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OUTLOOK Economic Data and Commentary

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The Graying of the American Workforce

On January 1, 2011, the leading edge of the baby boomers – the post-World War II generation born between 1946 and 1964 – hit the official retirement age of 65. Every day for the next 19 years, about 10,000 Americans will reach that milestone, according to the Pew Research Center. This group of 79 million people accounts for 26 percent of the U.S. population and is an influential piece of the nation's employment base.

Today, baby boomers sit on top of the economic food chain. In many organizations across the country, they are the movers and shakers: CEOs, long-tenured senior executives, veteran managers, the voice of experience and the keepers of vital institutional knowledge. Though some boomers have indicated that many intend to work past the age of 65, the wave of retirements is coming, whether society is ready or not.

To get some perspective on the graying of the American workforce and its potential impact on the nation's economy, OUTLOOK spoke with Ronald Lee, professor of economics and director of the University of California - Berkeley's Center for the Demography and Economics of Aging, and Dallas Salisbury, president and CEO of the Employee Benefit Research Institute, an independent, nonprofit organization that conducts employee benefits research.

OUTLOOK: How will the retirement of baby boomers be felt in the American workforce and in the broader economy?

Dallas Salisbury: The workforce is getting older because the top of the baby boom is right at the age of 65, and it is a dominant population group. The group that came behind them – those born after 1964, the so-called Gen Xers – is a much, much smaller population. That sets up the fundamental problem – there is a smaller population of qualified workers replacing the boomers. It's a real predicament for employers.

The Gen Ys, the demographic group born starting around 1977-88, are a larger population, but they're just beginning to move into the workforce and are tending to enter the labor force later than was traditional. For instance, the baby boomers tended to enter the labor force between the ages of 18 and 21. But the Gen Ys and Millennials – born around 1988 to 1990 – look like they're not going to get into that track; many of them are extending

"We'll have slower labor force growth, which means slower GDP growth.

their time in school and their part-time employment period a bit longer, so they're actually trying to move into a career and full-time employment in the 24 to 27 range.

Ronald Lee: Over the last 45 years or so, they've been swelling the size of the labor force, paying payroll taxes and so on. Rapid growth of the labor force brings more rapidly growing GDP. It may mean less rapidly growing wages, but it also means a more favorable environment for investment.

As the baby boom generation entered the labor force, it had a difficult time. Large generations do when they enter the labor force, because they're competing with many other entry-level workers. It means they initially have higher unemployment, lower wages and less rapid promotion, because there are so many other young workers they are competing with. Those problems gradually diminished as the baby boomers aged, but initially it was rougher going for them.

The dynamics are shifting rapidly in the other direction now. If we look at the period from 1970-2010, the rate of growth of the labor force was 1.3 percent per year, which is very rapid in the context of the last 40 years. But if we look at the next 40 years, the rate of growth of the labor force will be only a third of that, about 0.4 percent per year.

OUTLOOK: What will be the economic impact once the boomers begin to retire en masse?

RL: We'll have slow labor force growth, which means slower GDP growth. We'll see what macro-economic consequences that might create. The thing that has received the most attention about the baby boomers aging is the effect it will have on our public entitlement programs. This is mostly an issue for the federal government. The aging of the baby boomers means there's an enormous impact on Social Security, Medicare and, with some delay, the cost of Medicaid for long-term care. Those are the three big hits, and these programs are in some trouble in the future. Of course, that's partly because of the baby boomers, but it is also just because of the generosity of these programs. The costs per person have increased dramatically over the last century.

In 1960, people over 60 years old consumed a good deal less in terms of goods and services than other adults. In addition, our big transfer programs of the day were very modest in size – public health was small, Social Security was relatively small and Medicare spending was very modest. By 1981, that had begun to change, and you can see that elderly people were

About this article

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SAMPLE WORKFORCE AGE DATA - BY INDUSTRY

High-Growth Industries	Workers Age 45 and Older
Aerospace	55%
Energy	52%
Transportation	47%
Advanced Manufacturing	43%
Health Care	43%
Automotive	39%
Financial Services	38%
Construction	34%
Retail	34%
Information Technology	33%
Hospitality	33%

Source: Report of the Taskforce on the Aging of the American Workforce

consuming more than younger adults. The reason was the rising cost of health care and the expansion of public health care programs for people in older ages. By 2007, the whole situation had become even more pronounced. You see consumption rising very strongly with age. You see, for those above age 80 to 85, it really takes off with the cost of long-term care. You also see some increase in the cost of private health care, but it is mostly public spending for institutional health care that's driving the trend.

So, at the same time that the population's age distribution is shifting toward an increase in the ratio of elderly to working-age people, which will begin happening now very rapidly, we also have had this change in the life-cycle pattern of consumption. Elderly people are consuming much more than the younger adults. It's sort of a double whammy that the economy and society is going to be experiencing at the same time. That's the downside, that's what we are all really worried about. If these trends continue – rising costs of Medicare in particular – then this is just going to be more and more problematic. I don't think we've found the policy reform that is going to contain those costs yet. Something will have to be done.

OUTLOOK: What are the options for dealing with the impending entitlement issue on the federal level? When is it too late?

