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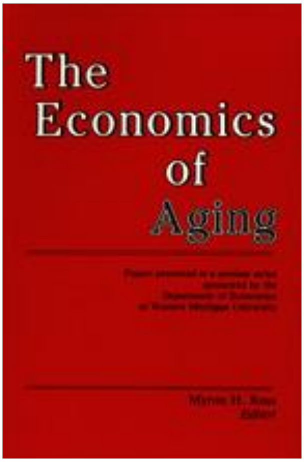

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The Economics of Aging*

Doomsday or Shangrila?

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The well-known social commentator Gunnar Myrdal (1963), writing in the early Sixties, had this to say about the elderly in America:

> The treatment of old people in America, many of whom have a hard life behind them, is remarkable. . . [This is illustrated by] the terrifying extent to which old people are left in poverty and destitution. . . . It cannot possibly be the considered opinion of the majority of Americans that so many of those who in America are often called "senior citizens" should be left in misery, squalor, and often forbidding loneliness, unattended though they are in need of care. The situation is overripe for a radical reform of the old age security system.

Contrast Myrdal's comment with a recent story that appeared in the *Washington Post:*

> A new Census Bureau study shows that the elderly in this country are much better off than previously believed and, in fact, are better off than the average American. . . .

The article by Spencer Rich (1983) in the *Washington Post* goes on to describe how the per capita, after-tax income of

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the elderly was $6,300 in 1980 versus $5,964 for the population as a whole.

Looking at these new Census Bureau findings and a number of other recent studies, one can begin to see the outlines of a very fundamental change with regard to the economic status of the elderly. From a statistical point of view, *the elderly in this country are beginning to look a lot like the rest of the population:* some very rich, lots with adequate income, lots more with very modest incomes (often near poverty), and a significant minority still destitute. This is very different from the past when most were destitute.

The past three decades have been marked by steady improvements in the economic situation of the elderly. Pension coverage has spread rapidly, real benefit levels have increased, and health protection is generally financially obtainable. Moreover, the general economic prosperity of the post-World War II period (that is, up until recently) has served to facilitate among those middle-aged and older the accumulation of an impressive stock of economic wealth in the form of housing, durables, and pension accurals.

But just when we thought the problem of providing adequate income in retirement for most elderly was solved, a whole new set of uncertainties arose:

1. *Life-Threatening Economic Instability.* I say "life-threatening" as a way of dramatizing the differences in the character of the macro problems that suddenly appeared in the Seventies. Inflation and unemployment unexpectedly became both more severe and of longer duration—to the extent that the resulting economic deprivation, mental stress, inadequate medical care, and malnutrition threatened life itself for a much broader spectrum of the American population.

As families attempted to cope with the harsh realities of this economic instability, few realized (or had the time or inclination to think about) the simultaneous erosion of the base for their retirement security that was also occurring. Wealth in housing and consumer durables deteriorated. And a private pension system, designed to reward long-term workers at the expense of those who lose or change jobs, proceeded to wipe out billions of dollars in potential pension accruals as millions of workers changed jobs without vested pension rights. And probably what is more serious is the gradual, invisible erosion of pension benefit rights that will take place over the coming years. The forced mobility of the Seventies and Eighties also produced a gigantic pool of pension benefit accruals for those job changers fortunate enough to be eligible for vesting. But since these accruals are not indexed, they are highly vulnerable to monetary depreciation from the inflation that can be expected in the years ahead. Few people today (even policymakers) are sensitive to this problem. Few see that this is the great retirement "legacy" of the Carter-Reagan years: lost pension benefits. Instead, most attention has been focused on social security, the next uncertainty to be discussed.

2. *Chaotic Social Security Financing.* It is almost amusing to look back over the social security events of the recent past: a nation bumbling along from one social security financial crisis to another, like a little mom and pop grocery store always on the brink of bankruptcy. What we have witnessed is one of the great social programs of the richest country in the world seemingly almost brought to its knees by the economic instability discussed above. The result: cries of anguish, much handwringing, and finally a financial "fix" until the next crisis arises.

To me, a pension expert who has given years of attention to pension financing issues, events seem more the result of political maneuvering than the product of fundamental economic problems. But to others, the problems (both economic and political) seem very real. And for the first time since it was established, support for social security seems in doubt as confidence deteriorates among policymakers and program participants. What was once unthinkable—major cutbacks—have become a reality: benefit cuts, benefit taxation, and a scheduled rise in the retirement age.

