



Demographic Change : Aging Societies

Social Security: Passing the Bill

As the baby boom generation gets ready to retire, the baby bust generation is wondering how it will foot the bill.



A nurse checks the oxygen levels of an unidentified patient in the cardiothoracic unit at the Northern General Hospital in Sheffield. Aging societies face increasing costs for health care and related services (Photo: Reuters)

"A very large generation followed by a very small generation is a terrible problem for healthcare programs and pension programs," warns Robert J. Shapiro, author of Futurecast 2020.

Older people, Shapiro argues, save less, spend more, and need more social security benefits. "People save from their early 30s to their mid-50s," says Shapiro. "After that, they start spending. Japan had a savings rate of 25 percent. Today it is 5 percent. The result is a slowdown in investment."

In the short run, a spending spree is good for business. In the long run, however, low savings rates rid banks of the cash they need for investment. This, in turn, spells reduced economic growth, and means less returns for governments that use taxes to finance social security benefits. Compounding the problem is the shrinking working-age population: more people receiving social benefits and less workers financing them.

Balancing burdens

Consequently, governments are overhauling their social security systems, moving away from pay-as-you-go financing to privately funded systems.

In the pay-as-you go system, premiums are used to finance expenditures. There are no savings, and the workforce simply pays for pensions of those who have retired. This model is also called an inter-generation contract. But the system runs into problems if a demographic shift – like the one currently underway – changes the ratio of young to old. With an aging society, the young generation has to pay rising premiums without seeing their future pensions increase.

HEALTH CARE COSTS

Health Care Costs in Selected Regions (click the image to enlarge)

If the system is based on private funding, however, the insured has to save for himself. In the beginning premiums will be quite high to accumulate savings that will be used later to finance one's pension.

The funding principle system is driven primarily by interest rates paid in the capital market. This gives the system "demographic independence." It helps to distribute the "demographic burden" over time in a different way – through today's saving (and thus a higher load in the present) future loads will be reduced.

Compared to the U.S. or UK models, the generous European and Japanese pay-as-you go systems are "unsustainable," says Shapiro, and "serious reductions (or serious increases in taxes)" are necessary.

The pension toolkit

In practice, more and more countries are mixing their pension funding between pay-as-you go and other measures. The Japanese government increased co-payments by recipients of healthcare services and created a separate insurance system for those 75 and older. Japan, which boasts one of the highest life expectancies in the world, also increased the age of eligibility for social security benefits for seniors from 60 to 65.

Postponing retirement age is another measure that has been used to ramp up pension systems. To do so, governments can increase retirement age, which Germany and Britain have boosted to 67. Alternatively, countries can increase the number of years a worker must contribute to qualify for a full pension; in France, this has recently jumped from 37.5 to 40.

Many countries also employ financial incentives to encourage people to work longer. In the United States and Germany, elderly workers receive wage or social security supplements. French and British workers receive pension bonuses for delayed retirement. Canada is even considering allowing workers to draw a partial pension before retiring.

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Finally, governments are trying to reduce dependence on state programs and encourage workers to save more by offering tax incentives for private pension schemes. In the United States, health savings accounts accumulate tax-free funds for medical costs in

retirement. The one solution that would end pension problems once and for all, however, seems out of reach for most industrialized countries: more children.

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