

ROAD TRIP: WHERE WILL THE JOURNEY TAKE YOU?

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I would like to share a story about a farmer, his dried-up well, and his donkey with you.

One day while inspecting the dried-up well, the farmer's donkey fell in!

The farmer panicked. He did not know what to do. Eventually he decided it was time to fill-in the well. After all, the well was dry and the donkey was old. Besides, his wife had been nagging him to fill-in the well.

So he called upon the other farmer's near-by to help him to fill in the well.

As they began to shovel the dirt into the well, the donkey made a terrible fuss – braying and screaming, it was loud and awful.

This prompted the farmers to shovel even faster.

To the relief of everyone, the awful sounds finally stopped.

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The Donkey, so it seems, had figured out what was going on.

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As the dirt landed on him, he shook it off, and took a few steps and trounce down on the dirt.

In so doing, he was able to remain on top of the growing pile of dirt.

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You should have seen the look on those farmers' faces when the donkey was able to just step up and out of the well.

The Donkey fell in, the farmer saw no hope, and he wanted to fill the well anyway.

He seized the opportunity to make a bad situation better; of course, *what he failed to anticipate was the ability of the donkey to adapt to his circumstances.*

I thought of this story when I heard the theme of your conference:

Road Trip! Where Will the Journey Take You?

Different goals, different expectations, and different choices, lend themselves to different experiences.

Along the way, there are signs providing guidance and billboards of information as well as persuasion. There will also be plenty of places in which decisions will

be necessary; decisions that might not be made with confidence. Many of the bill-boards register concern: clearly the doubling of the population age 65 and older within the next 25 years will lead to tremendous demands on resources. Some of those demands will be deemed “market opportunities,” while others will be considered market failures. Increases in the demand for publicly financed or publicly provided services raise concerns about the fiscal integrity of governments.

The signs are everywhere and the messages are virtually self-evident.

Everyone knows the baby-boom is large and getting older. Moreover, in 4 ½ years they will be eligible for Social Security benefits, followed, soon thereafter by Medicare and Medicaid benefits. Everyone knows that the Social Security and Medicare Trust funds are perilously close to insolvency. Social Security taxes fall short of expected benefits in 2018 and by 2042 the trust fund that filled in the shortfall will be exhausted. The Medicare Part A trust fund will fall short even sooner, by 2012, with exhaustion by 2019.

People are concerned. They worry about the financial debt that will be left to their children and grandchildren. They want to do the right thing. But do not know what that is.

Pollsters have been asking the public their opinion on these programs for almost as long as there have been beneficiaries, and consistently the general consensus is: people are concerned that benefits will be cut in the future; they would like to see benefits increase; and they would be willing to pay more in taxes to ensure that benefits are not cut.

In their gut, they know Social Security and Medicare is a good thing – not just for their family but also for the nation. These views tend to be held strongest by adult children. They can make the connection between these programs and the financial independence of their parents – they know that without these programs their in-laws might have to move in with them.

When I look at focus groups and these polls I can almost hear the desire from people: They want someone with authority to stand up and “say it ain’t so.”

Some people, however, have a different vision of the moral and legal obligations that underscore the existing structures of social insurance and social welfare. For them, the fiscal anxiety inherent in the retirement of the baby-boom provides an opportunity to change the underlying fundamentals of these arrangements.

One such mechanism was included in Title VIII of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. This is the cost containment section. The Trustees of Social Security and Medicare are now obligated to report a new measure, and declare a Medicare funding WARNING whenever general tax revenues are anticipated to reach 45 percent of total Medicare spending within the next 7 years. As you may know most of Medicare is financed through the trust funds, which are treated differently than general revenues, but general revenues are used to fund 3/4’s of Part B and most of Part D of Medicare. Medicare Part B is primarily physician coverage and Part D is the new prescription drug coverage.

This is not a test of fiscal solvency – it is a decision that we as a society are not willing to spend general revenues on Parts B and D in excess of 45 percent of Medicare expenditures for Parts A, B, C, and D.

Upon the second year in which the Medicare warning is issued, the President and the Congress are obligated by the new law to propose the changes necessary to reduce this percentage. This will mean either cutting the portion funded by general revenues or decreasing overall Medicare spending or some combination of both. The law suspends the normal legislative process concerning hearings, the allotted time for floor debate, and the voting rules. It was designed to facilitate a sense of crisis to enable making politically difficult choices.

This provision has received virtually no attention.

And here they come:

It is hard to imagine, but, little babies, like this

Could grow up to become the model for this caricature of the baby-boom.

In that process, however, babies born during the baby-boom, grew up, and guess what – many of them had babies.

While baby-boomer mothers did not have as many babies as did their own mothers, there were a lot more baby-boomer mothers, than mothers of baby-boomers. As a consequence, nearly as many babies were born in the past two-decades as during the baby-boom. Babies grew up and had babies, who in turn, someday will have babies. Imagine that. Everyone should know this.

This is why school enrollments are so high and add-on classroom trailers have become quite common. But low and behold, many school classrooms are not as crowded as they once were, because we are desperately trying to finance a larger education system with smaller classes! Something we did not do for baby-boomers born in the mid-to-late 1950s. They had more classmates per class.