For purposes of this paper, then, it only remains to ask the question: if social security is in a state of change, what can be counted on? Obviously this new uncertainty makes it difficult to plan for the future.

3. *The Early Retirement Bomb.* For many years now analysts have pointed with great anxiety to the dramatic declines in labor force participation among the older population. For reasons we summarize below, many have referred to this social phenomenon as a ticking bomb that might explode in the nation's face at some future time.

It is important to distinguish the growing interest and ability to retire in general from the phenomenon of exercising the retirement option at *increasingly early* ages. The "right to retire" is not what is at issue. Rather the issue is the age of election and who will pay the costs. For example, actuaries point out that pension costs increase by about 50 percent once the normal age of retirement is reduced from age 65 to age 60.

Yet, throughout the country, powerful forces are at work to remove people from the labor force before age 65. Increasing numbers of workers are retiring under the social security early retirement option. Federal employees can retire on full benefits at age 55 with 30 years of service; in fact, the President's Commission on Pension Policy reported that 59 percent of retiring male civil service servants (fiscal

1978) were age 60 or younger. Most state and local government employee plans also have very liberal retirement provisions. Early retirement is usually possible after 20 to 30 years of service—often as early as age 50 or 55.

Less well known are the retirement options provided under private pension plans. The generous provisions of the big plans—for example, in the auto industry—are well known. Few data are published, however, on the hundreds of thousands of plans in other industries. One recent study of pension plans by the U.S. Bureau of Labor Statistics (1980), has found that more than half of covered workers were eligible to receive *normal* retirement benefits *before* age 65. And almost a third were eligible for normal benefits at age 60 or earlier!

Another study of defined benefit plans covering about 23 million workers in 1974 (Schulz, et al., 1980) shows that 70 percent of these workers were eligible for early retirement benefits at age 60 (provided service requirements, if any, were met). Over half could retire as early as age 55, and 15 percent were in plans with even earlier eligibility ages (or no age requirement at all).

But these numbers do not tell the whole story. More than 90 percent of all workers covered by private pensions are in plans having "early retirement" options. When a worker retires early, that is before the "normal" retirement age, the benefit is usually reduced. A large number of employers, however, encourage their employees to retire early by absorbing some of the costs of paying pensions over a longer period of time. Thus, while some plans reduce benefits by the full actuarial discount, many plans, in effect, give actuarial bonuses to workers who retire early.

The study of defined benefit plans in 1974 indicated that powerful economic incentives are provided in many plans.

For example, there were about seven million workers in 1974 covered by plans permitting their retirement at age 60 with less than a full actuarial reduction in benefits.

Thus, we see that social security is not the sole force pushing workers into retirement. Certainly social security income, when it becomes available, encourages workers to retire. But for many workers it is military, federal, state/local, or private plans that make it possible to retire at increasingly early ages.

Pensions have become an important tool of personnel management, especially in dealing with excess labor situations. As Juanita Kreps (1977) pointed out a few years ago, "retirement, a relatively new lifestage, has quickly become a . . . device for balancing the number of job seekers with the demand for workers at going rates of pay." But make no mistake, early retirement is also very popular with unions and the workers themselves.

This trend of early retirement raises new uncertainties. To the extent that early retirement benefits are *reduced* benefits, will the resulting retirement income be adequate? Will the lower benefits ultimately trigger demands for higher ones? Will meeting the costs of paying pension benefits over increasing periods of time create financing problems for public and private pension sponsors—threatening the viability of the pension plans themselves? Since the costs of early retirement policies are relatively low but grow rapidly over time (as the trend continues and spreads), some see this situation akin to a quiet bomb that is currently dormant but capable of suddenly exploding sometime in the future. Already many see social security costs out of control. Concern about private pension costs may soon follow.

Given these uncertainties (economic instability, problems of social security financing, and the trend toward early retirement), what can we say about the future? Here we find very little agreement among analysts. Of course, such a state of affairs is not too surprising. We have learned not to be too surprised by the unpredictable, especially given the large number of unknown factors surrounding a social phenomenon like "the economics of aging." Still, for those who have taken more than a passing interest in this area, the current situation represents a significant and somewhat unexpected watershed.

Some analysts see us at the beginning of a long period of economic stagnation and decline. Others see current economic problems as just another temporary setback in the long-run history of economic growth and the ever-rising prosperity that has characterized the American economy for more than a century. Economic policies for the aging and ultimately the future economic status of the aged depend critically on which viewpoint is the more realistic.