RL: It's not clear what 'too late' means. We know we're going to be burning through the Social Security trust fund, and it will be gone around 2037, which is the current government estimate. The policy could be to do nothing, just continue the current taxes and scheduled benefits the way they are now. As soon as the trust fund hits zero, the government will have to start raising taxes, cutting benefits or both to keep the system in balance on a year-to-year basis. That's a possible policy – we'll just deal with it when it happens. I think that could be done, but it should be stated that it's the strategy. That might do something to relieve the anxiety of younger generations, many of whom don't seem to believe that Social Security will be there for them when they turn 65. If we adopted that policy, we avoid the political risks of policy makers having a huge trust fund to play with. But on the other hand, it does mean that when taxes are raised or benefits are cut, a bigger adjustment will be needed than if we were to address the problem now.

People disagree on the semantics of whether or not it is in crisis now. It's a political decision. My view is that you should raise taxes now, you should also have a scheduled increase in the normal retirement age to 70, you should probably raise the early retirement age, too, and maybe fiddle with some other things. Some mixture of modest cuts in benefits and some

"Coming out of the recession, the proportion of individuals confident about their retirement preparation has gone down significantly.

increase in taxes now is what I would suggest. We have a relatively small pension program compared to other rich, industrial nations, with a relatively low replacement rate and relatively low payroll taxes. It's a policy decision whether we try to preserve the trust fund or just state as an implicit policy that we're going to let it run down, but we're not going to let the system go broke. People just need a plan on the table that they can look at, believe in and have some faith in for the future so that they can plan their own savings around that.

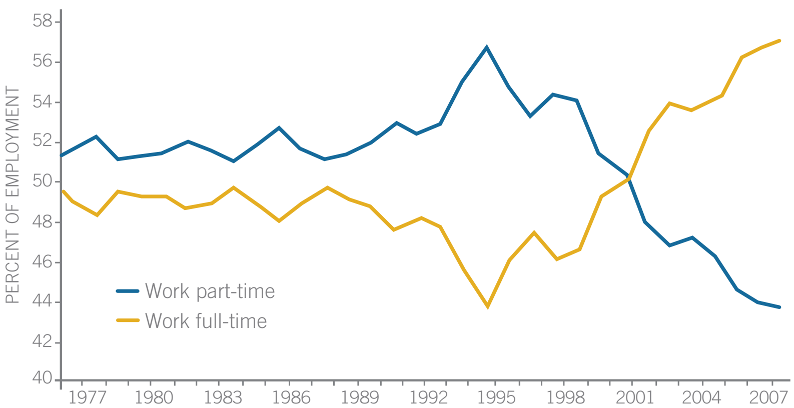
OUTLOOK: A few years ago, the big concern for companies was the coming wave of retirements. How has the recent recession changed that?

DS: Just before the recession, many enterprises, large employers in particular, were beginning to focus heavily on something called 'phased retirement.' They were looking to see how to get those approaching retirement age to work longer. During the recession, that emphasis shifted almost overnight, and they were looking to get more baby boomers to leave so they didn't have to lay off recent hires, which is really their future workforce, those that they'd hired in the last five years and spent a lot of time and resources training. Now the economy is coming out of recession that is just beginning to reverse itself. I think you will see a return to the focus on phased retirements and stemming the loss of human capital in the form of older workers.

OUTLOOK: Does the recession fundamentally change the problem of baby boomer retirements or just push it back a few years?

DS: A new retirement confidence survey shows that, coming out of the recession, the proportion of individuals confident about their retirement preparation has gone down significantly. The recognition of their increased longevity is rising; the recognition of health care inflation and medical vulnerability is rising; the proportion of the population concerned about the future of Medicare and Social Security continues to rise. All of those factors have an increasing number of baby boomers saying that they expect they'll need to work at least part-time in retirement. Additionally, the proportion of those saying they'll work longer before retiring is going up. We believe that, in the same way that in the investment world you've seen investors refer to a so-called 'new normal' following this recession, the after-effects of the recession also may well be creating a 'new normal' in retirement expectations and patterns. And because of the state, local and federal government fiscal situations, which are not good, we believe this is going to be a long-

WORKERS 65 AND OVER BY WORK SCHEDULE, 1977–2007



Source: U.S. Bureau of Labor Statistics

lasting effect. You're not going to see it reversing itself anywhere near as quickly as would have been assumed previously. Baby boomers will likely be in the workforce long after they reach what had come to be viewed as a normal retirement age range of 55 to 65.

RL: People are working longer, but that's due not just to the recession but to the long-term trend we've seen away from defined-benefit pension programs toward defined-contribution benefit programs, such as 401(k)s. That trend in general has led to an increase in retirement age for those that don't have defined-benefit pension programs.

Health is also a contributing factor – the increased vitality of older people, including baby boomers, as they age. For a long time there had been big questions about whether declining mortality and longer life was going to mean more healthy years, more active years, or whether it meant more years of disability and lower quality-of-life. Some very interesting and important research over the last 15 years or so has found that, since the early 1980s, there was quite a rapid decline in disability rates for the elderly. This is good news for the possibility of people working longer, and it was also good news from the point of view of long-term care costs. So the baby boomers, of course, as they are aging and moving into retirement, are really in much better shape than there parents were and their grandparents were.