This does, however, raise a question – just how many baby-boomers are there? Yes, I too have heard that there are some 75 million of them. But what if there had not been a boom in fertility rates between 1946 and 1964? Surely there would have been babies born. But, how many would be marching toward retirement between 2011 and 2030?

By my calculations there would have been about 64 million babies born – or 12 million fewer babies!

The world is much older now. That is, there are more older people as a percentage of the population, both domestically and globally. About 12 percent of us are age 65 or older; by 2050, perhaps 20 percent of us will be age 65 or older – an 8 percentage point increase. We have already experienced “population aging” in the past, increasing 8 percentage points since 1910.

Population aging, however, has not diminished our economic capacity.

Despite the doubling of the population age 65 and older since 1962 or the quadrupling since 1938, standards of living have increased. Real GDP per person has increased by more, than the increases in the older population.

Over the past three decades, Social Security and Medicare beneficiaries nearly doubled and the expenditures for Medicare and Social Security, as a proportion of GDP increased by a similar but smaller percent. (81 and 78 percent, respectively)

While beneficiaries and expenditures increased, the federal budget, as a percent of GDP, declined.

Most of the rhetoric is about federal expenditures, but it has been state and local government expenditures that have been increasing as a percentage of national income. And, more importantly, Gross Domestic Product, or national income, increased an average of 3.2 percent per year, after removing the effects of inflation.

It's worth dwelling on this point.

Over the past 30 years, the Medicare Hospital Insurance Trust fund was projected to be insolvent, within a couple of years; at least 9 different times. Social Security was within several months of insolvency; at least twice. Difficult choices were made, albeit usually at the very last minute. Yet the economy grew and federal government spending as a proportion of our nation's income declined.

The Fiscal challenge at the federal level arising from population aging was met.

In fact, the changes in Social Security that were enacted in 1983 contributed to the budget surpluses that emerged at the end of the Clinton Administration.

The real challenge of an aging society has relatively little to do with Social Security and Medicare.

I want to focus on three particular sets of challenges.

The first challenge I want to talk about is the hardest to effectively define and implement. It is the challenge of organizing communities. Resources are necessary, but resources are not sufficient. It takes more than that.

While population aging is gradual nationwide – it is not so gradual within communities. Some communities will be getting older faster than others and some communities will be getting relatively younger.

Ultimately, vibrant communities need to be places where people want to move into. It is a place where people feel safe, want to raise their families and then remain a part of the community. Otherwise, you will have a community of people who could not afford to leave. A community of people who want to leave but cannot afford to leave reflects a community with a poorer tax base but with greater social and medical needs. This leads to a community filled with social isolation and economic decline.

Regionalization and intergovernmental funding can help stem an outbound tide, but this is a real challenge for those in communities that are not able to meet the

educational needs demand by employers and the social service and health care needs of its citizenry.

Communities are in many ways like families. There is a common bond and structure that enables a dynamic that varies along a continuum of cooperation, between public institutions and private enterprise and the citizenry. A key ingredient may be community-based organizations.

Community-based organizations often derive a fair share of their revenues from the provision of social services – there has been an emerging trend in some states to by-pass these organizations and hire firms to provide specific social services.

These contracting arrangements are made based on claims of cost effectiveness; but it seems that this is a deliberate effort to undermine the political voice of these community-based organizations. I hope I am wrong about this since cooperation among community-based organizations can be a tremendous force for transforming a transitioning community.

Longer life imposes a substantial challenge: in particular, being able to finance the additional years, and, being able to effectively insure against the additional financial risks such as needing long-term care.

While more people survive into old age, more people face the risk of outliving their savings.

Saving “enough” begins with saving early and saving often. But even if you save “enough” -- stuff happens! And what was enough is no longer enough!

Social Security and Medicare have been quite effective at pooling many of the risks of longevity and therefore are true anti-poverty programs. Their existence has enabled a generation of older persons to remain financially independent.

Soon we will witness the retirement of a generation that has increasingly had to take more responsibility in saving for their retirement. Those whose working years were primarily before 1980 were able to define retirement one way; and those whose working years were after 1980 will define retirement differently. In large part because of the changes that occurred in employee benefits. Starting in the late 1970s, but accelerating after the 1981 recession, first dollar health insurance coverage was on its way out; managed care was beginning to take a toe-hold; employers were revamping and starting to end post-retirement medical benefit promises for new hires; and defined benefit pension plans were increasingly being supplemented and then replaced with defined contribution savings plans.

It took a long time to recognize, let alone institutionalize, the importance of helping people navigate the accumulation phase of retirement planning. Now we need to get people to recognize the importance of the de-accumulation phase of retirement. Spending too much too soon could be hazardous to your health and financial well-being.

Of course, this is compounded by the fact that not everyone has saved enough!

