Harvard Generations Policy Journal

THE AGE *EXPLOSION*: BABY BOOMERS AND BEYOND

Preface by Derek Bok
President Harvard University

Paul Hodge, Founding Editor
Chair, Global Generations Policy Institute
Director, Harvard Generations Policy Program

Cambridge, Massachusetts

A joint publication of the Global Generations Policy Institute and the Harvard Generations Policy Program

The Age Explosion: Bay Boomers and Beyond is an update of the 2004 original publication and is published by the Baby Boomer Media Group LLC. All inquiries should be directed to the Global Generations Policy Institute, 124 Mount Auburn Street, Suite 200N, Cambridge, MA 02138, tel: 617-491-1171, fax: 617-547-1431, e-mail: *genpolicy@genpolicy.com*, website: *www.genpolicy.com*.

ISBN 0-9778688-1-8

The Age Explosion: Baby Boomers and Beyond is a *pro bono* public service publication whose mission is to develop and implement creative, intergenerational national policies that will prepare the country for the aging of its baby boomers.

Eldercare: The Challenge of the Twenty-First Century

Richard Thomas
Contributing Editor and Chief Economic Correspondent
Newsweek *Magazine*

Two hunters are dragging their dead buck downhill. One finally observes, "Downhill is getting us farther away from the truck." "Keep going," responds the other, "it's easier this way."

Like those hunters, almost everyone discussing the Social Security problem these days is dragging the problem downhill in exactly the wrong direction. We do have a serious, fundamental problem, and it is not Social Security alone. The problem involves the combination of all three programs for the elderly: Social Security, Medicare, and Medicaid.

Medicaid may not readily come to mind as part of elder care. But two-thirds of Medicaid dollars provide nursing home care for the aged poor or for those who became poor after using up their own funds. And the remaining third approximates expenditures on other federal programs that provide help for the elderly—particularly Supplemental Security Income, which is old age welfare and runs about $36 billion dollars this year.[1] So Medicaid, in fact and proxy, is an elderly program.

Combined, Medicare, Medicaid, and Social Security will double their relative burden on working-aged Americans over the next 30 years.

Combined, Medicare, Medicaid, and Social Security will double their relative burden on working-aged Americans over the next 30 years. A reform in these benefits should have been made yesterday. Certainly, it needs to be made today. The longer we delay, the larger the change that must be made and the greater the shock to everyone. For example, an increase in the retirement age or reduction in benefits to wealthy retirees probably could not be made effective before the year 2015, even if enacted right now. Existing retirees or people within ten or even 15 years of retirement have built all of their plans on existing benefits. They have no time to adapt their savings habits to reduced government promises.

Why, then, isn't the problem being addressed? Unfortunately, ideologues, public policy wonks, and politicians of every stripe have devised magnificent stratagems of avoidance and denial. Most liberals and elected Democrats, for instance, artfully focus their analysis on Social Security alone. Medicare and Medicaid together, however, are already three-quarters the size of Social Security and their collective costs are rising much faster than those for Social Security. But by ignoring them, supporters of the status quo regularly produce studies showing that the increased burden of Social Security alone will require only about a ten or 15 percent increase in Social Security taxes. They conclude that such a modest increase is doable, so what is the issue?

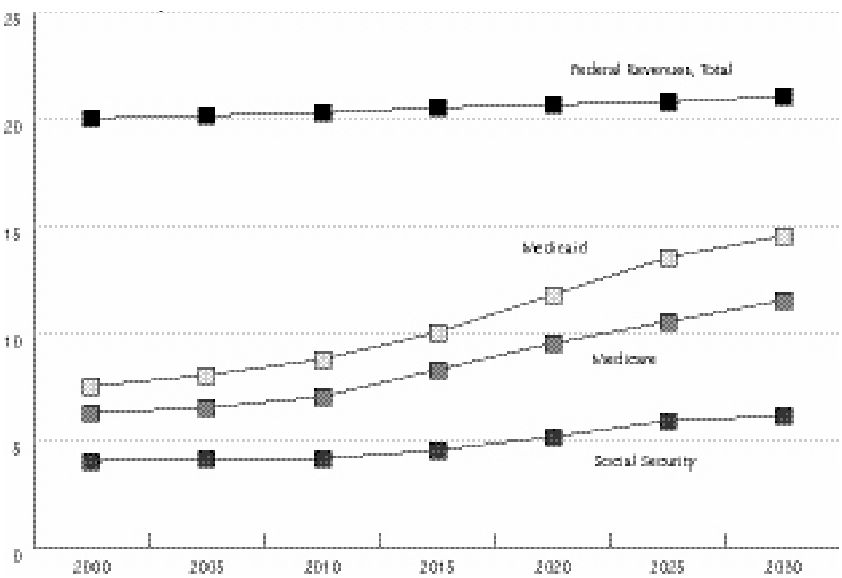
Conservatives and Republicans also focus solely on Social Security, ignoring Medicare and Medicaid. They say, as President Bush has proposed, that we can fix Social Security by diverting a portion of the Social Security tax paid by younger workers into private, individually owned pension programs.[2] Once there, the investments in Wall Street securities should yield vastly larger rates of return than the funds that are supposedly invested in Social Security. Consequently, conservatives suggest, the need for either benefit reductions or future tax increases is also eliminated.