OUTLOOK: The boomers control a large percent of the wealth in the nation, much of it tied up in equities and other assets. As they begin to leave the labor force, will the fact they are starting to spend their assets have an economic impact?

RL: Older people in the U.S. support their old-age consumption by spending their accumulated assets. It's a much higher proportion than in other rich, industrial countries, where people rely on public-sector transfers to fund their old-age consumption. In the U.S., roughly 60 percent of the funding for old-age consumption comes from our own assets. Pension and Social Security benefits are just lower relative to our earnings than in most other developed countries. Yes, boomers will be spending a lot of their assets to fund their retirement. So, when we think about this political debate over privatizing Social Security and having personal retirement funds, which has been a policy that has had a lot of backers in the U.S., we're already doing that to a greater extent than other countries. That's not to say it's a bad idea and we shouldn't do more of it, but we've gone much further in that direction than other rich industrial countries.

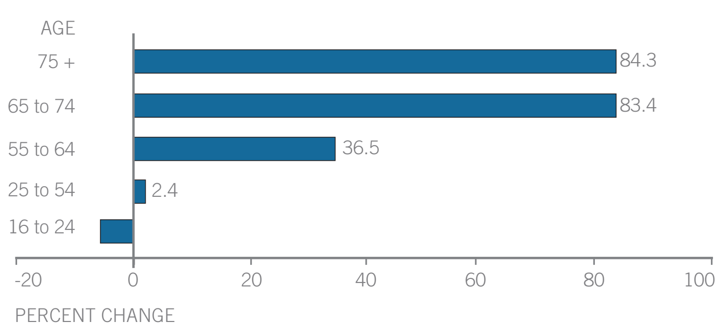
Additionally, older people in the U.S. – and I imagine this will still be true with the baby boomers – make net transfers to younger people, to their children and grandchildren. Some of this is through bequests when they die, but aside from bequests, if you look at what they are doing during their lifetime, older people are making significant contributions to younger people through gifts, through helping out with the mortgage, helping out with the grandkids' expenses and those kinds of things. Some older people are getting help from their adult children, sure, but the net direction is that older people make private transfers to younger people. They are also using asset income to do that.

This is good news for the children of the baby boomers. Baby boomers' parents had very high fertility rates – that's what led to the baby boom. But the boomers themselves had very low fertility rates compared to their parents. Instead of having three children per couple, they had two children per couple. The transfers they make to their kids are shared among two kids rather than among three kids. From the point of view of the children of the baby boomers, they are going to be getting more.

OUTLOOK: As boomers move out of paying jobs and into retirement, won't they scale back their consumption habits and become more conservative consumers?

RL: You might expect so, but when I look at consumption by age of individual in a given year, non-health private spending stays quite constant until around age 80, and after that it declines. When you add in private spending on health care and public spending on health and long-term care, consumption rises steeply by age, particularly after age 85 when long-term care becomes important.

PROJECTED PERCENT CHANGE IN LABOR FORCE BY AGE, 2006–2016



Source: U.S. Bureau of Labor Statistics

OUTLOOK: What will happen to asset valuations as the boomers move into retirement? For instance, will there be a big selloff of equities and a corresponding decline in stock market values?

RL: There are certainly plenty of people who believe there will be real problems and steep declines in the value of certain assets as the baby boomers begin to draw on their various savings and investments to fund retirement. Some people talk about an asset-price melt down. The sober assessment of this likelihood by economists is that it's not likely to happen. These behavior patters are sufficiently diffused across various age groups so that you really won't see anything change.

On the other hand, the aging of the baby boomers is likely to go with an increase in the amount of assets per capita in

> Generations coming up behind the baby boomers may benefit from wages that are higher and rise more rapidly.

the broader population. Older people in general hold more wealth and assets than younger people. When there are more old people in the population, then there will also be more wealth relative to the total population and relative to the working-age population. To the extent that this wealth is held in the form of capital here in the U.S., the amount of capital per worker may rise. That should raise the productivity of labor somewhat, which would be good, potentially leading to higher wages and other benefits.

So, if you look at it from the perspective of the generations coming up behind the baby boomers, they may benefit from wages that are higher and will rise more rapidly than they otherwise would have due to the slower labor force growth. But we also know the costs they will likely have to bear in terms of rising taxes for the entitlements. The younger people are going to have to pay higher taxes to maintain scheduled benefits or else they are going to have to plan on receiving lower benefits than they otherwise would. That's fallout of population aging in general.

OUTLOOK: What impact will the boomer retirement have on housing?

RL: The elderly generally like to hold on to their housing, even when the house is larger than they need, so I do not expect a big sell-off.

OUTLOOK: Have the younger generations been stuck with an unfair burden of having to pay for the public-sector entitlement programs to support the aging baby boomers?

RL: Yes. If you look at Social Security and Medicare, you see that the older generations, including the baby boom, got more out than they put in, and the future generations as a whole will get less than they put in. You might say the baby boom generations are saddling the younger generations with a net cost.

