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The Outlook:
As Populations Age, Fiscal Woes Deepen
by David Wessel

JACKSON HOLE, Wyo. -- Balancing the federal budget will be tough, as Republicans in Congress are demonstrating daily. But even if they succeed, they won't have truly fixed the government's fiscal problem. Balancing the budget isn't enough?

"No," was the nearly unanimous conclusion of central bankers and economists gathered at the Grand Tetons for a Federal Reserve Bank of Kansas City conference.

The U.S. and other industrialized economies face a common demographic fact: Their governments inevitably are going to have more and more elderly to care for, and the cost is going to be staggering.

Today, about 17% of Americans are over age 60; by 2020, 25% will be. Overseas, the aging is even more rapid. In Germany, the proportion over 60 will rise to 30% from about 22%. In Japan, it will go to 31% from 20%. By 2030, the problem will be even worse.

Longevity is, of course, a measure of social progress. But an aging population means that health care will eat up an ever-larger share of government spending. And public pension funds won't have enough money to maintain current benefit levels without significant tax increases.

In corporate parlance, governments have a mind-boggling unfunded pension liability. In the U.S., this liability -- the sum that would have to be set aside today to cover the value of future benefits minus trust-fund balances and all future Social Security taxes at current rates -- amounts to 43% of the value of the economy's annual output, the Organization for Economic Cooperation and Development estimates. In Germany, it is 160%. In Japan, 200%. In Canada, 250%.

If current spending trends and benefit formulas continue, the tax increases needed to pay the health-care and Social Security tab when baby boomers retire are too big to implement. "The tax burden would be very close to absorbing all the lifetime income" of future workers, says University of California economist Alan Auerbach. Arguing that "high levels of taxation already provide disincentives to employment in many industrialized countries," International Monetary Fund economists Michael Mussa and Paul Masson call for "major measures . . . to rein in the growth of government spending on health care and on pension benefits."

The Jackson Hole consensus: The world's governments are moving too slowly to prepare for the demographic time bomb.

"Central bankers are often accused of being obsessed with inflation. It's not true," says Mervyn King, the Bank of England's chief economist. "If central banks are obsessed with anything, it's fiscal policy." He might have added that budget deficits are one problem about which central bankers can complain without ever having to solve.

The specific spending cuts being contemplated on Capitol Hill got little notice; the only politicians on hand were budget-cutting finance ministers from Canada and Sweden. But the academic discourse had a clear message for Washington.

First, Social Security is off the table now, but it can't stay there. The longer politicians wait to consider raising the future retirement age, altering future benefit formulas or raising taxes, the more disruptive the changes will be.

Second, financial markets and voters will judge this year's deficit reduction by its impact over the next few years. But the long run is important, too. "If we use this opportunity to make changes to Medicare that might not lead to immediate savings but through which large savings may be realized 10 or 15 years from now, we will have made a tremendous step in the right direction," says Robert Reischauer, former head of the Congressional Budget Office.

Third, a growing economy is vital. Caring for retired baby boomers will be a drain on their children and grandchildren. "We need to make the economic pie as big as possible so the increased size of the slice needed to support the retired population won't starve the rest of the population," Mr. Reischauer says.

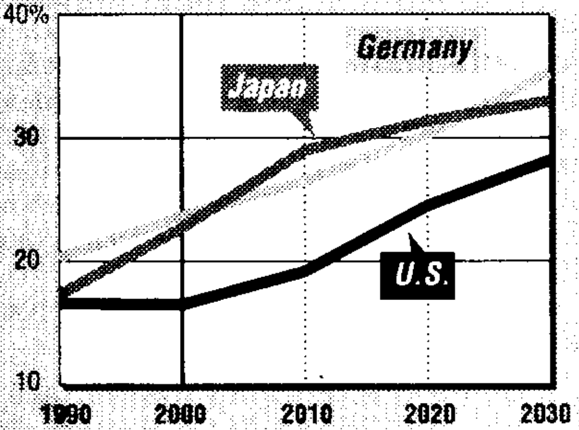
Fourth, how the deficit is reduced will affect the size of the pie 16 years from now, when the first boomers turn 65. With taxes out of the question, the issue is what to cut.

"It's fashionable to talk these days as if government spending is entirely sludge," says Robert Johnson, a former Beltway economist now at Moore Capital Management. Siding with President Clinton, he suggests that spending less on education, research and even highways could hurt economic growth.

The current debate over deficit reduction, too, often misses the point. Of course, the better the government's fiscal health five years from now, the easier it will be to prepare for the baby boomers' retirement. But focusing exclusively on making the numbers add up this year and next obscures the bigger reason for worrying about government spending trends: the widely shared goal of making life better for today's children and tomorrow's.

Older and Older

Percentage of population over age 60



NOTE: Figures for 2000-2030 are forecasts

Source: World Bank