Rather than taking sides in this dispute, it may be more useful at this point to enumerate some of the key assumptions that lie behind the two very different points of view. Our ability to finance economic programs for the aged in future years will be influenced greatly by the following factors:

1. *The Growth of Real Wages.* Until the late Sixties the growth in American productivity was relatively high for most of the post-World War II period. Since then, however, the rate has slackened and in recent years the slowdown has been quite dramatic. Moreover, this downturn has not been confined to a few special industries but has been experienced by a very broad spectrum of industries in the United States. Despite much research, economists have not been able to satisfactorily explain the changes in productivity that have taken place and, as a result, there is currently a great deal of uncertainty with regard to what is likely to happen in the years ahead.

Pessimistic projections generally assume that recent experience results from fundamental changes in the economy that are not likely to change quickly. They therefore assume that real wage increases based on productivity gains will be very low, averaging significantly less than 1.0 percent per year.

Optimistic projections, in contrast, assume that the recent experience is transient and in large part associated with the unexpected economic shocks of the last couple of decades—war, OPEC, crop failures, etc. These projections assume a return to rates closer to those of the 1940-60 period and real wages soon increasing between 1.0 and 2.0 percent per year.

2. *Unemployment.* Intimately relatd to productivity and growth is the level of employment. In addition to the general economic stagnation depressing employment opportunities, pessimists point to an apparent increase in structural problems associated with the American labor force as its age, sex, and race composition changes dramatically and as we shift away from manufacturing production and toward services. Thus, pessimistic projections assume unemployment will not decline to the earlier low levels but will range between 6 and 8 percent (high by historical standards). Optimistic projections assume rates only slightly higher than those of "better times"—declining to below 6 percent.

3. *Fertility Rates and Mortality.* We have witnessed wide fluctuations in fertility over the past century, creating an unevenness in the population structure and resulting difficulties in planning (for housing, schools, pensions, etc.) The sharp decline in fertility following the "baby boom" of the late Forties and early Fifties is currently the cause of serious concern with regard to the costs of the elderly population in the 21st century. But trends in fertility over the next several decades are also important, since they will in

great part determine the number of working-age persons available when the "baby boom" retires.

While most demographers continue to stress the volatility, and hence unpredictability, of future fertility, the projections we make now must guess as to the likely trends. Pessimistic projections assume that fertility will continue to fall to about 1.6-1.7 children per woman; while the optimistic ones assume fertility will increase slightly to 2.1-2.4 births per woman. (All projections fail to include illegal immigration.)

Remaining life expectance at age 65 is currently about 18.0 years for women and 14.0 years for men, up from 1940 by four and two years respectively. For projection purposes, the major breakthroughs in prolonging life that some predict are generally not made a part of the projections, and almost all projections generally assume some continuing but gradual improvement in mortaility experience at the later ages. Thus, the optimistic and pessimistic projections differ only by rate of improvement in life expectancy assumed, and this difference is typically small.

4. *Private Pensions.* Private pensions have grown dramatically during the post-World War II period—in coverage, in types of protection, and in benefit levels provided. Optimistic projections see this mechanism for income in old-age continuing to increase in importance. With liberalized tax provisions for IRAs and a variety of new pension options (e.g., 401(K) cash-or-deferred plans), private pension coverage—and hence pension benefits—are assumed to increase significantly. In contrast, the pessimistic projections see pension coverage growing slowly (perhaps even declining) as a result of (a) government regulations which make pensions a much less flexible management tool and raise administrative expenses, (b) higher benefit costs arising from continuing demands to liberalize benefits, and (c) escalating

premiums to the Pension Benefit Guaranty Corporation to protect against plan termination resulting from industry, and hence plan, instability.

5. *Health Care Costs.* There is now growing awareness among analysts and policymakers that the rapid rise in health care costs of the recent past is not likely to abate in the years to come. With regard to the elderly, most of the attention is focused on Medicare, which currently finances about 45 percent of their health care costs and most of acute care expenses. Since its enactment, Medicare expenditures have grown at a rate far faster than the other social security programs. In early 1983, the White House issued statistics to support President Reagan's "health care incentive reform proposal." "This year," said the fact sheet, "Medicare and Medicaid will spend more *every two weeks* than they did during the *entire year* of 1966, their first full year of operation" (White House, 1983). If the early retirement bomb is threatening us, many would argue that the Medicare bomb has already exploded, and the only argument is over how many more will follow.