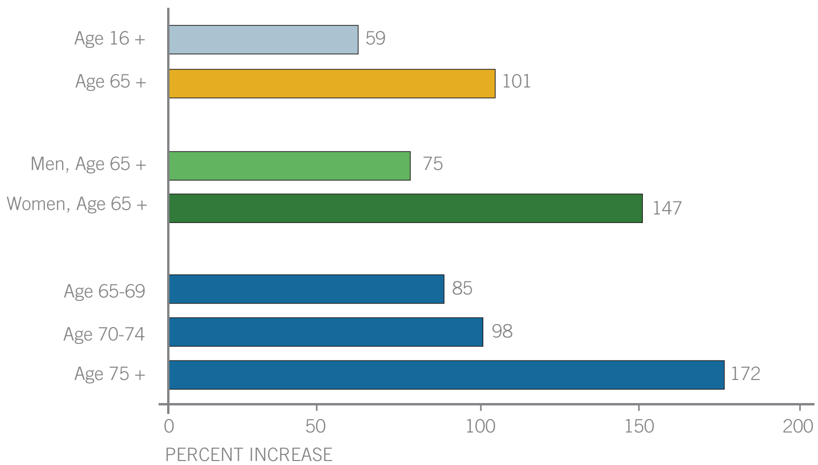
But I also have a little different take on this. If you take public education into account – which is another big, public transfer-of-wealth program that's received at the beginning of life rather than at the end of life – and ask what each generation received in the value of public education

LABOR FORCE PARTICIPATION RATES, 1994–2005

MEN					WOMEN			
Year	55 to 61	62 to 64	65 to 69	70+	55 to 61	62 to 64	65 to 69	70+
1994	73.8	45.1	26.8	11.7	55.5	33.1	17.9	5.5
2000	74.3	47.0	30.3	12.0	58.3	34.1	19.5	5.8
2005	74.7	52.5	33.6	13.5	62.7	40.0	23.7	7.1

Source: Report of the Taskforce on the Aging of the American Workforce

PERCENT INCREASE IN EMPLOYMENT BY AGE AND SEX, 1977–2007



Source: U.S. Bureau of Labor Statistics

and what it paid in taxes for it, then you get a rather different picture. The baby boom generation paid a lot more into public education through property taxes than they got out of it. They also bore the costs of a big run-up in secondary enrollment. The younger generation, however, got much more from public education than they will have paid in taxes. For them, the public education program has been a big net benefit, even if the transfers to the elderly in terms of entitlement programs have been a net cost. If you look at the combination of those two, it turns out that the younger generations of today got a big gift from the public sector – as much as 5 percent of the present value of their lifetime earnings.

OUTLOOK: How did corrections in the stock market during the recession affect the retirement plans of baby boomers?

DS: Even with the stock market downturn and its impact on 401(k)s, there were large companies during the recession that maintained good defined benefit plans and retiree medical plans. But even those companies still found that retirements ground to a halt during the recessionary years. It was broadly due to a concern over economic security, economy uncertainty and fear that we were about to go into another Great Depression. The evidence from surveys, as well as what companies and the federal government were experiencing, was that individuals were stopping in place almost regardless of their financial circumstances. The counter to that, which is very interesting, is the level of people placing their claims for Social Security at the age of 62 went up significantly at that point in time. Even though people weren't necessarily retiring, they were taking their Social Security eligibility in order to get that cash flowing in the event they had financial difficulty.

There's been an environment in the last 30 years of people retiring when they were told they were eligible. But our surveys indicate that at least 60 percent retire without even knowing what their income and expenses are going to be. They just assume that since they're eligible to retire, that must mean they'll have enough money. But there seems to be an awakening in that regard, and many employers are reinforcing that. In this more digital world, the powerful nature of web-based tools made available to individuals gives them the ability to do calculations of what they need for retirement. And more and more employers are providing direct access to financial advisors and planners in order to try to make sure their people are better prepared. All of that combined is going to serve to keep some of the healthy people working longer.

The employers that face the biggest challenge with regard to retirements are the federal, state and local governments.

OUTLOOK: Are there any industries or sectors that will be hit harder than others with these retirements?

DS: The employers that the face biggest challenge in this regard are the federal, state and local governments, because you have a far higher proportion – in the 26 to 27 percent range – of employees who have spent their full career in a government job. Among private sector employers broadly, it's closer to 7 to 10 percent. That's not to say the private sector isn't impacted. Industries that are heavily unionized will definitely be feeling more pressure from the retirement wave than those that are not.

The scientific industries, particularly the aerospace industry, have a relatively older workforce and so do some of the big chemical companies. As a practical matter, it tends to be those companies and industries that were the fastest growers during the decades of the 1970s and 1980s. They ended up filling up with the most baby boomers.

OUTLOOK: Given the boomers are roughly age 46 to 65 right now, we can presume that's an age group well-represented in the executive ranks. So one has to assume if there's a wave of retirements, one of the big voids will be at the top of organizations, rather than the middle or bottom.

DS: It's a fair characterization, but with a caveat. Executive positions in recent years have become relatively high-turnover positions. Enterprises that are performance-based and have the type of system where you are evaluating and adjusting the workplace annually based on performance, the fact you've had such movement in those positions frequently means they're already filled by people in their 40s or early 50s as opposed to the latter points of the baby boom. So, yes, while there will be an effect on executive ranks, there have been an awful lot of younger boomers, as well as those behind them, that have been feeling a bit clogged in the pipeline. So having these retirements take place, as long as enterprises have been engaged in effective workforce and succession planning, can be viewed as a refreshing workplace experience as much as anything else.

