



Demography, the Fiscal Gap and Social Security

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January 17, 2019

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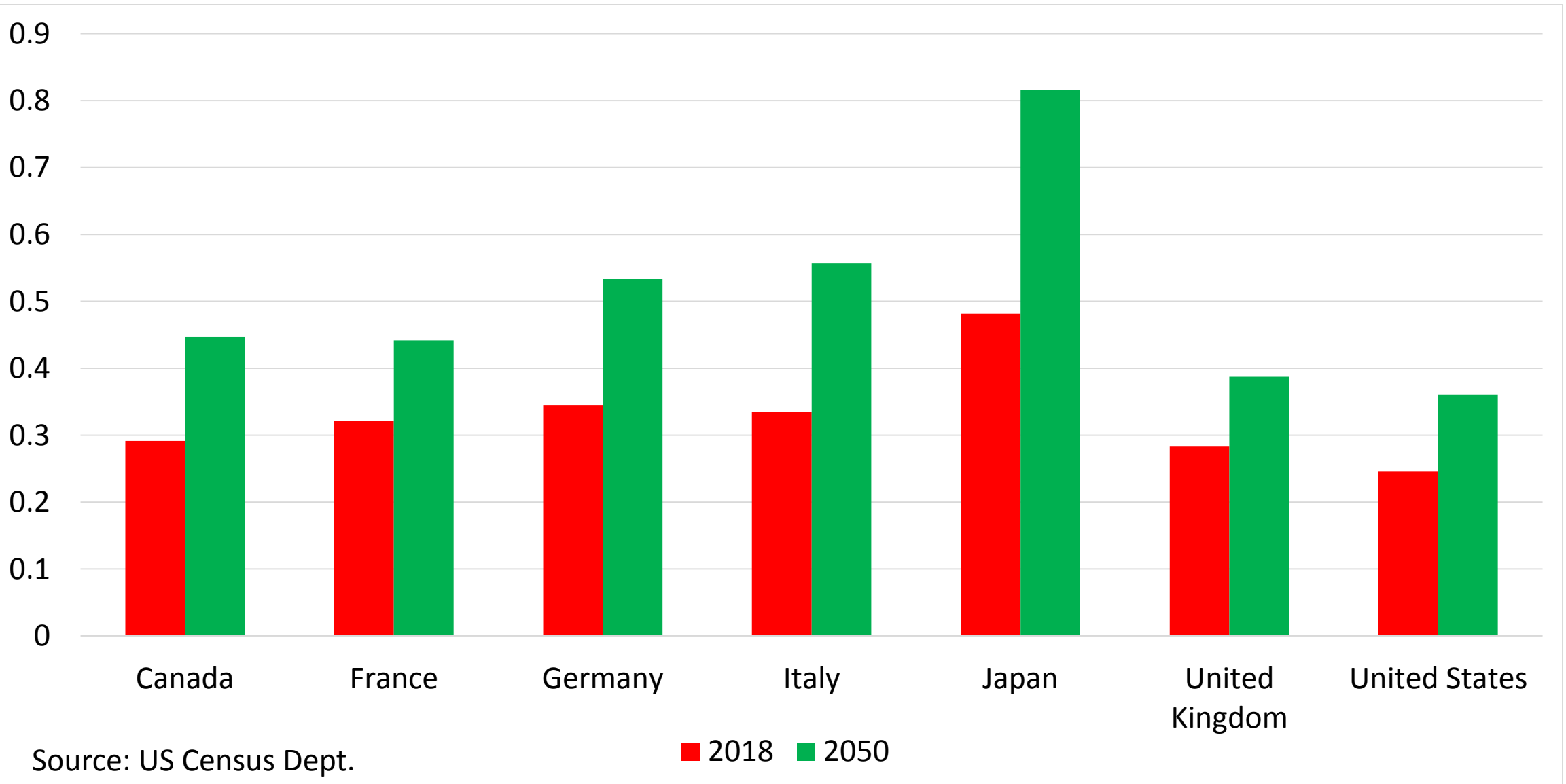


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- Rising old-age dependency ratios (OADRs)
 - More young to pay for fewer old
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 - Life expectancy growing much faster than retirement ages, so an even larger old-age population to support
- Together, contribute to growing gap between contribution inflows and payment outflows, for given tax and benefit rules