A second mechanism of denial is provided by the Social Security and Medicare trust funds. Statisticians—and politicians—often insist that these trust funds, now in surplus, indicate that there is ample money. But as I will explain later, the trust funds are a cruel smoke screen, an accounting gimmick that hides a wildly over-promised and under-funded reality.

Right now Washington is wallowing in these dodges. Both political parties in Congress, far from contemplating benefit reductions or tax increases, are planning to add a free drug benefit to Medicare this year or next. Congress is now only quibbling about the details. Increased survivor benefits for widows are also possible. Whatever their merits in human terms, these proposals obviously add hundreds of billions of dollars to the long-term financial burden that is being placed upon working Americans. It will cost more than $1.2 trillion over the next 30 years.

It is easiest to understand the problem in terms of percentages, the relative burden that the elderly programs place on the entire economy and on the federal budget. Figure 1 shows the present and future share of total US output received by the federal government under present tax laws. (See top line.) After a dip to 20 percent caused by George W. Bush's tax cuts of 2001, revenues rise back to roughly 21 percent of gross domestic product (GDP). Revenues, in other words, are roughly a steady state. But the chart simultaneously shows a doubling of the GDP share that will be taken by Social Security, Medicare, and Medicaid from 2001 to 2030. Notice that Medicare and Medicaid are the real culprits in doubling the oldster's bite; they rise by two-and-a-half fold as a share of US production versus only a 33 percent increase in Social Security. If Congress adds drug benefits for Medicare recipients, the share grabbed by the elderly will climb even higher.

Figure1: Federal Taxes Stable, But Elderly Programs Double Their



Source: Congregational Budget Office (October 2000 estimates).

Look at the chart again. Absent any increase in taxes—and not counting the additional drug benefit—all non-elderly programs, which now receive two-thirds of all federal revenues, would have to shrink to just 30 percent of the total US budget to accommodate the projected rise in the oldsters' programs. These programs include such essentials as defense, interest on the national debt, law enforcement, education, national parks, agriculture subsidies, aid to families with dependent children—everything. Alternatively, all federal taxes would have to be increased by about 50 percent to maintain non-elderly programs at existing levels and still fund projected increases for the elderly. If the Social Security/Medicare tax alone were used to raise the extra revenue, it would have to double from its present 15.3 percent of wages to about 30 percent.

All federal taxes would have to be increased by about 50 percent to maintain non-elderly programs at existing levels and still fund projected increases for the elderly.

Clearly, halving non-elderly government operations or raising taxes by one-half represents a hard-to-imagine shift in government resources and in the nation's politics. The implosion of non-elderly federal operations would be socially and politically traumatic. The tax solution, on the other hand, would raise the burden of government to the level of Great Britain's—yet without covering health care costs for children and working-aged adults, as Great Britain's tax does through its National Health Service.

Simple demographics drive these projections. US fertility rates are relentlessly declining and, after 2020, birth rates drop below replacement levels.[3] This follows a path already traveled by most other industrial countries. The decline in domestic birth rates will be partly offset by increases in immigration. Projections provide for 600,000 legal and 330,000 illegal immigrants annually.[4] Still, even if immigration were to double this projected inflow, the additional taxes these mostly younger workers would pay would reduce the burden of retiree benefits by less than 25 percent. So increased immigration would help, but it is not a solution.