The Importance of Succession Planning

Bill Conaty was the top human-resources executive at General Electric, a company that, in Conaty's words, is "obsessed with people, with talent development and succession." During his tenure at GE, Conaty oversaw the successful handoff of power in 2000 from CEO Jack Welch to Jeffrey Immelt, which is considered by many experts to be a text-book example of good succession planning.

With co-author Ram Charan, Conaty's written The Talent Masters, a book that explains what companies must do to master the process of talent development and succession planning. OUTLOOK spoke with Conaty about what companies, no matter how big or small, need to do to prepare.

OUTLOOK: Who bears the burden of succession planning with an organization – the board of directors or the executive leadership?

Bill Conaty: The way I look at it is that the board members have three distinct responsibilities: governance, strategy and succession. I think most boards have paid much more attention to governance, especially post-Sarbanes Oxley and Securities and Exchange Commission rule changes, and strategy than they have succession. Giving equal weight to the succession side of things is critical for a board member.

But succession planning should also be a focus for the executive team. After 40 years with GE and other Fortune 100 companies, one of my lessons learned on management is that great leaders develop great succession plans, whereas weak leaders are threatened and intimidated by succession. I grew up in a company where we were obsessed with people, with talent development and succession. We knew we wouldn't get promoted if we didn't have robust succession. I always felt I had to have two or three viable successors who could replace me before I was ever going to get promoted. We never had a situation where we had a job in the company and weren't ready for either an orderly succession or an emergency crisis situation. Fortunately for us, (Jack) Welch to (Jeffrey) Immelt was an orderly transition that had been worked on for years in advance, with the board intimately.

Even though we did good succession planning at GE, there were times when we had to scramble. In one instance, the CEO of our $6 billion-plus appliance business out of Louisville, Kentucky, pops into my office on a Monday morning and lets me know he's resigning to take a job as the CEO of Albertson's grocery stores. After we spent about an hour trying to talk him out of it, we realized it wasn't going to happen. So the executive team and I met

About this article

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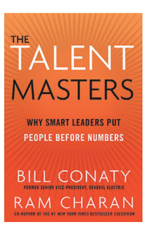

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for the next couple hours to decide who was going to replace this individual. Based on our previous succession plans, we were able to quickly identify three or four internal candidates. We made the decision and I jumped on a plane with the CEO who was resigning, flew back to Louisville, announced his departure and announced his replacement. We were able to talk to employees about the candidates that were moving up the line, one to CEO, one to his job, one to the next job, and the ripple effect. Within eight hours, we had gone from shocked to naming successors and having it be a great day in Louisville rather than it being a downer. Same-day succession was the objective – to be ready for an orderly transition or for an emergency.

OUTLOOK: With the Welch-to-Immelt transition, Immelt was one of three executives who were possible successors to Welch. When one was selected, the other two left the company. On one hand, it seems to be ideal that you had multiple people with the capabilities to step into a role that becomes vacant. But the downside is only one person can step into that role. Can you lose valuable talent through these types succession of scenarios?

BC: Yes and no. It depends on the position and the size of the organization. In the case of the Welch succession, it was a unique case. We told all three candidates that they were all superb players with great careers at GE. But we also told them only one would get the job, and the other two would have to leave, primarily because we felt the pressure on the two who were not selected would be too great. We also named their replacements six months in advance, so before we made the final call on Immelt for the Welch job, we had put three new business leaders in position under the top three candidates. The day the announcement came, what we had done was protect the company, and that was applauded by the investment community. And just as we'd planned, both the runners-up, so to speak, had major CEO jobs at 3M and Home Depot within a week. And we had no more succession to do. We'd already named their replacements, they'd been on board for six months, and they were six months into understanding the role of CEO in their businesses segment. So in that particular case, yes, we lost some real top talent and some institutional knowledge, but we planned it that way given the nature of the position.

In my case as senior vice president of HR, we went through a similar process where I had three or four potential backups for me. We eventually made the call, and the others are all gainfully employed in larger-scope roles inside the

Succession planning is an ongoing, alive process so that you're always prepared no matter what happens.

company. None of them have left, and all have had opportunities to take jobs outside of GE.

OUTLOOK: How far down the company hierarchy should succession planning stretch?

BC: GE is a company with more than 280,000 employees. We – meaning the CEO and me – felt we had ultimate control over the careers of the top 600 people in the company. We knew them intimately, we knew their families, we knew their strengths, we knew their direct development needs, we knew their career aspirations, and we knew their gaps. There was a degree of intimacy at GE that really caused this ability to determine who was ready for what. Then we would expect each of our business leaders to take that same kind of look down in their organization. So they would have intimacy with the four to five hundred people in their organization. Ideally, regardless of the size of a company, it cascades all the way down from the top to the new hires and it pervades the organization.

OUTLOOK: Why do some companies choose not to develop succession plans?

