

The Intergenerational Balancing Act: Where Children Fit in an Aging Society*

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Today's children face unprecedented challenges. The world they inherit will be less safe, more environmentally precarious, and less economically secure than the one inherited by their parents. Less safe because of the Global War on Terror – a war seemingly without end. Less healthy because of global warming and other environmental challenges. And less economically secure because of globalization and a very low savings rate in the U.S.

Since I am an economist, I want to especially focus on this third challenge, but I also want to emphasize that it is the combination of all three that is especially troublesome. My theme is very simple: We need to do what we can to modify some of these trends, but since we won't be able to control them completely, we also need to equip the youngest generation to cope with all three.



The economic challenge has two major dimensions. The first is globalization. Globalization has both a bright side and a dark side. On the bright side, the world economic pie will grow, and the slices of the pie that go to each country including the U.S. should be bigger. On the darker side,



- wage levels in different countries will tend to converge;
- the overall pie will be bigger, but the U.S. share of the pie will be smaller than in the past, and;
- many workers will face job dislocation or lower wages as a result of the transition.

To compete in this new economy, children will need higher levels of education and strong interpersonal and problem-solving skills. Much has been made of the importance of education in this

new environment, and it bears emphasis. But keep in mind that the only jobs that can't be sent offshore are the ones that involve direct interaction with other people and the ability to come up with new solutions to old problems. So interpersonal skills and creativity will be in especially great demand.

* This paper was originally given as a lecture in honor of Kristin Anderson Moore at Child Trends on October 17, 2007.

The second economic challenge – one that is much more within our control and thus subject to change – is a very low savings rate in the U.S. In recent years households have had a negative savings rate – in other words, they are spending more than they receive in income and are borrowing the difference. But the biggest dissaver, and the biggest borrower, by far, is the federal government. Current federal deficits aren't all that large, and as you may have read, they are coming down. But this is the calm before the storm. There is a tsunami coming once the baby boom begins to retire, and that's just about to start. Unless something is done, deficits will swell to roughly \$700 billion within a decade under realistic assumptions and keep rising indefinitely to levels that simply explode off the charts.

The major drivers of this explosion are the aging of the population and rising health care costs per capita. Of the two, it is health care costs that are the biggest problem by far, and it is the growth of Medicare and Medicaid that are producing unsustainable deficits as far as the eye can see. The accumulation of debt that this is producing is being primarily financed by foreigners. Eventually we will need to pay them back.

It is very much like taking out a jumbo mortgage on your house but expecting your children to pay both the interest and the principal after you are dead. Anyone who did this would be considered an irresponsible parent. But that is exactly what we are doing as a nation.

So, how are children doing? Are they well prepared to face the challenges I have outlined? The simple answer, I think, is no. According to UNICEF, we rank 20th out of 21 rich countries in terms of overall child well-being (Figure 1). The averages, of course, are a little misleading. The truth is that some U.S. children are doing very well and others are not. We have one group of children who are born into affluent, well-educated families. Their parents delay having children until they are married and well-launched in their careers – often in their thirties. They invest heavily in their children's education, health, and well-being.

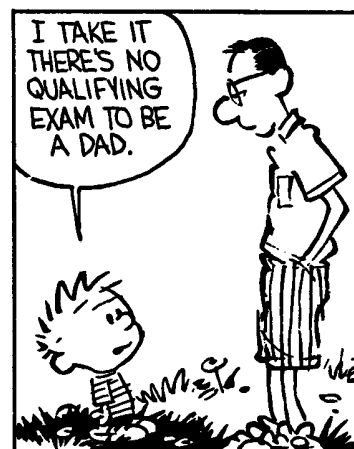
Figure 1. A comparison of children in the U.S. with children in other rich countries

• Overall child well-being:	20 out of 21
• The U.S. ranks poorly on all 5 measures:	
– Health and safety:	20 out of 21
– Family/peer relationships:	20 out of 21
– Behavior and risks:	20 out of 21
– Material well-being:	17 out of 21
– Education:	12 out of 21
Source: UNICEF Report Card No. 7, Child Well-Being in Rich Countries, 2007.	

We have another group of children who are born into poor, less-educated families. Their parents are having children outside of marriage, typically in their teens or early twenties. They are often not prepared to be parents and have little in the way of time or money to invest in their kids.

So, both in terms of economics and in terms of family environments, we have in the U.S. what I call a bifurcation of children's early environments and, as a result, a bifurcation of their future prospects. If we want to reduce the widening gap between the haves and the have nots in the U.S., the place to start is with the children.

Let me turn, then, to what we might do to better prepare children for the future and the special challenges that they will face. The most important people in a child's life are, of course, his or her parents. And we need to convince today's teens and young adults that the most important decision they will ever make is the decision to have a child. They must take this responsibility seriously and many do not.