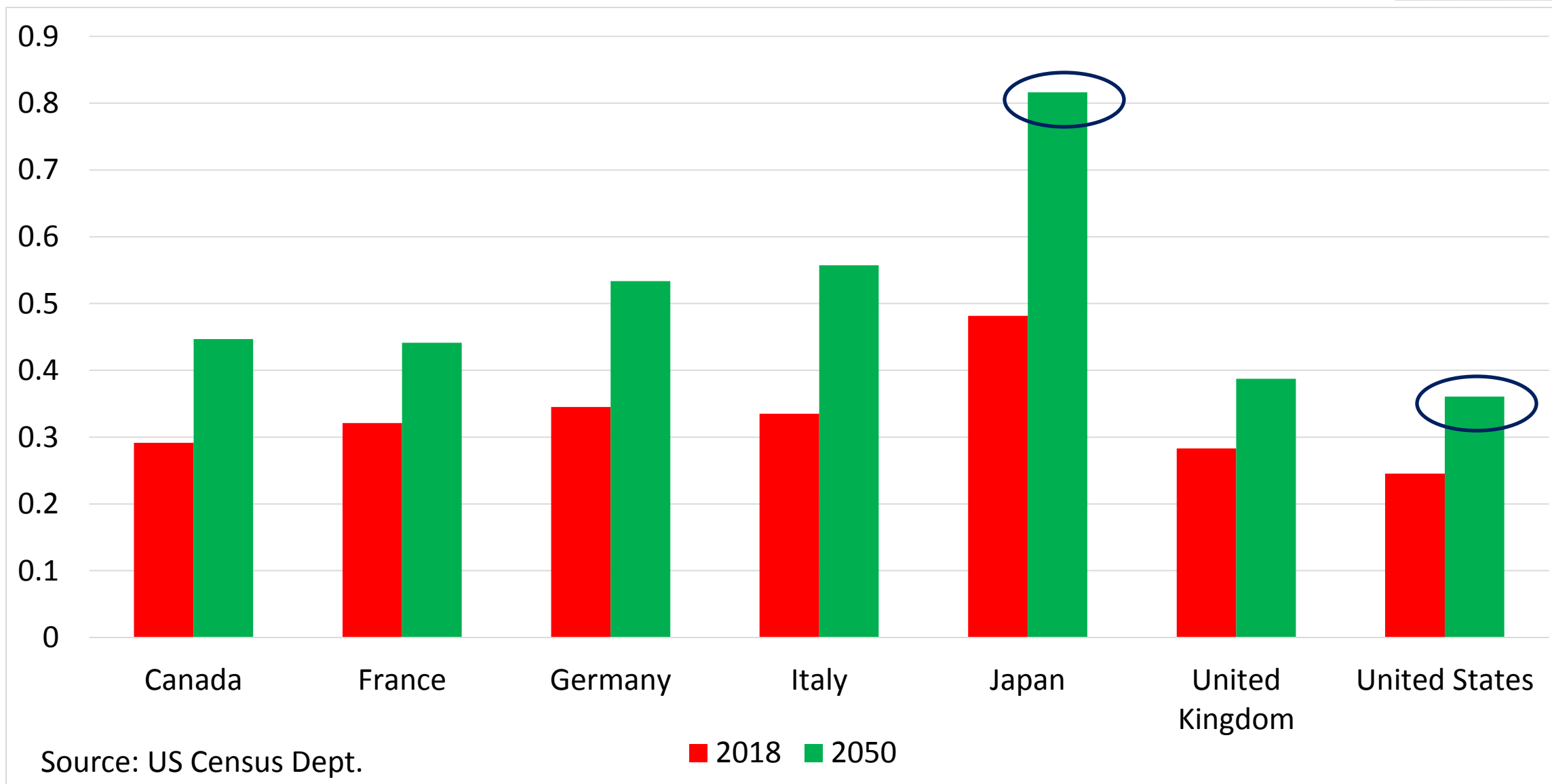


- A big problem in more developed countries, with large OADRs and generous Social Security programs