BC: Well, I think some CEOs don't develop succession plans because they don't foresee anything happening to them. Boards look at it that way, too. They'll say, 'We've got a 48-year-old leader, which means we've got 10 years before we have to worry about this stuff.' That's when you get lulled into a big problem. That was a big part of the problem at H-P. Mark Hurd was only 53, doing a hell of a job, and, bam, he resigns suddenly as a result of a scandal and the company is in chaos.

At GE, we put as much concentration on succession and talent development the day after we announced Jeff Immelt as the day before. It's a process viewed as an ongoing, alive process so that you're always prepared no matter what happens. At a company the size of GE or Procter & Gamble, strange stuff happens, and you can get surprised a lot. Plus you've got every company in the world trying to poach our top talent.

OUTLOOK: How should companies handle employees who are not top performers?

BC: We believed in making GE a meritocracy. So we felt if you were going to have a meritocracy, you better have a way of identifying, recognizing and rewarding your very best. The other end is, if you've got less-effective performers, you owe it to those individuals to let them know where they stand, to let them know what their shortcomings are and to give them a chance to address those shortcomings. If they can't, you move them out. So we had a concept of the top 30 percent, a highly valued 60 percent and less-effective 10 percent. We tried to do smart things with good people and tried not to be so formulaic and mechanistic that we did dumb things with good people, but it was a great way to look at things when you were doing bonuses, stock options and special rewards. You have to ask yourself whether you're really taking care of your best people or just giving everybody a little bit of the pie. That's why we use the technique such as 30/60/10.

While it's harder to apply that kind of concept at a small company, it still applies. Let's say you only have 10 people in your company. I'll bet you have some superior performers, some that are damn good performers and some that are less effective. If that's the case, you've got to customize and find your own technique to raise the bar and improve the performance of the less effective ones. Certainly those kinds of rankings work best when you've got big numbers to work with. But I don't think the concept is wrong, no matter how small the organization is.

OUTLOOK: How do you balance having a rigorous culture where employees are measured against each other and also having a collaborative culture?

BC: In a company like GE, it's part of the value proposition when you join the company. I knew when I joined GE 40-plus years ago that there were going to be ratings and rankings. People who join a company like GE know it's striving to be a meritocracy, and they know they're going to be rated, ranked and slotted. I felt as long as it was an equitable system, the right kind of people were keeping score, that if I was really good and giving the extra effort, somebody was going to recognize that, and fortunately, they did. It's a matter of having a culture around that kind of meritocracy.

Ford came in 10 years ago or so and decided, 'If Jack Welch can do this at GE, we ought to be able to do this at Ford.' They tried to implement a hardcore ratings-and-rankings system with no climate set, no culture of receptivity, and the thing blew up in their face. They had a massive class-action suit and had to abandon their plan. So you can't take a system and culture like the one GE had established over decades and just air-drop it into another company's culture. That's how you get in trouble.

For this type of system to work, people have to trust the system, trust the process and trust the leadership. And that's a huge deal – it takes a long time to really establish that credibility, where you can sit down and have a career discussion with someone and say, 'Here are a half-dozen things that you really excel at, and I love having you on my team, but here are a couple

"The HR process at GE is every bit as systematic and rigorous as the budget reviews, the strategy reviews and the operations reviews.

of development needs. If you spent some time addressing those needs, you could enhance your performance dramatically.' It's being able to have those kinds of discussions without having the person think that it's a 'gotcha' or that you're looking for their fatal flaw. We called them 'development needs' as opposed to 'fatal flaws' because they are only development needs at that point. They don't become a fatal flaw unless they are never addressed.

OUTLOOK: So how should a company which doesn't currently do succession planning go about setting up a system to identify talent, evaluate them and promote them?

BC: In the book, we talk about a set of seven principles that are the keys for a company, big or small, to be thinking about to get on the road to being a 'talent master.'

The first point is an enlightened leadership team starting with a CEO. It has to be someone who really gets it, who sees talent development as a competitive business advantage. If the CEO of the company doesn't think this is important, it's not going to be. I don't care how strong the rest of your senior team is – if the CEO isn't leading the chorus, you're never going to get off the ground.

The second one is a performance-driven meritocracy: a willingness to differentiate talent based on results as well as values and behaviors behind those results. A willingness to be able to say 'these are my superior performers, these are my highly valued performers and these are my less-effective performers.' Everybody's got them; I don't care what the size of the company is. You have to be able to identify them and to deal with each of those categories.

The third point is what we call a set of 'working values.' Every company has a set of values, usually on a big billboard behind the receptionist's desk. But we're talking about values that people really can believe in that cite company beliefs and expected behaviors from employees. So, a set of working values that become the basis of your assessment systems, your appraisal systems, the whole gamut.

The fourth, and the toughest, is the whole issue of candor and trust. Really being able to have those conversations with an individual, have an appraisal, cite their strengths and give them one or two – one or two is plenty –

development needs as to what they can do to become even more effective in the organization. A lot of times career discussions are 'I love everything you're doing. Here's your 6 percent raise. I'll see you a year from now.' That's not good enough. Usually, those discussions are holding back information.

The fifth principle is having processes. I'm talking about talent assessment and development systems that have as much rigor and repeatability as the systems used for finance and operations. The HR process at GE is every bit as systematic and rigorous as the budget reviews, the strategy reviews and the operations reviews. So putting equal weighting on this as a business process.