There are also critical risks that are not pooled. While the recent Medicare legislation *will* make a substantial impact on drug coverage – keep in mind that the benefit structure is a political compromise between trying to gain the biggest political bang while trying to protect those at greatest risk. The fact that the negotiations began with a goal of covering about ¼ of expected drug costs, means you can either provide generous coverage for a subset of beneficiaries or limited coverage for all beneficiaries. The more you stretch the benefit design to include everyone – the less you have to differentiate coverage by need. Many people will have substantial gaps in coverage, year after year.

In-addition to gaps in prescription drug coverage, long-term care remains the elephant in the room that no one seems to notice. While health care coverage has rightly been a part of the presidential campaign – where is the debate about treating chronic and disabling conditions, providing supportive services, and helping families provide the long-term care that their spouse, parent, or child needs?

In addition to the question of financing – there is an even more pressing set of issues: how are we going to organize and deliver the care, both by family and professionals, when fertility rates have been as low as they have for as long as they have?

In addition to a spouse, older people who currently need long-term care are more likely to have 2-4 adult children. Older persons, who may need long-term care in 2040, are more likely to have 1-2 adult children. All one needs is one child, but the decline in fertility rates also reflects an increase in the proportion of women who never had any children. Having 1 or 2 children available for assistance is likely to be a very different dynamic than having 3 or 4.

After 2015, the rate of growth in the labor force and the rate of growth in potential adult caregivers will be dramatically less than the rate of growth in the population, of all ages, who need long-term care.

The third challenge concerns recognizing the fundamental importance of life long education, training, as well as public investments in basic knowledge, and the supportive infrastructure. The reason standards of living have more than doubled in every generation is because each generation of workers has been more productive than the previous generation. Each generation of workers has been more productive primarily because of publicly encouraged advances in science and technology and the improvements in sharing information and transportation. Investments in physical and human capital are necessary to ensure that tomorrow's workers can produce even more; using fewer resources.

Some of the investments in physical capital could be done now. Every bridge, tunnel, or cable that is replaced today, delays the time in the future in which it will need to be replaced. Investing in these structures now – enables future generations to devote their accumulated wealth on other priorities. This might have been a wiser investment than doling out anticipated budget surpluses in relatively small reductions in individual taxes.

In no way do I believe we can avoid difficult choices: we can't grow our way out, but economic growth makes these choices more palatable. Keep in mind, as the

age distribution of a growing population shifts, there will be a relative decline in the resources needed to finance education, public health, criminal justice and social services for children. More attention and resources will be available for each child. And each worker will be facing an even larger market in which to produce goods and services.

As a result, after 2015 workers with skills valued by the market are likely to earn substantially more than workers in similar positions today. Their higher incomes, along with the greater wealth of the nation will still be subject to different perspectives about how best to use this additional wealth.

It probably will still be easier to call for a tax cut before calling for a tax increase. And it will still be easier to increase government spending before cutting government spending.

As we have learned from looking to the past, while population aging matters, other factors also matter. There is no doubt that federal expenditures for Medicare and Social Security will increase, but the significance of this increase, depends on economic growth. Meager economic growth will result in difficult choices about the role of government.

The Congressional Budget Office and the Social Security Trustees use very conservative assumptions for economic growth – assumptions that in my opinion make sense for policy discussions, but are substantially less than the rate of growth anticipated by most private institutions. If economic growth is even more anemic – growing 1 percentage point less than CBO's assumed rate of growth – then government spending could increase from about 33 percent of national income to nearly 70 percent of national income! Otherwise, we could see the size of government increase to about 43 percent of GDP. But, if economic growth is just 1 percentage point above CBO's assumed rate of growth – the relative size of government could actually be less than it is today! This is not a terribly optimistic assumption – if the economy grows in real terms about 2 percent per year we will be in 2050 exactly where we are today! By comparison – over the past 50 years, real economic growth has exceeded 3 percent per year.

In fact, even the Social Security trustees, anticipate that future generations of workers will be able to afford to fully cover the anticipated shortfalls in Social Security and Medicare. Given the dearth in workers relative to the growing numbers of consumers, the market value of workers should increase. This slide shows the anticipated median wage for workers by the Trustees of the Social Security and Medicare Trust Funds. We have purposely overstated the payroll taxes by assuming that future workers would pay the entire shortfall in Social Security and Medicare. Under this assumption, median wage workers will still have earnings. Even though the gap between gross and net wages increases, median wage workers in 2050 should be able to afford the additional taxes assumed necessary to close the funding shortages anticipated in Social Security and Medicare.

Public policies that encourage and support lifelong learning, encourage research in basic and applied sciences, and eliminate arbitrary barriers in the flow of human and financial capital, may yield new technologies that open up new

markets, improve efficiency and improve productivity. Public policies that provide the physical, financial and educational infrastructure to support and encourage economic growth will increase standards of living and make any decisions about the need to raise taxes or cut benefits, less difficult.

Retirement is our gift of rising national wealth and longevity.

It is up to all of us to define its purpose and it's meaning.

As we journey forward, the hard part is figuring out how to integrate and balance family and community.

I wish you all well as we travel down this road together. But remember, when a shovel-full of dirt lands on you, just shake it off, and take a few extra steps.

May we all be able to adapt and grow! Thank you for inviting me here and the privilege of sharing this time together. I hope you have a great conference.