Testimony submitted to the

House Ways and Means Committee

Hearing on
"Retirement Policy Challenges and Opportunities of Our Aging Society"

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Thank you, Mr. Chairman. It is an honor to have the opportunity to testify before the 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 national 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 or Theodore Roosevelt, your odds of a random encounter with an elderly American were about one in twenty-five. Today, they are about one in seven. A generation from now, they will be about one in four.

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, 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 TK percent of the economy today to TK percent by 2040. 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 2040, according to the CBO's long-term budget projections, spending on Social Security, Medicare, and Medicaid is on track to consume more than 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 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 believe that it may 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 more sensibly between extra years of work and extra years of leisure. Encouraging later retirement and longer work lives 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 1970s, it was possible to argue that age was a reasonable proxy for disability, unemployability, and, above all, financial need. This is argument is no longer plausible. Over the past quarter century, the real median income of households aged 65 and over has risen by over one-third, while that of households 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 large advantages. Beyond income, the elderly have a higher average net worth than younger adults. And, counting in-kind benefits like Medicare, their poverty rate is as low as the rate for any age group and just one-half the rate for children. Basing eligibility for publicly subsidized retirement benefits on age alone is no longer equitable or affordable.

The third reality is the failure of the pay-as-you-go paradigm. That paradigm made sense back in an era when rapid growth in the workforce seemed destined to continue indefinitely. With the end of the baby boom, however, the demographic underpinnings of the pay-as-you-go paradigm collapsed. In the future, workers will have to prefund more of our own retirement through greater savings during the employment years. I am well aware that funding is not a magic bullet. Saving more requires consuming less, at least until the productivity benefits of higher savings kick in. Over the long run, however, funded systems have decisive advantages over pay-as-you-go systems, especially in an aging society. At the macro level, they can shield government budgets from demographic pressures while helping to maintain adequate rates of savings and investment. At the micro level, they can offer workers a higher return on their contributions. This is why funding is being embraced by countries as diverse as Australia, Germany, and Singapore. 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 TK percent by 2050, up from TK percent today. Meanwhile, the elderly share of the population will climb to TK percent in Germany, TK percent in Italy, and TK percent in Japan. Although the United States will have to cope with a dramatic slowdown in workforce growth as boomers retire, Europe and Japan are heading toward a long-term future of workforce and population decline. By the middle of the century, according to UN projections, there will be 32 percent fewer working-age Germans than today, 39 percent fewer working-age Japanese, and 47 percent fewer working-age Italians. The Japanese government actually projects the year 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 in 2040 after the last of the boomers have retired. Thanks to our strong work ethic, flexible labor markets, and model age discrimination laws, the United States also has a relatively high elderly labor-force participation rate. Eighteen percent of Americans aged 65 and over are 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 or German 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 rates, help take pressure off government budgets. According to Intersec, a standard source for international pension data, US pension funds own an astonishing 59 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 the 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.

Perhaps the greatest challenge of all, however, is the moral challenge. America has always been a young —how to be wise stewards and meet the needs of the growing number of us who will be old while still leaving room for the hopes and aspirations of youth.

Thank you again for the opportunity to share my views on this vitally important issue.