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POPULATION AGING IN THE UNITED STATES: RETIREMENT, REFORM, AND REALITY

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Although the United States will experience significant population aging in the 21st Century, the demographic situation of the U.S. is distinctive. Because its immigration and fertility are comparatively high, it will not confront the population decline facing so many developed nations. Instead, the United States must deal with the succession of cohorts of uneven size. As the large baby boom generation grows older, population aging will accelerate. Older persons will constitute a growing share of the U.S. population, albeit not as large as the percent projected for Europe. Because the Social Security retirement system has been the object of serious study and debate, it offers insights into the institutional implications of population aging in the United States. The probable policy response--some reform package of lower benefits, higher taxes, and higher retirement age--points up the difficult choices confronting pay-as-you go retirement systems. The problems of mature retirement systems are not amenable to quick resolution, if only because of the complexity of underlying structural and behavioral relationships as well as the uncertainty inherent in long-range projections.

DEMOGRAPHIC PROSPECTS

In contrast to other developed countries, the population of the United States is expected to grow larger as it grows older. According to the medium-variant projections of the United Nations (1999, p. 418), the American population will increase from 278 million in 2000 to 349 million in 2050. U.S. fertility has not fallen to the levels of Europe, Japan, and other developed nations (United Nations, 2000a), where fertility is too low to offset deaths, replace the parental generation, and avoid a decrease in population. The fertility of the United States is at or slightly below replacement. From 1989 through 1998, the total fertility rate ranged between 2.0 and 2.1 annually (United States National Center for Health Statistics, 2000). By contrast, the total fertility rate fell below 1.5 in developed nations such as Germany, Spain, Japan, and the Russian Federation (United Nations, 2000a).

The United States is a major receiving country for immigrants. In the 1990s, net international migration approached one million persons annually (United States Census Bureau, 1999, p. 9). Immigration accounted for about one-in-five new Americans. Even with fertility somewhat below replacement, the current level of immigration to the United States is more than sufficient to keep the total and working age populations from declining over the next 50 years (United Nations, 2000b, p. 75). Immigrants will not prevent the long-run aging of the population, except in the highly unlikely scenario of a ten-fold increase in annual immigration levels. Although immigration is selective of young people, they offset population aging only temporarily, because young immigrants eventually grow old.

Future fertility in the U.S. may fluctuate in response to cyclical forces, but dramatic fertility declines to very low levels appear unlikely. Americans have not

experienced fertility markedly below replacement levels, despite high levels of maternal employment combined with low levels of state subsidies for child rearing (Treas and Widmer, 2000). Immigration is also expected to sustain fertility levels in the United States. Immigrants from developing countries with higher fertility acculturate slowly to the family formation patterns of native-born Americans. Population projections by the U.S. Census Bureau assume Hispanic and Asian and Pacific Islander fertility will converge to national levels only very gradually over the long-term (Hollmann, Mulder, and Kallan, 2000).

Of course, the historical record cautions against complacency about the future course of American fertility. The 1946-1964 "baby boom" was the unexpected result of rising living standards in the United States. Although many countries saw fertility increase after World War II, few experienced a sustained elevation in fertility like the U.S., where about four million infants were born each year. Since the baby boom was followed by a baby bust, fertility swings created a bulge in the age structure that has had significant implications for population aging.

The initial effect of the baby boom was to make the U.S. population younger. Then, as the baby boomers grew up and grew older, the median age of the population climbed from 28.0 years in 1970 to 35.7 in 2000 (United States Census Bureau, 1999, p. 14). Today, support ratios remain favorable, because there are baby boomers who are workers, taxpayers, and caregivers for an older generation. For every person, 65 and older, there are about five younger persons, 15-64. The older population is growing slowly as the small cohorts born during the Great Depression of the 1930s move into old age. In 2011, however, the first baby boomers will turn 65 years old. The growth of the older population will accelerate markedly. Also contributing to aging are mortality declines, especially at the older ages, which raised 1997 life expectancy at age 65 to 15.8 years for men and 19.0 for women (United States Census Bureau, 1999, p. 93). Between 2000 and 2050, persons 65 years and older will increase from 12.5 to 21.7 percent of the U.S. population, according to medium-variant projections (United Nations, 2000b, p. 132). Even as the U.S. undergoes unprecedented aging, it will remain young compared to Europe where the population 65 and older will increase from 14.7 to 27.6 percent over the same period (United Nations, 2000b, p. 136).