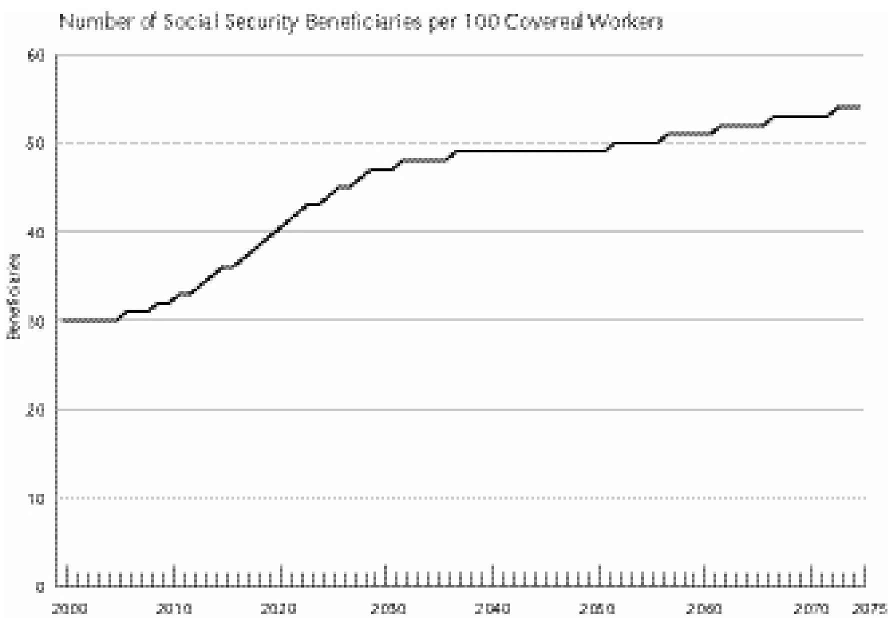
On the elderly benefits side, spending begins to explode when the baby boom generation starts retiring after 2008, when those born in 1946 reach

62. Yes, the official age for full retirement in this country is 65, but almost two-thirds of Americans actually retire sometime around 62 or 63.

Americans are also living longer, particularly men, and once retired, they are drawing benefits for ever longer periods. Life expectancy at birth in 1940, the first year Social Security benefits were paid, was 63.5 years in contrast to the retirement age of 65. Life expectancies have advanced to an average of 76:73.7 for males and 79.4 for females. Furthermore, life expectancies of those who do reach 65 have doubled—a male now enjoys 15.7 years of retirement before he dies, versus eight years when Social Security was founded.[5]

By the year 2030, the length of male retirement creeps up two years to 17.7.[6] For women, there is also an increase, but not of such magnitude. All this is good news for those looking toward and already in retirement. Yet it is certainly bad news for the financial burdens carried by the shrinking numbers of those who actually will be going to work and paying the bills. Look at Figure 2.

Retirees today represent 30 percent of the number of tax-paying workers. In other words, there are presently 3.3 workers for every retiree. That ratio is going to shrink inexorably so that by the year 2030, there will be just 2.1 workers per retiree. The relative burden on workers in the economy, in other words, is going to rise by 50 percent.[7]



Source: Congressional Budget Office (October 2000 estimates).

Other mature democracies, from Japan through Europe, face the same kinds of problems or even worse ones. Britain and Australia are the exceptions since they have already reduced promised benefits and partly privatized their programs. The others have failed to address the coming crunch. For example, the Europe-wide ratio of workers per retiree collapses to 1.7 by 2030 and continues to deteriorate after that.[8]

> ***We are creating . . . an upside-down social democracy where younger and sometimes poorer taxpayers are increasingly subsidizing older and often richer retirees.***

An increasing perversion of social democracy is hidden under all these numbers as well. In 1935, when Social Security was launched in America, 90 percent of the elderly were poor. Today, retirees enjoy per capita incomes that almost match the average of all working-aged Americans.[9] Today, only one in ten Americans above age 65 lives below the poverty line.[10] By contrast, families containing one in five dependent children are impoverished.[11] We are creating, in other words, an upside-down social democracy where younger and sometimes poorer taxpayers are increasingly subsidizing older and often richer retirees. Government is slowly adopting a reverse Robin Hood role, if you will.

Whenever conservatives or Republicans raise these issues, Democrats attack them as economic fascists trying to strip grandma and grandpa of their dignity and security. In response, conservatives have developed the "nose of a camel" approach. Politically timid, they have proposed privatizing a portion of Social Security. This at least starts a dialogue on elderly issues and it also helps win votes among the young. The privatization proposal, as it happens, is extremely popular with all Americans under 49. The younger they are, the more popular it is. The polls even show that a majority of retired Americans now favor some privatization of Social Security reform—as long as their own benefits remain sacrosanct.[12]

This brings us to the great question of the trust funds. Politicians and commentators wanting to avoid the retirement issue—and others who are simply confused—point out that Social Security and Medicare are funded by taxes that are paid into trust funds in the US Treasury. They argue that these funds are in fine shape, with $1.5 trillion in surplus.[13] In fact, the surpluses are projected to more than double between now and about 2020. So what's the problem?

The problem is that the trust funds are accounting gimmicks and the line of reasoning based on them is essentially a lie. Taxes for Social Security never, until fairly recently, covered true retirement liabilities. When the program started paying benefits in 1940, there were 16 workers per retiree and a tax level of just 2 percent covered all current payments.[14] Over the years, politicians merely advanced the tax rate to its present 15.3 percent to cover benefit payments for both Social Security and Medicare to increasing numbers of retirees. This was basically a pay-as-you-go program.