G-7 Old-Age Dependency Ratios

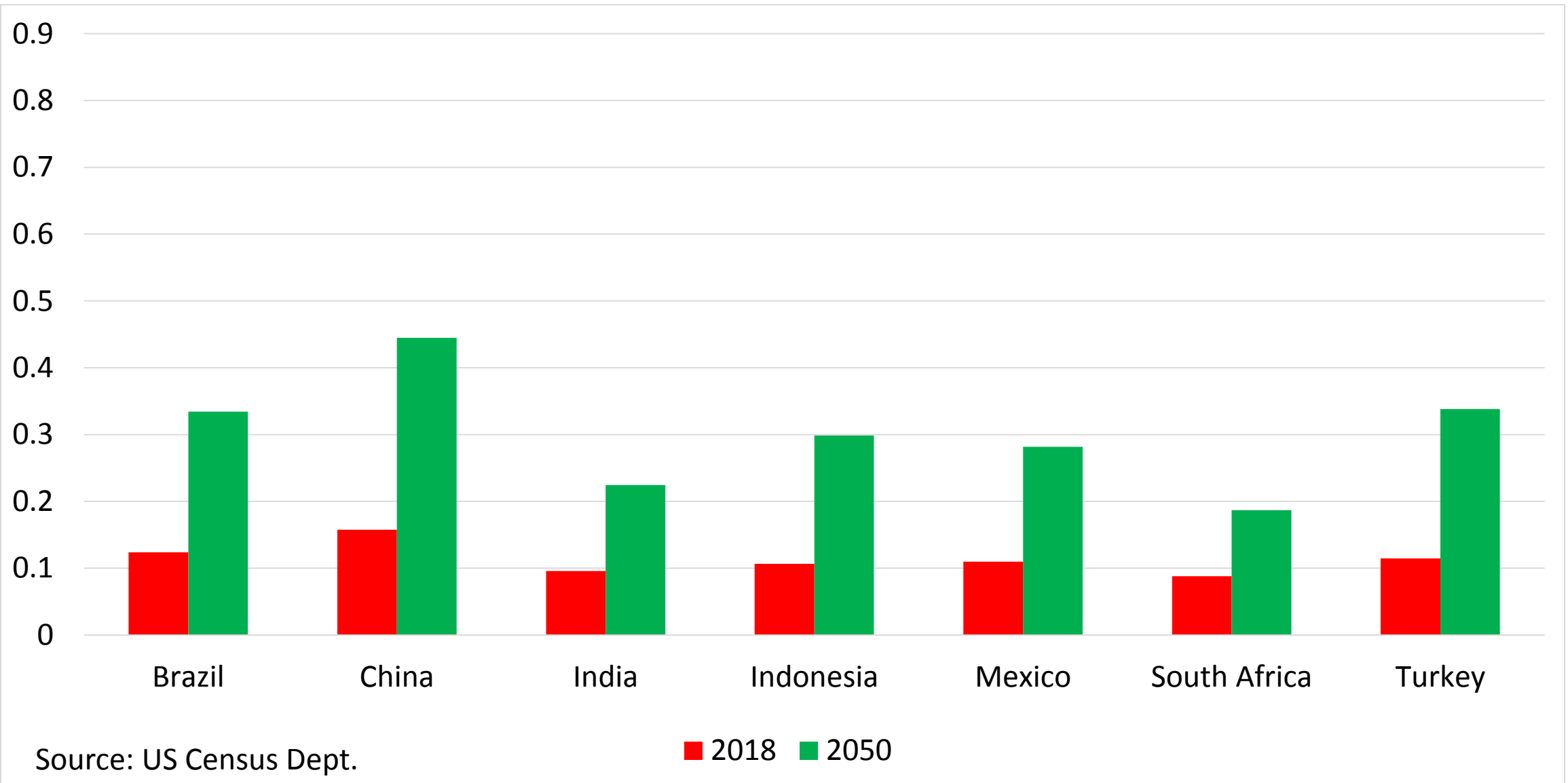


G-7 Old-Age Dependency Ratios

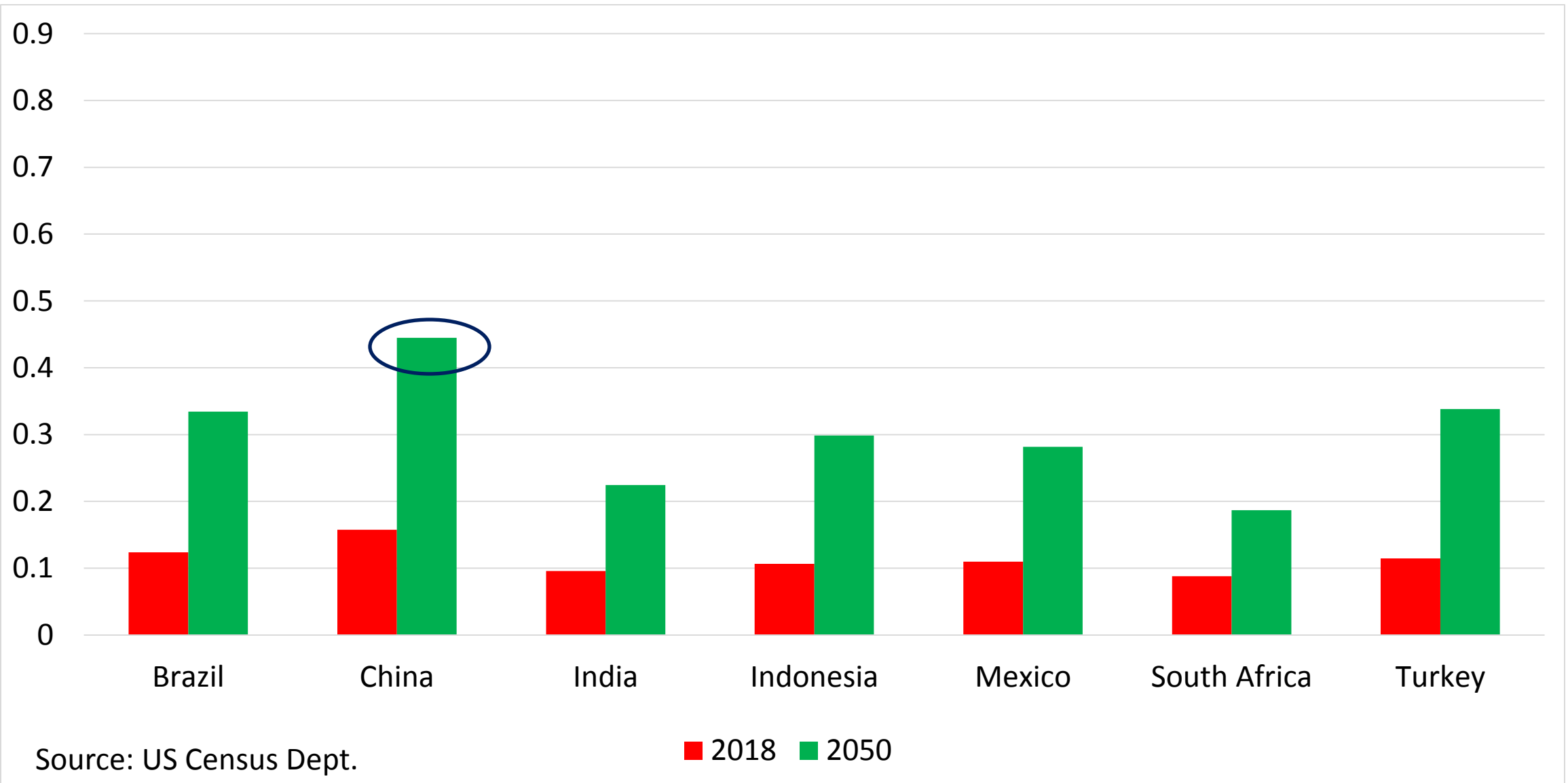


- A big problem with more developed countries, with large OADRs and generous Social Security programs
- But a growing problem in large, rapidly developing countries

Other G-20 Old-Age Dependency Ratios



Other G-20 Old-Age Dependency Ratios





Many Possible Solutions and Pitfalls

1. Adjust Contributions and Benefits



- Most straightforward approach
- But
 - Tax increases can stifle economic incentives
 - Benefit reductions can leave retirees with inadequate retirement income

2. Immigration



- Reduces OADR...
- But
 - Young workers get old and must receive benefits
 - Immigrants are often lower-skilled, meaning lower contributions relative to their future benefits
 - Social tensions must be reckoned with