IMPLICATIONS OF AGING POPULATIONS

The challenge of aging populations arises because older people, especially those in advanced old age, become too sick, frail, or disabled to take care of themselves. They need economic support, health care, and assistance with activities of daily living. Although family members take care of older people, population aging places greater demands on public resources as well. For example, under intermediate assumptions, Social Security costs in the United States are projected to rise from 4.2 percent of gross domestic product (GDP) to 6.8 percent in 75 years (Board of Trustees, 2000, p.3). The dilemma of an aging population is that the increase in younger adults does not keep pace with the growth of the older population. There are more old people in need of help and fewer working age adults to help them.

Each year, Social Security actuaries prepare short-range (ten year) and long-range (75 year) projections of the financial status of the system. The projections, based on

assumptions determined by the Board of Trustees that governs Social Security, point to disturbing, long-range financial problems. Using intermediate assumptions, estimates indicate that the annual Social Security deficit will amount to 2.2 percent of the gross domestic product in 75 years (Board of Trustees, 2000, p. 3). Although Medicare, the federal health insurance program for older Americans, faces even more pressing problems, its mix of public and private health care financing does not generalize to other nations. Social Security is a more instructive example of policy issues facing aging populations, because it is similar in broad outline to the pay-as-you-go retirement systems in many other developed countries.

Current workers in the U.S. support current retirees through the payroll taxes paid by the workers and their employers. Social Security (OASDI) actually consists of two programs, Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI), each of which maintains its own trust fund account with the U.S. Treasury. According to intermediate projections (Board of Trustees, 2000), the trust funds will grow larger in the short-run as baby boomers pay into the system. The first baby boomers will begin to leave the labor force even before reaching the age of 65 in year 2011. Because disability insurance covers workers who are not yet old enough for retirement benefits, the disability trust fund will peak as early as 2005 and be exhausted altogether by 2023. By 2015, the expenditures for the combined OASDI programs will exceed income from payroll taxes. By 2024, these expenditures will exceed not merely taxes, but taxes plus interest on the trust funds. It will be necessary to spend the trust fund principal to pay benefits. OASDI will be exhausted by the year 2037, only eight years after the last baby boomer turns 65. After 2030, costs as a percent of taxable payroll will level off and even decline slightly due to smaller cohorts of retirees. A big gap will remain between costs and income, however, and costs are projected to rise again slowly in the middle of the 21st century due to increases in life expectancy.

Without legislative changes, benefits will eventually exceed tax income, reserve funds will be spent, and the system will eventually be unable to meet its obligations. As a consequence of the persistent drumbeat of troubling projections, the American public is aware that Social Security faces serious financial difficulties. Only seven percent of American workers surveyed in 2000 stated that they were "very confident" that Social Security would continue to provide benefits equal to those received by current retirees (Employee Benefit Research Institute, 2000).

FIXING SOCIAL SECURITY

Although the Social Security problem stems from a demographic imbalance of generations, a demographic fix, propping up old age support ratios by raising fertility and immigration, is not very feasible. First, pronatalist policies have had little success raising fertility in democracies. Second, even if it were politically feasible, the American economy could not readily absorb the 10.8 million immigrants estimated to be needed annually to maintain current old age support ratios until 2050 (United Nations, 2000b, p. 75).). Nor can a mature Social Security system rely on the strategy that served it well in the 1950s, that is, maintaining support ratios by bringing in new categories of workers who accept taxes in exchange for future benefits. Fully 96 percent of paid civilian

workers is already covered by Social Security (Ways and Means Committee, United States House of Representatives, 1998).