One third of all pregnancies in the U.S. are unwanted. More than one third of all births occur outside of marriage. Many single parents do a heroic job, but we also know that children born and raised in mature, two-parent families have the best chance of success. Organizations such as The National Campaign and Child Trends have been actively engaged in bringing attention to this set of issues. But as much as we need responsible parenting, we also need responsible policies from our government – especially for children in less advantaged families.

Let's look at where children fit in today's federal budget (Figure 2).

Figure 2. Current Federal Priorities (FY 2006)

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|---|---------------|
| • Total Federal Investments in Kids: | \$207 Billion |
| • Cost of Tax Cuts Enacted Since 2001: | \$233 Billion |
| – Cost of Tax Cuts for Households with \$200,000 or More: | \$87 Billion |
| • Projected Growth in Spending on Social Security and Medicare, 2006-2009: | \$198 Billion |
| • Cost of the Operations in Iraq, Afghanistan, and for the War on Terrorism | \$190 Billion |

Source: Author's Calculations from CBO, The Budget and Economic Outlook: Fiscal Years 2008 to 2017, Table 3-1, January 2007; Author's Calculations from CBO, The Budget and Economic Outlook: An Update, Box 1-1 and Table 1-6, August 2007; Brookings-Urban Tax Policy Center, Tables T07-0213 and T06-0273; Adam Carasso, C. Eugene Steuerle, and Gillian Reynolds, Investing in Children, 2007.

In 2006, we invested \$207 billion in children, according to a study done by the Urban Institute. That sounds like a lot of money, but in relative terms it's not. As you can see, we are spending more than this on the tax cuts enacted since 2000 – tax cuts that have mainly benefited the very wealthy. These tax cuts expire at the end of 2010. I don't expect the Congress to allow all of them to expire, but if

they did, that would produce enough revenue to double investments in children. Alternatively, this same revenue would go a long way toward eliminating currently projected deficits.

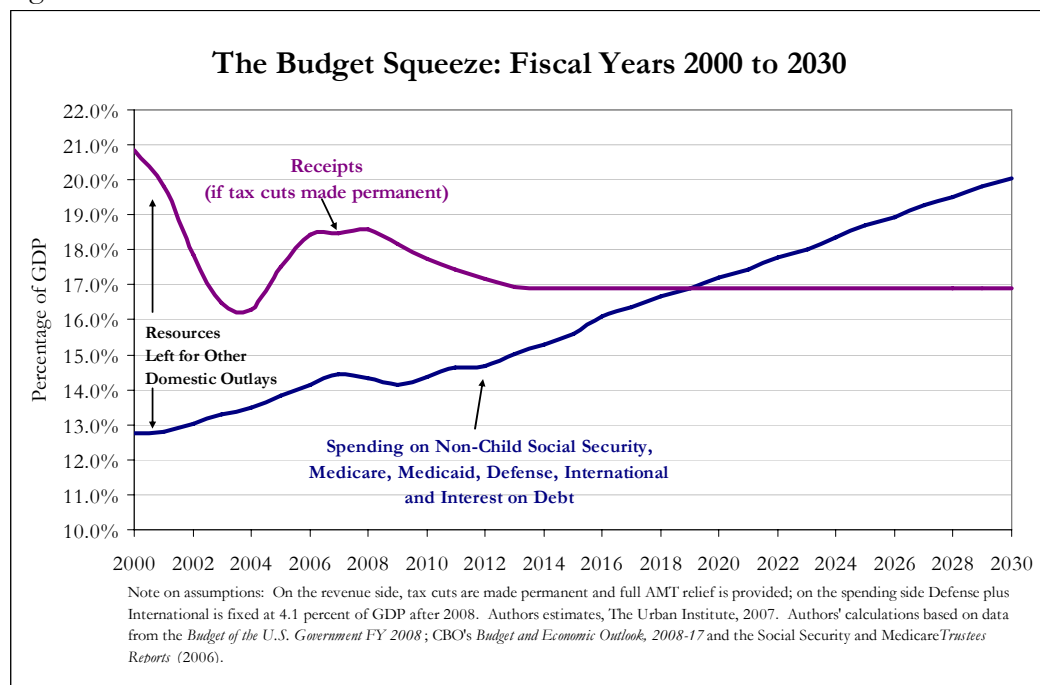
We need to do both. That is, we can strengthen the nation's future by both investing in the next generation and making sure that their standard of living is not undermined by the large debt that the U.S. will then owe to people in other countries. Will we make these investments? Right now, it seems unlikely.

It's not just tax cuts that are putting pressure on children's programs; it's also spending on the elderly. Currently, federal spending on the elderly dwarfs spending on children. Just the next three years of growth in the Medicare and Social Security programs will cost almost as much as the entire budget for investments in children.