3. Funding



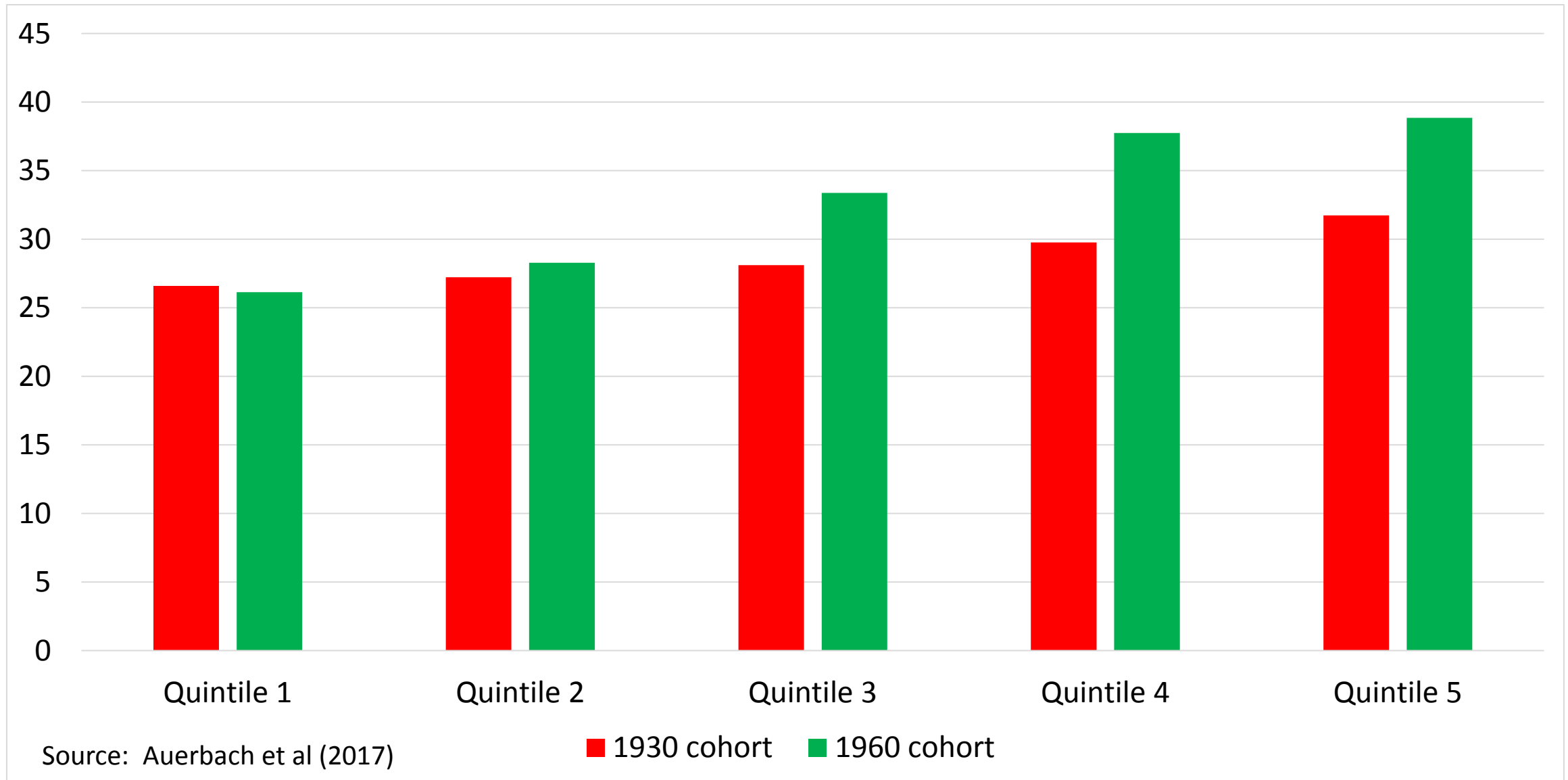
- A solution to the pay-as-you-go problem; each generation fully or partially supports itself
- But
 - Initial transition funding must come from current cohorts, who then must pay twice, for retirees and themselves
 - This can be avoided through government borrowing, but borrowing simply replaces implicit liabilities (to pay future retirees) with explicit ones (to pay bondholders)

4. Increase Retirement Age



- Basically, a benefit cut, as retirees receive benefits for fewer years
- May be a particular problem if life expectancy is not increasing uniformly

US Male Life Expectancy at 50, by Lifetime Earnings



5. Substitute Private System for Public One



- May help provide workers with more retirement saving choices
 - However, requires government oversight to ensure adequate provision for retirement
 - Also, in no way a solution for imbalance between taxes and benefits for existing workers and beneficiaries
 - if private system is funded by contributions, need alternative funding for “legacy” obligations
 - If private investments yield higher rates of return, these reflect higher risk

6. Improve Work Incentives



- Modify benefit rules to encourage elderly who wish to work to be able to do so
 - Don't penalize decisions to continue to work; allow continued benefit receipt or accumulation of higher future benefits
- Improve linkage between contributions and future benefits, so workers do not perceive contributions as taxes
 - Adopt more transparent benefit calculations, for example through Notional Defined Contribution (NDC) schemes, which for PAYG systems still provide workers information on accruing benefit values

Conclusions



- Demographic challenge for PAYG systems is common across leading economies and affecting emerging economies, too
- Many proposed solutions would be partially or wholly ineffective at addressing basic problems
- Ultimately, rationalization of systems will be needed, combining some realignment of benefits and taxes, along with improvements in transparency and work incentives, especially among the elderly