the political fallout from significant cutbacks in welfare, unemployment benefits, health, education or infrastructural spending would be unacceptable. The only country that has a large, highly discernible and arguably non-essential spending program is the United States. Its defense budget is immense and could easily be scaled back if it weren't for the threat posed by militant Islam. Before long, Americans will have to choose between the indirect economic benefits derived from an aggressive military power projection or the direct benefit of manageable taxes and a balanced social security regime. The Japanese and the Europeans don't have that luxury: they've spent almost nothing on defense during the past two decades, with the result that cutbacks are not an option.

### **Borrowing On an Ever Greater Scale**

So how will various nations pay for the looming hole in social security? The answer is obvious. Tax increases and some cutbacks in program spending are probably inevitable, but most of the money will be borrowed. Government borrowing is the easiest way out for politicians and the seemingly most acceptable solution for the electorate. This reality casts an enormous shadow over the longer term prospect for the bond market—the very market on which so many pensioners depend!

The world's rapidly changing demographic profile will cause havoc in other areas, as well:

- It's a fair bet that demand for consumer goods and real estate in the developed world will sharply fall during the next few decades. Demand for health care products and aging related services, in contrast, should boom.
- Unemployment in the developed world will go away. With a shortage of working people, real wages will have to rise.
- In the developing world, unemployment will persist. Many countries with high fertility rates, especially in the Muslim world, already have a huge percentage of young unemployed adults. This trend will intensify and, in turn, swell the ranks of Muslim extremists.
- Demand for all goods and services in the developing world will skyrocket. Eventually, hundreds of millions of new consumers in China, India and the Muslim world will more than offset the drop in demand in the developed countries.
- By the end of this decade, all commodity prices will be in a steep upward trend. Increasingly, commodity pricing will no longer reflect cyclical economic patterns, but the structural reality of the emerging world demanding its fair share.
- Outsourcing will further accelerate. I predict that the entire automobile industry will shift to South and East Asia, first from Europe, then from the United States. And millions of service sector jobs are yet to leave the developed economies.
- The growing debt burden stemming from financing social security, along with the sheer implosion in population size, will radically alter existing power structures. Japan will become irrelevant; Russia will be hampered; and Europe's star will rapidly fade.

-The concept of the welfare state is dying. Especially for Europe and Canada, this will be a bitter pill to swallow. For decades, their citizens have paid far more in taxes than they would have paid in the United States—all in order to allow their governments to engineer “a gentler, kinder society”. Yet the social machinery has been mismanaged to such an extent that neither Europe nor Canada have advantages which they couldn’t achieved for a fraction of what their US counterparts have had in tax savings. The psychological adjustment that still lies ahead for citizens of social welfare states is brutal.

In short, the demographic changes underway will have a traumatic effect on most of the world. Some nations, like the US and Britain, and to a smaller extent Australia and Canada, have constructive or at least benign fertility profiles. Others, like Japan, Russia and most of Europe, face crises of unimaginable proportions.

It’s a troubling prospect, particularly when considering the threats which lurk at the doorstep of each of these powers. Japan is likely to become a minor pawn in China’s hemisphere, while Russia and Europe will be Islamicized. When viewed from a global perspective, America’s prospects look remarkably favorable, which is perhaps the reason why Washington has so little trouble financing its huge deficits. □

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