In hindsight, a system that requires each generation to fully fund its own retirement would be preferable to a pay-as-you-go system, because retirement financing would not be directly affected by deteriorating old age support ratios. Proposals for compulsory individual retirement accounts move in this direction, but someone still needs to pay for current retirees and for low-income workers who cannot save enough for old age. Projected Social Security deficits have prompted serious consideration of a number of ideas (e.g., income and assets tests for benefits, investing trust fund reserves in private markets) that would once have been considered radical (Kingston and Quadagno, 1997). If pay-as-you-go retirement systems are to remain solvent, however, policy makers cannot avoid some combination of lower benefits, higher taxes, and higher age of eligibility for benefits.

These are painful courses of action. They call for some group-- whether workers, retirees, or both--to make sacrifices sooner or later. The United States has tried all three strategies before. Payroll taxes were raised many times--most recently in 1990. Benefits were effectively cut in the 1980s when cost of living adjustments for recipients were delayed. And, the normal retirement age for full benefits is being raised gradually from 65 to 67. Early retirement benefits continue to be available from age 62 although the actuarial reduction is greater (Ways and Means Committee, 1998, p. 20). Financial projections indicate more needs to be done.

CUTTING BENEFITS

One can argue that it is only fair to reduce benefits, because the economic circumstances of retirees are so much better than they were in the past. Forty years ago, one-third of Americans, 65 and older, fell below the federal poverty line. By 1998, only 10.5 percent were poor (Dalaker, 1999, p. xiii). Current retirees have benefited from private pensions, from appreciation in home values, and from higher lifetime wages that permitted them to save for retirement. Unfortunately, this argument for benefit cuts overlooks the fact that Social Security is the primary reason that many older Americans lead reasonably secure lives. OASDI makes up 48.2 percent of the income of elderly individuals who live alone, for example (Ways and Means, 1998, p. 1041). If Social Security and other government benefits were eliminated tomorrow, half of all persons, 65 and older, would live in poverty (United States Census Bureau, 1993, Table 2).

There are, however, several options for cutting benefits while protecting low-income elderly people. The formula used to calculate benefits could be made more progressive so that only those workers with high earnings would have their benefits cut. Another approach is to cut everyone's retirement benefits, but compensate the poor for their loss of income by expanding public assistance. (The federal Supplemental Security Insurance (SSI) program supports the low-income aged, but this means-tested program has strict income and asset limits). Social Security itself might become a means-tested program: Benefits could be reduced or eliminated for affluent retirees with high incomes and substantial assets. Even if no benefits were cut, high-income elderly could have more of their benefits taxed away.

The political risk is that these measures may undermine public support for Social Security as a universal, social insurance program. Americans remain more skeptical of welfare programs than most Europeans for whom citizenship confers more rights to state support. As a right earned by working, Social Security has none of the stigma attached to public assistance programs in the United States. The Welfare Reform and Personal Responsibility Act of 1996 demonstrated that U.S. needs-based, poverty programs are vulnerable to major cuts. The 1989 repeal of Medicare catastrophic coverage showed that middle-class retirees are unwilling to bear the burden of supporting low-income older people.

RAISING TAXES

Raising taxes is another budget-balancing strategy for public retirement systems. One way to measure the long-range Social Security deficit is as a percent of payroll subject to OASDI taxes. According to intermediate projections by the Board of Trustees (2000, p. 3), the deficit for Social Security programs is 1.89 percent of taxable payroll in the next 75 years. Payroll tax rates are 6.2 percent each, from employees and employers, on covered earnings up to a specified maximum amount ($72,600 in 1999) (Board of Trustees, 2000, Table I.C.2). The maximum is indexed annually to the average wage for all workers. Social security recipients with adjusted gross incomes above specified levels pay income tax on up to 85 percent of their benefits, and these taxes are credited to the OASDI and Medicare trust funds.

There is no lack of precedents for Social Security tax increases. The OASDI tax rate has been raised twenty times since 1949 when it stood at one percent of taxable earnings (Board of Trustees, 2000, Table II.B.1). In addition to increasing the tax rate, additional revenue can be generated by removing the earnings maximum for payroll taxes and by increasing the percent of Social Security benefits subject to income tax. Both economic and political considerations determine the extent to which tax increases can resolve the issues of aging populations.

