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Demographics and Destiny

By Paul Krugman

WILL AMERICA GROW UP BEFORE IT GROWS OLD?

How the Coming Social Security Crisis Threatens You, Your Family, and Your Country.

By Peter G. Peterson.

Illustrated. 237 pp. New York:

Random House. \$21.

THE AARP

America's Most Powerful Lobby and the Clash of Generations.

By Charles R. Morris.

286 pp. New York:

Times Books/Random House. \$23.

In this silly season politicians are once again promising that we can have it all -- that we can cut taxes, spare every popular spending program from even the smallest cut and still balance the budget. Nobody really believes them; if the public is willing to indulge such fantasies, it is because it does not, when all is said and done, really take the budget deficit seriously. After all, we have run huge deficits year after year as far back as anyone except economists can remember, and the sky has not fallen. Where is the crisis?

Just over the horizon, that's where. Through a kind of sound-bite numerology, the political debate over deficits became fixated last year on the seven-year prospect; each party insists that its economic program will balance the budget in the year 2002. Neither will, but that is beside the point. Responsible adults are supposed to plan more than seven years ahead. Yet if you think even briefly about what the Federal budget will look like in 20 years, you immediately realize that we are drifting inexorably toward crisis; if you think 30 years ahead, you wonder whether the Republic can be saved.

Peter G. Peterson states the reason for this succinctly in his brief, scary new book, "Will America Grow Up Before It Grows Old?": "By 2025 at the latest, the proportion of all Americans who are elderly will be the same as the proportion in Florida today. America, in effect, will become a nation of Floridas -- and then keep aging." As one of his chapter titles puts it, "demographics is destiny." Because baby boom was followed by baby bust, the United States a generation from now will have far more retired people than ever before, while it will have hardly more working-age residents than it has today.

Why is that scary? Because although politicians encourage the public to believe that its hard-earned dollars go to support legions of unnecessary bureaucrats and Cadillac-driving welfare queens, in reality what the Federal Government spends your money on mostly is benefits to the middle-class elderly. Well over half of Federal spending -- other than that on national defense and interest on the national debt -- goes in one way or another to retired people, mainly in the form of Social Security and Medicare, but also via Federal pensions and veterans' benefits. "The AARP," by Charles R. Morris, points out that even Medicaid, which is usually described as medical insurance for the poor, has increasingly become a program of aid to the elderly, with a

growing share of the money paying for nursing homes, often for retirees whose middle-aged children are middle-class or better.

Generous benefits for the elderly are feasible as long as there are relatively few retirees compared with the number of taxpaying workers -- which is the current situation, because the baby boomers swell the workforce. In 2010, however, the boomers will begin to retire. Every year thereafter, for the next quarter-century, several million 65-year-olds will leave the rolls of taxpayers and begin claiming their benefits.

The budgetary effects of this demographic tidal wave are straightforward to compute, but so huge as almost to defy comprehension. Mr. Peterson, the chairman of the Blackstone Group, a private investment bank, informs us that "the combined Federal cost of Social Security and Medicare, expressed as a share of workers' taxable payroll, is officially projected to rise from the already burdensome 17 percent in 1995 to between 35 and 55 percent in 2040. And this figure does not include the many other costs -- from nursing homes to civil service and military pensions -- that are destined to grow along with the age wave."

But aren't Social Security and Medicare basically pension funds, in which workers' contributions are invested to provide for their retirement? Hardly. A private pension fund that planned to pay the benefits these programs promise would be accumulating huge reserves. In fact, the so-called "trust funds" are making barely any provisions for the future. In another spectacular statistic, Mr. Peterson notes that if Medicare and Social Security had to obey the same rules that apply to private pensions, the reported Federal deficit this year would be not its official \$150 billion, but roughly \$1.5 trillion.

In short, the Federal Government, however solid its finances may currently appear, is in fact living utterly beyond its means. While the present generation of retirees is doing very nicely, the promises that are being made to those now working cannot be honored.

How did such a state of affairs come to pass? Mr. Peterson simply deplures our improvidence, but Mr. Morris, the author of several books on public policy, provides at least a partial explanation. Indeed, even if the aging of the American population were not our most crucial economic policy issue, Mr. Morris's book would be an invaluable and depressing case study in the sources and misuses of political influence. Textbook political economy tells us that large, diffuse groups of people are usually ineffective at defending their interests. How, then, did the 32 million members of the American Association of Retired Persons, most of whom joined only to get the travel discounts it offered, become what Mr. Morris calls the "800-pound gorilla of American politics?"

Mr. Morris's answer is enough to give even a hardened cynic pause: for most of its history the A.A.R.P. was basically a business enterprise using politics as a sales gimmick. Until the 1980's, a mogul named Leonard Davis effectively controlled the organization, using its publications and mailing lists as a way to sell insurance to members. The A.A.R.P.'s political activism was undertaken essentially for advertising purposes: just as corporations sponsored the recent Olympics to enhance the credibility of overpriced gym shoes, the A.A.R.P. sponsored pro-retiree legislation to enhance the credibility of overpriced insurance policies. Of such seeming trivialities are public policy disasters made.

Ironically, the Davis years were brought to an end by another institution whose commercial success depends on its image as a public crusader: the television program "60 Minutes," which did a devastating expose of the organization in 1978. Since then, the A.A.R.P. has gone a long way toward cleaning up its act. But efforts to turn it into an advocate of responsible policy have failed: like the broader body politic, the A.A.R.P. has been unable to defy its own vocal minorities, who are refusing to make even minor sacrifices. When the A.A.R.P. endorsed the Catastrophic Coverage Act of 1988, which would have benefited at least two-thirds of its members but imposed a modest net burden on affluent retirees, it faced rebellion -- and supported the bill's repeal the next year.

Both Mr. Morris and Mr. Peterson offer plans to avert the crisis ahead. The details differ, and Mr. Peterson's proposal is more completely fleshed out, but the general thrust is clear: slow the growth in benefit levels, gradually raise the retirement age, impose limits on expensive terminal medical care that prolongs life for only weeks or days and -- last but not least -- raise taxes moderately now, rather than massively later. We need not dwell on their sensible proposals, however, because there is not the slightest prospect that they will be put into effect -- or indeed that we will do anything serious about the looming crisis until it is almost upon us.

Both books take comfort from the economist Herbert Stein's famous dictum that unsustainable trends tend not

to be sustained. Something is bound to give -- but what? Will retired boomers -- who will have even more political clout than today's smallish population of retired voters -- be willing to accept a sharply reduced standard of living? That is hard to imagine. Will younger voters be willing to accept huge increases in tax rates to support the boomers in the style they have been promised? That is equally hard to imagine. Or will the Government try to square the circle by simply printing the money it needs, creating runaway inflation? Surely that is inconceivable. Yet one or more of these unthinkable things will happen, because something must.