The sixth principle, one I've been working on a long time, is having HR leaders as business partners and trustees of the talent-development system, with functional expertise that's valued as much as the chief financial officer. HR needs a seat at the table as a facilitator of these processes, and the HR leadership really needs to understand the business and make an impact on the business. There are still far too many organizations where HR is viewed as the old personnel function, the admin function. HR's got an obligation to step up and become a legitimate business partner.

The seventh and final one is that companies need to make the investment in continuous learning and improvement to update the leadership on the changing world. Providing individuals with opportunities to learn and grow on the job, bigger and broader assignments, but also outside training or coursework. At GE, we were fortunate enough to have an in-house educational university. That's way too costly for most companies to put together from scratch, but companies of any size can find opportunities for learning and growth through a local university or other development opportunities. They need to provide avenues for individuals to continually raise their performance bar and learn as they go.

OUTLOOK: The current crop of recruits seems to want different things from their work-life balance than baby boomers did. Are companies having to make significant shifts in their culture to attract the next generation of leaders?

BC: Some industries have, like the major accounting firms. Those jobs, while terrific jobs for young folks coming off campus, used to be viewed as jobs with basically no quality of life. So those firms have done a hell of a job over the last five years in finding ways to be a lot more flexible with how the work gets done, where it gets done and when it gets done. And they've moved up on the scales from some of the toughest companies to work for to some of best companies to work for, as judged by young graduates. So I think companies in general have become more flexible to those kinds of work-life issues. Yet the requirements of a job are what they are. If you're going to have to travel around the world to get the job done, then that's what you're going to have to do. But there's a lot more sensitivity around the topic of flexibility than there was in the past.

In the case of GE, that we're able to attract great talent from great schools – highly, highly motivated young college grads who really want to make a difference. They are much more concerned about the environment than graduates were 10 or 20 years ago. They're much more concerned about the social aspects of being a good employer, a community employer, good to the communities you live and work in. And I think that's all a plus.

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 4/30/11. They are intended to provide rate or cost indications only and are for notional amounts in excess of $5 million except for forward fixed rates.

KEY ECONOMIC INDICATORS

Gross Domestic Product (GDP) measures the change in total output of the U.S. economy. The Consumer Price Index (CPI) is a measure of consumer inflation. The federal funds rate is the rate charged by banks to one another on overnight funds. The target federal funds rate is set by the Federal Reserve as one of the tools of monetary policy. The interest rate on the 10-year U.S. Treasury Note is considered a reflection of the market's view of longer-term macroeconomic performance; the 2-year projection provides a view of more near-term economic performance.

ECONOMIC AND INTEREST RATE PROJECTIONS

Source: Insight Economics, LLC and Blue Chip Economic Indicators

				US Treasury Securities	
2010	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q4	3.10%	2.60%	0.19%	0.50%	2.90%
2011	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.60%	4.70%	0.16%	0.70%	3.50%
Q2	3.20%	2.70%	0.15%	0.70%	3.50%
Q3	3.30%	2.00%	0.18%	0.80%	3.70%
Q4	3.40%	2.00%	0.20%	1.00%	3.80%

PROJECTIONS OF FUTURE INTEREST RATES

The table below reflects current market expectations about interest rates at given points in the future. Implied forward rates are the most commonly used measure of the outlook for interest rates. The forward rates listed are derived from the current interest rate curve using a mathematical formula to project future interest rate levels.

IMPLIED FORWARD SWAP RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	0.28%	0.38%	1.27%	2.16%	2.80%	3.38%
0.25	0.30%	0.48%	1.48%	2.33%	2.92%	3.47%
0.50	0.39%	0.66%	1.68%	2.56%	3.09%	3.60%
0.75	0.51%	0.90%	1.97%	2.76%	3.29%	3.77%
1.00	0.71%	1.17%	2.18%	2.97%	3.42%	3.86%
1.50	1.34%	1.77%	2.69%	3.35%	3.75%	4.13%
2.00	1.83%	2.29%	3.11%	3.70%	4.01%	4.29%
2.50	2.32%	2.74%	3.47%	3.95%	4.21%	4.46%
3.00	2.80%	3.20%	3.83%	4.21%	4.42%	4.62%
4.00	3.54%	3.92%	4.40%	4.58%	4.74%	4.85%
5.00	4.06%	4.43%	4.68%	4.83%	4.93%	5.00%

HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

FORWARD FIXED RATES

Cost of Forward Funds

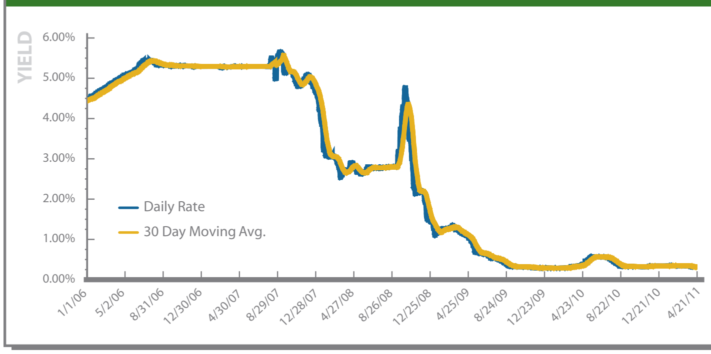
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	9	10	9	7
90	22	25	23	17
180	41	49	44	33
365	97	104	89	65

Costs are stated in basis points per year.