Since the early nineties, taxes collected have slightly exceeded yearly benefits and a "surplus" has built up in the funds that have been "invested" solely in US Treasuries. But these surplus tax collections have actually been— and are still being—spent year-in-year-out by the government for all of its other operations, from defense through welfare. The so-called "US Treasuries" in the trust funds therefore are simply an accounting entry. They represent a political promise by today's politicians that future politicians are going to raise taxes to pay benefits when the funds in the accounting fiction trust funds are needed. In more personal terms, this is like a parent giving his children an IOU promising them that *their* own children, as yet unborn, will raise taxes on themselves to pay benefits to them when the IOU finally falls due. Some trust funds!

The truth is that one single federal government stands behind everything that the federal government does. It collects a number of taxes—personal and business income taxes, excise taxes, import duties, user fees, and social security taxes. It funnels these into a single agency, the US Treasury, which then pays all the bills. Social Security and Medical trust funds are just one set of payment-making accounts at the Treasury, like those of the Justice Department, the National Park Service, the federal highway tax trust fund, and many others. When these combined accounts of government are pushed into persistent deficit by the rising costs of Social Security, Medicare, and Medicaid, the taxes that supply the funding, whether they be payroll taxes, income taxes, or corporation taxes, will need to be raised.

Alternatively, the government can sell real US Treasury securities to private investors to raise funds to pay that year's costs. But this money comes out of private pockets too, just like taxes. It reduces the consumption or the private investments of taxpaying working people and businesses as surely as do taxes. Moreover, the willingness of the public to buy those US Treasuries in the year they are issued, of course, depends on the public's faith that the government will raise future taxes to pay off the new debt being issued. In other words, no matter how much money is listed in the old-age trust accounts now, the benefits to the elderly, just like other government payments, must always come out of the taxes paid or new bonds bought by working Americans and businesses in the year the payments and benefits are delivered.

As the percentage of total output dedicated to the idle elderly rises, the share remaining for workers must shrink.

This is why the gathering crisis is one that no amount of financial legerdemain can avert. As the percentage of total output dedicated to the idle elderly rises, the share remaining for workers must shrink. Taxes on working Americans must rise to meet this shift in resources and growth in their living standards must slow proportionately. Either that, or the government has to cut all of its other programs by half. Since either route is politically painful, a combination of some tax increases and some cuts in non-elderly spending would be more likely.

Another alternative, of course, is that the government reduce the benefits that are promised to the elderly. Why should the full retirement age of 65, which was set in 1935, when life expectancies at birth were 63 years, be raised only to 67 years old in 2030? By then, life expectancies will have risen to 79.6 years.[15] That represents a life expectancy advance of 16 years, versus a retirement age extension of only two. Then there are the wealthy. Why should a wrinkled, rich 72-year-old like myself with a Social Security-supplemented income above $100,000, be given free new drug benefits and continue to enjoy nearly free and massive medical benefits at the expense of working families whose median incomes are only $49,000?

For ten or 15 years, the financial time bomb created by elderly programs has been ticking ever more loudly. Yet we not only fail to defuse it, we hardly even talk about it. Who's to blame? We are all to blame—but particularly the opinion arbiters of the East and West Coasts. We are the deniers. We set the national agenda, echoed and magnified in *The New York Times*, and in the pages and over the airwaves of other national media. To date, we have branded anyone raising this issue as a selfish hard-heart or some kind of right-wing scrooge. We refuse to tolerate serious debate.

The noble social democratic programs for the elderly, begun in the thirties, when lives were generally poor and short, must be disciplined by the reality of lives that are now generally prosperous and long. Otherwise, government programs must be slashed in unthinkable ways—or our children and grandchildren must be stuck with impossible increases in their taxes.

NOTES

1 Appendix, *Budget of the US Government, Fiscal 2004* (Washington, DC: Government Printing Office, 2003), 995.

2 Former President Bill Clinton, incidentally, in a December 2002 speech in New York, endorsed this idea.

3 Board of Trustees of Federal Old Age Survivors and Disability Trust Funds, *2003 Annual Report* (Washington, DC: 2003), 76.

4 *Ibid.*, 79.

5 *Ibid.*, 85.

6 *Ibid.*

7 *Ibid.*, 51.

8 Organization for Economic Cooperation and Development, Paris, France.

9 Bureau of Census, Commerce Department, US Government, *Detailed Household Income Series* (March, 2001), P60 package.

10 Bureau of Census, *op. cit.*, Poverty Data, package P60–219.

11 *Ibid.*

12 Cato Institute/Zogby International Poll (Washington, DC: July 7, 2002).

13 Board of Trustees, FOASDTF, *2003 Annual Report*, 184.

14 *Ibid.* One percent each from employee and employer, 130.

15 *Ibid.*, 85.