Testimony before the
Committee on Ways and Means
United States House of Representatives

"Retirement Policy Challenges and Opportunities of our Aging Society"

May 19, 2005

A Statement by

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Thank you, Mr. Chairman. It is an honor to have the opportunity to testify before the Ways and Means Committee today.

The aging of America promises to usher in one of the most fundamental social transformations that our nation has ever experienced. Over the next few decades, it will restructure the economy, reshape the family, and redefine our cultural self-image. Perhaps most fatefully, it will push a growing share of the nation's resources towards an ever-larger elderly population whose "entitlement" to public benefits has come to rest on age alone.

In the days of Thomas Jefferson or Abraham Lincoln, your odds of a random encounter with an elderly American were about one in forty. Today, they are about one in seven. A generation from now, they will be between one in four and one in five.

Longer life spans are a great personal boon, but they also pose a great collective challenge. Graying means paying—more for pensions, more for health care, more for social services for the elderly. According to the Congressional Budget Office, federal spending on the three major senior entitlements—Social Security, Medicare, and Medicaid, a large and rising share of which pays for long-term care for the elderly—is due to grow from 8 percent of the economy today to 18 percent by 2050. To put that number in perspective, just the projected increase in spending—10 percent of GDP—is two and one-half times everything the United States now spends on national defense, even after the post 9-11 build up.

The growth in senior entitlements should obviously be of concern to conservatives, since it is inconsistent with the goal of limited government. But it should also be of concern to liberals, whose vision of progressive government is being increasingly crowded out by retirement and health-care spending on the middle- and upper-income elderly. By 2050, according to the CBO's long-term budget projections, spending on Social Security, Medicare, and Medicaid is on track to consume three-quarters of all noninterest outlays.

In the end, an aging America will have no choice but to rethink its whole system of senior entitlements. The goal must be to fashion a new system that is capable of ensuring a decent standard of living for the old without imposing a crushing burden on the young. In my view, a fair and sustainable solution to the aging challenge will need to reflect three fundamental realities.

The first reality is the ongoing growth in life expectancy. Since Social Security was established, life expectancy at age sixty-five has risen by five years, or by roughly one month per year. Few demographers believe that the pace of improvement will slow—and a growing number expect that it will accelerate as breakthroughs in biomedicine begin to unlock the secrets of the aging process itself. Yet far from rising to reflect the new demographic circumstances, average retirement ages have fallen over the course of the postwar era. In the future, America will need to split its longevity dividend between extra years of work and extra years of leisure. Encouraging later retirement and longer worklives could achieve large fiscal savings without hurting the living standards of the elderly. It would also have enormous benefits for the economy, and, many gerontologists believe, for the elderly themselves.

The second reality is the transformation in the economic status of the elderly. Until the early 1970s, it was possible to argue that age was a reasonable proxy for financial need. This argument is no longer plausible. Over the past three decades, the real median income of households headed by adults aged 65 and over has risen by nearly one-half, while that of households headed by adults under age 45 has remained virtually stationary. Today, elderly household income per capita is about on par with the national average—and that's before taxes, where the elderly enjoy considerable advantages. Counting in-kind benefits like Medicare, the elderly poverty rate is now as low as the rate for any age group and is just one-half the rate for children. Yet most senior benefits are disbursed through programs that write checks regardless of financial need. An aging America will have to reconsider the equity and affordability of making age alone a blanket criterion for access to a public subsidy.

The third reality is the declining viability of pay-as-you-go social insurance. The pay-as-you-go paradigm made sense back in the 1950s or 1960s, when workers outnumbered retirees five or six to one. With the end of the baby boom, however, the demographic underpinnings of the paradigm collapsed. In the future, workers will have to prefund more of their own retirement income through greater savings during the employment years. Over the long run, funded systems have decisive advantages over pay-as-you-go systems in aging societies like our own. At the macro level, they can help shield government budgets from demographic pressures while maintaining adequate rates of savings and investment. At the micro level, they can offer workers higher benefits at any given contribution rate than pay-as-you-go systems can. This is why, from Germany to Australia, countries around the world are moving in the direction of greater reliance on funded retirement savings. Even Sweden, Europe's quintessential welfare state, has added a mandatory second tier of funded personal accounts to its public pension system.

At the CSIS Global Aging Initiative, we have looked closely at the "vulnerability" of the major developed countries to rising old-age dependency costs. As it turns out, the United States enjoys a number of enviable advantages. To begin with, we are now the youngest of the developed countries—and, thanks to our relatively high rates of fertility and net immigration, we are likely to remain the youngest for the foreseeable future. The UN projects that the elderly share of the U.S. population will reach 21 percent by 2050, up from 12 percent today. Meanwhile, the elderly share of the population will climb to 28 percent in Germany and to 36 percent in Italy and Japan. Although the United States will have to cope with a dramatic slowdown in workforce growth when boomers retire, Europe and Japan are heading toward a future of workforce and population decline. By the middle of the century, according to the UN, there will be 19 percent fewer working-age Germans than there are today, 32 percent fewer working-age Italians, and 33 percent fewer working-age Japanese. The Japanese government actually projects the date there will be only one Japanese left.

Along with more favorable demographics, the United States also has a relatively inexpensive Social Security system. Incredibly, several European countries already spend more today on public pension benefits for the elderly than we will be spending after the last of the boomers have retired. Thanks to a strong work ethic, flexible labor markets, and model age discrimination laws, the United States also has a relatively high elderly labor-force participation rate. As of 2000, 18 percent of Americans aged 65 and over were still on the job, compared with 6 percent of Italians, 5 percent of Germans, and 2 percent of Frenchman.

Finally, there is our large and innovative private pension system. Outside the United States and the other English-speaking countries, the dependence of the elderly on public benefits is close to absolute. The typical French, German, or Italian retiree receives between 75 and 85 percent of his or her income in the form of a government check, compared with about 50 percent for the typical American. In the United States, private pensions, along with higher elderly employment, help take pressure off government budgets. According to Intersec, a standard source for international pension data, U.S. pension funds own roughly 60 percent of global pension assets. France, Germany, and Italy combined own just 2 percent.

None of this means that the United States can afford to be complacent. Although we spend less per capita on public pensions for the elderly than most other developed countries, we spend more on health care. Despite the size of the U.S. private pension system, nearly half the private workforce remains entirely uncovered, even by a meager 401(k) that can be cashed out long before retirement. Reform must also reckon with a powerful senior lobby—and an entitlement ethos that considers public benefits earned rights, tantamount to personal property.

Mr. Chairman, America stands on the threshold of a great demographic transformation without precedent in its history. I have focused on the fiscal dimensions of the challenge. The implications of the aging of America, however, reach far beyond the impact on public budgets. America's businesses will have to cope with a deficit of entry-level workers, while its families will have to cope with a surplus of frail elders. Slower growth in the workforce may translate into slower growth in the economy. Even the nation's ability to maintain its security commitments could be affected as armed forces experience chronic manpower shortages and defense budgets come under relentless pressure from rising retirement costs.

Confronting the aging challenge will require today's adults to make difficult trade-offs between their own future retirement consumption and their children's living standards. These trade-offs are not easy to make in a democracy that has difficulty focusing on slow-motion crises. But make them we must. At stake is whether America will be able to meet the needs of a growing number of old while still making room for the hopes and aspirations of youth.

Mr. Chairman, that concludes my testimony. Thank you again for the opportunity to share my views on this vitally important issue with you and the Committee's members.