THE CASE FOR RAISING RETIREMENT AGES

The cost of old age benefits has increased, in part, because retirees collect benefits longer. This results from increases in life expectancy at older ages coupled with declines in the age at which American workers retire. Most U.S. workers today choose to retire before the normal retirement age, taking the actuarially reduced benefits that become available at age 62. Although the mean age for electing retirement benefits was 70 years in 1945, it declined sharply until the 1980s and stood at 63.6 years in 1995 (Ways and Means Committee, 1998, p. 21). In addition, between 1940 and 1997, life expectancy at age 65 increased by 3.6 years for men and 5.7 years for women (Board of Trustees, 2000, p. 63). According to the Social Security Advisory Board (1999), a normal retirement age (NRA) of 71 years for receipt of full benefits, rather than 65, would be consistent with the remarkable increase in life expectancy.

Improvements in the life expectancy, health, and functioning of older people offer a persuasive argument for raising the age at retirement and perhaps indexing it (e.g., to life expectancy at age 65 or to disability-free life expectancy). During the 1980s, the

health of older Americans improved markedly (Manton, Corder, and Stallard, 1993). Under most scenarios, the "health-adjusted" ratio of persons, 20-64, to chronically disabled persons, 65 and older, is projected to remain above the 1994 level, assuming a continuation of recent trends--a 1.5 percent decline annually in chronic disability for older people (Singer and Manton, 1998). Better health has translated into greater ability to work, as reported by persons, 50-69 years of age, in 1982 and 1993 (Crimmins, Reynolds, and Saito, 1997). Surprisingly, this improvement occurred primarily among the retired population, not those still in the labor force. This finding is consistent with the observation that health has become less important to the retirement decision over time (Costa, 1996).

Social Security was enacted in 1935 to insure workers against a time when they would become too old and too disabled to support themselves through their own labor. Today, most workers in the United States retire at a younger age and in good health. Workers look forward to leaving the labor force, having more free time, and taking advantage of the leisure activities for older people that have developed around the institution of retirement. In short, the United States, like other developed countries, has developed a "retirement culture." Leisure values promote labor force exits as surely as the availability of retirement income. The serious financial problems confronting the system, however, create pressures for Social Security to return to its mission of insuring against old age infirmity, leaving individuals to save for early retirement, if that is their preference.

PROPOSALS FOR RAISING RETIREMENT AGES

In 1983, the U.S. Congress took the first step toward raising retirement ages. Changes in the normal age of retirement (NRA) are being phased in gradually from age 65 to 66 between 2000 and 2005 and then from age 66 to 67 between 2017 and 2022. Higher NRAs and different phase-in periods have been proposed. Eliminating the break in NRA increases (scheduled for 2005-2017) is projected to reduce the long-range deficit by five percent (Goss and Wade, 1998, cited in Rix, 1999). Quickly raising the NRA to age 73 is projected virtually to eliminate the deficit (American Academy of Actuaries, 1997, cited in Rix, 1999). Without putting too much emphasis on particular proposals, it is clear that any serious reform of public retirement systems must consider the age at which workers retire. Raising the retirement age to 74 would maintain 1995 old age support ratios (United Nations, 2000b, p. 74), but these ratios generate a big OASDI surplus. Thus, most proposals focus on modest increases in the retirement age to 70 or less.

The U.S. Government Accounting Office (1999) concluded that a higher retirement age would reduce the cost of lifetime benefits. A large increase in retirement age that is phased in rapidly would have a bigger financial effect than a small one phased in over a longer period of time. Assuming that an older eligibility age results in workers waiting longer to retire, the measure would also raise the amount of payroll taxes that are paid into the system. Savings to the OASI Trust Fund would be partially offset by greater demands on the DI Fund, because some people in poor health would choose to receive disability benefits rather than to wait until they are old enough to retire (United States Government Accounting Office, 1999). Greater numbers of older workers might

increase productivity, but they might also result in higher unemployment. Older workers with very low earnings, those who become unemployed, and those in poor health who do not meet the strict eligibility standards for disability benefits would have a longer struggle before qualifying for retirement benefits. This burden would fall disproportionately on already disadvantaged populations, including African-American, Hispanic, and blue-collar workers.