This spending on entitlements is slated to grow rapidly as the baby boomers retire and health care costs continue to rise. In about 25 years it will be as large as the entire federal government is today. Moreover, unlike most programs for younger families, this spending is on automatic pilot and does not require annual appropriations. And finally the elderly have a lot more political clout than children because they vote in large numbers.

For all these reasons, you can expect to see a huge squeeze on existing commitments to children. Gene Steuerle and his colleagues project that spending on the elderly together with defense and interest on the debt will crowd out all other spending roughly a decade from now (Figure 3).

Figure 3.



This is based on the assumption that the Bush tax cuts are made permanent. But even if we reversed the Bush tax cuts, this competition for resources between children and the elderly would be a big problem a decade from now. I think many people of a liberal persuasion are loathe to confront this problem; they tend to argue we should support both the young and the old.

Personally, I think this is the wrong way to think about the issue. After all we are all children at one stage of our lives and all elderly at another point in our lives. Ask yourself if you were given \$100,000 would you rather that it be invested in you when you were young or when you were old? Of course a lot might depend on your circumstances. No one would want to reduce the benefits going to an impoverished widow to give them to an affluent child. But that is not the trade off we face. Instead, our social insurance programs provide benefits to all of the elderly – even Bill Gates. With the possible exception of public education, this is not true of the benefits we provide to children. In addition, there will be strong resistance to paying the much higher taxes that supporting both would necessitate.

Don't misunderstand me here, taxes are going to have to be raised one way or the other. But several decades from now, they would have to be raised to European levels if we want to maintain current commitments to both groups and to even higher levels over the longer run. That's just the reality. It's inescapable – it's just math.

In our book, *Restoring Fiscal Sanity*, 2005, Alice Rivlin and I not only confront this reality, but we lay out an agenda of new investments – including many that would improve children's futures. For example, we fully fund early childhood education, child care and health care for low and moderate income families. We call for higher salaries and more in-service training for teachers, and an expanded EITC for low-income working parents.

Similar agendas have been laid out elsewhere, including in my edited book, *One Percent for the Kids*, and in a Brookings paper by my colleague, Julia Isaacs. These proposals are based on the best current evidence on what would be most effective.

But how do we pay for this agenda in a fiscally responsible way? We face some very tough choices. We could raise taxes to unprecedented levels for the U.S. Alternatively we could dramatically cut back on Social Security or Medicare. What we must do to make this work is some of both.

I sometimes hear people say that if we simply raise taxes, we can afford to both fund investments in children and maintain our commitments to the elderly. This is just plain wrong. Eventually commitments to the elderly will become so expensive that no feasible level of taxation would cover the costs.



"Sorry, friend, but if they're going to mess with entitlements, I'm going to need a little cushion."

So, in the brief time I have left, let me suggest a possible solution to this dilemma – an idea that needs to be on the table for debate and discussion.

I think we need to revisit the social contract with the elderly. It was affordable in the 1930s and even in the 1960s, but it no longer is. Americans now spend one third of their adult years in retirement. And health care advances, though they have greatly improved the quality of our lives and will continue to do so, are on a collision course with our ability to pay for them. Perhaps there will be new advances in medicine that will not only be better but cheaper than what we have now, but no one should count on that.

The solution, I would argue, is a new social contract between the young and the old. This revised intergenerational contract would invest more resources in the young, making them more productive, but it would then expect them to save more from this enhanced income to pay for their own and their parents' retirement. A bipartisan agreement to invest more in children now in return for a gradual phase in of cost-saving reforms in entitlement programs is the most obvious way to accomplish this goal. These reforms could involve slowly raising the retirement age and indexing it for longevity and asking more affluent seniors to pay for a larger share of their health care over time.

Social insurance was never meant to be the sole source of income in old age. It was meant to be one leg of a three-legged stool with the other two legs being private savings and employer pensions or 401K plans. Indeed, the basic notion behind any kind of insurance is that it should cover risks that people cannot predict. Yet, everyone knows that they will some day be old and that their health care expenses will rise with age. They should therefore be expected to save for this eventuality. That way, our current social insurance programs could be tilted much more toward providing assistance to two groups among the elderly: those who experience a catastrophic or unexpected illness or disability and those who worked in lower-wage jobs for most of their lives and thus cannot afford to save enough to cover even the routine expenses of retirement.

The savings from asking the more affluent elderly to save more for their own retirement along with higher revenue could then be used both to reduce the deficit and invest in children – both of which would improve the rate of economic growth, increase the revenues needed to pay for current commitments, and produce a more prosperous and competitive nation for the future.

To summarize, this new intergenerational contract would involve much greater investment in the young in return for greater personal responsibility on their part to prepare for their own and their parents' retirement years. To be sure, the transition from the kind of public policies we have now to the kind that I envisage would not be easy. But I have no doubt whatsoever that if we did this it would lead to a much stronger country and a fairer deal for the nation's children.