SHORT-TERM INTEREST RATES

This graph depicts the recent history of the cost to fund floating rate loans. Three-month LIBOR is the most commonly used index for short-term financing.

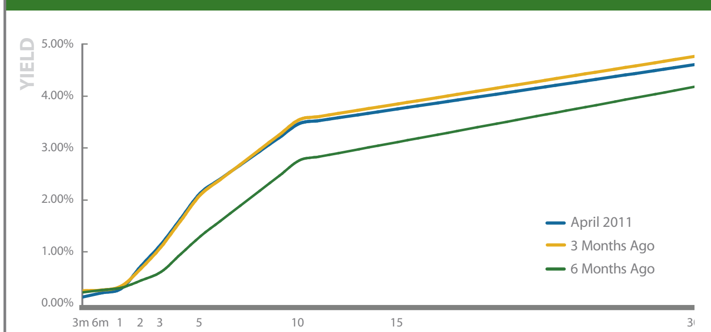
3-MONTH LIBOR



RELATION OF INTEREST RATE TO MATURITY

The yield curve is the relation between the cost of borrowing and the time to maturity of debt for a given borrower in a given currency. Typically, interest rates on long-term securities are higher than rates on short-term securities. Long-term securities generally require a risk premium for inflation uncertainty, for liquidity, and for potential default risk.

TREASURY YIELD CURVE



CoBank Reports First Quarter Financial Results

Net Income Increases 26 Percent To $212.1 Million

CoBank recently announced financial results for the first quarter of 2011.

Quarterly net income rose 26 percent to $212.1 million, compared with $168.7 million in the first quarter of last year. Net interest income for the quarter was $301.2 million, compared with $230.7 million a year ago. Average loan volume for the first quarter was $54.9 billion, compared to $44.7 billion for the same period in 2010.

Sharply higher prices for grains and other agricultural commodities had a strong impact on the bank's financial results during the quarter. Generally, rising commodity prices increase seasonal borrowing requirements for grain and farm supply cooperatives and other agribusiness customers. The bank also saw increased loan volume from rural electric cooperatives around the country and from Farm Credit association customers, which serve farmers, ranchers and other rural borrowers in the northeastern and northwestern United States.

"As always, we are focused on meeting the borrowing needs of our customers in market conditions that remain complex and highly volatile," said Robert B. Engel, CoBank's president and chief executive officer. "We're pleased with the financial performance of the bank and with the growth in loan volume we've seen in our agribusiness, rural infrastructure and association portfolios. Our strong results are, we believe, directly attributable to the value the bank provides its customers as a stable, dependable lender that is deeply committed to their success."

Credit quality in the bank's loan portfolio continued to improve. At quarter end, 1.61 percent of the bank's loans were classified as adverse assets, compared with 1.71 percent at December 31, 2010. Nonaccrual loans improved to $156.3 million, compared to $167.0 million at the end of the year. During the first quarter, the bank recorded a $12.5 million provision for loan losses, the same amount recorded in the first quarter of 2010. The bank's reserve for credit exposure totals $511.2 million, or 1.47 percent of non-guaranteed loans outstanding when loans to Farm Credit associations are excluded.

"The continued improvement we've seen in credit quality in recent quarters is a result of better conditions in certain of the industries we serve as well as resolution of a limited number of troubled credits," said David P. Burlage, CoBank's chief financial officer. "Overall credit quality is well within the

About CoBank

CoBank is a $69 billion cooperative bank serving vital industries across rural America. The bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states.

CoBank is a member of the Farm Credit System, a nationwide network of banks and retail lending associations chartered to support the borrowing needs of U.S. agriculture and the nation's rural economy. In addition to serving its direct borrowers, the bank also provides wholesale loans and other financial services to affiliated Farm Credit associations and other partners across the country.

Headquartered outside Denver, Colorado, CoBank serves customers from regional banking centers across the U.S. and also maintains an international representative office in Singapore. For more information about CoBank, visit the bank's web site at www.cobank.com.

bank's risk-bearing capacity, while our strong reserve for credit exposure continues to protect the bank's capital base, including the equity held by our customer-owners."

Capital levels at the bank remain strong and well in excess of regulatory minimums. As of March 31, 2011, shareholders' equity totaled $4.5 billion, and the bank's permanent capital ratio was 12.88 percent, compared with the 7.00 percent minimum established by the Farm Credit Administration (FCA), the bank's regulator.

At quarter end, CoBank held approximately $15.0 billion in cash and investments. The bank averaged 180 days of liquidity during the first three months of the year, compared with the 90-day regulatory minimum set by the FCA. No investment impairment losses were recorded in the first quarter, compared with a $3.0 million impairment loss in the first quarter of 2010.

"Credit risk in our investment portfolio remains limited, since approximately 97 percent of our investment securities carry an implied or explicit guarantee from the U.S. government," Burlage said.