The impact of policy changes in retirement age depends on whether workers have other financial resources that permit early retirement, whether they are willing and able to work longer, and whether employers want to retain older employees. Workers without other sources of retirement income will delay retirement in response to a higher retirement age for Social Security. Relying on assets and private pensions, other workers will continue to retire before they are eligible for Social Security. Because many American workers have employer-provided pensions with "defined benefit" formulas encouraging early retirement (Wise, 1997), NRA changes may have less effect in the U.S. than in countries where retirees depend more on public benefits. Private pension plans allow a worker to retire early by paying a larger pension that is reduced when the retiree becomes old enough to collect Social Security. Unless the earliest eligibility age (EEA) for Social Security is raised so the employer has to subsidize early retirement longer, employers will have little incentive to eliminate early retirement inducements.

Despite the popularity of early retirement, there are indications that older Americans are willing to work, especially part time (Treas, 1995). The labor force participation rates of men, 65 and older, leveled off in the 1980s, ending decades of declines. Increasingly, older people take a job bridging from career to full-time retirement. Between 1984 and 1993, growing proportions of men below the age of 65 were working while receiving income from a pension (Herz, 1995). In a nationally representative sample, 75 percent of workers expect employment to be an income source in retirement (Employee Benefit Research Institute, 2000, p. 7).

To be sure, older workers face barriers to employment, including employer discrimination, a shortage of attractive part-time jobs, and lower pension accruals (Herz and Rones, 1989). Employer reservations range from higher health insurance costs for older employees to concerns that older workers are less flexible, are less willing to learn new technologies, and lack the latest job skills (AARP, 2000). Particularly since recent cohorts of elderly Americans are better educated than earlier ones, a tight labor market may encourage employers to offer retraining, flexible schedules, and other programs for older workers. Conversely, corporate downsizing and high unemployment work against older workers (Quinn and Burkhauser, 1994).

CONCLUSIONS

The United States has distinct advantages in dealing with population aging. Its percent elderly is not projected to grow as large as in other developed countries, and it does not have to cope with population decline. Its public retirement provisions are less generous. Its systems of private and secondary pensions are better developed. Several decades of painful restructuring have resulted in a sustained economic expansion that is generating the tax surplus to address major societal problems. Like many other countries with aging populations, the United States has a pay-as-you-go public retirement system

and deteriorating old age support ratios. Having gained additional years of health and life, older persons have chosen to lengthen their retirements, rather than extend their work lives.

The challenges of aging populations are too complex for simple solutions. Comprehensive reforms to pay-as-you-go retirement systems will need to call on some combination of approaches, including benefit cuts, tax increases, and increases in retirement age. The Social Security Amendments of 1983 contained thirteen distinct provisions intended to build trust fund reserves, including covering new federal employees, taxing benefits, delaying benefit increases, and scheduling increases in retirement age (Ways and Means Committee, 1994, p. 40). These measures did not prove adequate, but the experience offers useful lessons for aging populations.

First, the long-run consequences of comprehensive reform packages for public programs are difficult to forecast. Various elements of any reform are apt to affect the economy as well as individual decision-making, and the different parts of reform programs may well interact with one another. Effectiveness will depend on how well policies are coordinated with other programs. The impact of higher Social Security retirement age is apt to depend on whether the eligibility ages for Medicare and private pensions also increase. Because the consequences often differ for different segments of the population, income distribution consequences need to be considered: Who gains and who loses from new policy provisions, and how can the disadvantaged be protected from loss?

Second, the most sophisticated projections provide only a moving target for long-range solutions. The projections of OASDI budget deficits are based on assumptions about a host of economic and demographic factors, including future wage growth, rates of return on trust fund assets, fertility, immigration, life expectancy, labor force behavior, etc. Small changes in assumptions--due to changing conditions, better understanding of the relationships between variables, or increased methodological sophistication--can compound into large discrepancies between old and new projections. It is possible to address some contingencies (e.g., indexing benefits to inflation and retirement age to life expectancy), but change and uncertainty mean that institutional reform will require on-going monitoring, evaluation, and modification.

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