Moreover, there seems to be general agreement among analysts that, in the absence of intervention, Medicare costs will continue to *accelerate* in future years. And many think that only very fundamental and radical changes in our health care delivery system will have any appreciable effect on future costs trends. In their *Annual Report* for 1983, the Trustees of the Social Security Administration project ("immediate" assumptions) that Medicare costs will continue to grow by 8 to 13 percent over the next two decades—significantly faster than the increase in revenues from taxable payrolls. The resulting costs (and deficits) are huge by any standard of comparison.

The Trustees attribute slightly over half of the annual growth in health costs to economic and demographic factors.

But the rest is expected to result from the continuing cost pressures within the health care industry itself—wage setting, insurance disincentives, and the costs of new technology. Peterson (1983) warns, for example, that the ". . . new medical technologies are priming the HI [Medicare] program for a cost explosion without precedent. . . ." And Alan Greenspan—testifying before the Subcommittee on Social Security, U.S. House Committee on Ways and Means (February 1, 1983) as Chairman of the National Commission on Social Security Reform—warns: "We cannot substantially constrain the cost of Medicare unless we slow the improvements in technology (a dubious goal) or choose not to employ the technology that is currently available. These decisions, of course, would raise very difficult ethical and moral questions."

Again, projecting future costs becomes a seemingly impossible exercise. Munnell (1983), arguing against the pessimistic projections of Peterson, counters in the following way:

> Outlays for HI [Medicare] today account for only 18 percent of total expenditures under the social security program; it is difficult to believe *that we will allow* the HI program to grow to a point where the cost for hospital insurance (20 percent of taxable payrolls) roughly equals the total cost to support the aged, disabled, their dependents and survivors (24 percent of payrolls). [Emphasis added.]

Thus, given agreement over the need for cost constraint, the optimists and pessimists tend to differ on how soon and how much we will change our health care system.

It is tempting to close by throwing up one's hands in frustration and exclaiming, "Who knows what the future will bring?" As our survey of the key factors has shown, there is clearly much intellectual justification for uncertainty—and anxiety!

Instead, I want to close by adding a reactive note of caution. In recent years, good economic news has been virtually nonexistent. For this and other reasons it is quite clear that the pessimistic projections and the problems they portend are being taken very seriously these days by "the people that count." Given the seriousness in recent years of our general economic problems and a number of major problems arising in connection with old-age and disability pensions, state and local pension financing, private pension reinsurance, and Medicare/Medicaid—the possibility of continuing and increasing problems is not likely to be ignored.

And for a number of years now a variety of "solutions" or remedial steps have been proposed. The changes are almost all pointed in one direction—drastic cutbacks in benefits to reduce social security costs. As I have pointed out previously (Schluz 1983), the logical question that follows from such proposed action is: What else changes in reaction to cutbacks in social security (i.e., what takes the place of social security)?

In examining the ability of alternatives to pick up the slack from a pared down social security program, we should not ignore economic history. Despite what Martha Derthick (1979) says about bureaucratic elites engineering the expansion of social security, the development of OASDHI was to a very large extent a reaction to the failure of the alternatives—namely "employment of the old" and "providing for old age through personal savings." Both these alternatives are largely untenable due to the vicissitudes of our economic system over the years:

a) past periods of unemployment and inflation that have made preparation for retirement (i.e., financial planning) extremely difficult for individuals (if not impossible);

b) an inability to achieve sustained full employment—except in periods when the nation was preparing, fighting, or recovering from war—causing the government to actively discourage employment by older workers and to develop pension mechanisms that encourage retirement; and

c) both social security and private pensions with a long history as tools of business management to deal with cyclical and long-term shifts in demand (see, e.g., Graebner 1980).

What then are the alternatives proposed today? Not surprisingly, we find that they are the same as in the past: private saving, private insurance, and employment of the old.

Thus, there is a high probability that the solutions being proposed today are simplistic and unworkable. If we cut back social security drastically, we are likely to see the economic status of the elderly decline over time. More important, this decline will fall disproportionately on the disadvantaged segments of the population—low income persons, women, and minorities who now depend almost entirely on social security for their support in old age.

The long term implications of this are quite serious. As William Graebner has recently argued, the elderly may be viewed by our society as a residual group to remain in or move out of the labor force, according to the macroeconomic situation:

> If elderly people of the turn of the century could compare notes with those of us approaching this century's end, the two generations might well con-

> clude that, whatever else has changed, the fate of the elderly remains the same: to serve the needs of other age groups and to be retired, or put back to work in the interest of someone else's conception of the general welfare (Graebner 1983).

If that is true, then it is quite unlikely that many people in the future can actually count on the rosy retirement period (the Shangrila) so much the fashion today in the stories of the media and the speeches of politicians.

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